Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO HORIZONTAL FISCAL EQUALISATION

MR J COPPEL, Commissioner
MS K CHESTER, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT FOUR POINTS BY SHERATON 707 WELLINGTON STREET, PERTH
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RESUMED **[9.00 am]**

MR COPPEL: Good morning, everyone, and welcome to the public hearings for the Productivity Commission's Inquiry into Horizontal Fiscal Equalisation. My name is Jonathan Coppel. I'm one of the Commissioners on the inquiry and I'm joined by Karen Chester, the other Commissioner on the inquiry and Deputy Chair of the Commission.

I would like to begin by acknowledging the traditional custodians of the land on which we meet today, the Whadjuk people of the Noongar Nation. I would also like to pay my respects to elders, past and present.

This is the first day of public hearing, first of two days of public hearings in Perth. We will also hold hearings in Melbourne, Darwin, Adelaide and Hobart in the next three weeks, and we will then work towards completing a final report which will be submitted to the Australian Government in early 2018.

Participants that have registered their interest in the inquiry will be advised when the final report is released by the government, which may be up to 25 Parliamentary sitting days after completion.

Just some brief points on the conduct of the hearing. The purpose of these hearings is to facilitate public scrutiny of the Commission's work, and to get feedback on the draft report. We would like to conduct the hearings in a reasonably informal manner, but I do remind participants that a full transcript is being taken and for this reason comments from the floor cannot be taken. But at the end of the day's proceedings I will provide an opportunity for anyone who wishes to do so to make a brief presentation.

Participants are invited to make short opening remarks. We ask you to keep those brief, in the order of five to seven minutes. This will allow us to discuss matters raised in submissions in greater detail and follow up on the brief introductory remarks.

Participants are not required to take an oath, but are required under the Productivity Commission Act to be truthful in their remarks. Participants are also welcome to comment on other issues raised in hearings today or in submissions.

The transcript that is being taken today will be available from the Commission's website following the hearings. That usually takes a couple of days. Also participants' submissions to the inquiry will be available, or are available, on the website.

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On another matter of inquiry process, are there any media in the room here today? Yes, okay. We do have some general rules that apply and. if you haven't already done so, speak to one of our staff to get what those rules are. Most importantly though there is no video or audio recording of participants allowed past this point without our prior permission.

Now, before we continue in order to comply with the Commonwealth Occupational Health and Safety legislation you are advised that in the unlikely event of an emergency requiring evacuation of this building, alarm tones will sound followed by an announcement alerting everyone to evacuate the premises. So please follow all instructions from hotel floor wardens and do not use the lifts.

They are the introductory formalities. Now I would like to invite participants representing the Chamber of Commerce and Industry of Western Australia to come to the front, and when you are ready and comfortable if you could give your name and affiliation for the purpose of the transcript, and then a brief opening statement. Thank you.

MS WILLMOTT: Good morning. My name is Deidre Willmott and I am the Chief Executive Officer of the Chamber of Commerce and Industry of Western Australia.

MR NEWNHAM: And I am Rick Newnham. I'm the Chief Economist at the Chamber of Commerce and Industry.

MS WILLMOTT: So on behalf of the members of the Chamber of Commerce and Industry of Western Australia I would like to thank you, Commissioners, very much for making the journey to Perth and for engaging with the Chamber of Commerce and Industry and other interested parties in Western Australia about this issue that is very important in Western Australia, and we thank you for your draft report which we believe makes some very important comments, observations and potential findings that we would like to discuss with you in detail this morning.

Perhaps if I can just give a little bit of background to the Chamber. We are the peak industry organisation of Western Australia. We have 9,000 members across every industry and every region of the state, and our members are very much focussed on the State Government, on good financial management within the State Government, and are very focussed on those taxes that impose on business in Western Australia.

Following this year's state election we surveyed our members as to their top three priority policy areas that they would like us to focus on for the balance of the year, and number two was GST. And when we drilled down it was that businesses in Western Australia were very concerned at the growing deficits and debts of the State Government, and that the GST was not returning in the

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way that we expected that it would after we had worked through very high royalties in the previous two to three years.

So we have spent the time since that survey focussing very much on GST, but very much on how GST can be reformed in a way that is in the economic interests of the whole nation. We understand that reform is not going to happen because Western Australians are unhappy, but when we look at the GST system as a whole we believe that there is a very real question as to whether it is operating genuinely in the national interest in terms of promoting economic growth. And certainly there has been a growing concern in Western Australia about the ability of our Government to manage a budget that has, as one of its primary sources of revenue, a very volatile source of revenue, and the impact that that is having on our share of the GST.

So the work at the Chamber has been led by our Chief Economist, Rick Newnham, who has, with his team, worked almost full time on this issue since that survey result came back to us in March, so I would like to hand over to Rick.

MR NEWNHAM: I just want to make a couple of points about our original submission and then our second submission, which we can come back to and discuss in more detail, if you like. As Deidre said, our starting point for this was looking at the GST from an overview of how does it impact on the national economy, and so our remit has fit very well into the PC's process, we think, with that scope. We are not involved in this because we think that WA deserves more or that there should be a greater share because it's fair. We are doing this with a national economic overview, and particularly looking at the incentives that each State has to develop under-developed industries and undertake tax reform that will grow the economy in the long run. So that's our focus.

In doing so, our initial submission highlighted that the current system is under significant strain and that incentives have been diminished under full equalisation to the leading State, and one of our recommendations was that you equalise at a point lower than full equalisation, and equalise to the average. So we're very pleased to see the PC draft report has drawn a similar conclusion and has also floated equalising to the average on that basis.

In the draft report you also make the recommendations to look at and discuss equalising to the average of the donor States, or to the second leading State. We think both of those have fatal flaws and they should be dismissed in the final report, the key reason being that equalising to the second leading State is still exposed to the extreme outcomes that equalising to the leading State falters under, in that if you have a simultaneous pulling ahead of the two leading States you can then put the system under significant strain. One example might be that you have another resources boom where both Queensland and WA coincides in cyclical or structural increases.

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Equalising to the donor States takes the recipient States out of the game, and they then have no skin in the game or incentive to develop their own economies because they will still be raised to the donor States. But more critical is that equalising to the average creates a marginal incentive, or an incentive at the margin, for all States to develop their own capacity and advance their own capacity, because in doing so they take themselves closer to the point of equalisation but they also raise the point of equalisation at the same time. And that's why equalising to the average is superior to the other options, because every time a State develops it will still lose a portion of GST but that is smaller because they will shift the average at the same time. And I think that difference is quite significant.

Our transition arrangements for GST have focussed on ensuring that every State can trust and have faith in their own forecasted revenues, in their budgets. Every State Government budgets on four years, so we have looked at those forward estimates from the point when a change would been announced, which we recommend should be early next year, and then the Government should top up States that will lose out compared to their forecast revenue over the following three years.

Most of the States have indicated they are comfortable with the current variance in GST revenue, so the variance between their forecast revenue and what they actually receive, and we have calculated that the average error in that forecasting range is about six per cent for all the States. So, given that they're comfortable with that forecast range, we've said they should be topped up to that level and we have suggested that they should all have a minimum of 95 per cent of their forecast GST revenue.

Now, for every single State except for one that means they'll receive 99 per cent of their forecast revenue over the forward estimates, and for one State it's more than 98 per cent, which we think is well within the normal variance for a State budget. That will cost $5 billion to the Government, and there's a few ways that they might be able to fund that. So they're our opening statements. We would be very happy to take questions.

MS WILLMOTT: I should just clarify. That's $5 billion over three years.

MR NEWNHAM: $5 billion over three years, yes.

MR COPPEL: Thank you, Deirdre. Thank you, Rick. I wanted to focus a little bit on those transition issues that you've brought up, particularly in your post-draft submission. This is an area - any reform will have winners and losers, but with HFE, given the nature of how the system works, you'll always have some winners and losers. Whether you have considered what would be the impacts on some of the smaller or fiscally weaker States from a move to less than full equalisation, other than those pure impact numbers in terms of what the change in the distribution would be that are there today?

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MR NEWNHAM: Yes. We have been very careful to ensure that every State can have confidence in their forward estimates forecasts, and that's the basis on which they do their current planning. And so we have said that should be the focus for transition arrangements, those following through years. And after that point for every subsequent budget after a change is announced the State Governments can then budget within those new parameters and expectations. So it's up to each State budget, or each State Treasurer and Premier to understand the impact of the change, and then to budget appropriately. But that's up to them.

MR COPPEL: But on that point, if I understand correctly, what you're saying is that on average there's a forecast error in budget revenue estimates of the order of about 5 per cent, and you've calculated that over a period of years?

MR NEWNHAM: Yes.

MR COPPEL: But those errors can be positive and negative errors?

MR NEWNHAM: Correct.

MR COPPEL: But what you are saying is that let's suppose that they are systematically 5 per cent or lower, and I am wondering what's the connection between looking at an average over an historical period and then looking forward say that systematically they are able to take a 5 per cent variation?

MR NEWNHAM: Yes, so the average variation, or the average error, in the forecast is 6 per cent, plus or minus 6 per cent. So that's the band in which every State has to expect that their GST revenue will fall. Whether they do it consciously or not, that's the band in which their GST forecast falls. So we've said no State should be worse off than the worst forecast error, which is minus 6 per cent. So we've said the top is 95 per cent, and then every State will have a minimum of 95 per cent of their forecast GST revenue.

MR COPPEL: For a run of years?

MR NEWNHAM: For the forward estimates.

MR COPPEL: For the forward estimates, three years.

MR NEWNHAM: For the next three years, yes. So, I mean that's within the band that they already will fall. They will already be expecting plus or minus 6 per cent, and so that's their expectation. And many of those States have put in their submissions that they believe that they are comfortable with that variance that now exists. There has been a complaint from WA that it makes it very difficult for WA to forecast, given the change in GST forecast to actual. And the other States have said, "No, there's no problem with that. We're very

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comfortable with that." So that's been our basis for what they would expect to be guaranteed under that system.

MR COPPEL: I don't want to labour the point, but when you say plus or minus 6 per cent, are you not assuming over each of the three years of the forward estimates that it is just a minus 6 per cent?

MR NEWNHAM: If you look in our - you've got a copy of our submission there. You can see the methodology that we've put in place. So it's the root means square error, and you can see each State's forecast error there over, you know, one year behind, same year, a year ahead, two years, three years ahead, and you can see that as the years - the further out that you forecast the States get worse and worse at forecasting their GST receipts. But that band is plus or minus 6 per cent, and we're saying as a minimum every State should expect 95 per cent, so they won't be any worse off than their worst possible forecast error, given the seven year average.

MR COPPEL: Okay. Could we get the workings that lie behind the calculations?

MR NEWNHAM: Sure. We will submit that afterwards, yes.

MR COPPEL: And one of the things you mention in terms of a transition in your submission is the pace of transmission, and you contemplated having an accelerating pace of implementation and then exclude that from consideration. Can you elaborate on why you've done that?

MR NEWNHAM: Well, if you take top up payments out of the equation for a moment and you look at the difference between current, a State's current GST expectations and what they would receive under equalising to the average, over a very short period of time it's a zero sum game. So if you draw a line between where we are now and where we want to be under equalising to the average, you have to transfer relatively sums between States. So you can either gradually move 25 per cent equalising to the average and 75 per cent full equalisation, gradually move that up to where you want to be, 100 per cent equalising to the average, and you can change the pace of that, so you can go fast or you go slow. But at any point in there some States will lose out relative to their forecast.

So we very quickly came to the position that you need to top up States to give them certainty about their current budget expectations, but you may apply pacing to those top ups. So we've said $5 billion is what would be required to top up to 95 per cent. If that was too much you might ask Western Australia and New South Wales, who would be recipients in the process, to pitch in some of the amount that they will have as windfalls into those top up payments. So you could halve the amount that the Federal Government has to put in by

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asking WA and New South Wales to halve the amount that they - or pitch in half the amount that they would receive. So that's what we mean by pacing.

If you take top ups out of the system altogether, and you do that over - you model that over the forward estimates, the States lose out somewhat so we have decided against that option.

MS CHESTER: So I knew Jonathan would cut to the chase and get straight to transition path and numbers, and I guess we've got the benefit of having had an earlier copy of your draft submission, and thank you for that. And thank you for the earlier submission and for the meetings that we've had. It's been very helpful.

And I know that you will share this post-draft report submission some time later today - - -

MR NEWNHAM: Correct.

MS CHESTER: - - - but just so we can understand what is being proposed and then I would like to come back to a couple of Deidre's opening remarks. So effectively we get to equalising to the average effectively in three years forward estimates plus, I guess, and as you've just said there's a - if you go for your 95 per cent confidence there's about a $5 billion bill to keep people happy or whole during that, 95 per cent whole during that three year period.

MR NEWNHAM: Yes.

MS CHESTER: And you have now suggested that there could be an option for those that stand to benefit from a quick move over that three year period, New South Wales and WA co-funding with the Commonwealth to foot the $5 billion bill. I guess where Jonathan's coming from is that getting to it in three years' time, just to understand that, because we are suggesting what could be quite a material change to the current way the GST relativities are calculated, why you didn't look at doing it over a more gradual period of time such that the funding task of keeping people whole is a more gradual one?

MR NEWNHAM: Well, the funding task becomes greater. If you go for immediate implementation and then you transition with top ups over a longer period of time, you have additional payments to be made to those States to keep them whole. So it becomes more expensive to do a top up over a five year or a ten year period of time, and that then becomes too great a task to undertake for any one budget.

MS CHESTER: But I think that highlights the point that you're only keeping people whole for three years as opposed to a longer transition period, given it is such a material change. Thus you'd expect it to be more costly if you're keeping it to do the smaller States, which is one of our guiding principles for a

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gradual transition hub, keeping them not significantly disadvantaged for a longer period of time. So effectively your driver here is it's only three years of keeping you whole, whereas if you're keeping them whole for a longer period of time it is going to be more expensive.

MR NEWNHAM: Well, keep in mind you're keeping them whole for what they've budgeted for so far, so they don't have any budgets set outside the forward estimate so there's no committed expenditure for that. The other point being that equalising to the average returns the States to their - essentially before the structural change in WA's relativity it returns States to their average relativities at that point. So if you look at that chart early on in our submission - - -

MS CHESTER: Yes, that was a really neat figure. So Figure 2 for those when they finally get to have a look at the document we've got.

MR NEWNHAM: Yes, and so the point being that every State has received major GST windfalls in the last five years thanks to WA's iron ore production, and that's been what you would think would come from the system. But returning, changing to equalise to the average, returns States to those average relativities. So it would not be anything out of the ordinary if you take a long term view since the introduction of the GST as to what the States would expect to receive in their GST. So it's simply returning them to a pre-boom normal of what they would receive.

MS CHESTER: Okay, well we'll leave it to you to convince the other States that that's what their expectation should be after three years. But when I actually look at that figure it makes me think, when you look at where WA stands across their long term average, you could look at that and intuitively think that there is a greater role for WA to fund a longer transition period. So I've only just raised it as a thought because we've only had a chance to read this yesterday as well.

MR NEWNHAM: Yes.

MS CHESTER: So do you think that would be a reasonable thought for someone who is from the eastern States?

MR NEWNHAM: We've said if you immediately changed to equalising to the average then there might be a role for WA to play in funding the transition from its change in GST receipts from that point.

MR COPPEL: Another option, and I don't know if you've considered it, is that the policy change may be announced imminently with effect from a period say at the end of the forward estimates. That would give recognition to the way the system works with a bit of catch up. WA is a State that benefitted during the upswing of the boom period and it's now part sort of compensating

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for that. Did you look at how these numbers change by having the policy announcement with an implementation start date delayed for a period of years, which would also bear on that initial starting point for the relativities?

MR NEWNHAM: Yes. I mean, a point I probably should have made in my opening remarks is that WA's position relative to other States is a structural change. We will not return to our relativity levels of ten years ago. We now have increased capacity of iron ore production which is 60 or 70 per cent higher than what it was in 2012/13, and with a low price it looks as though we are now heading back to normal relativity levels. But with 70 per cent more production in iron ore the iron ore price only needs to get back to $75 for us to return to the same royalties as we had in 2013/14.

2013/14 is significant because WA was assessed as having a single year relativity of .08. So we came very close to receiving - being assessed as requiring no GST in that year. And that means that if we get to $75 or more in iron ore, or above, WA will come very close to receiving, or being assessed to be eligible for zero or less than zero in GST. And this is significant because it's the point that your draft submission comes back to, is that the system is under significant strain and will continue to be so for the next three or four decades as WA's iron ore production will likely stay where it is for that period of time.

And so coming back to your question which I've talked around, the implementation point, we believe, should be immediate and that you should transition immediately because implementing four years out simply just exacerbates the problem and you don't really get the relief that I think we all are expecting, for WA to return to a high relativity that then makes it easy to transition from that point. I think our relativity will stay quite low and may even fall further than we've seen in the last few years.

MS CHESTER: I think there are two factors at play there I would suggest, Rick. So firstly - and it's a question that we put to you to try to help us and it's a question that we posed in our draft report. To what extent is WA being an outlier State or a royalty sense, the new norm or a blip? And I think we're getting some comfort based on information from you and others that it is a structural change and it is here for the foreseeable future, and thus that pressure that the HFE system is under, the rubber band is being stretched so far, it's here for the foreseeable future. I guess the issue though is that there is a forecast increase in the relativities for WA, and the cost of the implementation and the start date that Jonathan is getting to, is much greater if it's an immediate implementation than it is if we wait a couple of years for it to recover.

Which kind of brings us back to Deidre's opening remarks about the Chamber being very focussed on the good financial and fiscal management of the State, and I think it's fair to say certainly in your original submission and in our draft report we did have some very frank commentary around budget

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management of WA which has sort of contributed to the current fiscal position, as opposed to just being solely because of GST relativities doing some significant swings and roundabouts.

So that does make us pause for a moment if WA is not funding that transition path as to should we hasten a little more slowly so the cost of that transition path is less as the relativities begin to recover, and it's an open question.

MR NEWNHAM: It leaves you exposed to a big risk in that if you have a big increase in iron ore price you won't get back to that easy point of transition that you're expecting. You only need one year of $120 and you're back down to 30 cents again. So next year if we get to 50 cents or wherever the forecast is, that may actually be the easiest or the best time to transition, given the risks that are exposed. Yes, I take your point though that if the relativity does increase up to 75 cents or 75, then it makes it - the task of transition becomes smaller but I think it's still very exposed to the price risk for iron ore.

MS WILLMOTT: I think the way that we were looking at it was that a practice has developed now where Western Australia is being topped up by the Federal Government because of our very low GST relativity, and we've said, "Well, if we're going to fix this system in the long term and remove the remarks on the West Australian budget to absorb the volatility in the iron ore revenues, why can't we do that now and apply those top ups to the other States rather than keep topping Western Australia up in a system that is fundamentally broken?"

MS CHESTER: So I think we agree that we want to deal with the architectural longer term problem, it's just our starting point is such a very diverse band of relativities that the cost is very high and, I guess, coming back to the point, Rick, that you made it's how do we sort of share the pain of that cost? And hastening slowly with the pacing might be one way. And WA has been pretty good at forecasting relativities. Anyway, we will talk some more detailed numbers later.

Just coming back to the point about good financial management though, we did have some frank commentary around that in our draft report and I just wanted to know if you felt we'd got anything right or wrong there?

MR NEWNHAM: I think that's probably outside the scope of our submission, I would think. We've made it very clear that we're not doing this because of WA's current state of finances. We're doing this because of the incentives, perverse incentives it creates across other States. So it's not within our remit on HFE to comment on the WA State finances.

MS WILLMOTT: But as a matter of principle we are certainly very supportive of the initiatives that the current Government has put in place to

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rein in spending, particularly the wages policy and also their targets around numbers in the public sector. These are important reforms that do need to be made.

Western Australia as a State was like a lot of other organisations in our State in that while we were managing such a huge inflow of investment we had a lot of pressures, a lot of skill shortages, a lot of people being employed out of the public sector to go and work in the mining industry, particularly on the construction projects. We had 600,000 people come into the State. So there was certainly a lot of demand, a lot of challenges and like many organisations the public sector grew very fast, their expenses grew very fast, and the challenge has been for the public sector to find the levers to take those costs out of their services and their structures, as many businesses have had to do.

MS CHESTER: I guess it's fair to say we've had submissions from other interested parties around the fiscal management, from the fiscal management perspective, and looking at the CGC numbers of the $7 billion earlier wrinkle on GST revenues, if that had been sort of preserved in some way for the future where you knew that the relativities were going to be falling away, the budget situation would be quite different. And again, we're just sort of trying to take into account all of these factors when we look at what's the best way forward in managing a transition path.

MS WILLMOTT: Our fundamental argument would be that the GST system is broken and that that volatility is something that the West Australian budget is going to have to continue to absorb. And regardless of the financial management that led into the situation, we now have a federation where one State is running deficits between $3 and $4 billion, increasing its net debt, in order to transfer funds to other States to top up their budgets. And that does not seem like a sustainable or reasonable expectation for the long term.

MR COPPEL: In your initial submission you had a number of options that were different from the status quo of equalising to the strongest State, including equalising to the average. Have you landed on that as your preferred option because of the draft report or are there intrinsic factors from your analysis that lead you in that direction? That is one question, and the second is do you see alternatives other than those that are mentioned in the draft report that also characterise a distribution that is akin to less than equalising to the strongest State - - -

MR NEWNHAM: Yes. Our original submission - we had three proposals. Equalising to the average, discounting mining royalties and discounting overall revenue. Now, all three of those we believe create stronger incentives for States to develop, and trade off equity for efficiency, or a more balanced trade-off between those two.

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Mining royalties, we still believe there is an error in the assessment of mining royalties and that there's no potential capacity to produce - the potential capacity to produce is completely missed by the current assessment in that if there is no production whatsoever out of a State that's considered to be zero capacity, which we believe is an error, and that you could go some of the way to fixing that by discounting royalties. And I know the draft submission, the draft report, dismisses that argument but we still believe that that's the case.

Discounting revenue was seen as a way to incentivise development across all industries. So not just focussing on mining, oil and gas but across the entire industry. And we don't go into that.

But equalising to the average, we think, is - the more and more we have thought about this and the more we have studied, the more we have narrowed in on equalising to the average because particularly around its ability to remain flexible over the long term and to withstand extreme circumstances in the long run. We believe that for those reasons it's the superior option of the three.

MS CHESTER: In your post-draft report submission - well, the draft version that we've got at the moment and you touched on in your opening remarks - you sort of describe equalising to the second highest State as fatally flawed. The two Fs. I just wanted to talk a little bit about the efficacy of that statement and do you really envisage a situation where you'd have two outliers, being Queensland and WA? It's not something that Queensland anticipates. So what insights do you have that Queensland doesn't have about its future royalties?

MR NEWNHAM: If there's one thing we should have learned through this entire process it's that we must expect the unexpected out of our system, and that for one State to not foresee a particular outcome is not a reason to forge ahead with a system that is potentially flawed under extreme circumstances. So that's what we should have learned. And so it is entirely feasible that both - the two States, whether it's Queensland and WA or two others, pull ahead at the same time and we'll be left with the same very large equalisation task for those States. So I don't think we can rely on the current forecast from States to build a system that needs to last us say another 50 or 100 years.

MS WILLMOTT: As we thought it through too, we thought well, we don't want to leave the leading State with a premium that is just there, and if the leading State does have a really good year all States would benefit by and increasing the average. So we're not disconnecting other States from the fortunes of the leading State.

MS CHESTER: I guess some may look at our draft report and say our key conclusion really is don't equalise to the highest when you have such an outlier. So you can go to a world of equalising to the average, now we'll go to the world of equalising to the second highest, which during that period that

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matters, sort of 2008 plus, it does reduce the equalisation burden as it has blown out.

If the extreme unanticipated circumstances of Queensland and WA both going gangbusters and being the outliers were to emerge, you could still then consider the Government instructing the CGC to say equalising to the second highest now is nearly equivalent to equalising to the highest, and thus we'll move to equalising to the average.

So I'm just trying to think through our key finding was don't equalise to the highest when you've got an extreme outlier. Equalising to the second highest really still does reduce that burden and it makes a much easier transition path, and indeed during the period 2000 to 2007 there's really no difference between equalising to the second highest and the current arrangements, which makes it a little more acceptable to other States and Territories in an intuitive sense. So you can see where I'm kind of heading there with the logic. It would be good to get your thoughts on that.

MR NEWNHAM: I think the long term, the focus needs to remain on the long term, not the ease of the transition arrangements. If it makes the transition arrangements easier then that's great for the next few years, but we need to focus over the next few decades. And so if you're setting up a system that you can already foresee will struggle under extreme circumstances, that's what we should avoid.

And so equalising to the average - and one of the key benefits of equalising to the average, as Deidre said, is that every State has skin in the game. So if the leading State does even better than it currently is, all States will then equalise to a higher point. If any of the recipient States do better than they currently are then they will in turn raise the equalisation point and benefit all the other States. So it is an all States pulling together in the same directions model, and is very flexible under extreme circumstances.

And the other key point which should appease WA is that it is much more predictable and reliable in its ability to forecast because extreme circumstances from one State does not move the equalisation point dramatically, vis a vis the leading State. So for those reasons we think it's the superior model.

MS CHESTER: If indeed we as a nation have to choose one approach, but I take your point that the draft report looked at changing the objective and maybe that objective could be met by looking each year at what the appropriate formula would be, but we would need to make sure that over time we didn't get back into what you identified as the pure standing in the way of the best outcome.

MS WILLMOTT: Don't remind us of that wording. We've had to listen to many people who - - -

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MR COPPEL: Just on that point, because clearly if the recommendation is followed then there would by definition need to be a reformulated objective of HFE. Do you have any views as to how that process should be conducted? Should it be something solely within the remit of the Commonwealth Government, or do you see or envisage a role that would be played by the States and Territories?

MR NEWNHAM: In terms of agreeing what reasonable equalisation shall be? We believe, or we know, that it's totally within the Federal Treasurer's remit to direct the Commonwealth Grants Commission in the next Terms of Reference, and that we believe that that's what should be done. If the Productivity Commission final report finds that it's made a significant trade-off in efficiency under the current system, then that's holding the national economy back and the Commonwealth Grants Commission should be directed immediately to equalise to the average from that point forward. And it does not require, should not require, the agreement of the States, legally or politically.

MS CHESTER: So our draft report did suggest that there be a process of consultation between the Treasurer and the State parties, especially being mindful of the need to formulate a transition path, and particularly put options to fund that transition path. So you're envisaging a world of a cold turkey.

MR NEWNHAM: Well no, there's consultation that is already happening between the Federal Treasurer and his State counterparts, and we all know how that consultation is going. So under those circumstances - I mean, the GST and changing the arrangements has been discussed for quite some time now so I think all of the States' positions and interests are well known, and so I think there may be a short discussion that needs to happen. But there will also be some time, as I understand, between the Government receiving the report and when they will have to table it in Parliament, and so during that time they may want to conduct consultation and then make an announcement with the report.

MS CHESTER: Just one other quick question around your version of the transition path, and you're looking at the top up payments being paid by a Government or potentially a co-funding model against two State Governments and one Commonwealth Government, when you're looking at the numbers I guess it depends on what your benchmark of your starting point is in terms of how you make a focal whole during that three year period, whether it's against a 95 per cent confidence about what their relativities were likely to have been, and we'll get some of those numbers off you later, versus the starting point of today and then looking at it in terms of the GST pool itself and the growth in the GST pool, and whether that could perhaps be a funding mechanism. Is that something you thought about?

MR NEWNHAM: We did look down that path, but you end up in the same situation where - I mean, every State budget has assumed a growth in the GST

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pool already so if you use the pool itself to fund the transition arrangements then you still end up with a shortfall against forecast GST revenues for each State. So it might sound like a fancy way to do it, but I think once States then begin to compare what they think they're going to receive under a new model or transition arrangements against their forecasts, there'll be a shortfall.

MR COPPEL: On that point you have a quite substantial top up payment coming from the Commonwealth in the order of $5 billion. Do you have any views as to whether the GST itself could be a source of - changes to the GST base or rate, as a source of that revenue?

MS WILLMOTT: I think the business community generally is concerned about the disproportionate reliance on direct taxes in Australia compared with other OECD countries, and the relatively low reliance on indirect tax. So we believe that long term tax reform does require the GST to be examined, both in terms of the breadth of its application but also in the rate. But that's not the issue with horizontal fiscal equalisation. So tax reform is important and it does beg the question that if the States aren't getting enough from GST when will they look at engaging in a discussion about proper tax reform and perhaps rebalancing our tax system away from direct taxes to more indirect taxes, with a view to keeping that indirect tax base as a States' tax.

MR NEWNHAM: I think the other important point to add to that is that reforming the GST and equalising to the average unlocks a whole lot of other tax reforms that can be done after that. Your cameos were great in demonstrating that, around what State tax reform could be achieved. But also it will be very difficult, near impossible, to expand the base or the rate of the GST without the agreement of the States, and WA doesn't have confidence in the current system and so you won't have any discussion or progress around that topic without reforming the GST distribution first. So with all of those - changing the GST distribution allows you to build the foundation to do other tax reform down the road. That's the first step that you need to take really.

MS CHESTER: And I think our draft report did see stepping stones as well in terms of there's only so much we can do with HFE within the current fiscal financial relations. Indeed we have a finding and even a recommendation that some other more sort of fundamental issues be addressed in the medium to longer term. And I appreciate that a lot of the Chamber's efforts have been focussed on fixing the near term, but does the Chamber have a view of that longer term and the broader issue of fiscal Federal relations and going beyond HFE to the world of dealing with the vertical fiscal imbalance, the other three letter acronym we all love?

MS WILLMOTT: We haven't done any detailed policy work or published any detailed papers recently. In the past we've certainly made submissions to the Federal Government's Tax White Paper and other reviews. We would be happy to share those papers with you, but they're not sequential in terms of building on the work that we've currently done.

