

Submission to the Productivity Commission on Horizontal Fiscal Equalisation

Northern Territory Opposition

Background

The Northern Territory Opposition believes that Horizontal Fiscal Equalisation (HFE) is a core plank on which self-government is built. The NT Opposition strongly believes in the existing model of HFE. Similarly, the Northern Territory Opposition also believes that the current precepts and methodological framework critically underpin the viability of self-government. Any deviation from the hereto agreed tenets of HFE and self-government becomes challenged.

The Northern Territory Opposition further note that the Commonwealth Grants Commission most recently articulated the principle of HFE (in its report on its 2015 methodology review) as follows:

State governments should receive funding from the pool of goods and services tax such that, after allowing for material factors affecting revenues and expenditures, each would have the fiscal capacity to provide services and the associated infrastructure at the same standard, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency.

Challenges

There are a number of challenges unique to the Northern Territory, and the NT Opposition would like to restate these at this time, namely Indigenous disadvantage (Closing the Gap), remoteness and Developing the North agenda.

The NT is a small developing economy. It is an economy with rich mineral resources but very significant geographical challenges.

HFE has served the Commonwealth and the Federation of States and Territories well for many decades and the case to change has yet to be demonstrated or proven. In addition, critics of the current model have failed to provide a workable alternative.

Measuring the operation of HFE against Adam Smith's canons of taxation¹ one can see that it performs well with respect to ease of operation (burden) and equity. Alternative approaches may be administratively more cumbersome and hence expensive.

One could postulate that a move to a pro-capita or pro-rata distribution model would very possibly be the end of the Northern Territory as we know it. To support this statement look no further than the NT Budget. The total revenue for Financial Year 17/18 is \$6.3 billion of which 71% comes directly from the Federal Government, with over 50% coming directly from the redistribution of GST revenue. The current relativities see a 4.66 return for every dollar added by the NT to the general collection.

No State or Territory would be able to endure the catastrophic collapse in revenue that would occur if the GST model were to be changed, and if the HFE were to be replaced with a per capita model.

The NT Opposition puts on the record in the strongest possible terms its rejection of any such proposal.

Opportunities

In the Northern Territory there are several opportunities that HFE directly benefits and unlocks. The first of these is the geography of the NT. The NT is less than 2 hours by plane from our major trading partner Indonesia. Maintaining a minimum (or better) level of services in the NT will help attract more people. Critically, providing a nationally comparable level of service and amenities will keep people in the Northern Territory.

Ensuring the long run viability and sustainability of the Northern Territory is very dependent on the ability of the jurisdiction to attract and maintain population numbers. This is projected to fall by 0.3 per cent next financial year. One of the very important considerations in relation to attraction and retention is the provision of services.

For the Northern Territory to grow and achieve sustainable population growth it will require minimum levels of service provision.

It is important to note that the Northern Territory, while having one of the largest social provision obligation challenges, has as a corollary and consequence the smallest taxable base of any jurisdiction. This has obvious negative effects on the ability of the Northern Territory Government to raise own source revenue.

Similarly, the fiscal capacity of the Northern Territory must also be viewed in light of the fact that over 50% of the land and 80% of coastal waters in the Northern Territory is Aboriginal Land. This is not necessarily a barrier or impediment to economic growth. It is however an important consideration when it comes to some of the challenges of development, potential to develop, and the knock on consequences for Northern Territory Government revenue.

Concluding remarks

This review into the HFE framework comes in the wake of sustained criticism of the current model from New South Wales, Victoria, and in particular Western Australia.

The NT Opposition recognises the challenges that each of these States face with respect to financial and economic management, as well as the long term certainty, sustainability of revenue streams.ⁱⁱ

However, abandoning a heretofore workable framework for providing a minimum level of services across the country because of temporary opposition and outrage from some jurisdictions could be viewed as ill judged. Indeed, it could be viewed as knee jerk and would not address the underlying issues around productivity, competitiveness and sectoral make up at play in those economies.

The NT Opposition also notes and supports the WA Government acknowledgement on page 9 of their submission to the Productivity Commission (PC) Review of HFE (2017) when they state that:

“Western Australia agrees that States that have a weaker fiscal capacity, through no fault of their own, need financial assistance so they can provide an acceptable standard of service to their communities”.

The NT Opposition also questions the underlying assumptions and methodological framework used by Careaga and Weingast (2003)ⁱⁱⁱ and Weingast (2009)^{iv} when they point to strong theoretical and observed links between high fiscal centralisation and reduced economic development.

We reference these papers by Barry Weingast, and Maite Careaga as they form some the basis of the theoretical foundation upon which the Western Australia Government submission is based.

It is worth noting that while the NT Opposition is strongly opposed to unfounded and unnecessary change to HFE, if the PC finds otherwise, we do see merit in APPEA's recommendation that all State and Territory petroleum royalties (from onshore/offshore areas and conventional and unconventional sources) be excluded from the calculation of state and territory revenues by the CGC for GST distribution purposes. Treating petroleum royalties in this way would create a stronger incentive for states and territories to develop their resources and therefore discourage the imposition of non-science based restrictions and moratoria. This would allow for the greater utilisation of our natural resource base, improve energy security and enhance productivity in Australia. Importantly, it would also assist in stimulating economic activity in regional areas.

The NT Opposition hopes that the above point is given due consideration. It is an important point to record as it would put incentive at the heart of the GST distribution equation.

In the final analysis, there are better and more appropriate ways, means and forums to resolve inter-state tensions over the equity of GST revenue distributions than by discarding a longstanding and successful methodology. The Northern Territory Opposition does not support any change to the current principles and practice of Horizontal Fiscal Equalisation.

ⁱ The Canons of Taxation were first originally laid down by economist Adam Smith in his famous book "The Wealth of Nations" (1776). According to Adam Smith, there are four canons or maxims of taxation on the administrative side of public finance which are still recognised as classic:

1. Canon of equality or equity.
2. Canon of certainty.
3. Canon of economy.
4. Canon of convenience.

ⁱⁱ . As an observation we note that the current HFE framework ensconces what resembles a pro-cyclical GST revenue distribution.

ⁱⁱⁱ M Careaga and B Weingast (2003), Fiscal federalism, good governance and economic growth in Mexico, in D Rodrik (ed.) In Search of Prosperity: Analytic Narratives on Economic Growth, Princeton University Press.

^{iv} B Weingast (2009), Second generation fiscal federalism: The implications of fiscal incentives, Journal of Urban Economics 65, pages 279-293.