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MS CHESTER: Part of the reason I raise it is that I guess the one theme in our draft report is we are in a world of outliers, but the outlier is not just WA. There are two other outliers. How we do HFE - we are a world outlier there. But the third one was dealing with Indigeneity as a disability within HFE and the system is really struggling and grappling with that, and we couldn't see our way clear in the draft report to resolving that issue separate, dealing with funding responsibilities, Commonwealth versus State, and getting some greater accountability.

That's not something that you've commented on, but I know that you are looking more broadly than near term. Is it - where have we landed on Indigeneity as the third outlier? It would be good to get your feedback on that.

MR NEWNHAM: We've had discussions but not landed a position on how you might change the way you treat Indigeneity in the system. One option which I think has some broad merit, without going into it in detail, is that you essentially take the equalisation of Indigeneity out of the system and then link that to direct payments from the Federal Government and, as you say, link that more closely to outcomes. The Northern Territory has the highest Indigeneity so the major change would be between the Commonwealth and the Northern Territory. But it would allow for greater accountability as to how those payments are made and the use and the outcomes that you derive from that as well. But we've not done any more detailed work than simply discuss the merits of the proposal.

MS CHESTER: And I guess precluding that precursor reform occurring it's difficult, as some have suggested, just to take Indigeneity out of the HFE system.

MR NEWNHAM: Yes.

MR COPPEL: Thank you very much.

MR NEWNHAM: That's great. Thanks very much.

MS WILLMOTT: Thank you very much.

MS CHESTER: So we look forward to being able to put your submission on to the website today.

MR NEWNHAM: Yes.

MS CHESTER: Can you please allow us to do that some time later this afternoon - - -

MR NEWNHAM: We will.

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MS CHESTER: - - - so all the other folk get to enjoy the read. And we would really appreciate getting the underlying numbers for forecast and assumptions that underpin your post-draft submission.

MR NEWNHAM: We will share that with you today, yes.

MS CHESTER: That would be great. Thank you very much.

MR NEWNHAM: Thank you.

MS WILLMOTT: Thank you very much.

MR COPPEL: Our next participant is the WA Party, Andrew Mangano. If you could, when there's a seat available, make your way to the front and when you're comfortable give your name for the purpose of the transcript and some brief opening remarks, thank you. Please start.

MS CHESTER: Hey guys, if you want to have some conversations outside would be appreciated.

MR MANGANO: Thank you, Commissioners, for your time today to give us a chance to put our case forward for the HFE inquiry. My name is Andrew Mangano and sitting next to me is Julie Matheson who is the leader of the Western Australia Party. Just referring to the slides, I will just read through them quickly. Basically the party was called the Julie Matheson of Western Australia Party until recently and has now become the Western Australia Party. The party convenor is Julie Matheson and the party secretary is Stephen Phelan. We have approximately 600 members, and the party made submissions to this inquiry and a number of other inquiries recently.

Basically in summary the GST was established in 1999 to replace sales tax and a number of other taxes, and across Australia it is forecast to raise about $63 billion this financial year of which WA, being 11 per cent of the population, raises about $7 billion of that. But because of our very poor allocation, 3.7 per cent, we're only getting $2.3 billion of that $7 billion, leaving $4.7 billion leaving the WA economy never to return.

State taxes in WA raise about $8 billion per annum, which is relatively small compared to what the Commonwealth gets, and $5 billion of that is through three particular taxes which we find basically outdated and it forms a double taxation, being payroll tax, stamp duty and insurance duty.

Now, if the Government was really serious about reform these are the taxes that should be targeted because these taxes are firstly double taxation, they create negative impacts, serious negative impacts on employment.

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The Government has just raised the payroll tax here in Western Australia. Now, what effect is that going to have? Of course the first thing is it's going to say let's get rid of a few people. If I was a large employer I'd be saying, "Well, how am I going to save money? Get rid of a few people."

The other one being stamp duty. Stamp duty is particularly innocuous because stamp duty is a very large amount of money, especially when you're buying a house. For young people buying a house today - when I bought my first house in '88 I think I paid $2,000 stamp duty. Now, the same person to buy the same - if I was buying that same house today it would be more like $30,000. Now, that's a serious increase, tax creep, right.

And I know this is off the HFE subject, but what I'm saying is without HFE reform these taxes can't disappear. And then of course insurance duty, another $700 billion raised just for paying your insurance. Is that a good tax? No. It's also a double tax, the same as the other two.

Royalties raised about $5 billion. Now, they're volatile as everyone else will tell you. It's very volatile. We can't rely on them. And not only that, we've had to spend $40 billion over how many years to basically fund the growth that basically created those royalties. You know, the infrastructure, the support, mining and the increased - what, 600,000 people who moved to Western Australia during that time.

Now, people say, "Oh yeah, the Government wasted, the Western Australia Government wasted its money." Particularly the Tasmanians, I imagine, that would say that. What do you think? 600,000 people need roads. They need rail. They need services, water. Those services don't come for nothing, right?

WA needs a stable and fair revenue stream without resorting to double taxation. As I indicated, WA is a very big state, 33 per cent of the land mass. It creates significant additional costs to provide State Government services across the State compared to say a smaller State, like Tasmania or Victoria or the like. They don't have the roads that we build. It costs $1 million per lane kilometre to build a road. That's a lot of money to spend to build a road. And those sort of infrastructure builds just have to be funded from somewhere.

We also don't have an open slather on gambling here. We've only got one real place that you can gamble in Western Australia apart from the TABs and private betting agencies, which is the casino. So the revenue from gambling is relatively low in Western Australia. We don't want to have gambling become a revenue source like it is in other States. And in fact it's not even - it's quarantined anyway from the HFE calculation in my understanding.

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There is little incentive to raise royalties at all, or any tax, because when you could potentially lose 88 per cent of it out the door. Why would you bother raising a gold tax when you're going to lose 88 per cent?

The simplest way to give WA a fair go is to receive 100 per cent of the GST per capita share. Other forms of equalisation that should be considered to give a fair go to Western Australia - I mean, infrastructure funding already comes from Federal Government funds other than the GST. You know, roads, rail and other infrastructure. Even hospitals, et cetera, education.

We also would need, and deserve, defence spending to increase in Western Australia. We are only getting a pittance of what's being spent in in the defence side of things in Western Australia.

And we also think that Commonwealth equalisation funding shouldn't be used just to, you know, prop up the Government with no real use for that, no defined use for the money. In other words, not for infrastructure, just for, you know, employing public servants. GST, in our view, shouldn't even be used for equalisation. I mean you're quarantining everything that's subject to GST, but you don't talk very much about other forms of taxation that the Government creates, raises, Federally and that uses equalisation tools in other States and in Western Australia.

So in summary, Western Australia's economy is losing approximately $4.7 billion this year and it doesn't look like that's going to change significantly. 100 per cent of the GST share pool is - a 100 per cent per capita share of the GST pool is the simplest way to deliver a fair go to Western Australia. GST should not be used for equalisation between States.

Payroll tax, stamp duty and insurance duty are all outdated forms of taxation and produce negative impacts on employment, trade and the economy generally. These taxes should be abolished in due course, and Western Australia does deserve a fair go in this review.

MR COPPEL: My first question is picking up on one of your latter comments that GST shouldn't be used for equalisation, we should use other tools. What other tools do you have in mind?

MR MANGANO: Well, how much does the Government raise totally in Federal taxation? $300 billion per annum, something like that. Am I correct? $300 billion swamps $63 billion. I mean, that's what I'm trying to tell you. There's a lot more taxation that the Government, Federal Government - taxation levers that the Federal Government has to play with, but they focus purely on GST. I don't know why, but it's like yes, we'll just use GST for that and don't tell them about the other $300 billion that we're raising.

MR COPPEL: I think about half, half GST and half other transfers.

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MR MANGANO: Yes, yes.

MR COPPEL: So you are saying that income tax should be used for - - -

MR MANGANO: Yes, well any form of tax. I mean, they raise - there's company tax, income tax, FBT, capital gains. There's lots of tax revenues that the Government has. But as I said, it should be really only towards infrastructure spend because they're the big ticket items that State Governments need to fund their - you know, the small - like, they build a railway line that Metronet would - this Government is currently proposing. That's billions of dollars. You know, it's not small change. The money has got to come from somewhere, and certainly we haven't got the money at the moment to do it.

MS CHESTER: So I think the sort of reforms that you're envisaging are ones that were contemplated by the Commission of Audit a couple of years ago, that is taking the GST pool and moving it to distributing on an equal per capita basis, then with a top up arrangement for some of the smaller States. But that was only countenanced in the context of doing reforms of taxation arrangements from the Commonwealth and State Governments, and Jonathan has touched on income tax and that's what the Commission of Audit had in mind.

So I think in the terms of our inquiry we were talking about the potential for longer term fiscal Federal reform. Those sorts of options can be considered in that context, but I'm not - so in terms of just reforming HFE within the current arrangements of taxing powers and responsibilities, Commonwealth versus States, we are taking the previous agreement that the GST was struck upon, i.e. it was meant to be used for the purposes of horizontal fiscal equalisation.

So I think where you're taking us is further down the track of those broader reforms. Am I right in - - -

MR MANGANO: Yes, yes.

MS CHESTER: Okay.

MR MANGANO: We see GST just being split on a per capita basis and then other taxes to be used to do any equalisation, but again specifically not to be used for business as usual type activities.

MS CHESTER: Okay. And when you talk about the two issues for WA, so all the expenditure on infrastructure and the like that was related to the mining boom and the build up to the mining boom, and some of the disabilities about remoteness and breadth of land to cover, so the current CGC arrangements do

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take into account those expenditures and those cost disabilities when they do their assessed expenditures and assessed revenues across the State. So is there something in the way the CGC is doing that at the moment that - - -

MR MANGANO: I think it is flawed because we can't have got this pool at a return, like 34 per cent or whatever it is, without having - you know, taking these things into account - with taking these things into account, I should say. Yes, I feel that they've either underestimated what WA is actually spending or they - yes, that's my view, it probably is they've underestimated it, just seriously have underestimated just how much it costs to run a State this big, yes, and with an ageing infrastructure too, I might mention. A lot of this infrastructure in the metro area and - that has been added on to because of the 600,000-odd people that moved to Western Australia, who a lot of them live in Perth, they've stretched the infrastructure to the max and what I'm trying to say is that I don't think the CGC would have taken that into account.

MR COPPEL: If you replace the GST with some other Commonwealth tax source for horizontal fiscal equalisation, how does that ultimately change the bottom line if they continue the method that they have? You're just switching one funding source for another.

MR MANGANO: Well, I haven't modelled it. Obviously I'm not an economist, but I feel that that is the right way to head to go. It may not necessarily - what I'm trying to say is it won't penalise WA as bad as it is being penalised now. The way it is now it's almost a one way street. We can't win. We can only lose. Whereas if you look at it - you know, just where is the infrastructure required in Australia? If it needs to be in New South Wales, we spend the money in New South Wales. If it needs to be done in Western Australia, it needs to be done in Western Australia. If it needs to be done in Tasmania, it needs to be done in Tasmania. But at the moment it's just a one way street, money going out the door in Western Australia and no thought about where it's being spent and how it's being spent in those other - in the recipient States. That's my view.

MS MATHESON: If I might add - thank you very much for the opportunity. If I might add, the size of Western Australia, 33 per cent of the land mass, we're getting one small pot of GST money for our land mass. Now, on the eastern States they're getting three plus pots of money for their land mass. So there's the inequity there straight away. And if you want Western Australia to have a larger population which would mean we would get a larger share of the GST because part of the calculation is based on population, then to help us with our population we need the infrastructure to build throughout our State, to make our State even better.

I mean, if we really resourced and made the best and the most out of the resources, the rest of Australia would prosper immensely. But the GST as a one small pot of money to build the infrastructure that we require to do what

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we can do for the rest of Australia is very unfair. We're now three pots of GST money for the same land mass in the eastern States. So I think it's a very - we are at a disadvantage straight away.

And at the time of Federation our - Western Australia was very concerned about that, the fact that we were subsidising tariffs and we were very reluctant to join the Federation because of the subsidising of tariffs in the eastern States.

Now, at the moment we are subsidising all of the eastern States and we're encouraging some of those States to sit back and watch Western Australia dig up every inch of land, minable land, and farm every bit of arable land, just to make ends meet. So we have exported $1 trillion of minerals since the GST came about in 2000. $1 trillion we've exported. Not taking into account the farm and other exports that we could have. And we have $40 billion in debt to show for it. And it's not the mismanagement of the State. It's because of the mining, the extreme mining boom we've come through.

And I was born in Port Hedland in Western Australia, the economic hub, I might say, of this country. And our mining companies are doing everything possible to keep and maintain the prosperity of Australia, but when they're under pressure for mining royalties to increase because Western Australia is doing so badly, we're putting the prosperity of all Australia at risk.

Now, our mining companies are doing the best they can. Our State is doing the best it can. So the GST, in our view, 100 per cent needs to come back to Western Australia so that we can manage the things that happen in Western Australia. We need to be able to manage that.

And I find it a little bit strange that we're an outlying State. I mean, surely we are a State of Australia, not an outlying State. And I think that there needs to be a different perspective put on Western Australia. It's really important to the whole of Australia that Western Australia is not an outlying State. It's an important State.

MS CHESTER: Julie, by all means our reference to Western Australia being an outlying State is a positive, and it's not meant to be a pejorative. It's - you know, the mining boom has meant that Western Australia is ahead both fiscally and economically than it would have otherwise have been, and that's what we mean by - it's the fiscally stronger State by a great distance to other States and Territories because of those mining royalties.

MR COPPEL: So, your key recommendation is moving to a distribution of GST on per capita terms. That would have big shifts in terms of the GST allocation, and one of the areas that we're doing more follow up work is on how you would transition from what you have today to some other model. Can I ask you what you would envisage then as a way of transitioning to equal per capita and maintaining some form of fiscal equalisation?

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MS MATHESON: I think we raise - Western Australia raises a lot of income tax and all the various taxes. We are a big contributor to the tax pie of the Federal Government. So I think, you know, the handouts or the top ups as we call them, why not just give us our GST, let Western Australia manage its finances on its GST, and if other States need top ups because they've had less GST then you could use those top ups to help them with their infrastructure so that they can properly resource their State, and look for all the opportunities, economic opportunities, to grow their State with that money.

Because whether we get the top ups or not, we are going to grow our State. That's just in the mindset of Western Australia. We are going to grow our State. But we don't like being disadvantaged by expecting to get X amount of dollars in the GST, as Deidre and the other economist said. We're doing some forecasting on how much GST and how much revenue we're going to get and then we don't get it. You know, the Treasurer signs off on a different amount of money for Western Australia. I think that's really unfair.

MR COPPEL: But that may be exactly the argument that is used by other States, this is how much we're getting and this is how much we would get. It's a very difficult issue to move from the current arrangements to new arrangements. If you go back to the early 1990s there was a reform opportunity to the way the Grants Commission calculates. If I'm not mistaken, Western Australia at the time ruled that out. Western Australia had a relativity of above one, because looking at it from the perspective of that time, at that point in time it didn't stack up.

I would suggest that other States would probably make that same point vis a vis such an extreme shift to equal per capita. So something has to give.

MS MATHESON: But we're creating a GST welfare nation. If we don't do something about this soon it's becoming a welfare nation, you know, where one State raises an amount of GST to create this welfare for other States. I mean, where is the incentive to grow your economy in the other States? It's almost like a socialist policy.

You know, it's problematic for the prosperity of Australia. I mean, we are separate from every other country in the world and we need to harness our resources. Each State needs to harness its resources and not just rely on one State propping up the rest of Australia. You know, Western Australians will do whatever it takes to make our little piece of Australia work. We are isolated. We have to rely on each other, our own innovation, our own ingenuity.

But I think this reform is urgent. It is urgent because otherwise Western Australians will be feeling like what was the point of the boom? We could have just not engaged in the mining boom and sat back and got our share of the GST and had minimal infrastructure go on in Western Australia, and we

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probably would have had better job security, better business security and families wouldn't be suffering from the massive high cost of living that we have in Western Australia because the State Government has to put up the cost of living. You know, electricity, gas, water, everything has gone through the roof. You know, we've had not just a small percentage increase in the cost of living here. We've had 10, 20 per cent increase in those utilities.

So we would have much better certainty if we didn't go through the mining boom and we didn't have the - didn't put out the infrastructure that we did. But anyway, we're in the situation that we are and we need your help to put a better focus on Western Australia so that we can help the rest of Australia through our other taxes. But our GST is important to us. It's really, really important. We signed up to the agreement for the GST so that we would get - I believe, I think, it was 70 cents in the dollar back in the day - but we're not getting that.

So we really are here to plead with you to give a better focus for Western Australia because we are up to the mark of providing greater prosperity to the rest of Australia, if you let us do it. Thanks.

MR COPPEL: Thank you.

MS CHESTER: Thank you.

MS MATHESON: Thank you.

MR COPPEL: Our next participant is John Pitman. We are running a little bit ahead of schedule, but welcome. Like others, make yourself comfortable and when you're ready give your name for the purpose of the transcript and a brief opening statement.

MR PITMAN: Okay, my name is John Pitman and I'm here as an individual presenter representing people who aren't here, which is the youth of WA. As a semi-retired TAFE teacher and now part time op shop worker, I am indirect contact with the youth of Australia and I feel for them. I really feel for them. These are the people who put their faith in the elders in the community, and I think we've let them down. I cannot ever have experienced a mining disaster like we've had where, in the past when we've had our mining booms and busts, normally there's been a period of readjustment. But we've never had the funding stripped out of WA like the GST under the HFE.

Well, first of all I'd like to propose a question. What's the most common sign you've seen in WA since you've been here? I'll help you. And by the way, as a teacher there'll be a test at the end for you too. WA is basically up for lease. I have never seen so much vacancy in our shops, our commercial units, our houses. You name it, everything seems to be up for lease. Why is this so? Why is there so much unemployment? We've gone from the lowest

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unemployment within about three or four years to the highest unemployment in Australia.

So what actually happened? And it seems to me that the measures that the Commonwealth Grants Commission have used have not been exactly reliable. They have not been at the human level, and that's the level that I work at. In particular, I am thinking of the youth. They go to university or they go to TAFE or they get a job. That's just it, there is no work. In our op shop we have no shortage of school volunteers because there is no work. The supermarkets aren't taking anyone on. There's not enough economic activity in WA.

Sure, there's mining but that isn't always in Perth. And as previous speakers have said, job advertisements. You can look at the West Australian. There are very few jobs. That's why obviously we've got unemployment.

We've got a net loss of population. They estimate about 50,000. Okay, we took on 600,000. 50 have gone back. Why? There's no money here.

All our utility costs have gone up. Our State tax levels you've heard about. The property vacancy rates are at unbelievable levels. But worst of all, the commercial levels. And this is the engine room of WA. Mining just doesn't occur up north. It has a huge engine room in Perth of all the machinery, maintenance, repairs, the workers, where they live, all the things that drives the mining economy actually most of it originates in WA - sorry, in Perth, in the city.

Our wage levels are very restrained. It's great if you're a miner, but it's not if you aren't. Our education results certainly don't stand out amongst Australia. The other thing too is the implications with our hospitals and our wait lists, our elective surgery. Our cities are now congested. Our university graduation employment rates, 40 per cent of some courses, they just don't get a job. What's happened to the work? It seems to have gone east, like the GST. Could be a coincidence? I don't think so.

Our car sales, and very sadly something that isn't spoken about, suicide rate. We have a very high indigenous population and some people struggle to cope. So, have we put money into mental health? No.

Record bankruptcies. People have gone under. They just can't manage. There's not enough work. What? There's no money in the community, or not enough. And to have, as you have previously heard, a State that is so rich in resources and to actually end up with a $43 billion debt, plus $2 billion debt annually, is just mind boggling. How could this happen?

Now, obviously there are comments about the management of the State Government and I, for one, really don't see a great deal wrong with it. We've

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ended up with a stadium and Elizabeth Quay. That's what WA has to show for the mining boom. Plus a deficit.

3,000 State employees are looking like getting the bullet, but of course they'll come off the books and they'll go on to Federal unemployment benefits. And very sadly, along with suicide we have the highest illegal drug use. This is nothing that I'm proud about. This is terrible. This is people who are struggling.

So what is it that the horizontal fiscal equalisation tries to achieve? It seems to be robbing Peter to pay Paul. There's no incentives for us to do more. For instance, they are proposing a gold tax. What happens? We get more in gold tax and immediately the GST proportion drops. There's no incentive.

So what I think people need in WA is useful employment and jobs, and that is achieved by allowing the funds that are raised within WA to be used to employ people in WA. I guess there are some options, though. First of all, we could fly our 6.7 per cent unemployed to other States. They could get work there. That would be a great idea. If you're sick or you need surgery, go to another State. Maybe our youth could leave and go to another State.

Maybe people will change their voting patterns, as they already have. Our State Government has already changed, and let me tell you, the Federal Government is next. It's going to change. There are some key people here who will just not get their seat back.

And of course, the other one is whether we should secede from the Federation. This issue has come up before in mining booms. WA gets ahead, the money comes out, people talk about secession.

Now, I'm meant to be commenting on the draft report, and I thought there were some rather interesting comments in it. One was there doesn't seem to be incentive for any of the other States to develop their resources. When the GST has been handed out to them it didn't ever come with any obligations or requirements. I mean, if you want your kids to clean their bedroom you say, "I'll give you pocket money if you clean your bedroom." But when the money went to Tassie, South Australia and Northern Territory were there any requirements? No, it was just given to them.

Just recently a headline in the Tasmanian newspaper was, "Hands off our GST". Whose GST was it? It was WA's. But is Tassie doing anything with their resources?

Now, one thing I'm firmly in belief of is that Australia would be one of the most richest and wealthiest countries. All States are rich and wealthy. Maybe not in iron ore, but they've got human, they've got all sorts of other characteristics. Whether it be gas, coal, human, technical, all States have got

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something. What they choose to do with it is their business, but you shouldn't be giving them GST without some requirements.

As for the independent and expert Commonwealth Grants Commission, I really find this hard to believe. Blind Freddy can see there's a connection between politics and the States that are receiving the money. Now, we've changed from a Liberal to a Labor Government at a State level and I really think that the Commonwealth Grants Commission has either been complicit in this reallocation of money away from WA, or it's been exploited by the Commonwealth Government. They can't afford for total equalisation because they're going to be out of government, no matter who it is.

Some of the other phrases I thought were fascinating, too. It said, for instance, "beyond comprehension by the public and poorly understood by most within Government." Come on. This is not rocket science. This is distributing money so all States can provide equal services, and at the moment they are not equal in Western Australia.

Timing and careful transition are paramount. Now, hang on? Did that apply to WA? For three years we've had high unemployment. For three years there's been problems in WA. So what happened to the careful transition here? It didn't occur. The money came out. We didn't have any careful transition.

So, you may ask, well what does that mean to the other States? They may have to experience some pain, some incentive, to say things aren't right, maybe we need to change our thinking and not just look for the money.

MR COPPEL: Maybe I can ask a question because you have made this point several times and we have a draft report which is in the public domain. We have a suggested change to the way in which the Grant Commission allocates GST. Do you have any views on what we're proposing in the report, or are you suggesting something different?

MR PITMAN: Well, what I was coming to is that I think it should be based on population, and that will give all States a real incentive. And I think yes, there's going to be some pain politically, economically. Some States will all of a sudden say, "Gee, what happened to the money?". Well, it was an inheritance that you had and, by the way, you've spent it.

They have to learn to invest, and that's what WA has done. It has invested a huge amount of money. And I don't think the draft report has addressed that incentive side of things. It's just seen a way of distributing money but without any requirements, without any obligation, without any respect for where it came from. Who actually developed the money? Who developed the resources?

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And another comment that you mentioned was to ensure the physically weaker states are not significantly disadvantaged. Well, why are they physically disadvantaged? And it's because, as we found, they leave their resources either buried or they don't develop them. And I'm not talking about just minerals. I'm talking about the human side of things too.

Okay, so now we move on to the promised test. What do you think WA people are feeling about the Commonwealth Grants Commission? Just in general, two emotions.

MR COPPEL: Well, we're here today to ask you the questions so I'm going to dodge that one.

MR PITMAN: Okay.

MS CHESTER: I think, John, I can say that we've probably got greater insight after having listed to you giving your voice to some of those views this morning.

MR PITMAN: Yes. I mean, I'm here as a volunteer. You're paid professionals, and you're paid to fix these issues. I'm just here giving you some information which Blind Freddy could have told you, and that is the first one is there is anger in this community. There is anger, and if you can't feel it and you're not getting it from me then I'm not doing a good presentation.

I have never known people to be so disenchanted - that's the second emotion - disillusioned that the harder they work, the less WA gets. Now, you don't travel on the freeways but as I've been on the train this morning it's stationary on Kwinana Freeway, and also on Mitchell. There's a lot of congestion here. There's a lot of people. We have absorbed the population of Tasmania during our mining boom without the necessary money coming from the Commonwealth Government. That's no mean feat. Did we get a pat on the back? No, just take the money out of WA. WA is being treated like an ATM for the rest of Australia, and it's just unfair.

So, it's on behalf of the kids who need work and the reason, or the way they can get work is to retain more of the funds that are being generated. We're not asking for a handout. We don't want someone else's State's money. We just want our own back. Or maybe it shouldn't leave in the first place.

So, it is for the kids. My children, my grandchildren and the students that I teach. The ones in my op shop. They work really hard for nothing. Should they be given some employment opportunities, or do they go interstate to get them? I think they should stay here. We deserve to give them better.

MR COPPEL: Thank you. I think you were here for the earlier participants and I've got a similar question and it relates to your point that all States have

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resources, and you defined resources in a broader sense than natural resources, yet you are making the point that WA has developed its natural resource sector and it's been penalised to the extent that the royalties from those resources are largely being equalised across the States. If I put the hat of other States on they will say why should the resource sector be treated differently from other sectors? It may be tourism. It may be education, in the case of Victoria. Every State has different intrinsic advantages and disadvantages, and they focus on their strengths. So why so much special emphasis on natural resources?

MR PITMAN: Well, I think because Australia being a huge country and very poorly populated, or very sparsely populated, obviously it's got every known mineral and so that is the first thing to be used. We're not really a self-sufficient country, certainly after our car manufacturer has gone west, or gone out - but I think yes, you do have to start with the natural resources that we have. To turn them off - I mean, for instance it's given Australia an incredible standard of living - and by the way, it still does. I mean, we went through a construction phase in WA which is why we had the boom, and then a reduction. So to be really honest, WA is in a really good position if we could keep the money.

And as for Australia, we're actually in a fairly good position too. But it is interesting that if you do propose things in other states - and I have visited Australia, and I see they have signs in Victoria, "No coal mining in Victoria. No gas mining in Victoria." New South Wales, "No wind farms". Some of those restrictions, they have to realise that you just can't give them money unless they use their resources. For instance, why couldn't we have an industry in solar instead of bringing in panels from China?

So, I think that in some ways yes, most of our resources are linked to a physical nature, however there are some States that have got great people and this is where WA is trying to transition, I think, a little bit towards where we've got a great shipbuilding industry. We actually sell ships, would you believe, to the Americans in a time of Donald Trump. Don't tell him. And so, I mean this is just unbelievable technology. Australians are, because of our isolation, very, very innovative and, I would say, hardworking, if there's work. But you can't take the money out and expect it to keep going.

So, I'm in Canberra. When you look at it, the Territory, it doesn't have much of a land mass. You might say, "Well, how can it do anything?" Yet it's got an intellectual property though too, and that's where in some ways we need that. So that's their business, which they do pretty well except when it comes to GST.

So, I think every State has its ability and they need to sit down and say, "Well okay, what can we do? What can we do for Australia?" And WA has done that, and is doing it, but we're being penalised and that is unfair. And so it is for the children and the kids that are trusting us to provide the work

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opportunities because, as a previous speaker said, we have become a social welfare country. But not necessarily at a personal level, but you're handing out money and discouraging people from actually doing something with humans, with what the State has to offer, whether it be Tasmania, Northern Territory, Queensland, South Australia.

MR COPPEL: Can I then ask if your proposal of moving to an equal, a distribution on a per capita basis, there's still an accepted notion that in a Federation there has to be some capacity to equalise to some degree across the jurisdictions. How would you - what else - what would you do to achieve that goal?

MR PITMAN: Well, I noticed that your draft report didn't like the idea of floors in the GST, as in f-l-o-o-r-s, as in 50 per cent, 70 per cent. You know, a minimum that WA should receive, and maybe a transition period of three years I think is a reasonable thing to help the States to move.

But ultimately it has to be done by population, I think. The other thing too is WA is not a very big populated State. It's a big land mass, but it's not people. Did that answer your query?

MR COPPEL: Well, I think it's not an easy one to answer because, as I've said before, this is an area where by definition any change will have some winners and some losers. We have recommended in the draft report a standard which is less than equalising to the strongest jurisdiction, but that will have some winners and that will have some losers. We think the orders of magnitude could be managed through appropriate transition arrangements, and it then comes at the benefit of some of the advantages that we see in the order of stronger incentives, for instance, in terms of State tax reforms, better practices, greater flexibility to make trade-offs between equalisation and other economic goals. But ultimately you will stiff have those winners and losers, and how to get from A to B is the million dollar questions.

MR PITMAN: Well, I think there's going to be some pain, and WA is feeling it. You talk about winners and losers; WA is a loser. We know what it feels like. It's painful. As I say, this stunt is not just a stunt, it's reality. And so yes, I think in the other States there will be some pain, and that provides an incentive.

MR COPPEL: We have a table in the report that shows per capita government revenues in each jurisdiction, and WA has the highest per capita revenues. That's the sort of fact that other jurisdictions would put forward.

MR PITMAN: Yes, well I mean as the previous speaker said, WA is a difficult State to service. It's huge, it really is. And, for instance, I saw also too that Tasmania was given some money for its remoteness. And I thought you can drive from one side to the other in an hour. Here it takes about, you

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know, three tankfuls of fuel. So it seems to me that the measures aren't always - as I've mentioned before, they're not accurate.

We have a very high Indigenous population and they're isolated, and they have to be serviced, whether it be with power - and so the State Government looks at cutting costs of not providing fuel for their power generation. Well, other States don't have those same issues. Maybe Northern Territory to a certain extent. But WA is different. It is just a very different State, and you're never going to be able to treat everyone equally. There always will be winners and losers. It's called life.

One issue that I did pick up on too was that you've got this three years of assessment and two years of averaging, and I thought, isn't that interesting? How would we like our wages to be worked out the same way? To wait five years for some sort of readjustment. And I think in some ways that's way too low or way too long. The Reserve Bank changes its interest rates every month, or reviews it, and I think that's something that could easily be done. And that is - I know it's difficult for Government where they want three years of guaranteed funding, but I think it should be adjusted more quickly.

So, when the Prime Minister - sorry, the previous Prime Minister came to WA and we told him three and half, four years ago the mining boom went bust he said, "Oh no, no. It's still going well. Everything's good." Everyone knew. Not him.

MS CHESTER: So, I think John you've raised quite a breadth of policy, and indeed philosophical issues, for us. I guess within the confines of what we can do around a proposal for equalisation, we are trying to make sure that there are better incentives at the margin so States like WA and the eastern coast do have the right incentives to reform their tax bases and to develop their natural resources, whether it be iron ore, or whether it be coal seam gas.

I guess where there is a bit of a difference though is with iron ore, you know, WA has still come out ahead and it was politically acceptable to mine the iron ore base in the north. For some of these other, like the coal seam gas which is very politically controversial - but the issue there that we're struggling with is when that development occurs and the royalties are redistributed on an EPC basis to other States, the incentive for that State to do what could be a controversial form of resource extraction, the incentives get out of alignment.

So, we are trying to deal with the incentive issue broadly, and more narrowly where it is controversial. I think some of the issues that you're raising go to more fundamental reforms around the incentives for States based on all taxes and all expenditures that are raised within their borders, and that takes us to broader issues beyond our inquiry which is sort of about what the Commonwealth raises and what the Commonwealth spends, and what the States raise and what the States spend. And I think that's the area where it's

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most difficult for us because that's a whole other area to deal with, but also because that's not well understood it makes the understanding of how the GST buckets spread across the States even more difficult.

So I think you're raising some big policy issues, and not all of them we can deal with within the confines of this inquiry.

MR PITMAN: I agree. I think if iron ore had been discovered now it wouldn't be dug up. I think there would be very severe environmental concerns and land rights and all the rest of it, and they did go through those phases but it was never as controversial as those sorts of things would be today. So WA has got through those hurdles, and those other States have to get through their hurdles too.

If they don't want to dam their rivers and make hydro then they have to live with no power, or using alternative sources. You've got to provide incentives. But just piping out WA gas over to South Australia, which has been proposed recently - who gets the GST? WA. What will happen? We'll get less here. Do we want to send our gas to South Australia, which actually has oodles of gas but prefers not to drill for it? Why? Because it costs money in infrastructure.

MS CHESTER: Well John, it's good that you did come along this morning to talk to us because part of the reason we have public hearings, and we try to get around most of Australia, and indeed we will for this inquiry, is so we actually hear the voices not just of the Government authorities and the interest groups, but also from people like yourself. So, do you teach at TAFE?

MR PITMAN: I do.

MS CHESTER: What are you teaching?

MR PITMAN: Automotive, and I also train teachers.

MS CHESTER: How long have you been doing that for?

MR PITMAN: 40 years. So young people are my bread and butter, and apart from having my own family yes, I feel very strongly. Because they're not here, they're not being represented, and we owe them a future.

MS CHESTER: Well, I think you've given us a bit more of an insight into the views of WA this morning, the people. So, thank you for that.

MR PITMAN: Thank you.

MS CHESTER: Cheers.

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MR COPPEL: We're running a bit ahead of schedule. What I am going to propose is we have a ten minute break. For those that are interested you can help yourself to coffee or tea. So we will start again at quarter to 11 with the Put Western Australia First Party representatives, thank you.

ADJOURNED **[10.36 am]**

RESUMED **[10.50 am]**

MR COPPEL: Okay, welcome back. Our next participant is the Put Western Australia First Party, and I invite you to give your name and affiliation for the transcript, and then a brief introductory statement, thank you.

MR HOPKINS: Good morning. My name is Chas Hopkins. I'm a former Lord Mayor of Perth, a businessman and President of the Put Western Australia First Party, a party that has been formed by a group of Perth businessmen and the community that are very concerned about what's happening with the share of Western Australian GST, and I refer to Peter Leigh who is the Secretary of our party, and Peter is going to give an address for us.

MR LEIGH: Okay, thanks Chas. We just wanted to go over a couple of points that we raised in the overview of our submission. Firstly was just reiterating the point that the current model is broken. Secondly, making the point that there were some comments in the report saying that the Grants Commission's processes were good and well established, and we're just challenging that they're all good.

The next one was that you asked the question before about royalties and why should the mining industry be treated differently from tourism. I'd just like to make the point that the royalties are different, in our view.

We're supporting your proposal about equalising to the average. We see that it's the only chance that we've really got of getting a change that has got some chance of getting up across the country. We will talk a bit about the transition. I know you're particularly concerned about that. And lastly, I am very pleased that you are highlighting the point that the Treasurer is the man who can make the difference here.

So, firstly the current model is broken. We note that in your report you highlight that there are issues with the current model. We've had Bill Shorten, we've had Malcolm Turnbull, we've had Scott Morrison all coming out saying that the current system is unfair on WA and WA is getting a rotten deal. They recognise that. They're going to be the ones that fix it. That is basically what they're saying. We've even got the Grants Commission in their review of the

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2020 application of HFE, they're acknowledging that royalties are a particular problem for them and they're proposing a scheme of discounting increases in royalties. And I guess we'd say well that's fine, discount the increases but how about apply the same sort of logic to the entire royalty pot?

So yes, everyone knows that there's a problem. Everyone knows that it's broken - or sorry, not everyone. We have some people who are relying on the current arrangement who don't want to see any change at all, and so we recognise that making a change is going to be difficult.

The point about not all the Grants Commission's processes are good. In particular we'd sort of draw your attention to the issue of remoteness, and you heard some of the previous speakers talk about remoteness in WA. My understanding is that the Grants Commission uses a model from the ABS that says that anything beyond 1,254 kilometres is about the extent of what they treat as remoteness. So if you're over 1,254 kilometres that's the same as being 1,254 kilometres. Well, here in Western Australia Karratha is 1,500 kilometres away. Port Hedland is 1,600 kilometres away and Broome is 2,000 kilometres away. So when you look at the trade figures there's 42 per cent of the national trade, the national exports come from minerals and energy, and these centres are at the hub of producing those things.

So while you're here I'd invite you to take a little drive up to Broome. It only takes 24 hours so you'd be able to get up there and back in four days. And then go to Tasmania and take a drive up to Burnie and tell us it's the same, and that takes three and a half hours. So servicing Burnie is the same as servicing Broome. OK?

Royalties. Yes, we'd say royalties are different from other State revenue, and when you look at the trade figures they show that the surplus, the recent trade figures said that the surplus doubled and it was driven by the iron ore increase of 8 per cent. So minerals have a significant impact on our exports. We've already said that in the DFAT figures they're saying that 42 per cent of our exports, of the nation's exports, are either minerals or energy products.

So any increase in minerals production that we can do which generates royalties or which generates exports, generates wealth across the country but generates immediate flow-on wealth to individuals, and it also generates jobs. And I don't think there's any other sources of State revenue that have that sort of impact on the wealth of the nation. You know, it's an import of wealth rather than a recycling of wealth, which most of the other State taxes are.

We do support your idea about equalising to the average. It's not our favourite thing in the world. I guess in a perfect world we'd say we'd rather equal per capita, but we realise that's going to be particularly hard to get up and if we don't get any result out of this Productivity Commission process we fear that we'll get nothing if there's a change in Government, so the best chance

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we've got of getting anything is to get in the good rather than the pure. And if we get something in now it's better than getting nothing in the future.

As the point was made earlier today about equalising to the second strongest State, and we can't see any logic if you're changing from full equalisation why you would change to equalise to the second strongest State rather than the average. Using averages, you know, is widely used in the Grants Commission assessments and it just seems to make perfect sense. And as the CCI were saying this morning, it does give you that sort of buffer about significant changes, and we note in your report the charts that show how there's a low volatility of that equalise to the average model.

So we come to the question of the transition. And from our point of view we can't see how - if you come to the conclusion that the current model is broken, you come to the conclusion that the best way to replace it is the equalise to the average, we can't see any logic in continuing with a broken process and having our political leaders offer top up payments to WA to compensate for the inequity of that current broken process. We would much rather see that we move immediately to the equalise to the average model, and if people - and if Governments have got top up money let's use that top up money to pay the States who feel that they're losers out of that change.

You will see in our report, from my understanding of the tables in your report, there's a $3.6 billion gap that will be there between the current model and the equalise to the average model. And all the talk is about making the transition easy for the other States, we don't want to impact them. But hang on, at the moment that gap, that $3.6 billion gap, is all sitting with WA. Why shouldn't some of that, some of the pain of that gap be spread amongst the other States? And if there's top up money lying around, as both of our political leaders have offered, why can't we use that top up money to reduce the size of that gap? And if it's still a problem, as you point out in your report, the amount of money in the GST redistribution is quite small in the totality of Government, so it shouldn't be beyond the will of the Government to find the money to equalise.

So, lastly yes, as I said earlier, we're pleased that in your report you highlight the fact that it is the Treasurer who is the one who can make the call. It's not something that he needs to get every State to agree. There's a widespread myth amongst the world that Treasurers and Prime Ministers have spread that they can only change the GST with all the States' agreement, and I think, as you've highlighted and we've seen elsewhere, that's absolutely not the fact.

So, in summary, we thank you for your report. We think that the model that you're proposing is one that's as good as we can get in the foreseeable future, and we can't see any reason why, if that's the right thing to do, we shouldn't do it straight away. Thank you.

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MR HOPKINS: Thank you.

MR COPPEL: You guessed right, I'm going to focus on transition and one of the ways in which you would convince all States about a change is that that change not just affects the distribution of GST but affects their economic performance. And so in terms of developing, economic development, that can be seen as a positive to the extent that the current arrangements are a brake on that economic development.

MR LEIGH: Yes.

MR COPPEL: Now, that I think has been made as a point throughout this morning's hearings but again, putting myself in the seat of other jurisdictions that may lose quite a substantial amount of the current GST distribution, what would you say to them would be the advantage of a shift?

MR LEIGH: I guess apart from it being the right thing to do, I think I'd be saying - I'd be making the point as we heard in the first presentation this morning, what it is doing is readjusting the distribution back to where it was before the mining boom. And so why, you know, why is today's level the naturally absolutely divine, correct place to be? It's obviously not. If we have a look at all those models that you produced in your report of alternate ways of distributing, I think there are only two that showed that there wouldn't be an increase for WA, and they were - sorry, they were ones in which - I think one was revenue only and the other - I can't remember what the other one was.

But the point is that you haven't come up with any models, any other models that don't take us from a position where the new model gives WA more and the other States less. So we're assuming that the model we've got in place is absolutely perfect. It's been delivered from on high as being the absolute correct model for Australia. So it doesn't make sense.

MS CHESTER: I think, Peter, the issue that - and you're right in one technical sense, that we do say in our draft report that the Treasurer in a legal legislative sense can direct the CGC, but indeed we say in our report that we believe that if the Governments were minded to change the HFE objective to equalising to something less than highest, we call it a reasonable standard instead of the same standard, because same standard is what gets us to equalising to the highest, that that was something that the Treasurer would need to do in consultation with the States.

And the reason we say that is if we rewind the clock to when the GST deal was struck, it was struck on the basis that what is now $63 billion a year was going to be divided up based on the horizontal fiscal equalisation and the rules of the game that the CGC was implementing at that time. Now, how they implemented has tweaked a bit along the way but it hasn't changed

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fundamentally in terms of equalising to the highest. So we are in a world where a deal was struck, we've been asked to review whether the arrangements within that deal are appropriate going forward, given we're now in the world of WA being a fiscal outlier. Those on the east coast refer to it as, "You guys won the lottery." So we don't - we do say in our draft report - and I just want to correct the record. I don't want any journalists in the room to think that we've recommended the Treasurer can just make the call. In a technical, legal sense yes, but we've actually recommended it has to be in consultation with the other States and Territories because of the previous GST deal.

I guess the other issue is that within the current arrangements of equalising to the highest there are swings and roundabouts with the relativities, and you refer to the $3.6 billion. I think it sounds like to me like you've closely read our draft report and you would have seen in the overview that if you rewind the clock five or six years there was a net windfall in GST revenues to the State of $7.1 billion. So if you take the $7.1 billion and the additional $1.7 billion that WA has already received as top up funding, and the starting point today is where the relativities are at their widest - so the cost of moving to our equalising to the average is at its most expensive - you can see why Jonathan is going straight to the transition path and what's fair, given that starting point and given that collective history.

MR LEIGH: Sure, but also if you look back over the last eight years and if you said okay, that the equalise to the average is the right thing, if we look back over the last eight years the gap between the current thing and the equalise to the average is $16 billion. So we're not just dealing with a $3 billion gap next year. We're dealing with a $16 billion hangover. And even if you take the $7 billion off the 16 it still leaves a decent slab.

MS CHESTER: But you're not suggesting in a revenue sense WA is still not a net winner, given its economic circumstances and the mineral boom having occurred?

MR LEIGH: And I think I'm questioning why we shouldn't be a net winner.

MS CHESTER: Well, you are.

MR LEIGH: There is a mineral boom - sorry?

MS CHESTER: You are. If you stand back holistically and look at the revenue position of WA - Jonathan referred to some earlier numbers in our report - you are still a net winner.

MR LEIGH: Yes, I didn't see that table in the report. Are you saying that WA is getting more Government revenue in per capita than any other State, are you?

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MR COPPEL: It raises more revenue, including its own sources from stamp duties.

MR LEIGH: Right, and so the problem?

MR COPPEL: It's not necessarily - I'm not saying that it's a problem. Other participants have said that they are at a disadvantage because they have less revenue, and I'm just drawing out the fact that in per capita terms Western Australia is the State with the strongest.

MR LEIGH: But where does that revenue come from? Okay, we get the royalties but all the rest of the revenue is raised from the people of Western Australia and the companies in Western Australia.

MR COPPEL: Like other - - -

MR LEIGH: It's not like somebody is gifting that revenue to us from outside. You know, it's revenue that we're redistributing amongst ourselves, isn't it?

MR COPPEL: Well, like all jurisdictions they have their own sources of revenue.

MR LEIGH: Yes.

MR COPPEL: I guess the way to look at this is the starting point is in the Federation. Some have called it the glue of the Federation, that jurisdictions should have the same fiscal capacity to provide services to citizens and what the CGC have done is interpret that as providing the same average capacity across all jurisdictions, which corresponds to equalising to the strongest fiscal state. We're saying that there are some disadvantages in that. It puts all of the weight on the equalisation aspect and it comes at the margin of the expense of incentives, so something less than that full equalisation.

But we're not saying that providing some form of equalisation is - that's the purpose and that remains the purpose. It's just the extent to which that equalisation task is pursued, and there's very much a sense that what happens at the moment is perfect. And even the CGC would say that it's not perfect. There's a lot of things that they can't equalise. It's just allocated on an equal per capita distribution.

So often that view of what do we stand to gain or benefit from a change uses, I would say, an unfair benchmark of assuming that we're moving away from perfect equalisation.

MR LEIGH: Absolutely.

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MR COPPEL: But there's still that issue of how you transition to something which would mean less for some States and more for others. You've made the point about using some of the funds that the Commonwealth currently gives to WA as a sort of ad hoc top up, but the orders of magnitude would fall short of the orders of magnitude that we've calculated in some of our cameos. So something else would be needed.

MR LEIGH: I think you're right.

MR COPPEL: Do you have views?

MR LEIGH: Yes. I think I've got a fairly simple view. It's been the last however many Federal Treasurers have sat on their hands and watched this gap widen. They've been quite happy to sit there because there's been no pain to them. All the pain has been to WA. I think it's time they wore some of the pain, you know. It's a beast of their concoction, not ours.

MR COPPEL: So how do you respond to - if you go back further in time, WA had a relativity of $1.10. Others had a relativity of less than one. At the moment WA have got the strongest relativity, or have the highest capacity assessed by the CGC because of the mining resources that sit in WA.

MR LEIGH: Right.

MR COPPEL: But at other points in time it will be another jurisdiction.

MR LEIGH: Sure.

MR COPPEL: So it still creates a very difficult conundrum on how to avoid one State saying, "Well, this is what we're giving up. We in the past were in a similar situation to WA, being the outlier State in terms of the relativity."

MR LEIGH: I think I would only make the point that you've got a really good chart in there that shows the relativities paid by the biggest donor State, and I think initially it was Victoria and then it was New South Wales and now it's WA. And I think if you have a look at the amount that either of those other donor States were paying back in the days when we were getting $1.10, they were still getting 87 cents or something back. So I think the thing is that this huge disparity has been allowed to grow, and that's why everyone has got a problem now. You know, it should have been changed. It should have been fixed earlier.

MS CHESTER: So, I think we can all agree that the divergence in relativities was never anticipated when the GST deal was originally struck.

MR LEIGH: Right.

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MS CHESTER: And that's where the system is struggling, and the way that we viewed it is that divergence being so great by equalising to the highest now means that the equalisation task is so great as a percentage of the GST pool that it has more perverse incentives for people wanting to do controversial development activities like CSG and tax reform, or State tax bases.

MR LEIGH: Yes.

MS CHESTER: So if we take the pressure off the system by equalising to the second highest or equalising to the average, which reduces the redistribution tasks and mutes those disincentives, I'm just still trying to work out why you would view then royalties as being different?

MR LEIGH: I think to some extent you can take that as a different argument. You know, if we get to the equalise to the average and there's a reasonably self-adjusting mechanism that doesn't leave us or anyone else in the situation that we're in now, there's less pressure to deal with royalties. I think what I was trying to make a point was everyone points to saying, "Well, why should there be any special treatment for royalties?" And I'm just making the point that royalties are different. If you are going to give special treatment to anyone, you give it to the things that are building national wealth, not just redistributing wealth around the existing pie.

MS CHESTER: But so you're comfortable with if we address the redistribution task by narrowing the band - - -

MR LEIGH: Yes.

MS CHESTER: - - - for equalising to the average or equalising to second highest, that then addresses the issue of treating royalties differently, given that royalties were the driver of the outlier. I'm just trying to work out are you being Marie Antoinette, wanting your cake and eating it as well?

MR LEIGH: No, I think it's a deal of the - what's possible.

MS CHESTER: Okay.

MR LEIGH: And I think equalising to the average from where we sit, that's something that's possible. You know, if we support you and other people support you in that, there's half a chance of it getting up. And then we've just got to fix up the transition and we'll be right.

MS CHESTER: Yes, easier said than done. But coming back to another point that you made earlier on about compensation for disabilities?

MR LEIGH: Yes.

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MS CHESTER: And the way, you write the way that the CGC looks at assessed expenses, when it's looking at both sides of the budget it looks at it from the perspective of what's the average cost, so what States do, and then it also adjusts them based on disabilities. And the two key disabilities are remoteness and indigeneity.

MR LEIGH: Yes.

MS CHESTER: I'm just trying to work out the logic where you say compensating for disability. So if they're structural disabilities like remoteness and indigeneity, and the way the CGC is meant to do it is such that these are disabilities that are kind of policy neutral, so a State can't really change them in a structural sense, how does that compensation encourage States not to improve?

MR LEIGH: Um.

MS CHESTER: So I think the point - - -

MR LEIGH: No, I know what you're saying. I think there was a point raised by New South Wales where they were highlighting the fact that Northern Territory gets a certain amount of relativity based on their indigeneity disadvantage, but if you look at what they spend on that in the next year they don't spend the money that they got. And so in the following year they get reassessed on the disadvantage position they're in, and it's still low, and so they get a bunch more money that they don't spend and so it goes on. So I can't - that again is, I think, a really flawed process in the Grants Commission process.

MR COPPEL: But the same applies for other States, including WA.

MR LEIGH: Sure, but I think ours - if you look at ours I think they're reasonably close. But you're absolutely right, it applies to other States. But that doesn't make it right.

MS CHESTER: I think the key issue that we sort of focussed on - so I don't think there's any examples that we've been given on remoteness - - -

MR LEIGH: No.

MS CHESTER: - - - but on indigeneity the gap between the assessment, what's assessed as needed for the expenses and which is about fiscal capacity versus what's spent, there is a difference and Neil Warren at the University of New South Wales has done a lot of interesting work in the area, but we are in a world where there's an agreement that the States get the GST money on a basis that they have autonomy in how it's spent, which then just brings us back to the issue of well who is really accountable for that, where you've got a

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disability that's linked to something as egregious as overcoming the indigenous disadvantage. That issue in our report though, we say HFE can't really fix that. The underlying issue is about Commonwealth/State responsibilities for that expenditure.

MR LEIGH: Sure, yes.

MS CHESTER: So where are we going with the report? Should we have dealt with indigeneity differently?

MR LEIGH: Look, it's not something that we looked at closely, I've got to tell you. You know, I understand your point and it needs to be fixed differently and better, but it's not really something that we spent a lot of time on.

MS CHESTER: Okay.

MR COPPEL: What about on remoteness, because you made the point about the 1,200 kilometre benchmark, I think it was?

MR LEIGH: Yes.

MR COPPEL: Are you suggesting something less than that?

MR LEIGH: Well, it's just - Western Australians just look in astounded amazement that parts of Tasmania are treated as remote as outlying parts of Western Australia. You know, there's this crazy deal where the people in - remoteness in Tasmania is measured from Melbourne or something. Why don't you measure remoteness in WA from Sydney? You know, Perth is more remote than Hobart is.

MR COPPEL: Have you done any estimates of what that would mean for WA, do you know?

MR LEIGH: No. We don't have the team of economists that can do those things, I'm afraid.

MS CHESTER: And I think it's fair to say that a lot of the focus of our inquiry has really been on the architectural arrangements of HFE, not looking at the detailed formula within - - -

MR LEIGH: Sure.

MS CHESTER: - - - which is part of the CGC methodology review, which is of itself another parallel, wonderful process going on. And in that context you did raise issues around the role of the CGC and perhaps some potential for institutional reform there. I guess we took a view that the one area - if you look globally, Australia does punch above its weight in terms of we do have a

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statutory independent agency, the CGC. People can agree to disagree on how they do some of the methodology, but they are expert, they are considered to be independent. But I take it from your points you might differ on that?

MR LEIGH: I think from what we see is as you said earlier, there was an agreement way back when about implementing HFE and there were some - well, sorry agreeing - yes, implementing HFE and it was handed over to the Grants Commission and they set off on a path like that, and then found a slightly more elegant way to do it and went like that, and then had another move to there, to there, to there. And so instead of going that way they're now going that way. And I think that's part of the point we were trying to make, that we've ended up where we are not by active agreement by all the States, but we've ended up there by administrative decisions that the Grants Committee has made. And the Grants Committee are basically invisible. I think if you asked anyone around the country, apart from people who have spent time over the last few months looking at this stuff, they couldn't tell you who the Grants Committee were or who was on the committee itself.

MS CHESTER: Let's not be too tough on them. Many can say that about the Productivity Commission. We don't survive the Moorooka Bowls Club test there either. But I think it's fair to say, and because this is transcripted, that the way that they're equalised to the highest, so equalised to the same, they've been doing that since '81.

MR LEIGH: But it's the detail about how they get there I think has been the thing that's drifted, isn't it?

MS CHESTER: So I think there's formula that they can turn on and off. So, for example, what they're now suggesting is turning on one of the formulas, and that is for a rate increase for royalties. You might get to keep 50 per cent because there's a - - -

MR LEIGH: After 2030.

MS CHESTER: - - - neutrality issue. So turning on and off those things they do along the way as part of their methodology reviews. But the biggest issue that we've focussed on for our inquiry is equalising to a same standard, and there's equalising to the highest, being the architectural change. And that's been there from the get go. So when folk signed up to the GST deal, that's what they were signing up for.

MR LEIGH: Right.

MS CHESTER: So there's no surprises there, but nobody anticipated the outlier world of WA.

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MR LEIGH: Exactly, and I'm sure there's many other situations in Government where a law has been put in place, or an agreement has been made, and then you find that conditions have changed and people are quite happy to change the law or the agreement.

MS CHESTER: Yes. Like Darwinian man, we all evolve. But here we have winners and losers and a zero sum game.

MR LEIGH: Absolutely, and I guess what we're trying to say is we shouldn't be the loser all the time.

MS CHESTER: So, given that WA has so much to gain from our little recommendation to look at equalising to less than the highest, either second highest or average or there's a bunch of ways you could do it - - -

MR LEIGH: Average, please.

MS CHESTER: WA stands to benefit the most, and given that there's been swings and roundabouts on the relativities and WA still is ahead in a fiscal sense, you are the strongest State today albeit your fiscal situation might reflect a few other things, do you see WA perhaps pacing the transition such that to some extent there's an element of WA funding the move as well?

MR LEIGH: Well, I think - - -

MS CHESTER: Given it's all upside for WA if we make a change?

MR LEIGH: Yes, I make the point that if - this is the right thing to be doing, over the last eight years we've been funding the gap. We've funded the gap to $16 billion over the last eight years, so how many more years do you want us to fund the gap for?

MS CHESTER: So I think overall WA has still been a net winner if you look at the CGC numbers that we've set out in our report, and nobody has told us that those numbers are wrong yet.

MR LEIGH: Look, I can't - we don't have the horsepower to be able to get behind the numbers to prove or disprove that, so we've got to take them as read.

MS CHESTER: Well, we can chat to the WA Government about it tomorrow then. They've got some people focussing on it.

MR LEIGH: Yes, well I would be surprised if they haven't had a good look at it and have a viewpoint.

MS CHESTER: I'm sure they will.

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MR COPPEL: Yes.

MR LEIGH: But I think there's all this thing that Victoria came out saying ever since Federation WA has been a winner, and in terms of money that we've got. But somebody made the point earlier about WA being a net subsidiser of the rest of the country through tariffs. For the many years while tariffs were in place, people in WA and Queensland, and probably Tasmania in particular, were subsidising industries in South Australia with the whitegoods and cars, in Victoria with cars and probably whitegoods and clothing and so on. You know, those subsidies have been going for years through the tariff process and I'm not sure that people take those into account when they're looking at that long term picture of who's been getting what.

MS CHESTER: And I think that raises a really important point, Peter, that we try to draw in our report. Everybody is very focussed on the zero sum game around the GST bucket of $62 billion, whereas the redistribution task within that in an overall sense only represents one per cent of overall Government revenues. So we try to sit back and look at the broader picture. Government doesn't just do fiscal equalisation through the GST pool. There's other - there's Gonski funding, there's health funding, there's lots of other levers at work here.

MR LEIGH: And I don't have the numbers in front of me, but I think overall I've seen numbers that suggest that we do very poorly per capita in the total Government return. We get back a lot less than - we get back out of the Government a lot less than what we put in to the Government, the Federal Government. And yes, I've got the numbers in my office but I don't have them in front of me.

MS CHESTER: I think that's kind of beyond the remit of ours.

MR LEIGH: Sure.

MS CHESTER: We're kind of seeing what heavy lifting we can do with the GST bucket with incentives in mind. But we're also mindful that it is, when looking at those incentive effects, when you look at the redistribution task just being one per cent of overall revenue, you can see that in an economy wide sense, people moving and the like, it's not really that great.

MR LEIGH: Right.

MS CHESTER: Yes.

MR COPPEL: Although it can be for some jurisdictions.

MS CHESTER: Yes.

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MR COPPEL: Nationally it's small, but for some jurisdictions, Northern Territory in particular, it's substantial.

MS CHESTER: And South - - -

MR COPPEL: And Tassie.

MS CHESTER: And Tassie.

MR COPPEL: And on the other side for WA.

MR LEIGH: Yes.

MR COPPEL: OK, so thank you very much - - -

MR LEIGH: Thank you.

MS CHESTER: Thank you.

MR COPPEL: - - - for participating and also for your submissions.

MR LEIGH: Thank you.

MR COPPEL: Our next and final registered participant is Tom Atkinson, also WA Party. If you could again for the record give your name when you're comfortable for the transcript and a brief opening statement.

MR ATKINSON: I'm not much of a paper person. I will just quickly set myself up if that's all right.

MS CHESTER: No, that's okay. And just for my benefit, more than anything else, so we had Andrew and Julie earlier and now we've got Tom. Is it the same WA Party or are there two WA Parties?

MR ATKINSON: Yes, so when I initially submitted to speak I wasn't a member of the party. I was an independent. I've since joined the party so they've asked me to represent as that, but my position is similar but slightly different, I suppose, if that's okay?

MS CHESTER: Yes. No, just so we understand, thank you.

MR ATKINSON: It was just a timing thing more than anything. All right, so do I just say name and party, that kind of thing? My name is Thomas Atkinson, representing the Western Australia Party, to speak today. Thanks first of all to Karen and Jonathan for coming across. A lot of my points, being the final speaker for the day, are quite similar to aspects that have already been

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raised, with a couple of changes. Feel free to ask me the same questions you've asked everyone else because I've got some great answers for them now, which is good.

Being fairly new to this I've got a bit of a speech to read here so I don't get off track, because I can talk under water sometimes, if that's all right?

MS CHESTER: Can you promise us it doesn't go over five minutes?

MR ATKINSON: You can cut me off at five if you want, please. We are half an hour early so I've got a bit of time up my sleeve. And I will make some slight adjustments as I go to it, based on what we've heard today.

So look, good morning. My presentation today will focus on the proposition that horizontal fiscal equalisation shouldn't be applied to GST, and that it does provide an indirect direction to States to increase areas of revenue not included in horizontal fiscal equalisation with a primary focus on gambling revenue. It also encourages them in some respects to reduce activity that would be counted, which might be counter-productive to their original positions.

I use a similar term to what I suppose my party did earlier in regards to political welfare. We believe that the requirement for States to receive, or the current system that allows States to receive income regardless of their efforts or their resource allocation, their current political situation, is not right. We don't refer to that on a person by person basis. People receive welfare in the country but they're required to take steps, they're required to prove they're in certain situations, in order to be eligible for that. And the idea of distributing money purely because someone hasn't caught up I don't really agree with, although I'm sure we can discuss later the intricacies of that.

Equalisation in itself, my belief is that it is really an unjust concept. The idea that equalisation is a method to distribute a nation's finances really isn't what I would consider to be the Australian way of operating. As I mentioned before, the idea that a person that puts in significant time, significant resources, invests in the assets that they have and takes the brunt of that should be rewarded in the same way that someone who takes no risk, puts in no time, and somehow receives the same reward, I don't think is something that the Australian population would generally subscribe to. You would almost call it un-Australian, I suppose.

And I think take out the fact that I know you're going to go around and talk to a number of other States who are going to tell you the current system is great because their budget is ahead, you approach them on any other issue in this regard and they'd probably agree with that statement, I think. And we use it in a number of pillars of our current governance operations.

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I will touch on your draft report, and I thank you for putting it together. As you mentioned to the previous speakers, it does represent I suppose an improvement in position for Western Australia. You have identified the issue to some extent. It does state that attempts to fully equalise States is resulting in unacceptable fiscal damage to the strongest State. I mean, how it got to this stage is really mind boggling. I know I'm fairly young in this game, but reflecting on it now a lot of this situation, I would think, seems reasonably foreseeable. You've got a system that can be altered to the maximum ends of the earth. The possibility that that might happen I would have thought surely would have been considered, but it wasn't.

The solution proposed in the draft report to equalise to the second strongest State is, to some extent, a step in the right direction as it identifies that there has been a significant and foreseeable overstep in the current system. However, the draft report does advocate for, I guess, the continuation of horizontal fiscal equalisation and the problems associated with that. As one of the earlier speakers mentioned, you could foreseeably end up in a situation where you have two very strong States, whoever they might be, for whatever reason who find themselves in the same position, and you also still have the situation where if I was a smaller State or a State currently receiving quite a benefit from the GST distribution, the only way that I could, the only two ways I suppose that I could maintain my level of income would be to limit my performance in measurable areas, or to improve my levels of income in unmeasured areas, and with specific reference to gambling. And I can't see a Federal position that would say we want to advocate for the increase of gambling revenue.

But that's the position - that is a position, I suppose, we're maybe unintentionally putting people in and putting State Governments in. That's excluded, therefore it's open slather and will, in some cases, need to be used should your draft recommendations go through, I suppose. It will certainly be considered.

I would consider that those two options of limiting performance or increasing revenue, such as gambling, are foreseeable possibilities based on those draft recommendations.

As others mentioned, we have a wide range of income that the Federal Government takes where they can use to equalise. The fact that WA does have on the table some grants to some extent, really suggests to me that we could keep our GST and those grants could be offered to others. They money is there. That seems to be the political preference. There is something very political about the GST that we can't possibly change it, but they're happy to politically dish out money to anyone if they think it's a - if there's a couple of marginal seats which they want to win or something like that.

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My position is quite simple. Every State should receive GST distribution on a per capita basis. The concept in some respects, which we've touched on, would still see WA giving more than it should. It doesn't provide reference to the land mass which you have discussed with the previous speakers. They seem to know a bit more about it than me, so we won't touch on that too much. It does ignore the fact that we do the right thing in WA and don't provide access to our constituents to have gambling and poker machines in every corner, which whenever you visit the eastern States I'm sure you'd be familiar with. And we're very proud about that, and obviously want to keep it that way.

I guess the main position from me is about incentive. I would say that it's a complete, reasonable position to allow States to manage their own fortunes. The benefits which Western Australia has, when we talk about the mining boom and other sources of income, have through all kinds of other ways benefitted the rest of Australia. I'm not going to talk about State debt or things like that. That's I guess what I'm saying is that we chose to go into State debt to some extent to service that, and within some areas we were given that opportunity to make that choice. What we're finding is that the choice to go into debt, and the choice to support industries which employed hundreds of thousands of people from other States and which benefitted through all kinds of indirect taxation people from all around Australia, we're not now receiving any kind of support to acknowledge that or to put us back on level pegging, I suppose.

Yes, just to finish off my earlier points, the problems we're facing now with horizontal fiscal equalisation are foreseeable again if we remain with that factor. My position is that 100 per cent per capita GST is the model we should be moving to, but similar to other speakers I accept that what you're recommending in your draft report is a significant step for WA and if there is a requirement to get other States on board, which I know you're going to go around there and they'll tell you no change - kicking and screaming - to anything, please give us the money, but if you think that will get it across the line we'll take it, I suppose. Thank you.

MR COPPEL: Thank you. You have raised very many issues that have been raised by previous participants. On your preferred model of equalisation per capita, notwithstanding your final comment, how do you say it to someone who says the whole point of the CGC process is to equalise the capacity, the fiscal capacity of States to provide the same level of services to their citizens through an EPC approach? And you would have seen in our draft report we've ruled that out because it doesn't meet that equity goal. So can you elaborate a little bit more on why you see the current - I guess one way of putting it, can you elaborate to us why you see the current approach as not being - I think you used the term, "not being fair"?

MR ATKINSON: It's a very general term. I would consider the current approach not appropriate because it doesn't provide any incentive for anyone

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to change. There's currently States that are below the average, I suppose, in that regard. Their incentive to come up is nothing. There is no incentive for them to use their own income and their own income streams, and increase their own income streams, in order to provide a better level of services for their constituents because they know if they do the top up that they get will be reduced. The distribution they get will be reduced to some extent.

So that level of incentive, I think, is a really critical aspect which will always be there if we have this equalisation concept. Reducing that to as much extent as you possibly can provides benefit and understandably politically there's an aspect there where you could get to a certain level, reducing to the second strongest State or reducing to the average, where you still allow certain States to be happy that they're getting a bit of a top up, even if they're doing nothing for it.

MR COPPEL: I don't think that's quite a correct characterisation of how it works.

MR ATKINSON: You would know better than me. I'm happy to take guidance on it, yes.

MR COPPEL: So essentially it's providing the capacity to provide the average level of service across the jurisdiction. So if a jurisdiction wanted to provide a greater level of service it wouldn't be penalised for that. And likewise on many of the revenue bases it's looking at an average policy, and anything above the average policy would essentially not be impacted by the way in which the CGC calculates its relativities.

MR ATKINSON: Yes. I think in order to raise a level of service there's a level of income required for that. And so if I was a State Parliamentarian with a strong desire to get as much income from the Federal Government as I could you would say well, I could either spend my own money on lifting those services and therefore have GST distribution potentially reduced because I'm providing a level of service, and correct me if I'm wrong, or I could not take those potential risks, allocate that money elsewhere, and have the income stream guaranteed as a result. Am I off the mark there?

MS CHESTER: So I think, looking at it from the perspective of raising an income stream, so you're looking at then the State Government looking to encourage development activity, whether it be through infrastructure or the like, or allowing a development activity to occur - - -

MR ATKINSON: Or tax increases or similar to fund those gains.

MS CHESTER: So we'll come back to tax increases later, but - because that's not increasing activity, that's increasing revenue raising.

MR ATKINSON: Revenue, that's right. It's different, yes.

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MS CHESTER: But if a State were to do that, even under the current arrangements, they still come out ahead by doing it.

MR ATKINSON: Well, yes.

MS CHESTER: So we do make the point - - -

MR ATKINSON: I believe so. But I don't believe someone has necessarily taken that step.

MS CHESTER: - - - that this would be, and you're looking at it from the perspective of WA.

MR ATKINSON: Yes, of course.

MS CHESTER: And the system has been in place since the GST deal was struck. What development activity has not occurred in WA because of the current incentive arrangements?

MR ATKINSON: Has not occurred in WA? Yes, I couldn't answer that. I'm not an expert on it. You'd have to - I'm sure the State Government will present quite strongly on that tomorrow, yes. What they can't do as a result of the current situation, yes.

MS CHESTER: Because - - -

MR ATKINSON: I think we're probably going to - apologies for interrupting again. I think we're going to see that they're unable to provide certain services and certain projects now as a result of the current situation, rather than having it been a past issue.

MS CHESTER: So the question was what development activity is not occurring as opposed to what spending is not occurring because of the current fiscal situation?

MR ATKINSON: In Western Australia?

MS CHESTER: Yes?

MR ATKINSON: Yes, well I think a number of projects have been either halted or put on hold since the change in Government has occurred. They cite the GST income as a key factor in that. Again, they'll provide better detail on that I'm sure. There's also been significant tax increases to businesses and to households, which we've seen very recently as well. An increase to businesses will reduce activity. An increase to households will reduce household

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expenditure, which will impact businesses, which will reduce activity. No doubt I'm drawing a fairly simplistic line there, but that's the position.

MS CHESTER: Okay. I guess in our draft report we did go to some lengths to try to be very objective and even-handed in looking at the current fiscal position of WA and what's really been behind that, which is more a function of fiscal management of past as opposed to where things are with the relativities, albeit the relativities aren't helping the fiscal repair task that WA has ahead of it.

MR ATKINSON: Yes.

MS CHESTER: We have to view it from the perspective of all the other States and Territories, now viewing it as you're changing the system to help WA repair a fiscal problem - - -

MR ATKINSON: Yes.

MS CHESTER: - - - that's of their own doing.

MR ATKINSON: I would respectfully disagree with that. I think Western Australia had a position - they made decisions to go into significant debt, the Government at the time. They had a position where they could have chosen to not do that. They could have not taken on infrastructure projects. They could have not provided services at a certain level.

And we would therefore - well, I don't know the way it's changed completely, but could potentially be considered as not being able to provide a level of service because we've chosen not to go into debt. Instead the Government at the time chose to provide a certain level of service and take on infrastructure projects. As a result went into debt. So I don't really see it as a fiscal failure, to some respect. I mean, what the WA Government does with their money is their business. They might get a significant change to the GST, but not attack the debt level at all. I've got no idea what that is.

And we've spoken, a number of people have spoken today about the WA benefit and the WA impact, and no doubt that's been your focus in regard to some of the questions. I think we're talking about fixing a system which has impacted us, but could similarly impact anyone else in the same respect at a different time. It happens to be Western Australia that has been impacted, but I know even going to some of the other States there's just not an appetite to change anything while they're ahead. And if they were in our position they'd be advocating for the same thing. I mean, you had to even given some of the States a fairly serious prod to even provide enough representation for you to attend to listen to what they have to say.

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So there's no appetite for anyone to change while they're ahead. You mentioned Western Australia has been ahead in the past. It's not an issue. We're talking about what we're going to do moving forward. The current position of debt in Western Australia I don't see as an issue because any GST money which comes in won't have a tag attached to it that it has to be put towards debt. It's put towards providing, in my understanding, a certain level of service so whether they take some of that money and use it to attack debt or not is entirely within their remit.

MR COPPEL: Yes. I think - I mean, when we talk about the GST pool and HFE shouldn't be applied to the GST, GST is just the funding source that's used to act as the spirit level across jurisdictions. So if it's not GST, as it has been in the past, it's some other form of revenue that's provided by the Commonwealth.

MR ATKINSON: Yes. I mean, there's a sentiment and what provided me with the inspiration to appear at this before I joined the Western Australia Party is I was getting strong feedback from a number of people in the community that there's a sentiment that State Governments have, to some extent, the greater opportunity to impact GST revenue.

And I don't know the detail behind that, but that was some of the discussions that I had, that income tax goes, company tax goes, whatever other taxes there are - that goes, but there's something about the GST which people find to be particularly relevant to State Government income, and because it's guaranteed to come back to States at some percentage that a State Government would be more inclined to alter their operations to maximise the benefit returned to them.

Whereas - well, there's no other aspect which is directly linked to come back to State coffers. They're not so inclined to make alterations on that basis, if that makes sense.

MR COPPEL: Can I ask you about transition?

MR ATKINSON: Yes, please.

MR COPPEL: I think if I heard you correctly you were saying go for the big bang?

MR ATKINSON: No, I suggested that 100 per cent is my goal, but immediacy is not necessarily the biggest task. The solution that I would consider personally would be a rising floor over time. Exactly where that starts and how quickly it rises would be a discussion with Federal and State Governments as to what could be acceptable, I suppose, but starting at a base and working the way up to 100 per cent.

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MR COPPEL: To the point where it would equalise to the average?

MR ATKINSON: To the point where there would be no equalisation required.

MR COPPEL: So it would be distribution on an equal per capita basis?

MR ATKINSON: Yes, yes.

MR COPPEL: Okay. I thought earlier you had said that you had agreed with at least one of the options that we put in the draft report that the equalisation would be to the average?

MR ATKINSON: Yes. I suggested that it was willing to be put forward as a likely method which would be accepted, I suppose, but if you were going to put forward the position we like is 100 per cent per capita. If there is a requirement, which you have stated a number of times to go and get agreement among States and Federal Government as to how that's implemented, then a lesser number of equalising to the average might be more palatable.

MS CHESTER: Tom, I'm not sure if you were here earlier when we mentioned that where previously EPC for the GST pool has been recommended formally to Government in the past, it was in the context of changing the deal that was struck earlier and doing it on the basis of EPC and having top up for the structurally fiscally weaker States, and the Federal Government would fund that but that would all occur as part of the broader reform of Commonwealth, State, Federal financial relations and taxing arrangements, especially around income tax?

MR ATKINSON: Yes.

MS CHESTER: So to some extent we're looking at HFE and the GST bucket as it exists today, and what can be done to holistically improve it from the perspective of the Australian economy incentives, but still doing some form of fiscal equalisation. What you're raising is kind of like a further game changer in the context that the Commission of Audit have recommended it, but having to change those other Commonwealth/State taxing arrangements. So I guess in that context is that the direction that the Western Australia Party wants to go, and in terms of revisiting the current taxing and spending responsibilities between Commonwealth and State, and if so what - - -

MR ATKINSON: I think as Andrew stated earlier, we have concerns about double taxation and the ideas that we're raising State taxes in Western Australia to make up for the money which is leaving it. But we have tax people in our party who are more expert on that than I am, so I won't make it a position on behalf of the party.

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MS CHESTER: Okay. So you have just joined the party recently?

MR ATKINSON: Yes.

MS CHESTER: And it was 600 members at the moment?

MR ATKINSON: Yes, that's right. Yes.

MS CHESTER: And that's sort of spread out - tell us a little bit more. Are they spread out across the State?

MR ATKINSON: Yes. Well, because of this issue we have quite a good representation in the northern area of the State, which has been really positive, but a fairly good spread really. It's something which resonates with pretty much everyone we speak to. It's just a matter of whether they like the idea of joining a political party or not, which seems to be off limits to some people. But the general community support we've got is very wide ranging.

MR COPPEL: When was it established?

MR ATKINSON: That's a good question. 2016.

MS CHESTER: And I guess one of the issues that we also sort of grapple with in our report is the current way the CGC does things, like all the detailed formula and the whole HFE, it is horribly complex?

MR ATKINSON: Yes.

MS CHESTER: And I think we've even suggested on one occasion on the public record that we only think there's about 30 people in the whole of Australia who understand it in its entirety.

MR ATKINSON: Yes, I particularly on a - not really for this forum, but have a bit of an issue, and you mentioned it yourself I suppose, in regards to your roles with the seemingly significant role that unelected people have in distributing such a large amount of money.

MS CHESTER: Well, I think within the 30 the State and Territory Treasuries know how it works and - - -

MR ATKINSON: Hopefully some of them, yes.

MS CHESTER: But I guess it raises the issue, given your party represents 600 citizens of the State. Do you think - - -

MR ATKINSON: Well, 600 members, yes.

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MS CHESTER: 600 members, sorry. What is your sense of people understanding the way the original deal with the GST and the HFE, how the HFE works, the role of the CGC? That it's not all expenditures, it's only a small part of the expenditures?

MR ATKINSON: Yes, that's right. Look, I think if I can answer that question and say that the understanding you have seen me exhibit today would be pretty accurate as to what most of the members are. We know there's something wrong. We have a good, a general understanding of what needs to be done but if you get into the very economic details of how it works and how to fix it it's not - it's not exact.

WA has a very large population of people that are involved in the mining industry, either directly or indirectly, so they see how it impacts that. They saw at our last State Government election there were some people running a strong campaign to increase mining royalties, and that didn't get up at all because the people in Western Australia had a good understanding of how the royalty system works and how if we raise royalties we wouldn't see a lot of that and it wouldn't be beneficial on the back of the mining companies running a fairly strong campaign along those lines as well.

So there's an appetite to understand those things certainly, and I think as I mentioned before that what grasps most at people is the - when you speak to the average person in the street is just the potential lack of incentive it provides, and the fact that there's a feeling that Western Australians are taking a significant risk. We're doing things with our resources that other people politically aren't willing to do, and that we gain reward from that. I mean, the fact that we should be required - as others have mentioned, WA has got - no one has got any problem with WA digging up every square inch of land that we've got, but others take politically opposite positions on the basis of, I would say, election campaigning in some respects. It seems to impact that.

And there's a feeling, as I mentioned before, however accurate it is, that the State Governments have the opportunity to pull levers to impact the GST return more than in other areas as well.

MR COPPEL: Can I just ask one further question, and it gets back to a point that's been made by a number of participants about the way in which the GST that is distributed is untied, and there are no conditions on how that revenue is used. Could I ask what your view would be if central Government, the Commonwealth Government, adopted tied distribution, say telling WA that shopping opening hours are highly regulated, they should be deregulated as a condition, and many other conditions that could be attached by Canberra? Would that - - -

MR ATKINSON: Well, my own views on where the money could be spent - it would be an overstep. You're saying here's a significant portion of your

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yearly funding and we're going to tell you how to spend it. You'd ask as to what the requirement is for a State Government to exist if that was the case. We elect people at a State level to make State decisions. I think it's great that the return is provided to them at whatever level, and that people have faith in them. And in this case - I mean, in this State you get it all the time. We elect people to take a directly opposite position to what the Federal Government is doing because of that ongoing sense of unfairness in a variety of areas.

So I guess what I'm advocating for is that the GST stays but the grants system to some extent is more apparent, which I guess if you're providing grants the idea of a grant is that it is tied quite strongly to an activity. So that's almost what we're advocating for, I suppose. But it's a more ad hoc, potentially smaller pool, I suppose, to attack a need as necessary while the State Government then has that more significant revenue stream to operate its day to day business. Although I don't know if that's the position of the party or just mine, but the requirement to have a good sense of what your income is going to be and to be able to pull levers to maximise or minimise that, depending on what your overall goals are is really important, and I think we're lacking that to some extent now. And that would be in all of Australia, not just Western Australia.

MS CHESTER: Okay.

MR ATKINSON: Thanks guys. I appreciate you indulging me.

MR COPPEL: Thank you. So that brings to a conclusion the registered participants for today's hearing. Could I ask if there is anyone here who is not registered that would be interested in making a brief comment before we close today's hearing? If not then I do close today's hearing and we will reconvene in the same place tomorrow morning at 8.30 am. Thank you.

MATTER ADJOURNED AT 11.53 AM
UNTIL TUESDAY, 14 NOVEMBER 2017 AT 8.30 AM

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Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO HORIZONTAL FISCAL EQUALISATION

MR J COPPEL, Commissioner
MS K CHESTER, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT FOUR POINTS BY SHERATON 707 WELLINGTON STREET, PERTH
ON TUESDAY, 14 NOVEMBER 2017 AT 8.30 AM

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RESUMED **[8.30 am]**

MS CHESTER: Okay, folks. We might get under way. Good morning, and welcome to the public hearings of the Productivity Commission Inquiry into Horizontal Fiscal Equalisation or better known as how we divide up the GST bucket. My name is Karen Chester. I'm the Deputy Chair of the Productivity Commission and I'm one of the Commissioners on this inquiry. I'm joined by my fellow Commissioner, Jonathan Coppel.

I'd like to begin by acknowledging the traditional custodians of the land on which we meet today, the Whadjuk people of the Noongar Nation, and I would like to pay my respects to elders past and present.

Today is our second day of two days of public hearings in Perth. We will also be holding hearings in Melbourne, Darwin, Adelaide and Hobart over coming weeks. We will then be working towards completing a final report, which will be submitted to the Australian Government early next year.

Now before I run through very briefly how we go about conducting our hearings, I'm obliged by some legislation to say the following, if alarms go, common sense tells us not to use the lifts and to follow someone who looks like they're a staff member to an exit and get the hell out of here.

Okay. Now turning to the conduct of our hearings. So the purpose of the PC's hearings are really to allow public scrutiny of our work and to get feedback on our draft report. It's also to allow scrutiny and feedback on the submissions of other participants, and we'd encourage you to do so.

We like to conduct our hearings in a reasonably informal manner, but a full transcript is taken by the young gentlemen over here. So, for that reason, we can't entertain any comments from the floor. But that said, at the end of today's hearings, if there is somebody who's not registered as a formal participant for today and they have a burning desire to be heard, we're happy to hear from you briefly later today.

Now participants are invited to make some short opening remarks. The debater's bell goes at five minutes, Treasurer. Keeping these brief would be appreciated, because this does allow us time to really discuss the matters raised, open your submissions in greater detail, and our draft report. Now participants are not required to take an oath, but we just simply ask that you be truthful.

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Most importantly, the transcript from today's hearings will be available on our website as are our participants submissions to the inquiry. Now for any media folk here, and we do have some present, there are some general rules that apply. You should already know what they are. If you don't, please find one of our staff members and they'll make sure that you behave yourselves. Most importantly, there'll be - no video or audio recording of participants is allowed past the opening remarks.

Now I'd like to invite our first participants, and welcome you for joining us here this morning, the West Australian Treasurer and representatives from the Western Australian Government. So before we get underway and before you make your opening remarks, maybe if you could each just identify yourselves for the purposes of the transcript recording, thanks.

MR WATSON: Richard Watson, Executive Director, Department of Treasury.

MR WYATT: Ben Wyatt, the WA Treasurer.

MR COURT: Michael Court, Acting Under-Treasurer, WA Treasury.

MS LAURIE: Kirsty Laurie, Director of Revenue and Inter-Governmental Relations at WA Treasury.

MR SCHERINI: Alex Scherini, Inter-Governmental Relations, WA Treasury.

MS CHESTER: Great. Thank you very much for your pre-draft report submissions, the meetings we've had with your officials, Treasurer, and your post-draft report submission which you got in to us just in time for these hearings, which are much appreciated. But if you'd like to make some brief opening remarks, then we'll get into some questioning.

MR WYATT: I would. Thank you, Deputy Chair, and my remarks will be brief, you'll be pleased to know. Can I also acknowledge the Noongar people, and can I thank the Commission for the opportunity to speak to you today? Can I also note that we have Terry Redman with us this morning? I think he's presenting afterwards. Terry is the member for Warren-Blackwood, a senior member of the National Party, and I think leader of the opposition is presenting later today. Just to highlight I think there is a fairly bipartisan position in respect of the implications of Horizontal Fiscal Equalisation in Western Australia.

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My opening statement will focus on three key areas in respect of the policy debate. Firstly, the deficiencies of the current system which, by and large, will have already been well-ventilated. The package of reforms required to address these deficiencies and how we ensure that those reforms are implemented, are perhaps one of the key issues.

The WA Government was encouraged by the Commission's draft report. We are particularly encouraged by the Commission's key message that the current system is broken and needs to be fixed. The Commission importantly recognises the scope of the system to decrease incentives to states to develop their resources and to set optimal tax rates. These findings complement a position paper released by the CGC in September, the Commonwealth Grants Commission in September, which recognised the system is failing to achieve policy neutrality, especially with respect to some minerals, and I think, no doubt, we'll have some questions in that space.

So clearly, there is a growing recognition that the system is broken and needs to be repaired. Given this position has been held by the WA Government for some time by consecutive governments, we do feel a certain degree of vindication in respect of this.

In characterising the current system, however, we think it is important to also note that it fails to meet its equalisation objective in any consistent sort of way. This is despite the system's bewildering level of complexity. Nor does the system meet any reasonable standard of fairness. While "fairness" was not explicitly mentioned in the Commission's Terms of Reference, clearly whether the system meets the community expectation of fairness is relevant to the policy debate and fundamental to broader confidence in the Fiscal Federation that is our country.

Western Australia's strong mining industry is no accident, but the result of a long tradition of pro-development policies. We, Western Australia, have poured billions of dollars into developing our mining sector. Despite this support and the ensuing mining boom, because of the objectives of HFE, our revenue growth over the past decade has been no greater than other states.

At the same time, communities that bore none of the costs or risks associated with facilitating the development of our mining sector, reap these windfall gains. Yet, while our revenues have been equalised with other states, much of the significant expenditure associated with developing our mining sector was not, and certainly as highlighted in our submission, the North West Shelf, I guess, is a classic example in that regard. This isn't fair, nor does it promote equity. As a result, discussions about gains and

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losses to states in the context of moving away from equity are meaningless. They assume equity currently exists.

So what are we left with? A system that fails to meet its policy objective. A system that cannot ever be made to meet its policy objective, and a system that in nonetheless trying to achieve that objective, does great damage to our economy distorting economic activity, reducing productivity, economic growth and our nation's prosperity. Now, clearly, the system must be reformed.

To this end, I support the Commission's recommendations for an HFE objective that aims for reasonable rather than full equalisation. We consider that achieving a reasonable standard is best achieved by equalising to the average State. The chief advantage that equalising to the average has over the other options is that it does the best job of increasing incentives for states to grow their economies.

It also does much more to improve budget management by providing longer term stability to GST relativities. Clearly, this would represent significant reform. But, given the significant deficiencies in the system, we should not be aiming for anything less. At the very least, the highly distorting effects of the mining revenue assessment must be addressed. This is the standout failing of the current system, and I regard fixing this as the minimum threshold for meaningful reform. I do note, by way of aside, the Commonwealth Grants Commission appears to be acknowledging this at last as well.

It is not reasonable that our efforts to repair our budget are thwarted by such large GST offsets, and that in many cases much of the gains from difficult revenue measures fall through our fingers. I can assure you that, from my relatively short experience as a State Treasurer, the severe equalisation of mining revenues makes it that much harder to achieve optimal policy settings. GST losses have been a factor in recent debates in WA over rate changes for iron ore, gold and stamp duty.

Such debates impact on which revenues are increased and which are not. From an efficiency perspective, I would expect that such distortions would be of great concern to the Commission. I guess the best example is that if we were to desire to achieve an extra billion dollars in revenue, you can either increase our iron ore revenue by about $8 billion or stamp duty by about $950 million, to give you the idea of the impact of the redistribution process.

It is, of course, not enough to simply identify the reforms required. We need to ensure that the right conditions are in place to facilitate those

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reforms. This is an area that I encourage the Commission to focus on in its final report, mapping out a practical pathway to reform. I think there are two critical ingredients for achieving reform: credible transition mechanisms; and leadership from the Commonwealth Government.

On the former, we have offered some suggestions in our submission that illustrate the sorts of practical transition mechanisms available to help implement reform. These include: a steadily rising relativity floor with the Commonwealth initially funding the cost of the floor; and phasing to an average fiscal capacity by setting relativities at a weighted average of full HFE and average fiscal capacity with the weight for the latter steadily rising.

On the role of the Commonwealth Government, it cannot be overstated how important it is that this level of government show genuine leadership. The Commonwealth needs to commit to HFE reform, provide a clear HFE objective to the Commonwealth Grants Commission, and ensure that the Commonwealth Grants Commission achieves it. Where reform is in the national interest it is the national government that must take responsibility to ensure that it is achieved. Requiring all states and territories to consent to reform consigns the HFE system to a future of no reform.

Ultimately, I'm optimistic that reform can and will be achieved and I believe this because the weight of evidence now shows that the alternative, proceeding full speed ahead with full equalisation despite the economic and fiscal torpedos, is untenable. Common sense must surely prevail. The quicker we implement reform, the sooner we'll have an HFE system that promotes, rather than undermines, national economic growth and prosperity.

Finally, I say to the Productivity Commission, hold your course against the other states, other states who have been openly hostile since the Commission not just released its draft report but in respect of the request from the Federal Treasurer for you to undertake this, because I think we are – do have an opportunity, regardless of some hostility to the potential reform mechanisms, to actually provide a long term solution to this HFE problem that we have, particularly here in Western Australia.

Finally by way of an aside, obviously we have made some comments in respect of our submission around the transparency of the Commonwealth Grants Commission, the process by which it goes through its decision-making process, which are in dire need of reform, because ultimately there is a very limited capacity for states to actually feed in advice, views, recommendations to decisions taken by the Commonwealth Grants Commission. But, ultimately, I wish the Commission all the very

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best in its inquiry and I look forward to answering any questions. We look forward to answering any questions that you may have.

MS CHESTER: Thank you, Treasurer. Thank you for the royal "we" in answering the questions. We might just pause so we can allow the distraction of some of the media folk to make a graceful exit. Thank you. Terrific. Thank you, because Jonathan and I do have some questions we'd like to run through with you. But before - - -

MR WYATT: Madam Chair, are you happy for general conversation, so to flick around people who may be better placed to answer?

MS CHESTER: Absolutely. Whoever's got the content to share shall be heard, and I'll leave it up to your team to work out how you want to sub in and off there. So before we get into the issue of the HFE system and potential changes, I think it's fair to say that when we started the work on this inquiry, we kind of realised that the overarching theme was the world of outliers. The three outliers being: how we do HFE, we are a global outlier; what's happened in WA with the mining royalties, making you fiscally a stronger state and quite a fiscal outlier; and then third indigeneity, probably the most difficult one to grapple with.

If we come to the second outlier, some people might suggest to us that the system was going okay, the relativity rubber band wasn't being stretched too much back in the early 2000s, and it was only sort of post-2007 that we thought of relativities become very diverse. So some have suggested that this is a blip and thus we don't need to change the current arrangement. Things will get back to the cosy relativities of past, thus not stretching the system enough, not creating the extent of the disincentives with the equalisation task being so large.

So I guess, one of the issues that Jonathan and I thought would be good to touch on first with you now across in the West is your sense of how long this outlier world is here to stay with respect to the mining royalties for WA? We note from your post-draft submission that you've got some forecasts going out well beyond the forward estimates. So it'd be good to get your sense of is this a blip or do you see this being here to stay thus we do need to make architectural change and if so why?

MR WYATT: I'll make some broader comments and then I'll pass to the Under-Treasurer who might make some more specifics. Well, clearly, the – what has happened has been obviously impacted by the price of iron ore during a particular period of time and that has been – had an impact on our revenues, both in terms of price, but now price wise would have to be less

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dramatic to have a similar impact as the volumes of iron ore now are so much more dramatic than they were even five, six years ago.

The impact is actually much longer term than just a short, say, three or four year period where you have a relativity below 50 – rather 0.5 – simply because the impact on the finances now are probably going to be feeding through three or four terms of government, regardless of who's in power. We have a scenario now where this year, we're looking at an operating deficit of around $3 billion and that's driven by not just the decline in iron ore, but also the lag factor. We've made comments around how contemporaneous the GST changes should be. That is now expected, at this point, to get to more respectable levels above 0.6 by the end of the forward estimates.

In terms of predicting iron ore price, which really is perhaps the more decisive factor on our GST level, we're as good as anybody else at that, but it is not a reliable method. We have good methodology, but it is – doesn't lead to reliable outcomes, and I guess the best example has been the rapid decline in iron ore that, whilst the decline was predicted, at some point the speed of it simply wasn't. Perhaps now that we're moving into a state where the futures market around iron ore is much more mature. We get a better signal around it.

But I dare say, whilst the price of iron ore, $150 a ton, is relatively short term, it may be other commodities that are dominated by a particular State, be it Western Australia or others, that in due course will have a similar outlier problem, if you like. So that's why we're of the view that the architecture does need to be dealt with. But I might pass to Michael, who might make some more specific comments.

MR COURT: As the Treasurer indicated, you know the volume of iron ore has started to stabilise, but still it's moved from a decade ago of about 240 million tons per annum to 830 million tons of production. The WA budget is highly sensitive to the price of iron ore as well as the exchange rate. So even this year, we've seen the iron ore price move from a high of $US92 a ton to $53. So between February and June we've had that over $US40 a ton volatility, which equates to a $3 billion impact on the State's revenue.

As the Treasurer indicated, we are expected to see our relativity increase to about 0.62 by the end of the forward estimates. We have done some longer term projections, but they're highly sensitive to our assumptions. So I think they've indicated that the relativity may get up to around the 0.86, so well still below per capita share. But obviously it depends on, as I've indicated, the iron ore price is very volatile and our

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revenue is very sensitive to that. So the state does have an issue, in terms of budget management, around the volatility of our revenues. The relativity would only increase at a relatively stable rate, whereas our other revenues are bouncing around quite dramatically.

MS CHESTER: I guess we understand that it's no longer a quantity and price game, it's more a price game for iron ore based mining royalties going forward, and that there's volatility issues from the budget management perspective. But I guess from our perspective, we're looking at - I guess the question is over what sort of time horizon do you envisage WA, assuming no other dramatic change – structural change to other states and territories being the fiscal outlier, where would iron ore prices need to get for you to go back to not being the fiscal outlier? We're just trying to get a handle on that.

MR COURT: I'm just getting a bit – yes.

MR WYATT: I'm assuming - - -

MR WATSON: I might comment on that, if that's all right?

MR WYATT: Yes. Richard's - I'm assuming the long run average, but Richard might - - -

MR WATSON: So we've got objective recovery of WA's relativity in our forward estimates. That's driven by a couple of things. The first is it's driven by a property cycle in the eastern states that's increasing their transfer duty revenue. It's also driven by, basically, a historical unprecedented down turn in the domestic economy and then the contributing effect of weaker iron ore prices.

So what will happen eventually is that the domestic economy will recover. We'll start to experience sort of trend growth in our own source revenues, our taxes, such as transfer duty and payroll tax, and I'll point out to get a sense of how dramatic the downturn in Western Australia has been, payroll tax contracted by, I think, 7.6 per cent in the last financial year, which again is historically unprecedented.

We will always have, well at least for the foreseeable future, have a very strong mining base in terms of basic volume, which won't be replicated by other states. So what will happen down the track is our domestic economy will recover, our own source revenues will begin to grow sort of at roughly sort of longer than average rates growth. It'll be comparable to what goes on in other states at the time, and we'll have that large mining base sitting there.

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Now prices will go up and down because commodity prices do. But we will still have that, I guess, royalty base that other states don't have and it will drive our relatively. So we will continue to have a relativity that is well below other states and well below 100 for the foreseeable future in mining.

MS CHESTER: Okay. So, Michael, when you mentioned getting to around the sort of 80 plus relativity rate, how far out do you forecasts suggest that might be? Given I know that we're dealing with very wide confidence factors because you're dealing with commodity prices.

MR COURT: So we took those assumptions out at 2026, 2027.

MS CHESTER: Okay.

MR COURT: Yes. So some time away.

MR WYATT: Some time.

MS CHESTER: Yes.

MR COURT: But obviously, there's a lot of uncertainty around how those projections, not only in terms of what we assume, but then what happens in other states, as Richard has indicated.

MR WYATT: You'll see that that is important to note because even since the budget, which was only September and the mid-year review that we're dealing with now, our projections even for 2021 have already taken – have changed and blown out to 2026, I think it is, before we projected 0.8.

MS CHESTER: No. But I mean that's really kind of helpful for us from the two – twin perspective of one, the outlier – our second outlier's here to stay for the foreseeable future, and secondly also, it does help us a little bit with how we're going to be looking at the transition path for any changes that we may recommend to the government ultimately, going out beyond sort of three or four years.

I just note for the transcript, I think you've kindly agreed to share those forecasts and numbers, which means you've also been forecasting relativities for other states to be able to have done the numbers that you've done, which is terrific and very helpful. I'm sure our team will spend quite a bit of time unbundling all of those with you. So we don't need to go into those in detail, but just to say thank you and, for and the record, you're on the hook giving them to us.

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MR WYATT: They're very good, and the Treasury has been generally very good at predicting GST across the forward estimates period. This is obviously a bit longer than that. But it just highlights what the outlier has become almost in all. We've become a normal outlier, if you like, as a result of this happening.

MS CHESTER: Yes, and that was the key issue.

MR COPPEL: But just on that point, you made an observation that it's extremely difficult to forecast royalty income because of the changes in commodity prices. You also mention the payroll had fallen something like 7 per cent the previous year. How does the stability of GST revenues compare with your other own sources of revenue? Is it more stable, notwithstanding how these relativities can move from year to year, compared to payroll taxes or compared to stamp duties?

MR COURT: Well, the relativity is based on sort of your three year average, whereas all of our other revenue items are based on that, you know, the one year. So that provides some stability. The relativity has also taken into account actual data, whereas we're, I guess, payroll tax, transfer duty, royalties, are looking at forecasts of the relevant parameters that go into those forecasts. So payroll, what we're projecting in terms of employment ranges from – so the relativities do have – are based on actual expenditure.

They then also depend on the accuracy of what our royalties are going to be over forward estimates, our payroll tax, our transfer duty, and every other revenue item that is in all the other states. So we're dependent upon the forecasts that are prepared by other states to determine those relativities going forward as well.

MS LAURIE: So the forecasting for GST is fairly – highly accurate because it is based on sort of some of the old data as well sort of forward looking. But the issue is if you can actually have those, the time lags make it sort of more easier to forecast, but the time lags also mean that those other changes and our other revenue sources are hitting the budget in a harder way. If you didn't have the GST time lags in the same year that you had to make the changes in the iron ore royalties or the payroll tax or the like, GST would respond to that immediately and help offset that, so then the forecasting errors that occur in the other ones wouldn't be nearly as important if the GST didn't have time lags.

MR COURT: Yes. That's the key point. I mean, whilst with your backward data we can generally forecast pretty well, but when you've had – for the 0.34 relativity we had for 17/18, it's still based on data at a time

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when iron ore was $130 a ton which, at the time with payroll taxes declining, all our property taxes are declining and are still expected to decline for at least another 12 months, the slow reaction is what's really exacerbated, as I said, probably in our $3 billion deficit for this financial year, which will be our biggest, makes that – highlights, I guess, that. When you have that perfect storm of declining own source plus GST, the slow lag is having a particular – so is it stable? I guess, yes, in terms of you can predict it. But is it stable for budget management? Then it hasn't been.

MS CHESTER: Yes. I think it's fair to say from the submissions and the feedback that we've received, folk are happy with the current averaging provisions when they're not an outlier. But once you become an outlier, then it does become more difficult, thus which lever do we use here? Do we deal with the HFE architecture as dealing with the outlier or do we try to change the averaging arrangements to make things a bit more contemporaneous for you? Although I think at the end of the day we've agreed that the levers we've allocated in our draft report, and let us know if you disagree, is that let's deal with the outlier in terms of the holistic architecture of HFE leaving the averaging and the lag arrangements in place, which I think all the other states and territories are more than comfortable with.

MS LAURIE: Our submission sort of notes that the proposals that you've put forward would go a long way to helping some of those time lags problems.

MS CHESTER: Okay. All right.

MR COURT: Sorry, just one other point on the stability though is a small change in some of the parameters that go into the relativity can have a big impact. So one example being the census results where the State's share of population went from 10.8 to 10.5 [per cent] and that had a $2 billion impact on our GST revenues, so the forward estimates were - - -

MS CHESTER: Yes.

MR COURT: - - - affected through a – you know, what it meant in terms of the individual assessments that go into determining that forecast.

MS CHESTER: Okay. Great. Maybe if we turn then to, I guess, what was the other key issue in our draft report, and you touched on it in your opening remarks, Treasurer, and that is what impact does HFE have on incentives? I think historically, when people have looked at the impact of HFE on efficiency, it's been really about interstate migration.

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We sort of focussed on it a little bit more from the perspective of does it encourage or discourage states from daring greatly and doing the right things with tax reform or undertaking controversial development activity? I guess, we had a couple of questions around this. The first one would be, historically has there been any sort of development activity that hasn't been pursued in Western Australian because of the current HFE arrangements?

MR WYATT: I'll make some broader comments, but this has actually been something that became a particular issue during the last state campaign, and Terry might make some comments around this then shortly. So regardless of sort of the broader conversation around you know amending State Agreement Acts, the National Party had a particular policy of changing the lease rental fee, which is a royalty. So it's a sort of a charge per ton that historically has been in State Agreement Acts. Now that would've, if changed accordingly, resulted in significant short term revenue, but washed through pretty – would, start of year 4, affect the wash through and send off to other states in the nation.

Similarly, we're having a similar conversation at the moment. My budget is predicated upon a gold royalty increase. Now we lose about 60 per cent of our gold royalty, and so some of the public debate has been around "What's the point? What's the point of actually doing this if you're going to transfer 60 per cent to other states?" When your mechanisms are limited as a State Treasurer and they're all in decline, the own source revenue then you - sort of you do have to sort of, you know, consider even the ones that you don't capture.

So historically, it's been a decision that would be perhaps in the last six years, people are much more aware of what's the point of actually capturing that - a revenue return from your mining sector if it's going to be redistributed. I've actually brought with me one of the many letters I sign off to Western Australians suggesting that we might have a better opportunity with the Commonwealth Grants Commission if we abolished royalties and simply sought some sort of iron ore focussed payroll tax. I dare say the Commonwealth Grants Commission would probably look through that in any event. But it gives you an idea of the sort of conversation that we're having more broadly. But in terms of more specific, Michael, you might be the best.

MR COURT: Well, I suppose as the Treasurer said in his opening statements, the state is generally or has been, a pro-development State. So it has been focussed on developing the resource sector and has done so through this unique way in terms of State Agreement Acts. So those State Agreement Acts have been all about trying to provide that certainty for

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these projects. They're often in very remote areas. They're complex, large projects.

So the state has taken a very pro-development attitude to facilitating the resources sector, providing for land tenure and approvals, streamlined approvals, for those projects. I think what the state has also done is to look at trying to also ensure that there's also a contribution from those projects to the infrastructure and, you know, to help the state manage the impact of those projects. In terms of what it means, I guess, the more direct impact in terms of how, it's more about what it does to the revenue policy settings as opposed to not approving projects because it has a GST impact.

MR WYATT: Can I just – there's just one policy change of late that - and yet it's not a political comment, but the effect of port fees out of Port Hedland's port, not for the juniors but for the – for BHP and more broadly capturing Rio as well and FMG, were frozen. Now it might've good policy rationale for that for encouraging increasing tonnage. We changed that and I've now increased that reasonably significantly. But it just highlights that when you're looking at the iron ore sector, because it's the iron ore sector we're talking about, you have to – you're probably doing – making decisions to capture revenue that won't be re-distributed, but may not be the ideal trade facilitation decision. So that's I guess a more recent example that I could give.

MR COPPEL: The CGC has put out a paper for its 2020 review which includes the idea of quarantining from the equalisation process, 50 per cent of additional revenues, say for example from an increase in the gold royalty. Do you have any views on that suggestion?

MR WYATT: Yes, I was very pleased to see that. I mean, I think it's actually the Commonwealth Grants Commission kind of recognising that their rigid defence of the status quo has, perhaps, not been – has had some flaws. Whilst it is going, it only applies on my understanding, or would apply, to any increase beyond the status quo, at least it recognises that a state that has had, for example, pro-development policy for a long period of time, should be rewarded according to the revenue that it creates.

Now ultimately, that would only apply if we decided post-2020, I think it is, to increase royalty rates. But again, whilst we have had, and I think it's been a very good approach by State Governments for 40 years, that we've had State Agreement Act approaches to large scale developments, it makes it very difficult to then change anything within it. So it probably is having a broader impact on policy decisions around how you go around creating certainties with that sort of huge capital investment that the private sector undertakes to get resources developed. Michael?

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MR COURT: Yes. So look I think the Grants Commission process has had to play catch up to what's happening. So in terms of the expansion of the iron ore sector, the government had to look at, you know, the demand for services and infrastructure provided for that, had to look at the revenue seatings to provide for those services. The option it had was, around iron ore, to increase the iron ore royalty rate on fines.

At the same time, the Grants Commission put out a new mining assessment with the low/high category with, probably, a lack of consultation with the State around that assessment and that led to the State actually losing more of that revenue generated by the increase in the iron ore rate through lower GST and led to the Commonwealth Treasurer having to direct the Grants Commission to treat that iron ore fines in the lower rate. So a catch up methodology.

Similarly, until then we didn't have any recognition of the impact of population on a – you know, the infrastructure requirements driven by our population growth. So there's another methodology change back then to sort of catch up to what was actually happening. That obviously makes it very difficult for governments in terms of the incentive to grow your state when you don't know what the revenue impacts might be from those drivers of growth.

MR WYATT: That's a point we've made in the submission is, and that's really the operation of the Commonwealth Grants Commission, is that this - often you're making decisions with really unknown repercussions because the Commonwealth Grants Commission don't engage with a dialogue of, "Well, if you do that, this is likely to be the position we're going to take", which is infuriating half the time.

MS CHESTER: So if the policy settings were to change such that we moved away from full equalisation to - just assume for now equalisation to the average, the CGC follow through on the 50 per cent discount on royalties for increasing royalty rates from their stand point that there is a perverse disincentive and you're not getting policy neutrality and you're not optimising your royalty rates there. Thirdly, at one of our draft recommendations that the CGC would be required to give states a draft ruling on how they might treat a tax change or a new policy so you've got some certainty when you're going to Cabinet to say, "Here's the pros and the cons".

If those three things were to happen collectively is there anything else that the WA Government may need, from the perspective of any material disincentives that you think you still may face, when it comes to

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development activity, royalty rates and tax reform? Sorry, that was a very long way of saying, does that address the issues from the disincentives perspective?

MR WYATT: Yes. The Under-Treasurer will make some more specific comments, but they would be three very significant outcomes for Western Australia, absolutely all three. Michael, will speak to one or two. But certainly, the third, a draft ruling environment would be very useful, you know, obviously on a confidential basis so you can actually have a dialogue with the Commonwealth Grants Commission. But that would be incredibly useful for states, not just WA, but I dare say all. But in respect of the first of its Commonwealth Grants Commission proposal and an average equalisation would have – would effectively resolve the issues that WA has been raising for a long time now.

MR COPPEL: Do you need both?

MR WYATT: Michael, do we need - - -

MR COPPEL: Why is it so important to have both?

MR WYATT: That's a good question.

MS CHESTER: Hang on. Let Michael answer first and we'll come back to your question.

MR COURT: Look, I think in combination, yes, they would be a very positive step forward. Each one in isolation though does have some difficulties, but in combination, yes. We've been putting forward a case for a 50 per cent discount of the mining assessment for some time to recognise that there are additional costs in development of those revenues that aren't taken account into the expenditure side of the assessments.

MS CHESTER: So if equalising to the average does take quite a bit of the mining royalties off the table, I think Jonathan's logic was going where my logic was going as well, do you still need the 50 per cent discount for the royalty rate increase, and if so, why, because we're trying to work out the logic?

MR WYATT: I guess you would when there's a few rapid expansion, but I'm just trying to – we'd probably need some modelling done on that.

MS LAURIE: I think it's when you - like the proposal you put forward sort of helps states up to a point. But then once they're sort of past that point in their relativity, it doesn't actually hit. So the mining assessment

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having some sort of changes to the way that the mining is treated, still creates that better incentive for states in the way that they look at mining development. So, I think, the combination is useful.

MS CHESTER: Maybe that's something we don't need to get a full answer on today. But we do want to come to a landing on whether there's still a case for that. So if you want to provide us with some additional information or cameos to explain why you still think you need both, that would be helpful.

MR WYATT: We will do that. I guess there's a couple of things at play there, where you were just looking at - just regardless of the source, you're just looking at the revenue outcome or versus are you trying to create a mechanism that encourages development of your resources? That's been, hence, we're – as a government and I dare say Terry and Mike Nahan will make a similar point, and I know the CCI did yesterday, is we should be – have policies of – within the HFE objective that encourage development as opposed to encouraging not to develop. But we will provide a cameo to that.

MS CHESTER: Just going back to that earlier question though, so when I asked historically had there been any development activity that hadn't been pursued because of the HFE, I think where the answer led to was where there are perverse disincentives around changes to royalty rates. I still haven't heard any evidence of are there any development – you know, material disincentives that have stopped development activities from occurring because of the HFE arrangement?

MR WYATT: I think the cost to a private sector developer of the royalty regime is not necessarily going to stop a development if it you know – commercially stacks up. But certainly, it's probably more if the decision is made by government to extract value from that, that starts to have an impact. Hence my reference to the "port fees" as an example and also the conversation we had at the last State election around should we increase the lease rental fee, which Terry Redman will point out to you very shortly, hasn't increased for a long period of time. There's zero value in that for Western Australia. I mean you can do that. You lock in a bunch of spend that by your three year, four, you've got quite a large hole in your budget. Then there's also the other issue of well how certain are State Agreement Acts, which have been the bedrock of WA for a long time. Michael?

MR COURT: Look it's always a difficult one to prove because, I mean, projects don't go ahead for a range of reasons. Is it due to, perhaps, the State Government not providing a piece of infrastructure because it can't afford to and you can link that back to our budget and with GST? You

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know, it's very hard to directly prove that a project hasn't gone ahead because of the GST impact. As I said though, the government does promote development and it does it through State Agreements, and it's more about the revenue being able to accommodate the impact from the budget point of view.

MS CHESTER: Okay. So one other thing that would be helpful, in your post-draft report submission you've given us another very helpful cameo of a perverse disincentive around a revenue neutral tax switch with royalties and, I think, payroll tax from memory. Some of the other examples that you've cited here this morning where you're looking at changing royalty rates or revenue measures and you're obviously being lobbied by folk about what impact that might have on the GST distribution and your relativities.

It would be really helpful for us to get that on the record from you post today's meeting, if that's possible, because we were taken to task by some other states for our – and it wasn't a throw away, it was very thoughtful wording that we put in there – that an absence of evidence doesn't mean evidence of absence. So the more that we can point to those in our final report is very helpful.

MR COURT: Yes.

MS CHESTER: We might then move on to – yes.

MR WYATT: Can I just, Deputy Chair, you raised an issue before about indigeneity that I don't think we've dealt with. Was there a particular point you were going to make, seek some information from us on that?

MS CHESTER: No. No. I'm happy to make that now, Treasurer. So I think some folk had suggested – so we sort of identified the three outliers that the current system is grappling with, and the third one is really indigeneity. There the issue was, as pointed out by some, that with the way that that affects assessed budgets by the Commonwealth Grants Commission as a disability, what's provided to a state or a territory in terms of fiscal capacity for indigeneity in a dollar sense doesn't match up with what's actually spent.

We're living in a world, as you would know and we've done a little bit of work on it around overcoming indigenous disadvantage that, you know, the metrics there aren't improving there in terms of outcomes. Some have suggested taking it out of the HFE equation completely and reverting to a world of tied grants. We kind of struggled with being able to deal with the policy problems there in the confines of our HFE inquiry. But instead, we've suggested in our draft report that there'd need to be some meaningful

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reform between accountabilities and responsibilities, Commonwealth and state, when it comes to indigenous policies and programs before you could look at making any changes to the way indigeneity is treating in HFE.

So that's kind of where we landed in our draft report. We haven't heard back from many people on that element. Everyone's more focussing on how the GST bucket is divided up across states and territories. So we would welcome any feedback today or later that you've got on, was that the right landing in the draft report or should've we looked at doing something further in the confines of HFE?

MR WYATT: Well, firstly I'll make sure that there's further feedback from Western Australia on that. I guess, just quickly, because ultimately there's some other issues no doubt you want to deal with, the issue would be around, as you pointed out, the correct allocation between the state and the Commonwealth which has been a frustration I guess for a long time, and also the unique history of Western Australia. The homelands, for example, have quite a history of Commonwealth Government making decisions, funding decisions over decades and moving people around country, as have states. But also our, I guess, like the [Northern] Territory's indigeneity, WA is inherently tied up with remoteness as well.

MS CHESTER: Yes.

MR WYATT: But I'll make sure I deal with that specific issue as a government by way of follow up.

MS CHESTER: That'd be great. Also, Treasurer, it's consistent with an element that hasn't had a lot of attention yet in our five year productivity review paper where we talked about some reforms of Commonwealth/State/Federal financial relations and accountability and responsibilities and we did actually say that indigenous policies and programs should be first cab off the rank in that review area amongst the treasurers. Anyway, but thank you for - - -

MR WYATT: Thank you. I just wanted to see - - -

MS CHESTER: No. Thank you for raising it because most folk haven't to date. So then if we're turning to the transition path. I think we better get to the transition path, or do you have anything else before then?

MR COPPEL: Can I just get back to a very early comment you made in your opening remarks, that the current system fails to meet the equalisation objective, and also does not meet any reasonable standard of fairness. The objective that's defined at the moment by the CGC is to provide every

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jurisdiction with the same fiscal capacity to provide services to its citizens. So if I were acting as the devil's advocate or other jurisdictions, they would say, "Well why is that" - - -

MR WYATT: And they are all devils, don't worry.

MR COPPEL: **"**Why is that unfair and" – sorry?

MR WYATT: They are all devils.

MR COPPEL: **"**Why is that not meeting a reasonable standard of fairness?" What do you - - -

MR WYATT: The point I want to make about fairness is that issue around equity, and that is whilst it's not specific in your Terms of Reference, is fairness or confidence in this fiscal federation that we have, is it fundamental to its operation? Now having this, and I say this, so the reason I brought this letter in that I've recently written to a Western Australian, is to highlight that every week I sign off a dozen of these letters. Every Western Australian understands that if you – and this is the kind of conversation we're having – you make the effort to develop and you take the political cost of developing, and often there is significant political cost not just fiscal cost, then you should be rewarded and not penalised for that effort, for those efforts.

So the fairness issue now, and I dare say if you were to poll, whether it be a credible poll or just walk down the streets, the faith and confidence in the system, the fairness, would be very, very low. That is a problem for the Commonwealth. That's the point I was trying to make around whilst it's not specific to your Terms of Reference around equity and fairness, it's certainly something that can't be ignored by the State or the Commonwealth Government. This is something that has now been washing through WA for a while and there is great hostility to the Commonwealth Grants Commission, the process and the Federal Government regardless of their political colour around the distribution of what is seen as the efforts of Western Australians. Now just, sorry, the first part of your question was around the full equalisation?

MR COPPEL: Yes, does not meet the equalisation objective.

MR COURT: Yes. So, I mean the - as we said before the Grants Commission is continually revising its methods, so it's obviously not always fully accurate.

MR WYATT: And the complexity.

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MR COURT: And the complexity. In terms of - - -

MR COPPEL: We've got a bit of background noise. Can you – I can't hear everything you're saying.

MR COURT: Sure.

MR COPPEL: It doesn't pick up.

MS CHESTER: Actually we might pause. Can we ask the footy team outside to move somewhere else?

MR COPPEL: They're right next door.

MS CHESTER: Okay. They're next door. Sorry, we can't move the footy team.

MR COPPEL: Yes. Okay.

MR COURT: So, I mean, the Grants Commission looks to calculate grants on the basis that each state uses the same effort in raising revenue, but it doesn't take into account what the state's revenue policies are in calculating the revenue base, so. It's the same on the expenditure side where they use discounts and don't assess issues because they don't have the data to accurately do that. So it's not actually achieving full equalisation in that sense.

MS CHESTER: Yes.

MR WYATT: Which was the – earlier this year about health.

MR COPPEL: So just one final point on this, is it more linked to the poor understanding of the processes that the CGC uses or an intrinsic inequity in the system? Very few people understand in detail - - -

MR WYATT: I would've thought - - -

MR SCHERINI: It's intrinsic. There is intrinsic inequity. There definitely is intrinsic inequity in the system. The revenue assessments are basically equalised on the basis of, you know, what you see is equalised. On the spending side, it's just conservatism everywhere. I mean, in the last review, the 2015 review, you know, we basically – we had concerns about the Grants Commission assessments of wages, remote costs, capital growth pressures, various economic development issues, service pressures relating

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to mining employees. We had concerns across the board. In some cases, we had some data to support us. In all cases we had some data to support us. But generally, there wasn't enough data to meet the Grants Commissions standards. So you just get an asymmetric outcome.

MS LAURIE: There's a lot of gaps in what they look at.

MR SCHERINI: It's quite inequitable, quite inequitable.

MS CHESTER: I think there's maybe two streams to the inequity, one is when you're trying to have such a degree of precision by seeking the holy grail of full equalisation to the highest state, and you're doing it on a sort of a reactive basis as a starter and policies change across states and territories, you're always going to have that sort of – the inequity I think you're talking about. I guess the inequity that, I think, is more aligned with Jonathan and what the Treasurer are talking about is the concept that we called "unfair equality". That is because people don't understand the system and it's portrayed as "We're not getting our fair share of the GST, i.e. where are relativities reached". That corrodes confidence in the system.

MR SCHERINI: Yes.

MS CHESTER: It doesn't mean that the system's done anything that it said it wouldn't do. It's just it's not well understood and it's been stretched too far.

MR WYATT: Well, and I've got to say, I mean there's a reason. I watched the former Treasurer, Troy Buswell, first refer to the Commonwealth Grants Commission as a black box, and I kind of understand what he meant now because it's very much information goes in and something's spat out. As a Treasury you try to get a line of sight on that, particularly around decisions that were – that are made without really any feedback in.

I'm just trying to remember now, I'll provide this by way of supplementary, not long after I became treasurer there was a change in the way that Commonwealth Grants Commission assessed private health data, so the private sector and the private insurance covering health spend. Because of a lack of data to the Commonwealth Grants, because as you said it's a holy grail and it's sort of the never-ending supply of data, they changed their assessment and that resulted in a number of hundreds of millions of dollars over the forward estimates in reduced GST for Western Australia.

I'll provide that by way of supplementary because it's quite interesting because it was very much based around there's not enough data so we'll

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take an assumption that penalises WA. But I'll have to provide that by way of supp if I can?

MS CHESTER: Before we get back to policy directions, just on the data point, because you've raised it at this junction, we did have a draft recommendation say "Open the cupboards on data" in terms of what data the CGC gets from the states, how they crunch the numbers, and so similar to what we do at the PC and what we expect of other statutory agencies. I think in their post-draft report submission, it's kind of like the Commonwealth Grants Commission pointing the finger back at the states and saying, "[it's] States' data and some of them won't let us release it". So can I get you guys on the record saying that you're happy for the data to be released? We'll keep working through the other states to try to get that similar undertaking thus that the CGC will be able to not just release the data but also how they did the calculations, so you've got more line of vision going forward?

MR WYATT: On the record, absolutely. I mean, ultimately the more transparent the process is the better it is, and that's been, as I said, the frustration of consecutive governments around – the lack of transparency around it.

MS CHESTER: Yes. While we're on this issue of equity, and again touching back on the CGC's recent post-draft report submission where they've dared greatly and modelled some other policy changes, the key point that they make is what would be the impact on states if we moved to a world of less than full equalisation? Here, they've looked at equalising to the second highest state. So you might remember in our report we sort of had "Current arrangements with the equalisation task", then "Equalising to the second highest", then "Equalising to the average".

In that submission, they say to us that over the longer term and beyond the transition path, it would mean that for most states and territories, apart from yourselves as the outlier, they wouldn't be – they would be precluded from providing public services of an average level. So I don't know if you've had time to digest that and whether you'd have any comments on that because it's - - -

MS LAURIE: The CGC's assumption is that at the moment, the full equalisation process is working, but it's not actually delivering full equalisation at the moment. So the starting point is not accurate. So with the gaps that they've actually got in the system at the moment and some of the things that they don't assess the WA's spending needs on, it's arguable that WA currently doesn't have the ability to fund the average level of services. So the CGC's starting point is that the system works. We know

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that it doesn't. So therefore their argument that states won't be able to all have the average level of services doesn't really hold, because WA possibly can't do it at the moment because of the gaps in their system.

MS CHESTER: I guess the other thing is, and I'm just sort of thinking out aloud here, but they look at – through the lens of, "Well, what's the fiscal capacity that we're affording someone to meet those average level of services?" I guess the counter-factual in an outcome sense would be "Well, what are the states and territories actually spending that money on? Are they actually providing the average level of services, if they're given that fiscal capacity?" Is that something that the WA Government's looked at?

MR SCHERINI: Well, on the national average basis, the states in aggregate are providing standard of services as, you know – standard of services which the Grants Commission aims - - -

MS CHESTER: Because it's what states do.

MR SCHERINI: - - - to replicate for each individual state. The question is how successful is the Grants Commission in replicating the national average level of services across the individual states? Western Australia, if you like, I mean, our spending on health is in the order of – you know, it's about $800 million higher than the Grants Commission would think is necessary to provide an average standard of services.

Now, so what's the difference? What's the difference? We've had a look at that. We can identify some policy effects, but it's a large gap that we can't identify the reason for, other than Grants Commission methodology problems. We know there are large Grants Commission methodology problems in the health system.

In many respects, the Grants Commission, in some sense, tries. But it's a strange game. They change their method on a whim. You know, as the Treasurer referred to the case of the private sector impact on health. They change the methodology on a whim. Hitting us with a $200 million a year cut in GST and there's just nothing in the report to justify their approach. In the telepresences [between States and the CGC in the 2015 Review] that were discussing that methodology change they were squirming in their seats. They couldn't - - -

MR WYATT: I guess, it's a combination of, as you pointed out, I mean, if we were to spend the average I'd be taking what, about $800 million out of our health spend if I was to spend the averages assumed by the Commonwealth Grants Commission. Whilst as a Treasurer I love that idea, it's just simply unrealistic to expect that we could deliver the current

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services. This comes back to, I think, a conversation we were having around indigeneity and also remoteness which, effectively, a system that assumes the remoteness kind of expires once you get past really Kalgoorlie, is ludicrous. So that's why there's no way, for example, that the average around - health is always – it's the biggest part of the budget.

We spend above average because of the nature of our state. We have a small population spread amongst a huge state. I think the obsession with the data and the assumptions around what State Governments should be spending, by the Commonwealth Grants Commission, are based on their own assumptions around averages. But, of course, then make no comment or feel as though there's no role to play in making decisions around how states also maximise their revenue base.

MS CHESTER: Yes.

MR WYATT: So it's sort of this kind of – they do one thing but not the other.

MS CHESTER: Yes.

MR SCHERINI: The Grants Commission gets trapped sometimes by its methods. It's got a traditional method for identifying remote areas and very remote areas and so on. But when that breaks down, they don't know what to do. In the last review, we provided I thought pretty good evidence that costs in our remote and very remote areas were higher, significantly higher, than costs in other states' remote and very remote areas. Because their methodology is kind of created around the idea of comparability in remote and very remote areas, they're kind of left up the creek without a paddle. They don't really know how to handle it and their general approach is just to dismiss things that don't fit their models. That's the problem, they can't handle extreme - they can't handle extremes.

MS LAURIE: It's the outlier thing you were talking about before.

MR SCHERINI: Yes, the outlier thing - - -

MS LAURIE: Where there's outliers, the HFE system doesn't work very well.

MR SCHERINI: It just falters. It falters.

MS CHESTER: We did hear some colourful examples yesterday of comparing Burnie and Broome and we won't go there again. I'm not spending three and a half hours – three and a half days driving to Broome.

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MR WYATT: Between Burnie and Broome.

MS CHESTER: Let's turn to transition path, if we are looking at perhaps moving away from equalising to less than the highest state. Your post-draft report submission did provide two options around transition paths. Before we make sure – have a bit of a chat about those and make sure that we fully understand them, I guess it would be helpful for us to understand what sort of were the guiding principles that you sort of adopted?

When we kind of think of a transition path, the one that we identified in our post-draft – in our draft report was I guess looking at start date implementation timeframe, pacing, and also making sure that particularly the fiscally weaker states were not materially disadvantaged at least during the transition path. So if you could talk us first through the guiding principles and then we might go through the two options to make sure that we understand what you're suggesting.

MR WYATT: I'll just makes some comments and pass to Michael who's going to make some comments around this. We've given a couple of options, I guess. I note the CCI have a – gave another one yesterday which is to be frank, look there's – they're all fairly – how do you transition the same? There's different paths we can go. But we've also tried to provide you and the Commonwealth Government with options because we're not naïve. Ultimately, you can't do it overnight - you're just not going to get any Commonwealth Government doing it overnight.

So it also needs to recognise, so a - there needs to be a transition. There can't simply be a "Well, look at this one. WA's above 75 – 0.75 and we're all okay", and it's actually - but it's meaningless for Western Australia at the moment. But we've looked at a couple of options and the Commonwealth does need to have a role in this in terms of providing transitional funding.

I will say, I guess before I pass to Michael, perhaps one – this is perhaps expressing a frustration of many State Treasurers, is that biggest beneficiary of the mining boom that happened in Western Australia was the Commonwealth Government. It wasn't the WA Government. We lost the wealth that was created through the HFE process and so certainly see that there is a role and an obligation on the Commonwealth to help us get back to a fairer – well, get us back to a – whatever the objective of HFE is going to be, the transition does need to be funded by the Commonwealth and also to bring in those states that will otherwise be and, no doubt, continue to be hostile. Michael?

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MR COURT: Yes, so I think we've got two options where we look at equalising to the average fiscal capacity. So we would see that our first option would transition over three years, basically to be using rising relativity floors and as the Treasurer has indicated the Commonwealth would have to put in around about $2 billion to assist with that transition in relation to the impact on other states.

There's a second option which is a longer transition over nine years where we're faced with new relativities starting from 20 per cent weight for the new relativities and Commonwealth assistance provided over five years, which totals 4.7 billion. So under that longer time frame, no state would be worse off in terms of their current forward estimates period.

MS CHESTER: Yes. Under option one, which is kind of like two years of a floor that the Commonwealth pays, so the other states aren't impacted for those first two years and then we go, am I right to say "cold turkey" to ETA and there's no compensation for the other states?

MS LAURIE: The first year is 100 per cent Commonwealth funding with the 60 per cent floor. In the following year, it's 50 per cent Commonwealth funding, so it does start to phase in.

MS CHESTER: Okay.

MS LAURIE: Then by the time of the third year, that's basically yes, going straight to the partial equalisation approach with - - -

MS CHESTER: So when you say "50 per cent" that means the states that are – so the states are then contributing the other 50 per cent of your floor?

MS LAURIE: Yes. So table 2.2 in our submission outlines the dollar impact for each of the states and the Commonwealth on that.

MS CHESTER: Okay, cool. All right. And then option 2, the nine year phase in which takes us out to 2026/27 is, effectively, keeping the other states whole for four or five years with the Commonwealth putting in 4.5 billion?

MS LAURIE: Yes. So the first three years the Commonwealth will be providing the assistance to the other states and also the new process phased in sort of slowly starting at 20 per cent.

MS CHESTER: Yes.

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MS LAURIE: And then after the third year, the Commonwealth funding starts to phase out. So it's 60, two-thirds funding for the Commonwealth, then one-third, and by the next year the Commonwealth is no longer funding the other states.

MS CHESTER: Okay.

MS LAURIE: So it does mean that the other states don't have any impact over their forward estimates.

MS CHESTER: Okay. In terms of winners and losers, clearly the Commonwealth putting the bill up front for the paying of the other states and then all the states where we go to with ETA, I guess the other way of looking at it, and Jonathan and I are conscious that we're heading to the other states after today, is when you look at the winners and losers, WA and New South Wales stand to benefit the most from the move to ETA. So did you give any thought to a co-funding model?

MS LAURIE: Effectively, the transition is a co-funding model. So, in effect, like instead of jumping straight to addressing the problem immediately and WA having a benefit of multiple billions of dollars, the proposals we've put for transition have a benefit for WA and New South Wales under the second option, which is a lot smaller than it would be otherwise if we jumped straight to it. So, in effect, this is WA and all the recipients of the beneficiary states co-funding the reform process.

MS CHESTER: By not doing it immediately?

MS LAURIE: Yes.

MS CHESTER: I guess I was looking at it a little bit more realistically about a transition path and who's going to foot the transition bill. But at the moment, there is a delay in you getting to ETA, which is quite reasonable, given it is a material change. But it's effectively then the Commonwealth who's tipping in the additional money. You just get to ETA a little more slowly. I guess you could do the transition at a slower pace of getting to ETA and that's to some extent WA is co-funding on a greater basis as is New South Wales. Is that something - - -

MR COURT: Yes.

MS CHESTER: I mean, because I look at those dollar figures for a Commonwealth Government in the current budget situation that it has.

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MR COURT: Yes. So I mean, there are obviously different scenarios on how you want to transition that, depending on how fast and so on. So the Commonwealth, as the Treasurer said, has benefited from the economic development of this state. So the fiscal subsidy that goes to the Commonwealth was outlined in previous submission, the expansion of LNG, so WA is becoming the third largest LNG producer in the world. That revenue will flow through to the Commonwealth through the Petroleum Resource Rent Tax.

MS CHESTER: No, I appreciate all those arguments. We're kind of looking at - - -

MR COURT: Yes. But you're ultimately right, the Commonwealth is being looked to, to fund the transition by and large.

MR COPPEL: Supposing they weren't in that position, have you thought through options on how to structure an implementation or a transition?

MS LAURIE: The transition ones that we have chosen did have – like we were closely looking at what the impact would be on the Commonwealth, so we purposely chose some transition options that looked more affordable for the Commonwealth and more practical for them to actually be able to implement.

MS CHESTER: Okay. When you look at the funding source, again I guess it depends on what starting point you have in mind. Most of the states, and indeed if I was in their shoes, I'd be arguing the counter-factual is what I would've otherwise gotten if you hadn't changed anything, thus make others as whole as possible and somebody else pick up the tab and I don't want to know about it. If we were to look at the starting point as today, what have you got baked in, in terms of the GST growth rate in the GST pool going forward?

MR COURT: The pool? That's based on the Commonwealth's projections of the pool, which is growing.

MS CHESTER: Which is just the forward estimates, where as you go out to 2026/27.

MR COURT: Yes.

MR SCHERINI: We just assumed it all continues to grow at a steady rate.

MR COURT: Assumed the long run - - -

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MR SCHERINI: Yes.

MR WYATT: If it's like all the other assumptions around that sort of longer term modelling that I get from Treasury, it's usually based on whatever long run average up to a point has been.

MR COURT: We can provide that exact growth rate for you.

MS CHESTER: Yes. No, I was just thinking one option, and indeed I've seen it happen in previous incarnations, where you're looking at an ugly zero sum game, you start with a different bench mark and then you look at well if there's a growth baked into the pool, perhaps that growth slice can become a funding mechanism.

MS LAURIE: We have looked at options like that in the past, in terms of sort of relying on growth in the GST pool to compensate states and the states, you know, in nominal terms just to sort of catch up – it takes a very long time.

MR COURT: A very long time.

MS LAURIE: And I think the point you sort of made is WA has been paying for a long time, and the time to change is sort of as soon as possible rather than waiting that long to make reform.

MR WYATT: Yes and it'll be – yes. I dare say that it's unlikely there'll be any change to the pool that broadens the base or increases the rate any time soon.

MS CHESTER: So I guess just on the point of you feeling like the lottery needs to come your way again, other states will suggest that the current fiscal position for WA, and indeed we had a frank exposition of this in our draft report, suggests that a little bit more generosity and spirit around the transition path may be warranted. On that point, we were frank in our exposition of our historical story, the fiscal management of the WA Government. Is there anything that we had in the draft report that you wanted to take us to task on? Now is the chance because I don't think you touched on that in your post-draft report sub.

MR COURT: The feature box you had around financial management there, look, you indicated that our relativity projections were quite accurate. I think in '14, '15 our relativity came in at 0.37. We were forecasting 0.34. I think there was some commentary around about the level of expenditure. Expense growth in '14, '15 was two per cent. So we had relativities in the 30s. Our expense growth has been in that sort of two to three per cent. So

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it's not a high rate of expense growth. There was much larger expense growth previously. But those budgets were put in place on the settings of a reduction of expenditure growth which, in terms of when you look at the actual, was two per cent in '14, '15. So the commentary there around not managing expenditure in that year was, I guess, just putting some context to it.

MR COPPEL: I think we were looking at earlier years.

MS CHESTER: Yes.

MR COURT: '12, '13.

MR COPPEL: Yes, see we didn't think it was - - -

MR COURT: Yes, '12, '13 was 3.7 per cent.

MS CHESTER: No, I think there's one table that I just – I know I now will not be able to lay my hands on, where there were some assumptions made not in the forward estimates, about what would happen to relativities with the change of policy by Canberra and if you compare – here it is. So looking at the forward – the big CapEx and forward expense numbers, under assuming a GST relativity floor and assuming no GST relativity floor. They were kind of the same.

MR COURT: Yes, the expenditure was the same. So that was a scenario to show what the revenue impact would be of a 75 per cent floor on the net operating balance and net debt, compared to the two scenarios. So the budget aggregates included expense growth, and that was the same under that scenario.

MS CHESTER: I think others, including ourselves, would look at that and say that effectively there was no change to the CapEx and the forward expense profile, based on any change in – so basically, you were assuming if we did get the relativity floor, this is what the expenses would be and you'd pay down debt. Then the actuals were actually the same in terms of expenses. So that for us was quite problematic from a fiscal management.

MR COURT: The scenario was a – was around the revenue side. Yes.

MS CHESTER: I know this ancient history for you, Treasurer, but - - -

MR COURT: It was a scenario based on the revenue side, not expenditure side. So the budget included projections that took into account the current policy that the Grants Commission had around the mining assessment and

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produced the budget aggregates based on that current policy setting. I guess, as we said earlier, the Grants Commission's continually playing catch up and changing its methods. So one of - the state was arguing for a 75 per cent relativity floor at the time, so those aggregates showed the – all else being unchanged but there was a change in the policy in terms of the GST distribution what that had in terms of the budget aggregates.

MS CHESTER: Okay. I guess I look at that in a common sense way and think one table assumes no relativity floor and expenses are X. One assumes a relativity floor and expenses are the same. So there was no change in the expenses based on not getting the relativity floor. That's where I kind of struggled and that's where other states and academics have struggled. Anyway, I won't belabour the - - -

MR COURT: Yes.

MR WYATT: And that's ultimately the '12, '13 budget is one I remember well and it's one that has been – I'm not sure whether - - -

MS CHESTER: I think this is the '11, '12 actually.

MR WYATT: '11, '12 is it?

MR COPPEL: Yes.

MR WYATT: I'm not sure whether you were still in the meeting, Chair, when - the last Treasurer's meeting, but it's one that is held against me as a Treasurer by other State Treasurers. But ultimately, be that as it may, the issue around, particularly at the moment, around a GST relativity that still takes into account data that's long since gone, I dare say, any State Treasurer I think – or any reasonable State Treasurer would hopefully appreciate that particular issue that we have.

MS CHESTER: No.

MR WATSON: Can I make a comment about the - - -

MR WYATT: You've got Treasury agitated now, Chair.

MS CHESTER: So I'm only - - -

MR WATSON: I think there's – it's - - -

MS CHESTER: No, no, no. I'm only raising it from the perspective of what's reasonable through the lens of other states and territories when we're

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looking at a very material change to the HFE arrangements and we're trying to come up with a transition path that's guided by a broader lens of fairness, knowing that history.

MR WATSON: Well none of those folks have had to cope with the volatility that Western Australia has had to face. So their criticisms do not have – they're not based around a counterfactual of what good budget management might've looked like. You know, it's actually quite a cheap criticism on their part. If they'd had the same volatility, what would their financial outcomes have looked like, assuming that they managed their budget well?

MR WYATT: Which is the point I made earlier on is that trying to take the conversation out of, you know, the obvious political points that are made by both sides into a Productivity Commission review is something that we're very keen to get to. I'm hoping, and I've said this publicly both to my Federal colleagues and to other State Treasurers, to at least let the process have its run, and ultimately I think defending what has clearly become a mechanism that has gotten so – become so overly complicated because no one's been willing to actually address the fundamental principle or the fundamental objective of HFE. So it's become so incredibly complicated that no one really understands it, including the people sitting at this table as we try and get our head around it all. But there would be, I think, nothing to fear from other states if we can get a transition plan that the Commonwealth subscribes to.

MS CHESTER: Yes. No. We're very appreciative of the political environment within which this inquiry is being conducted, but also very aware that transitions paths do have to work within a political economy which does mean that history is still important. Okay. Well, I think that covers off transition path. We've done data.

A couple of other questions. So we just wanted to make sure we understood in your post-draft report submission, the logic around not moving towards an efficient cost benchmark, which was kind of into the future for us, in terms of you can't do it in the now but it would be something good to aspire to, especially if the CGC begins to work in a world which is – if it's less than full equalisation, you don't need to have the holy grail of the calculations and the world of false position.

MR SCHERINI: I mean, we are quite open to simplification in the spending area and particularly simplification that more clearly identifies the disabilities that the states face. It wasn't totally clear to me what you were aiming to achieve with the cost benchmark, whether you were talking about simplification or whether you were talking about depressing the cost

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differentials amongst states, and whether you were planning to apply that to costs as opposed to demands.

But the general point we have is that, at the moment, the Grants Commission's assessments are highly asymmetrical and the spending assessments are far more conservatively done than the revenue assessments. That's the fundamental base point from our way of thinking. So, you know, if you want to start – I'm not – as I said, I wasn't quite sure what you were trying to do with the cross benchmark. But if the idea is to try and depress differentials between states, I would say to you that there's already a lot of conservatism built into the spending side. There's no conservatisms built into the revenue side. So you would be basically deepening the asymmetry between the two sides and yielding an even more inequitable outcome.

MS CHESTER: So I guess the outliers driven by the revenue side and, if we move away from equalising to less than the highest, we deal with your first issue.

On the second issue, given the complexity including on the expenditure side and it's based on what states do, moving to an efficient cost bench mark – and indeed, I think we intimated this in our earlier report on natural disaster funding – would be, say with a lot of the health costs at the moment, we know what some efficient pricing – efficient costs are. So instead of saying, "Here's an average based on what states do", you can point to "Well, here's an efficient cost bench mark, so therefore we're going to say that that's how well inform the assessed expenditure side of the equation".

Anyway, we don't need to belabour the point today. It was just more I didn't understand the logic. Now I understand your asymmetry point which I think is sort of separate to where we're trying to go longer term on the efficient cost bench marks.

MR SCHERINI: Yes. Well, if you talking about using national health prices, national efficient health prices, I mean there is debate about how well those national efficient prices are capturing things like remoteness. It's a debate that we will have with the Grants Commission. But this is not a perfect – the national efficient prices for health aren't – that's not a perfect science at the moment. You know, if you look at the remoteness allowances in them, they're not particularly large and the question is why aren't they? You know, you have to look into all the data issues and all the econometrics and complex econometrics that's involved and stuff like that. It's pretty experimental stuff.

MS LAURIE: We can follow up some of that stuff here sort of.

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MR COURT: Yes.

MR SCHERINI: Yes.

MR COURT: I mean – and I mean - - -

MS LAURIE: But I'm just conscious of time, but if the – yes.

MS CHESTER: Yes. And we're only doing it from a broad looking perspective. We think if we deal with the taking pressure off on the outlier on the revenue side through changing the equalisation arrangements, it's then well what can we do in a future sense to reform the expenditure side so it's not as highly complex as it is today. Anyway, I think we've covered all the questions that we wanted to cover. But now that you've all had a chance, this is the – is there anything else that you wanted to say or any questions you have of us, she says bravely and perhaps foolishly?

MR COURT: I think just going back to your question around evidence of projects not going ahead, I mean the GST distribution doesn't assess each individual project itself. It's a broader assessment. There are many requests for expenditure that would help resource sector projects that come to government and can't be provided for a range of reasons including affordability. So I guess I just wanted to add that point to it as well. There would be mining companies like – say, a road that benefits their projects but not others. The government may not provide it in the time available due to affordability constraints. Obviously, the GST is one of those issues in the affordability.

MS CHESTER: Yes. Look, we appreciate it's very difficult to unbundle these things, like I think some of the tangible examples that you and the Treasurer gave about where people have lobbied you or you've taken into account in Cabinet discussions what would the implications be for the GST relativities, that's really helpful for us to get a handle on. I'm very conscious we've gone way over time, which means that this has been a very helpful session for us and we do appreciate it's been a frank exchange this morning. So we thank you very much.

MR WYATT: Thank you. Good luck.

MR WATSON: Thank you.

MR COPPEL: Thank you.

MS CHESTER: Thank you.

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MR WYATT: Thank you. Much appreciated. All the best with the other states. Lucky you.

MS CHESTER: We're getting fitted up with the asbestos suits now. See you. Okay, folks, we might resume.

MR REDMAN: Morning, Jonathan. Terry Redman to see you.

MS CHESTER: Hey, Terry, nice to meet you. Thanks for coming.

MR COPPEL: Yes.

MS CHESTER: Have you got someone – no, it's just you this morning, Terry?

MR REDMAN: Yes.

MS CHESTER: Yes, cool.

MR REDMAN: I'm not (indistinct).

MS CHESTER: Okay. No, no, that's all good. Take a seat. Make yourself comfortable and grab yourself a drink.

MR REDMAN: Bear in mind, I haven't got the benefit of a big stack of Treasury people sitting behind me.

MS CHESTER: And don't take it personally that half the room has vacated, because we never do.

MR REDMAN: No, no. They'll be chasing the Treasurer. Yes.

MS CHESTER: All righty, folks. Well, we'll get back under way and I'd like to welcome the Parliamentary National Party of Western Australia represented by Terry Redman. Terry, if you could – thank you, and welcome. If you could just state your name and who you represent, just for the purposes of the transcript recording, and then if you'd like to make some brief opening remarks and then we'll get underway.

MR REDMAN: Thank you. Terry Redman, Member for Warren-Blackwood, Treasury spokesman for the Parliamentary National Party, Western Australia.

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MS CHESTER: Thank you. Would you like to make some opening remarks?

MR REDMAN: Yes. Thanks very much. Thanks for the opportunity to present. Can I acknowledge the traditional owners, the Noongar people, and pay my respects to their elders past and present?

Obviously five minutes is not very long to go through a number of things, and hopefully a number of these points will get teased out. But I think it's fair to note that if you look at the National Party history, Tony Crook took a stance in 2010, sorry 2011, when he was the Member of O'Connor and put a motion in Parliament, Federal Parliament to have a 75 per cent floor. Of course, everyone's sitting on one side and Tony Crook and Bob Katter on the other.

I guess, I'm making the point in saying that not to necessarily pump up National Party views but to say that this issue has been around for a long time and I think the discussions you had earlier on with the Treasurer highlight some of the complexities with that.

We argue very strongly that WA is a very unique jurisdiction, a very centralised population, some two million people in Perth and 600,000 outside of Perth. If you include the sort of populated bit down to the south of Perth, it even gets worse than that. Large distances, remoteness, huge challenge, a big remote Aboriginal population, some 274 remote communities in Western Australia. A low, relatively low populations compared to the rest of the nation, therefore any economic shocks are much more pronounced in terms of having to cater for that shift.

Of course, we are heavily dependent upon the resource sector and the volatility around that, particularly the movement from construction through to production in the resource sector, more volatile in the oil and gas sector, which I'm told is something like 13 to 1 in terms of personnel. And some 6 to 1 in the iron ore sector.

Of course, with those issues, those unique issues for Western Australia, when you have a boom like we've had, there's a pretty significant cost to the state in managing that. Population growth and all the demand drivers that come from that. We've run the commentary in the past that since 2008 Western Australia has had nearly an increase of the population of Tasmania. In percentage terms, that's pretty substantial. Therefore the challenges of our smaller population compared to other states make it difficult.

Public services costs are in competition with the resources sector. At one stage, we were the highest paying state in terms of paying nurses, police

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and teachers. Housing issues, particularly in the regions. The Perth hotel market, much more expensive on the – during the week than it was on the weekends, for example. It tells you how many people are flying in to use that service. Of course, the pretty significant impact on regional centres. The Pilbara Region, interestingly going to the point of how important this is to the nation, pretty soon they'll be responsible for 40 per cent of the nation's exports, only got a population of something like 40,000 people.

We have had, in the previous government – I was a part of that, I was a Minister for eight and a-half years in that – a pretty solid regional development agenda. The Royalties for Regions Program was a part of that, and pretty significant investments in that Royalties for Regions Program to a response to the challenges of facilitating what was happening in the resources sector, including other areas of trying to diversify the economy and essential issues like even down to mobile phone service, for example, which fundamentally is a Federal issue but nevertheless was covered by the state.

Over that time the state's net debt grew from about 3 billion to 33 billion. Interestingly, we were running commentary with the Treasurer about sort of signals that show the distinction between services of other states. So I would argue that there's pretty substantial debt funding having gone on in Western Australia to maintain the level of services and support the investment to sustain the resource sector growth at that point. It'd be interesting to see how the state would cater for a similar boom if it was to be triggered now in the context of our current budgetary settings as distinct from where the state was back in 2008 and 9.

The challenge for government, and we're in the similar situation as the current government, in the absence of GST reform, you've only got a number of – a couple of areas you can focus on. Obviously cutting costs, you know, that will be criticism that other states might level on Western Australia. I would argue there's a range of reasons why, although we tackled that and pushed the public sector pretty hard, there are a number of sort of unique issues to WA that made that challenging.

Chasing new revenue sources, so trying to find a revenue source that didn't have a flow on impact to GST and hence your targets become the people. You're raising power and water charges, you know, so household costs. The Water Corporation, one of the GTEs now, has got a net accrual to government of some $400 million a year, which is the highest it's ever been. So the government chases those as sort of own source revenues from – you know by increasing charges and getting more efficient in some of those areas.

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Payroll tax, less impact on the GST clawback, so payroll tax becomes a target. A pretty inefficient tax and not a tax that every – pretty much uniform across government and opposition is the notion of don't like payroll tax. If we can find a way to reform that, that'd be a good thing. But it's clearly a target in this environment. The corporate sector, the Treasurer talked about the challenges of the gold tax. The iron ore, as a source of payroll and I'll come back to that in a second. Of course, the oil and gas sector which largely goes to the Federal Government, despite Western Australia having to wear the costs of sustaining and supporting those developments.

The Nationals took a position to the last election of looking for a new revenue source and considered this special lease rental charge which was in legacy State Agreements that were drafted up in 1964 for – in this case for Rio Tinto and BHP. There's a charge of two shillings and six pence a tonne, which was there that – for the best that we can understand, it was there to pay for nurses and teachers and police to support those regional areas where this development was happening. There was a grace period of 15 years and then it started to be paid. Now it's 25 cents a tonne. That number hasn't changed, effectively, for 50 years.

We looked at increasing that to $5. The wisdom I believe at the time, it wasn't me, which would've raised $7.2 billion across the forward estimates, before of course the flow on impact of the GST clawback. So you would've had this sugar hit, if you like, of revenue which would've been a short term measure. We chose to try and offset payroll tax. A pretty significant concession in payroll tax. I guess I make the point that here's a policy challenge of trying to reduce the impact of a tax that's pretty negative, it's choosing to get another source from a sector that, in our view, could afford to pay some more. Yet, with the GST issues that flow over that in time, you're not able to achieve that. The campaign was run pretty solidly against us, "so 90 per cent of that gets clawed back".

It's interesting to see the ambiguity that sits in the Grants Commission's policies on this. Old State Agreements, you have a number of things that sit in there. Obviously, royalty is one of those, the special lease rental is another, and legacy – sorry, long term value adding commitments to build steel mills for example. If we change the royalty it affects the GST. If we change the special lease rental it affects the GST in the same way as the royalty.

I don't know why something that was put in place to fund teachers and nurses to support the growth of those industries should have a clawback in terms of the GST distribution in time. Even if we were to cash that out, three to four billion dollars in a one off cash out, if you sort of take it out

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over a very long term, you can get a sugar hit of that up front, but ultimately it does get impacted by GST.

Another question to ask is if, as the Treasurer said before, if you chose not to have a royalty and chose to take an infrastructure fund for example, how's that applied in the Commonwealth Grants Commission? Is there a balance between the two where you can support common use infrastructure as well as supporting the resources sector?

Also, if you were to cash out a commitment that those companies made when they signed those State Agreements to effectively build steel mills, if you were to cash that out with a one-off payment in either another infrastructure investment, which has happened in the state, some water infrastructure that Rio Tinto paid for to help supply Karratha plus their own use, a couple of hundred million dollars cashed out some of their long term commitments. How's that treated? So you've got ambiguity in terms of the treatment of a number of elements that sit in these old State Agreements. That was a challenge for our policy settings as well as trying to play that out politically.

Our recommendations that come through here are working towards a partial equalisation. I don't think anyone dismisses the fact that we're not necessarily looking for equal, but we're looking for a better deal than what we have right now in terms of our payment in relative terms of GST. We think there should be some immediate signals. We'd like to see a floor put in place early, as blunt as that might be, and even if that was temporary to cater for transition. Of course, increasing policy neutrality as suggested by the Commonwealth Grants Commission.

In terms of practical outcomes, any adjustment needs to have an impact in the billions, not millions for Western Australia. That's how significant the issue is for the state. A long term fix avoiding some unintended consequences. Obviously, the Commission needs to have an eye to the politics of this, and that was your last discussion with the Treasurer. It'll be the same with us. You've got that challenge of how you put something on the table that has got practical opportunities. As in that Tony Crook vote a number of years ago, there's not the political will necessarily to land something that impacts politically on other states, so therefore there has to be something that manages the sensitivity around that.

I would argue that you need to also resist calls that exempting royalty revenue will push states to increase royalties. States should be able to have the right to consider all options on the table if it wants to have any sort of reform in terms of how it takes on its own source revenues. Of course, something that has an incentive both to invest in development, but also an

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incentive to move towards tax reform as a strategy to improve the taxation arrangements in Western Australia.

I don't think you will see significant differences between the three parties, the Liberals, the Nationals and Labor Party on the GST front. Whilst my presentation here might not be as eloquent as having the Treasury people behind it, it comes from the point of view of being, sitting around the Cabinet table for eight and a-half years and Nationals looking at options to cater for what is front and centre for us, and that's regional Western Australia and the growth and development of that part of Western Australia. Thank you.

MS CHESTER: No, thank you, Terry. They were very helpful, insightful, and tangible opening remarks in terms of examples that you've seen. Maybe if we go to one of the first examples, and the contemporary one that you've spoke about, so this idea of changing the special lease rental and doing a switch with payroll tax in terms of a tax reform change that's being considered. You might've been here earlier on when we talked about the CGC methodology review and their recent report that suggested – has put on the table, the idea of where there is an increase in royalty rates – and I'm assuming that this would be construed as such, if not tell me so – 50 per cent of the increase would be captured by the State Government.

So I guess coming back to the question that I posed a little earlier to the Western Australian Government and the Treasurer was, if we were to move towards equalising to less than the highest state, whether that be equalising to the second highest or equalising to the average combined with the GCG proposal for the 50 per cent retention of any increase in royalty rates, are there any existing elements of the HFE arrangements that you see from the experience that you've had over that decade of material disincentives remaining imbedded in the government system with respect to HFE?

MR REDMAN: I would agree strongly with the Treasurer about the assessment of remoteness in Western Australia. I think that's significantly understated, and the challenge in and around that is understated. In fact, added to remoteness is that some of the most disadvantaged people in Western Australia reside in those remote areas. So therefore you add the complexity of the challenge of supporting that. A 50 per cent concession, I think, on the new revenue was what was pushed. I don't know how quickly. I can't predict how quickly that would come back. Treasury would need to run the numbers around that.

But I know that the current government runs a $3 billion deficit now, predicting they'll, hopefully, get into surplus in the fourth year. We had about three budgets that looked exactly like that and every time we came

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back with those budgets, the GST was rebased, both on our – on the Treasury's incapacity to accurately assess what that might be, but also on rebasing on population as we got into the most recent years. Every time it came back there was this population rebase which kept the relativities low. So the return of GST was just pushed out. Very, very difficult. So I'd be looking for all measures to be in place to support the broader based challenge. In fact, I've been – we've been slightly more aggressive in suggesting a floor would be a very early signal to help in that regard.

MS CHESTER: I guess we see transitioning to, whether it be equalising to the highest or the second highest state is effectively a dynamic floor over time. Indeed, if you look at some of the numbers that we put in our draft report, if we'd been living in a world of ETA or equalising to the second highest state, WA's relativities wouldn't have fallen below 87 cents for the former and, I think, 79 or 80 cents for the latter. So there is that element of the dynamic floor. So before we get to transition path, are there any other elements of our draft report, Terry, that you wanted to give us any feedback on?

MR REDMAN: To me, the challenge is that I'm not sure it matters what you put down in your report. The political challenge will be a massive one and I'm not sure it will give either the current Prime Minister or, if indeed it's Bill Shorten after the next Federal election, the cover necessarily to take that forward. So there's going to have to be a political will there. Whether Western Australia carries the political weight to achieve that or not, I don't know.

So therefore, I do make the point of having an eye for something that sort of helps transition, even if it's extra revenue. We're going to talk about that in a second, I guess. But I think that's almost the most important piece of this, as distinct from what the elements are that's there. It needs to be something that recognises Western Australia to the tune of billions rather than millions. That's pretty much the collective assessment of the challenge that Western Australia has to try and meet its service needs. If we were to respond to a significant resource sector shock right now, I don't think the state could do it.

MS CHESTER: I guess that opens up the issue of the CGC methodology review as on a slower boat shall we say, (inaudible) the 2020 methodology review, to the extent that there could be changes that they think have merit, delaying that to 2020, in effect, exacerbates the starting point that we have with the relativity band at the moment. So that might be something we might need to get some more guidance from the WA Government on. If there were to be a move earlier to some of those proposals that the CGC's

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suggesting that could have an impact, thus allowing a slower transition path, because it'll take some pressure off.

MR REDMAN: I wouldn't have thought there's anyone in Western Australia that wouldn't support an aggressive transition, but that butts heads with the political realities of trying to get a shift that's actually long term and real for Western Australia. So I think there's a trade off on that front.

MS CHESTER: I guess what I'm just thinking out loud here now is that to the extent that the methodology review may have what I call pressure release valves in them, waiting until 2020 for them to come into play is an awfully long time. So that's an overlay to any transition path around changing how we do HFE today in a more architectural sense. So you prompted a good thought, so we'll circle back to WA Government on that one.

In terms of the transition path itself, I guess the overarching principle for WA is sooner rather than later. But you've rightly pointed out, we have to be feasible about, effectively, arrangements that are going to be acceptable to other states and territories or something that the Treasurer feels that he could take to other states and territories. I don't know if you've had a chance to look at what was proposed by the WA State Government in their submission to us?

MR REDMAN: Not in detail, no.

MS CHESTER: Okay.

MR REDMAN: No. I think, you know, the Treasurer made some remarks and I guess ours, with the exception of some sort of early signal with the GST floor, would be - would carry weight on our front. The Federal Government - these were considered and putting in some - you know, some kick-in payments if you like, so actually funding - helping fund the transition would be a pretty good strategy. It's only temporary. You know the scale of that becomes a challenge, and some sort of glide path to get to the longer term structural changes would obviously suit.

Having some sort of exemptions on – you know, we considered our special lease rental as to seeking the Federal Government's exemption from any new resource. So whether it's new volume or new mines, whatever it might be, get some exemption from this point. So the pool, effectively, is the same and hopefully another state's not disadvantaged from this point forward. Having some exemptions in there for the short term, I think it's described as "discounts" in some of the commentary that's come through in the reports.

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One of the discussion points that I had with the Treasurer across the chamber, not necessarily Nationals position, but it was interesting discussion to say that if you sought to cash out the special lease rental, for example, this historic charge that was there to fund teachers and nurses 50 years ago, which you could say is a piece of history that doesn't apply now. If you sought to have that bit exempted from consideration in the ongoing Grants Commission process, I think it only draws a couple of million – a couple of hundred million dollars a year, so it's not significant in terms of the significant pool of GST funds.

There might be some special arrangements like that, that might assist and give some incentive to Western Australia considering those options. The Treasurer was open to that in discussions across the floor. It's not necessarily a policy position from our party, but those are the sort of things that, you know, might have to be considered that are slightly outside the box in helping with the transition arrangements.

MS CHESTER: Yes. I guess, where we landed in our draft report on sort of – those sort of ad hoc exemptions is not an ideal path from our perspective, because it does then call into account what's in and out, infrastructure grants out of cycle by – the whole political pressure within the HFE system, because it effectively means you've got two relativities. You've got the relativities that the CGC thinks are being followed, the nominal relativities, and then there's the effective relativities through these other ad hoc arrangements or infrastructure grants from Commonwealth to states.

So I guess we're kind of looking at it from the perspective of the CGC feels that there's a change from the policy neutrality or a policy disincentive perspective, like the 50 per cent discount on the royalty rate increases, bringing forward the timing of that might be a pressure valve as opposed to another special deal, for want of a better description.

MR REDMAN: You know this issue of managing transition is probably the biggest and most central issue in this. How open is the Commission to put up some options like that, albeit not – it doesn't make the niceties of the sort of economic assessment, but they are blunt enough to manage or help in that pathway, as long as they're defined and very clear, and maybe even have some boundaries around it and temporary in nature? You're probably going to have some of those choices, or the governments will be looking for some of those choices.

MS CHESTER: Yes. So I think consistent with our Terms of Reference, and indeed commentary that our Treasurer has said publicly, that our final

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report will try to address a transition path and indeed it's a large part of the focus of our post-draft report consultation and public hearings and we had a couple of questions around that in our draft report. Indeed, the Commission over the last sort of three to four years has spent a lot more time and energy between draft and final report helping government with transition paths for major policy changes. So that is something that we will be looking at focussing on.

I guess there's two strands to what we need to kind of finalise our thinking around and our evidence base. One is what's a reasonable and principles-based transition path? Secondly, the evidence gaps that we still struggle with, and you might've picked up on this earlier, where we can point to examples of where policy decisions were taken or not taken, when it comes to royalty rates or revenue changes at the State Government, or where they were influenced at the margin because of what the implications would be for GST relativity.

I get a sense from your comments this morning, Terry, that you might be able to share some examples with us, not right here and now, but perhaps following today's public hearings if you could provide us with any other examples that you've been aware of or know of that would help us fill out that part. Because I guess from our perspective, the big question to ask and answer was what's the economic impact of HFE on the Australian economy? This world of disincentives was where we kind of landed. We've got some cameos and we've got some examples but it's limited. For us to get a better sense of the breadth of that impact, would be really helpful.

MR COPPEL: You mentioned the - - -

MR REDMAN: If I can just make one comment? You know, we put a fair bit of effort into looking at State Agreements, and the Treasurer made the comment about the investment signals that would issue if you were to go and break those – largely seen as contracts. We are less sensitised to that as an issue, given that they've been in place for 50 years. So if these same State Agreements are in place in 100 years, at what point do we see any sort of depletion of the settings that were drafted up in a very different environment to what we have here in Western Australian now?

One of the things that changed, and there are points of influence a government can have when either they're extended or renewed or tender arrangements or requests come from the companies, mostly from the companies to change it for a range of reasons, and one of the rules that changed back in the mid-90s – I think, the previous Premier was around the table at the time point – so rather than say if BHP doesn't, you know, build

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a steel mill then they're going to shut the whole BHP industry down, they had to go away and find someone else that might want to mine it.

Can you imagine that pressure that is on a Minister and/or a government to make a call like that. They looked at putting a cap on the amount of iron ore. So, "You cannot go past this particular cap, it's embedded in some agreements, unless you seek support from the Government". So even then, you know, the pressure on governments to consider or look at one of the - you know, the two most significant companies in Western Australia being BHP and Rio Tinto to have a look at that as options and choices, you know, for considering new revenue sources for the state irrespective of the GST outcome, is very, very difficult. But we believe one of the things that needs to be in play, and I guess the GST doesn't help the cause.

So there's certainly decisions, one based on the impact and threat that comes from the companies if you don't support a particular path. The second is the GST implications. So inherently, there are decisions that happen as a consequence of where we sit financially, and the GST implications of some of those decisions in particular.

MR COPPEL: I've got one very specific point that you mentioned about the lease rental and the original purpose was to fund teachers and nurses. If you can subsequently provide us a bit more information on whether that revenue was actually set aside specifically for that purpose, I think that's sort of an interesting example. It doesn't have to be now, but if you can point us - - -

MR REDMAN: Yes. Now. We've actually struggled to find a lot of information, including going back and reading Hansard of when this stuff was introduced. Very, very difficult and very little commentary on it. That's the best we can come up with. A lot of it's anecdotal talking to people. It's not necessarily written there, but it was, nevertheless a challenge that was there. In the 90s it was put into the Mining Act, so it applies to mining companies that have been mining iron ore for 15 years. So the only ones that pay it now are BHP, Rio Tinto and, I think, Cliffs. FMG starts to pay it in 2023. I don't think it should be in the Mining Act. I don't think it should be a charge that's relevant today, for the reasons that we understand it was there before.

I think at one stage, the Treasurer sought advice and, from memory, it was the Bureau of Statistics, which sounds a bit unusual, who - you might correct me if I'm wrong there, to assess who makes the judgment of whether that's a relevant revenue as it applies to GST. It was deemed that it was. We sought to have that assessed, from memory. I wasn't playing a direct role here, the previous Treasurer was – sought to have that assessed to see

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if it, perhaps, should've been exempted for the reasons that you just described. If that's the reasons why it was put in place, well why the hell should that apply to recalibrating the GST 50 years later?

MR COPPEL: Okay. The second point I wanted to make is the options that you characterise as facilitating in the transition of a relativity floor or discounting, they amount to effectively equalising to something less than the strongest state. So the option that we consider in our report, or one of the options, is equalising to the average. They don't inform a transition. What they do is underscore that in this system that we have, any change that moves away from the status quo will have winners and losers. The manner in which to demonstrate how to make that transition is also to be compelling in terms of what would be the benefits of that? One of them is this sense of the system being unfair. The other is the policy incentives. I think, the point that you made about how it can bear on the choice of the tax mix.

But apart from that, it's an incredibly difficult case to make because, just by definition, you're going to have winners and losers. So my question to you is, if you were in the position of trying to justify this to one of the smaller or fiscally weaker states that don't necessarily have resources, what arguments would you use to convince them that it's also in their interest?

MR REDMAN: I think it's relevant. Although it's interesting, it's another point that was made by the Treasurer. It's relevant that Western Australia has moved from a position of having $3 billion net debt to $33 billion, or predicted $33 billion at the end of the last financial year, that there's been a lot of debt funding in order to manage the maintenance of state services and/or support for the growth or the period of boom that happened.

The challenge for government is it needs to keep paying public servants to stay in front of kids and in hospitals, otherwise they're going to finish up driving trucks in the mining sector. The government has always got a challenge of trying to wind back from that resource – sorry, the private sector can do that very efficiently and very quickly. The government has a challenge of managing that over time, including the cost of redundancies, and that's what both the last government and this government has on the table. I still think it's been why it's got the challenge of taking out 3000 public servants. That'll be a massive challenge to sort of adjust it. So I think those are very real things that you do that you see that give a measure of that.

The remoteness factors and, as I say, the lack of – you know Ben made the point that I think the Hon Alannah MacTiernan wrote an article in The West Australian some years back when she was a Federal member about that remoteness factor running out after 800 kilometres or whatever the

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distance is, comparing that to Tasmania and other states. So I think there are some clear points that can be pointed to in terms of Western Australia's situation. I guess, if there's a lack of data then let's provide the data or find the data.

I think, the thing that stood out to me was comparing Queensland to Western Australia. I think the last financial year, I might have the numbers slightly wrong, but I think we were getting $2 billion a year in GST with a relativity of 34 cents or something. Queensland was getting $13 billion, a relativity of $1.12 or thereabouts. So there's a state that doesn't quite have the same – double our population. You know, it's got a level of resource sector up there. But that to me is just in stark contrast. As was highlighted by the Treasurer, the North West Shelf development, which we support and sustain and invest in communities to keep that sort of stuff happening and not getting a skerrick for it.

MS CHESTER: So there isn't, maybe, a fourth outlier at times which takes Queensland into the net recipient quadrant and that's natural disasters. What we've seen in the last two budgets is - - -

MR REDMAN: We chipped into a levy one time, I recall, to help with that.

MS CHESTER: Yes. Rewind the clock three or four years and there was just back to back natural disasters in Queensland. But anyway that's an outlier that we're not going to go to. Jonathan and I have had the joy of an inquiry on that one already. I didn't have any other questions, did you?

MR COPPEL: Well, we've got questions that we've been posing to a number of participants, but they're all really focussing on what we need to grapple with, moving from the draft report to the final report, which is this issue of transition. I would make one point that I'd like to get your feedback on, because it's been made several times that WA has received an increase in population in the order of half a million. One of the impacts that's been attributed to HFE, or that you don't want HFE to contribute to, is migration from one jurisdiction to another induced by the stronger level of services or tax competition.

So our conclusion is that we didn't find any evidence that the HFE system distorted that migration decision. If anything, it's seen as a positive. There's been a boom in the WA that led to an influx of workers. That construction phase is winding down, and we've seen an opposite flow. I was wondering if you have any reaction to that conclusion?

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MR REDMAN: I'm in no position to point to anything that suggests that there's any impact on people shifting around states as a product of the different level of servicing. I just know that the impact of a period of time in Western Australia was massive, which flowed – which rippled right down through the supply chain. It wasn't just, you know, mining towns or mining companies or Perth. People who worked in the hospitality area just couldn't get staff. Farmers couldn't get staff to drive machinery. You know there was massive flow on impacts to the tourism sector. You know the price of rents up in Karratha were $3000 a week. There was a massive short supply of land. We had to invest in getting the pipeline of land availability happening to support that.

Of course, this stuff comes at a peak and it turns off really quickly, and you've still got all this stuff in train which you've either got to put a halt on or wind back, or have something that sort of addresses the more longer term challenges. We made some pretty big investments in regional Western Australia, which we don't back away from at all, in an attempt to try and get more people living in areas that are impacted and where those jobs are up there, to get a more de-centralist focus. Don't retreat from that either.

Some people criticise that as being one of the causes of our net debt. I don't agree with that at all. The National Party would certainly contest that, that it was important that we do have proactive de-centralist policy in Western Australia and that goes on for a number of terms of government.

MS CHESTER: Well, look, Terry, thanks very much for appearing and for providing us with your earlier submission. If we could take you up on your kind offer or if you can provide us with any examples of where you know how the HFE arrangements have impacted on those sorts of decisions.

MR REDMAN: Yes.

MS CHESTER: And the more recent one that you talked about with the lease arrangements, that would be much appreciated.

MR REDMAN: Thank you.

MS CHESTER: Thank you very much for appearing today.

MR COPPEL: Thank you.

MS CHESTER: Okay, folks, we're going to take a little five minute break to stretch legs and do whatever else people feel like doing. So we'll resume at 10.30. Thank you.

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ADJOURNED **[10.24 am]**

RESUMED **[10.30 am]**

MS CHESTER: Okay, folks. We might resume. Our next participant joining us is Damien Kelly, individual.

MR KELLY: Yes.

MS CHESTER: Representing himself. So Damien, thank you for joining us. Just for the purposes of the transcript, if you could just state your name. If you'd like to make some brief opening remarks, that'd be helpful.

MR KELLY: Yes. Thank you, Commissioners. Damien Kelly, that's my name. Okay. The GST cover is merely the tip of the iceberg when it comes to Horizontal Fiscal Equalisation. Historically, it's about 10 to 15 per cent of the total on actual transfers from WA to other states. Each year, the WA Treasury estimates the net redistribution across each state that occurs through Commonwealth revenue raising and spending. The data shows that the Federal Government consistently extracts far more revenues from Western Australia than it's spending in or for the benefit of Western Australia.

In FY16 there was about $54 billion in Federal revenues derived from Western Australia versus $32 billion in outlays. The $22 billion difference is, effectively, a subsidy to other states. That's in one year. It works out to about $8500 per capita and about $16,000 per paid worker. Over the last decade it amounts to a total of 170 billion and over 115 billion of that in the last five years alone. To put it into perspective, New South Wales and Victoria contributed $4.6 billion and $1.3 billion respectively in FY16. It works out to about $600 per capita in New South Wales and $200 in Victoria. The Northern Territory on the other hand received about $19,000 per capita. So for a family of five, that's basically almost $100,00 free kick, and that's in one year.

The burden on WA has been relentless and it's been going on for at least 30 years. It isn't limited to just mining booms and strong commodity prices, it includes major commodities downturns in this period. If you look at chart 3 – sorry, chart – the chart on the first page of my submission, the data – it's basically got the, Western Australia's net fiscal subsidy to other states in the blue bars, and the index of commodity prices being the red line. That's the RBA index of the commodity prices, and it's indexed – sorry,

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it's – these figures are also adjusted for inflation over the past 30 years. I'll come back to the chart later.

It brings me to my next point which is page 3 of the draft report. There's a couple of paragraphs in there. One says, "A key factor behind this", that's Western Australia's share of the GST, "falling to an unprecedented low, has been the recent mining boom which had a particularly strong impact on Western Australia's revenue raising capacity. This saw Western Australia's relativity start falling from the middle of last decade". Firstly, the mining boom is over. It's unlikely to enter any new sustained boom for many years, perhaps decades. Even in 2021, WA's GST relativity is only expected to be 62 per cent. So on GST alone, we still lose almost 40 per cent of it in 2021, well into this next downturn.

But on a much wider scale – measure of Horizontal Fiscal Equalisation, that is the effective financial transfers between states that result from overall Federal Government expenditures and revenues, the story is far more compelling. Even during the last commodities downturn, WA was consistently one of the largest net – one of the largest net contributors on a per capita basis, and we were never a subsidy recipient in the last 30 years. So that's in the red period there, the last red period.

Even in FY – in 2003, 2004, after 15 years of sustained low commodity prices, we were still the largest contributor or subsidiser of other states and we were easily the largest – we were still the largest on a per capita basis. We never were a recipient during that period and we were about double New South Wales on a per capita basis, and they were the next largest contributor.

The FY16 figures that I mentioned before are in the next commodities downturn, which we pretty much just started, there doesn't seem to be any chance of symmetry in the decades ahead. In other words, you know, actually – a bit of give or take coming back this way. It almost seems, you know, little chance of even an annual balance in that time. So clearly, it's driven by much more than mining cycles and commodity cycles and it's unsustainable. Unsustainable systems eventually break down one way or the other.

So, essentially, all I'm saying is the draft report does not consider the effective financial transfers between the states that result from overall Federal Government expenditures and revenues, and it also gives the somewhat misleading impression that Western Australia has been an overall net beneficiary of Horizontal Fiscal Equalisation until the middle of last decade, which is not the case.

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So I ask that you acknowledge this in your report, especially the key points, and either complete or recommend the completion of further robust studies quantifying the financial transfers to and from each state, looking back further in time and decades forward. They are currently unaccounted for, yet arguably more comprehensive and correct measures of the effects of Horizontal Fiscal Equalisation. So I guess the point is, when it comes to Horizontal Fiscal Equalisation, GST is only the tip of the iceberg. Thank you. Cheers.

MS CHESTER: Thanks very much, Damien. We might just start with your closing remark about HFE as it relates to the GST pool being distributed across states and territories as only being part of the equation of Horizontal Fiscal Equalisation. Indeed, it's something that we go to length to point out in our report and contextualise it in terms of there are many other transfer payments made from the Commonwealth Government to states and territories beyond what's relevant for the HFE. Indeed the assessed budgets that the Commonwealth Grants Commission does is only a percentage of expenses and revenue. So you're right, it's not the whole story and, indeed, we go to some lengths in our report to contextualise it.

Turning to the, I think, the key point in your submission too, as in I take it these numbers are numbers that have been developed by the WA Government with respect to net overall fiscal transfers, state, Commonwealth.

MR KELLY: State to state by the Commonwealth, yes.

MS CHESTER: Yes.

MR KELLY: Yes.

MS CHESTER: Because I know that some of these numbers don't exist, so therefore the WA Government must've imputed some of them, for example, we don't know how much GST is really raised from the citizens with both feet planted behind WA's borders.

MR KELLY: Yes.

MS CHESTER: So these aren't sort of Commonwealth Treasury numbers, these are numbers that have been imputed by the State Government, just so people understand the status.

MR KELLY: Yes.

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MS CHESTER: What would be interesting to know, and it comes to the point of part of the reason – one way of viewing revenue is what's derived of effort of the people of a state versus what's a windfall. To some extent people, economists, may argue that what's under the ground, oil and gas in the waters off shore, are a windfall to the people of that state, albeit we do recognise, as does the CGC, that there's effort and endeavour that's required and costs involved in mining and extracting those mineral and energy sources. So when we look at your net fiscal transfer story, Damien, what would those numbers look like if you were to take out oil and gas revenues and mineral based royalties?

MR KELLY: I couldn't say because I haven't got the detail and those figures. The publicly available WA Treasury figures – wasn't published. So there is a – in the budget some light – sorry, in the budget papers, some light that's shed on that. Where are we? So the actual sole amount for oil and gas revenues, no, but there is – there's taxes and royalties on mineral/petroleum extraction. There's a line on that one. So I guess in the whole scheme of things therefore, so the FY15/16 that was $567 million is the estimate. Yes.

MS CHESTER: Yes. It's okay, you don't have to answer. It's not a spot question.

MR KELLY: Yes.

MS CHESTER: It's not a spot test. But it's more making the point that, to some extent, that story – those numbers would look quite different if you were to take out what are sort of oil and gas royalties off shore and mining royalties, to the extent that some may construe that they are a sort of a windfall gain to the state, albeit the costs of actually bringing them to the surface and exporting them are borne and recognised in the CGC calculations.

MR KELLY: Yes. Can I just, just on – I mean, just on that point, I mean, certainly by these figures even if you assume the whole lot, you know the $567 million, it's actually half a billion dollars out of $22 billion. So it's not that great a number. In years gone back, like '13, '14, when prices were a lot higher, the number here is like $1.6 billion. So then it did have more of an effect. But then, you know, back then the numbers were also $26 billion going to other states as well. I guess I just make that point so, yes.

MS CHESTER: Yes. I mean, just looking at it intuitively given where the bars go during the period of commodity prices, it would make sense that a lot of that bar is accounted for by commodity based royalties and revenues. Anyway, it was just - - -

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MR KELLY: Somewhat, yes.

MS CHESTER: Yes. We can ask the WA Government if they've cut the numbers that way.

MR KELLY: Yes. Sorry, that was my other point, yes. I guess that's the whole point of saying we need more robust studies to actually shine light on all this as well so, yes.

MS CHESTER: So I guess our report did say that there is Horizontal Fiscal Equalisation and some indeed describe it as the glue of our fiscal federation. Do you agree that we should have some form of Horizontal Fiscal Equalisation in Australia and if so what form should it take?

MR KELLY: Some form, yes, but not - what we've got here is almost you know Horizontal Fiscal Marxism really, you know it's bringing everyone to absolutely equal. I mean, just the disincentive effects on that for anything - you know whether you can actually point to – cite specific individual examples is one thing, but you know just the bringing – making everyone absolutely perfect and equal, I don't think – morally, I don't think it's the right thing to do to have perfect equality in that sense, because then it takes away any incentive for individual, in this case, state endeavour as well.

You know, I think it's a – in a nation, it's a worthwhile objective. But when it comes to GST redistribution for example, you know there's already other Horizontal Fiscal Equalisation that goes on, like I mentioned with these other figures. I don't think it should be necessarily taking it from one state to pay for another, you know directly from one state's budget and one state's budget to pay for another state's budget. Say, you know, coming out of consolidated revenue or the Federal Government, just the general budget is one thing, but the disincentive effects that it has, certainly on the state which is providing the subsidy is – it then becomes great and at the forefront of the minds of those making the decisions, like just - not just at the business level but also a state level.

There was a gold royalty debate that was – happened just recently in Western Australia. I'm guessing you're probably aware of that. But one of the major factors behind its ultimate defeat was the fact that it's a short term sugar hit, but eventually more than half of the benefit of the additional royalty is going to go to other states. So where the cost is borne in Western Australia, but the benefit of that – the long term benefit of that royalty, you know more than half of it goes to – directly to other states. It's a disincentive, so.

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MS CHESTER: But I guess if you were to take the logic of what you're presenting, all Commonwealth consolidated revenue is effectively attributable to the endeavour or activity of individuals or an activity in a particular state or territory.

MR KELLY: Yes.

MS CHESTER: Which I think probably takes us into the direction of future Commonwealth, State, Federal financial relations, which is another recommendation in our draft report about the whole vertical fiscal imbalance issue.

MR KELLY: Absolutely.

MS CHESTER: So I think well, your submission is heading more in that direction, so what do - - -

MR KELLY: I think addressing vertical fiscal imbalance would help to addressing the issue of horizontal fiscal imbalance in - you know in the context of these overall revenues. It was touted having a state based income tax at one point you know, provided the Federal Government makes space to remove – to reduce tax itself. That is a notable objective, and that would go some way to addressing this.

Also I noticed in your draft paper but also there was an appendix or an analysis about accountability in the Federation in the – that was released at the same time as the draft report. It promotes accountability. I guess just from a basic corporate governance management function, accountability and making one responsible for one's own actions and both the risks and rewards of that is – yes, on average it tends to produce better outcomes so, yes.

MS CHESTER: So then in terms of moving towards longer term, reforming a Commonwealth, State fiscal Federal relations and addressing VFI, what changes would you want to see in terms of tax and responsibilities, given I think not that long ago that there was an idea on the table including the recent Commission of Audit Paper of a couple of years ago of reverting to allowing some income taxing powers to revert to state and territory jurisdictions.

MR KELLY: I was disappointed when that was binned, basically. Those two recommendations were a step in the right direction. There was a green paper on the form of the Federation as well, that was produced which never made it to a white paper. Yes. But that Commission of Audit was particularly good in that respect I thought, so yes.

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Actually, just on the bit before about windfall as well, you mentioned about you know sort of what's in the ground essentially being a windfall or a – you know it's like a free kick. It was never part of the deal at Federation to actually – you know there was never any agreement or otherwise that those resources would belong to people in the other states. There was never any – and again this comes down to a basic governance issue and almost a contractual issue really. There was never anything, that I can see in the Constitution or in State, Federal Laws, Agreements or anything like that, that actually handed over those – the economic benefit of those directly and said, "Well, okay, this actually belongs to everyone, not to each state". You know, there was a Federation that came and this is the deal.

To me, to assume and say that, "Well, that doesn't really matter". That you know - that "The resources of Australia belong to all Australians", that changes the fundamental nature of that deal. Now that may be something that we agree to or whatever, but that's – to say that unilaterally without one side agreeing to it, I just think it lacks moral ethics so.

MS CHESTER: I think that's when you're signing up to a Federation, a fiscal Federation, that's what you're signing up for. But I'm not going to get into a - - -

MR KELLY: Yes, okay. Yes, yes.

MS CHESTER: I'm not a Constitutional expert and I won't stray into that territory.

MR KELLY: Yes, okay.

MS CHESTER: Jonathan, did you have any other - - -

MR COPPEL: You made the point that the mining boom is over.

MR KELLY: Yes.

MR COPPEL: Which, if you're just looking through the lens of HFE, you could then argue that the relativity that WA receives would continue to – would rise. So I'm wondering, in the context of that statement, whether you have any views of how WA relativity will evolve going forward?

MR KELLY: Well, like I said, even during the last commodities downturn, there was still – we were still the largest contributor on a per capita basis. So I imagine it will return to – the imbalance will be mitigated

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and become less imbalanced, but still nevertheless an imbalance and a significant one.

MR COPPEL: When you refer to the mining boom over, is it the construction phase to ramp up production? That obviously has to come to an end at some point or is it - - -

MR KELLY: That has come to an end, yes.

MR COPPEL: Are you arguing also that the production levels will fall from their current levels?

MR KELLY: I doubt production levels will fall significantly. No, no. I mean, certainly not - when it comes to high CapEx type projects, oil and gas, iron ore, whether production levels fall? I would be surprised if they fell significantly, particularly for the large producers that sit in the lower cost quarter. Higher producers at the margins, yes, there'll be some impact there and there already has been impact. But, yes, I'd say on the large producers there would be less impact on the actual production rates so.

MS CHESTER: So, Damien, obviously this is something, like many West Australians, that you feel quite passionately about. What sort of prompted you to, you know, actually put pen to paper or fingertips to keyboard and make a submission?

MR KELLY: Yes. I guess I've been looking at this data for years now, probably at least three, maybe four years, and it's just – it's something that I, yes, am obviously passionate about. I guess one of the things that got me thinking about, you know, putting pen to paper a bit more was a mate of mine who's from Perth but he lives in Melbourne now, came back last year and we were having a bit of a chat about you know "There's a mining boom". He's been to places like Dubai and other places around where they've had mining booms and you know you can see the effects of everywhere. There's infrastructure being built, you know you can feel the effects of it and you see it around. There was obviously some effect here but nothing like you would expect on that sort of scale.

My instinctive response, "When there's $20 billion plus going out of the state every year you know, that – what would otherwise be money to spend on those sorts of things just isn't there any more". So that, yes, I guess, made me think well most aren't really aware of these figures. They're not – they're hard to – like WA Treasury, they're in the WA Treasury figures. But they're not – you know there's a page and a-half of it, I think, is what it comes down to and there's not much of a publicity around it. I guess in that sense as well, when I see and hear things like –

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saying that WA has been – you know, we've been on the teat of the Federation only until the last you know 10 years or so and we're only whinging now because the GST isn't going away, I have those figures in the back of my head and then naturally talk, "Well, no actually it's been going on for 30 years".

Again on the point of a windfall, and you mentioned about – and I'm acknowledging you said there's some degree of effort and policy that goes into making sure that you know we create an environment that those resources can be extracted. But I mean things like with the North West Shelf, there was a major financial risk that was taken on by the State Government for example back in the 70s to secure a deal to actually get the North West Shelf built. At that stage they were only looking at domestic sales not exports.

The State Government had to enter into a substantial take or pay agreement with the developers at that stage, so that they could say, "Okay, yes, there is enough financial certainty here for us to invest the billions of dollars that's required to develop the North West Shelf". Had the State Government not assumed that risk and built the Dampier Gas Pipeline and things like that, we may not actually have that today or it might only just be sort of starting to ramp up now so. Yes.

MS CHESTER: Well, look we thank you for coming today and for being involved in our inquiry. Thank you.

MR KELLY: Thank you.

MS CHESTER: All right. Now we've got a little bit of time. I'm just conscious that our next participant's not here, although we're just checking on that. If that's the case, what we might do is, we normally wait till the end of our proceedings to see if there's anybody else that would like to be heard. I understand there might be one other person that would like to be heard this morning.

MR DAVIES: If possible, I'd like to be heard.

MS CHESTER: Yes. So if they're not ready, if it's okay, we might move to you. But if they are ready, we'll go to them and we'll come back to you. Is that all right?

MR DAVIES: That's fine.

MS CHESTER: All right. Cool. We'll give - - -

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UNIDENTIFIED SPEAKER: They're outside.

MS CHESTER: They are outside? They're being shy. It's very unlike the next participant. Okay.

MR COPPEL: Well, why don't we go ahead?

MS CHESTER: Why don't you come on up, we'll get started. We're not going to wait. If they're going to be shy - - -

MR DAVIES: I might be interrupted.

MS CHESTER: No.

MR COPPEL: No.

MS CHESTER: You can have five, 10 minutes, let's go. No. We're starting, Mary. Yes. Mary, we'll only be five. Yes. Hello.

MR DAVIES: I'll have more than five, to be honest.

MS CHESTER: Sorry?

MR DAVIES: I have to have more than five minutes, to be honest.

MS CHESTER: How long do you need?

MR DAVIES: Less than 10.

MS CHESTER: Less than 10?

MR DAVIES: Yes.

MS CHESTER: Okay. We might do a switcheroo then.

MR DAVIES: Okay.

MS CHESTER: Is that okay? If you'd like to do 10, we'll do a switcheroo. All right. So I'd like to welcome our next participant, the leader of the opposition from the Parliamentary Liberal Party of Western Australia. Good morning.

DR NAHAN: Good morning. How are you?

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MS CHESTER: Please join us. Well, thank you. We're enjoying the second day of our hearings here in WA. If you wouldn't mind, just for the purposes of the transcript that's being recorded this morning, just state your name and who you represent?

DR NAHAN: Mike Nahan, the member for Riverton and the leader of the opposition.

MS CHESTER: Good.

DR NAHAN: And the former Treasurer of Western Australia.

MS CHESTER: Well, thank you very much for joining us this morning. Would you like to make some opening remarks?

DR NAHAN: Yes, I would. First, on the Commonwealth Grants Commission process, it's an old institution and has evolved its process over many decades. Its objective is to reallocate grants, now GST payments according to Horizontal Fiscal Equalisation. It also is made to strengthen and make our Federation whole and equitable.

I think the system is fundamentally flawed both in terms of how it – in terms of the process and also in terms of the extent. These flaws have been augmented over the last 10 years because it was done as if things were normal and the economy, and particularly in Western Australia, was not normal. We went through the biggest boom in history and the system continued as if everything was normal. I will go through that.

So my argument is that there is excessive equalisation and there was a failure of the Grants Commission to respond to abnormal circumstances. Those exceptional circumstances were many fold, for instance, over the probably 12-year period. Western Australia had 490,000 people, almost the population of Tasmania migrate to it. We had $600 billion invested in new infrastructure, mainly in the regions but across the state, LNG, mining of all sorts.

We ran out of people, so that all the government agencies had to open up recruitment offices around the world to recruit police, doctors, nurses, electricians, and so on and so forth. We had, as I said, $600 billion invested in infrastructure and mining infrastructure, and we had a population of 2.5 million people. We ran out of people. We, of course, brought in people on FIFO. I don't know what it peaked at. I imagine it pushing 100,000 people. We also had the demand for labour was concentrated in a few areas, particularly investment because it was an investment boom. We ran out of people. Wages were high. Costs were high.

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It was a classic boom. In fact, I think you measure it, it was the largest economic boom in the nation's history, at least since the gold rush in Victoria in the 1880s. It was concentrated in WA, (indistinct) – Queensland had a bit, but nothing of the same scale. It was largely up in the Pilbara. Very exceptional circumstances, both in terms of the scale and the time and (indistinct).

We also had something change in terms of the revenue flows to the states. Before that all the states provided the same type of services, same type of taxes. There has been a historic exercise, both by the states and the Commonwealth, to normalise or equalise the revenue raising effort, the types of taxes, and the types of services. Because we interact at the state basis, the Commonwealth is involved, and also ministerial committees. So we do a lot of the same things. Therefore, before the boom the variations in – from year to year over a short period of time – between fiscal capacity, didn't vary much at all. It was pretty steady. So the equalisation system, even though excessive in my eye, wasn't – didn't lead to very high distortions.

Then the boom came and we had a massive change in circumstances in one state, WA, where iron ore royalties went from – I can't remember exactly, about $300 million to $6 billion over a very short period of time. The production went from 120 million tons to over 800 million tons of iron ore. The differences between Western Australia and other states is largely the iron ore story. A single commodity, single source of revenue. Most of the LNG, which was a heavy cost to us, the revenue flows entirely to (indistinct); it's an issue but - so we had, I think, revenue from iron ore peaked at $6 billion in 2012/13, 13/14, something like that.

At the same time during that period, the pricing of iron ore changed fundamentally from long term contracts to spot market. First it went from a three year contract where it's very predictable, you knew what the price was three years in advance and it didn't vary. Then it - I think it shortened to a one year contract. Then it went to spot market and varies 50 per cent within a year. Highly volatile, highly volatile revenue space. Probably more so than any other major revenue flow into a state, including I might add the stamp duty conveyancing. That varies quite a bit, but nothing like this. That's a transaction issue, not a pricing issue. So we had that.

We had a huge cost boom. Huge infrastructure both to the mining sector and oil sector, and population. Housing starts went from about 12 to 13,000 a year to 30,000 a year. So we had huge costs pressure on the state and the government. Prices were up, almost out of control in terms of wages. I can remember 2006, Chip Goodyear, the head of BHP, stated that

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he would build no more infrastructure or mines in Western Australia because if he builds another one, that adds more cost to all the existing ones. So we were at full capacity.

Then the Grants Commission continued as if this was just normal. Of course, it had a policy of equalising to the top, which was us, but we had the highest costs. Basically, if you're equalised to the top, what do you do? You bring the top down and backfill everybody else, that's – otherwise you can't – if you fill to the average it's – the average is across. If you average to the top, you basically bring the top down and average it.

So we were - eventually saw the - in terms of revenue flows before the boom, we got 25 per cent of our revenue on GST. Quite predictable. Some variation. About 4 per cent on all minerals. 16/17, we got 22 to 23 per cent on iron ore and 7, 8 per cent on GST. So we shifted during that period. This is one issue is the volatility. We shifted from a stable source of income to a highly volatile – highly volatile, 50 per cent within a year, and unpredictable. It was also tied to the China boom, and who knows what's going to happen on that. Most of the people who are in the business of predicting iron ore prices have given up because of the volatility.

Then we had this cost pressure, and it was immense. No other state felt it. No other state experienced the cost pressure this state was under to provide - not just provide existing level services but to expand it for a 35 per cent increase in population over a seven, eight year period.

So we had the Grants Commission saw something that was abnormal. Instead of saying, "We have an aberration, let's treat it as something different", there are many ways to do it, they kept it as normal, and basically, redistributed 90 per cent of this one-off revenue to other states with a lag of three years. They also have, as bureaucracy tend to be, particularly become all very data driven. That is they're very empirical, if they can't measure it, it doesn't happen. They also are very focussed on things across the nation, so if one state does it uniquely, it is basically an equalised state.

Then during that boom, we had a unique circumstance in Western Australian more generally, the other states, except certain places in Queensland, weren't experiencing. Give you an example, in most states, wages outside the metro area are lower than the metro area. In Perth, particularly during that boom and still, they're double. The wages in the regions are actually probably more than double but let's say double, than Perth. So they decided that if it's regional development, wages are lower than the city. That's just ridiculous. It might fit Queensland or New South Wales, but it was absurd for us.

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Also they take, in terms of the cost measurement, if you can't measure it, it doesn't exist. That's all right, let's say for Gladstone which is going on incremental developments. It's been there for a long time as an industry city. But we had to go out and put $300 million in Onslow that, before the boom, was a 600 person clapped out fishing camp.

MS CHESTER: Dr Nahan, I might just interject there, if I may, because you've had a chance to speak now for about 10 minutes.

DR NAHAN: I'm not done though.

MS CHESTER: And we are - - -

DR NAHAN: I need to emphasise this because the - - -

MS CHESTER: We allow participants five minutes introductory remarks and then we need to get into questions.

DR NAHAN: Okay.

MS CHESTER: And Jonathan and I would like to get into some questions with you, so maybe if you could just wrap up briefly and then we'll get into some questions.

DR NAHAN: Yes, yes. So there's a severe measurement problems with the Grants Commission. These were augmented by its decision to not – to equalise to the top, and that top was an aberration and it overestimated, because of its problem with costs, the amount that it could equalise and I might add also when it equalises at average. A couple of things, one is the dynamic efficiency effects which is over time equalise to the top, especially in the boom time economy like that, gives an incentive to the other states to not undertake the serious political decisions of extracting resources.

I know in your preliminary report you indicate that this is a possibility, but you did not measure it. It should be measured. It's been raised many times in many reports in the past. The dynamic efficiency effects are significant and obvious. What I think has to happen, the – because of this impact, the Grants Commission process led to, particularly with the lags in the GST adjustment and the simultaneously reduction in GST share from 70 to 30 per cent and the decline in iron ore revenue – which was a major source from $600 million to 300, $6 billion to $3 billion – led to the state needing to borrow in the vicinity of $8 billion. The cost of that borrowing is not taken into consideration of this. It was an adjustment effect. It was

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an aberration and that imposed significant cost on Western Australia in the past.

My view is that we should, as our submission made, move to a per capita, but the – in the spirit of trying to come up a practical second order – second best solutions, our recommendation is, like you suggested, is to move to equalising to the average. But I would like to suggest a couple of alterations to it. One is that the territories, ACT and the Northern Territory, be taken out of the equalisation process and dealt with directly by the Commonwealth in whatever means the Commonwealth wishes to deal with it. The reason for that is ACT, which is - by income has the highest average income of all the states and territories. Its problem is its major business, the Commonwealth, doesn't pay taxes. Therefore, the Commonwealth and its workers should directly compensate the ACT.

The Northern Territory's – which receives substantially in aggregate more GST than Western Australia for one-tenth of the population – its problem is not Darwin, which is quite a lucrative and wealthy city now, but Aboriginality. It's largely to deal with Aboriginality factor and the Grants Commission process. Both of them are constitutionally the responsibility of the Commonwealth. So my suggestion, our suggestion, is that we take – we equalise to the average without the territories being in them at all, and that one of the biggest problems we have is in fact that this requires unanimity amongst the states and Commonwealth and therefore it's a zero sum game, it's a (indistinct), a fixed pool, and that the - there has to be a substantial transitional arrangement. We recognise that.

If you equalise to the average and take the territories out of the equalisation process, the transitional arrangement is not as severe. There is a scope, as other people have argued, for the Commonwealth to step into adjust this, particularly interim arrangement for Western Australia. But my argument will be - is that the interim payment should be used to reduce that $8 billion debt that was built up because of the shocks of the GST and iron ore prices, and should be used to make a transition to ease Western Australia's debt build up because of the shocks to the GST.

In summary, the issues – you need to look at the methodology pursued by the Grants Commission. Its aim is to strengthen Federation, but is actually weakening the Federation. Indeed, bringing the Federation to the brink by failing to react to shocks to the system, and that equalisation to the top is impossible to sustain in the long term. Moving to the average will be a better thing and ameliorate the problems with it. But also, it will lead to a higher transitional arrangements cost and probably therefore no change is being undertaken by the political masters. Therefore, my suggestion is that we eliminate the equalisation process to the territories.

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MS CHESTER: So thank you for those remarks, and thank you for giving us an update on what your views on what the policy should be to deal with the world of outliers. Before we sort of get into changes to policy settings and transition paths and the like, I guess just two questions prompted by your remarks. The first one is around WA being an outlier with iron ore and the mining royalties. I think a lot of people refer to the mining boom as being over. I think it's perhaps best to say the construction boom is over, and the wonderful mining bedrock remains.

So one issue that's been put to us is if you look at the numbers 2000 to 2017, the outlier problem that highlighted the system struggling to deal with outliers really kicked off about 2006, 2007 in terms of the relativities. To what extent is the current outlier system, with WA having such a high fiscal capacity, the new norm or is it a blip?

DR NAHAN: Yes, it depends upon your assumptions about prices and quantity of iron ore. But I think if you assume that the $50 or low 50s iron ore price is a long term, take the consensus forecast, 10 year consensus forecast, it is – there will be for as long as we – for that prediction holds, a very large outlier to Western Australia from iron ore.

MS CHESTER: Okay.

DR NAHAN: Exactly how much I can't say but this is – you're right, it was an investment boom that led to very, very high cost structures that were not adequately considered by the Grants Commission. It did produce a production boom that employed a hell of a lot less people, and that was a problem. But it will that - for as - on the given expectations by the experts, that high outlier in terms of revenue, WA will continue for the foreseeable future.

MS CHESTER: Okay.

DR NAHAN: And it will be unique to WA.

MS CHESTER: Okay. The other comment that you made earlier on in your opening remarks was about effectively suggesting that we should measure the counterfactual, so what would happen if other states were to undertake developmental activities that they're currently not. I'm not aware of a reliable methodology to do that and indeed the CGC itself and states and territories struggle to have an assessment of say what CSG base would reside below the surfaces of other state and territory jurisdictions is – how do you suggest we undertake that?

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DR NAHAN: The Grants Commission does a review every five years and there's a lot of data, and other places do it. One way is – which is in the public domain, is the treatment of gambling revenue. Now that's slightly different in that the - a theme of the Grants Commission is that it's policy neutral, that is that it doesn't try to determine the policies or dictate policy to the states, and that it is the policy of the states to leave resources in the ground or not. Then the statement is if you decide to peer through that policy decision, how do you measure it? You can't measure it precisely. We have a lot of uranium in this state but we don't export any because the price is low, so what's to value to that?

Others - we have now lot - we've - so – but there are - what the traditional way is to discount things. For instance, there has been a lot of suggestions in the Grants Commission because of the lack of precisions about measuring things about urban or regional development for example, about uncertainty, uncertain things. They give discounts, crude discounts of 25, 50 per cent from the cost of it. You're going to have to use those types of measures.

We're not arguing that the Grants Commission should be turned on its head and start getting involved in saying what's good policy and what's bad policy. We're not arguing so much for crude discounts like that. The way to solve it is not to equalise as thoroughly. Your interim report suggested that you move from the - equalise to the top to the second top or equal – that will diminish the disincentives quite a bit. Our argument is you know, and our submission is, that we should even go further than that and go mainly to equal per capita over a transitionary period with about 20 to 30 per cent of the GST pool equalised. The less you equalise, the less the distortion of the dynamic efficiency effects are.

MS CHESTER: Yes. I think that's part and parcel for the direction that we identified in our draft report. Will we be getting a submission from you outlining in more detail your position post our draft report in terms of moving away from, I think it was EPC 90 per cent and 10 per cent on full equalisation?

DR NAHAN: Yes.

MS CHESTER: Because it would be good for us to get a better understanding of the transition path that you've got in mind and how that can be funded.

DR NAHAN: Yes.

MS CHESTER: Are you able to share any insights on that today?

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DR NAHAN: In our first one we didn't. We left the transitional arrangement up to you. We didn't explore it very – and it will be – the transitional arrangement is, to a large extent, the guts of the issue. Without an adequate transitional arrangement, without your ideas on it, one would have to fear reforms, the – whether the reforms would be carried out.

We're not that interested in the Commonwealth just borrowing more money and placating the state for – WA, for a period of time. That's just a sugar hit. It would help, particularly to defray that $8 billion in debt we built up because of this transition arrangement, but then fundamental reform is needed. To look at the transition, you have to crank some numbers. For instance, what would be the magnitude of the adjustment once you took the territories out and moved to an average? To some extent we have, in opposition, limited capacity to model that. We don't have Treasury access. You might be more able to do that so we could spell it out in terms of the objectives of that.

I would think a three to five year adjustment period. The Grants Commission goes in five year cycles, both three and five year cycles. You would have to have that for a period of time, and you'd have to take – look at the numbers of it. The longer you stretched out the transitional arrangements, the longer Western Australia has to carry that $8 billion burden which – the cost of which, $350 to $400 million a year in interest costs, for a period of time. So the Commonwealth might want to put some assistance in there to carry – to assist WA during the transitional period. My argument would be any moneys should be used to reduce debt, not to – not tie into infrastructure as such.

MS CHESTER: Okay. So do you still stand by the principle, I think in your pre-draft report submissions then that "For the transition period of several years", and you've said "five", "but no state experiences a year to year decline in actual GST receipts"?

DR NAHAN: Yes. I think the appropriate - - -

MS CHESTER: So keeping the other states and territories – well, keeping the states that remain within that system whole for the five years?

DR NAHAN: Yes.

MS CHESTER: And who would be funding that if you say that you don't want the Commonwealth Government to raise that?

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DR NAHAN: My view is we should go up to that period. Western Australia's share will pick up. It will, unless we get another huge increase in iron ore prices, which no one's expecting. So the way you could do it is do a floating floor, that is as Western Australia grows its share goes up. Over a three to five year period, no other state is ex ante worse off. Now true, if iron ore prices don't meet as predicted, let's say the higher, other states might ex post be worse off.

So my suggestion and the way that no one's worse off, is have a floating floor for a five year period till Western – till the system gets back to something like that would be - with the territories excluded, something like an averaging to the – I'd say equalising to the average would achieve. These are empirical questions but I can't really measure it. Then go to the new system.

MS CHESTER: So over that five year period is – and I'm – so the floating floor is like - - -

DR NAHAN: It's three to – three to five year period.

MS CHESTER: Three to five year period, so that's moving to ETA. So if we were to do ETA tomorrow that takes WA to 87 cents, .87 of a relativity.

DR NAHAN: What's "ETA"?

MS CHESTER: Sorry, equalising to the average.

DR NAHAN: Okay, yes.

MS CHESTER: Forgive me. I've been living in the world of ETA a little bit longer than others.

DR NAHAN: Okay, yes.

MS CHESTER: So looking at the – that transition path if we were to keep the other states whole, we are looking in the order of magnitude of billions of dollars, if you don't want – I'm just trying to work out who's going to be funding that if you didn't - - -

DR NAHAN: Well if you - - -

MS CHESTER: Given your earlier statement that you didn't want the Commonwealth Government borrowing to do that.

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DR NAHAN: Yes. First of all, you'd take the – if you take the territories out and the Commonwealth funds those, the transitional arrangement, the equalisation is much less to the states, to the residual states. We've done some numbers in the past and it reduces - taking the territories out, particularly the Northern Territory, which is in the vicinity of $2 billion and you put them together at about $2.5 billion, that reduces substantially the redistribution in the pool, residual pool. As Western Australian moves up over the next three to four years towards 70, which is what I believe it's going to do, if you take a three to four year period you allow WA to go back towards the 70 and you take the territories out, I think if you crank the numbers you see the compensation external to the states is greatly reduced.

MS CHESTER: I think we can agree it's reduced, but even hundreds of millions to Queensland alone would be required, given their starting point of I think 1.12 or something.

DR NAHAN: Yes.

MS CHESTER: So you see the Federal Government funding that but not borrowing.

DR NAHAN: No.

MS CHESTER: So how would they fund it?

DR NAHAN: Well, I'm not sure. You'd have to look at the numbers. If you take the territories out which as – and I don't think you've done yet, in your measure - modelling.

MR COPPEL: No.

MS CHESTER: No. No, no, we've not recommended that.

DR NAHAN: Okay. You take the territories out and you go for a four year, let's say, period, because I've never looked beyond four for forward estimates, Western Australia goes up towards 70 per cent, under the existing model with the territories in. If you took the territories out, we would push towards 80 per cent, I would think. You would see that the adjustment period is not large relative to where you would, under the existing model. Then you make some adjustments and - - -

MS CHESTER: So but if we're taking the territories out, who's then paying – so - - -

DR NAHAN: Territories, it's Commonwealth.

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MS CHESTER: Yes, so – okay. So effectively the Commonwealth is really paying for the transition path. You're taking the territories out, they've got to pay for that. They've paying for those that stay within. So the Commonwealth is picking up the tab for everything.

DR NAHAN: No, the Commonwealth is not picking up the tab for the states. The Commonwealth is picking up the tab for the territories which are Commonwealth – constitutionally Commonwealth entities. They do have self-governance but that's bestowed on them by the Commonwealth.

MS CHESTER: Okay.

DR NAHAN: So you – the – you take the territories out and you give them back to the Commonwealth and you - then the - your pool is not changed. But the equalisation process across the states is greatly diminished and you allow Western Australia to go back up towards 80. I think, if you model that, you will find the impact on individual states is not huge. There will be some. But the – that - in my view is that that has to be borne from within the states, not the Commonwealth.

MS CHESTER: After the transition period?

DR NAHAN: Yes.

MS CHESTER: But during the transition period, the Commonwealth's picking up the tabs for the states?

DR NAHAN: No.

MS CHESTER: Keeping them whole?

DR NAHAN: No, no. The Commonwealth takes on responsibilities for its entities, the territories. Okay?

MS CHESTER: Sorry. So I thought your pre-draft report submission said that "The transition period would be such that no state experiences a year to year decline in actual GST receipts".

DR NAHAN: Yes.

MS CHESTER: And the Commonwealth would pick up the tab for that transition period.

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DR NAHAN: No. That was moving to a per capita. I've said I'd gone to a second best to accommodate your – so the - - -

MS CHESTER: Okay.

DR NAHAN: We had moved. We still think per capita, but we have moved and responded to your draft report and the response to it was quite positive to move to an averaging from the top to the average. Our view is if you move to even - the compensation even moving to that would be excessive. So the argument we have is you bring the territories out. That we move 2.5 and therefore - 2.5 billion from the pool, over a three to five year period as Western Australia's share adjusts, you hold it there, during that period ex ante there should be no need for compensating the states. There's a need to compensate the territory and not the states. There is an adjustment period. Then when you get to a stable 80 per cent, I would think, then you go to averaging per capita.

MS CHESTER: Okay. So you're saying by taking the territories – so I think I may have connected the dots now. Sorry, it's taken me a little while. So by taking the 2.5 billion out with Northern – out of the GST pool of the Northern Territory and the ACT, the 2.5 billion that the Commonwealth is now funding separately, would keep the other states whole during the transition period?

DR NAHAN: Yes. Largely, yes.

MS CHESTER: Okay. So how is the Commonwealth Government going to fund that if they're not going to raise debt?

DR NAHAN: Well, it's their workforce that they're not paying the payroll tax, stamp duty, land tax, and other things on. So my argument for the ACT is that it's just a – it's like Newman, who pays all the royalties and – for Newman is a mining town up north. The mining firms pay for that. The ACT is largely a home base for the Commonwealth and they should – which has the highest average income of any city. The Commonwealth should carry that. So the Commonwealth carries the responsibilities, as they should, for the territories. Just like they do for - - -

MS CHESTER: So a payroll tax for the territories?

DR NAHAN: Well they can – how they fund it - - -

MS CHESTER: I'm just trying to work out what funding mechanism you have in mind, if you didn't want to - - -

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DR NAHAN: That's for them to decide. They can equal out – they can come up with a – they can encourage the territories to levy additional taxes which they don't levy now or they can pay it out of their own source income or whatever.

MR COPPEL: Just shifting gear, in your opening remarks you said that the process and the extent of HFE are fundamentally flawed, and we've spoken a bit about what you see as the solution to the extent issue. What do you have in mind in terms of how to address the fundamental flaw, what you characterise as the fundamental flaw in the process?

DR NAHAN: Well, the best way that – you cannot get perfection in this system. If you tried to equalise with perfection, you come in – especially if you're empirically driven like you - like they have to be, and the lack of data and lack of comparison. So there's a couple of – perfection's not possible, particularly in this - in their task. Data is not equally available and there aren't uniformities about approaches. Once you go achieve to, equalise to top, the flaws get worse. So one way is diminish the extent and thoroughness of equalisation. If you look around the world, that's what most Federations have decided to do, they diminish equalisation over time. Okay. There is other forces at work, like politics, that tend to do that too.

So your proposal - our proposal would move to diminish equal – Horizontal Fiscal Equalisation as the priority and move to equal per capita. That's our priority. Your proposal, which we're – in the interests of a reform the - we'll support, is diminishing to the average, which I actually thought 20 years ago was the policy, to be honest. I might be wrong on that. But when I looked at Grants Commission in the early 90s, they often equalise to an average for some levels, but nonetheless. So once you diminish the extent of equalisation, your targeted equalisation, the distortions diminish.

I actually think that the boom was a construction boom, but that's where the pressure was, has eased and therefore the distortions, the data distortions that the Grants Commission used that underestimated our cost, should not re-appear right away. That was a one-off blip, hopefully.

But another issue is that the Grants Commission, I think, needs to be wary of perturbations in the system, shocks to the system. This should've been identified earlier on where the norm no longer fit. The Grants Commission, as a bureaucracy, failed to respond. They could've responded in many ways. They did respond a little bit when the – and the governments responded when they changed the treatment of iron ore fines. They kind of rolled that over for a couple of years. That was an illustration that the system didn't sit very well and there was problems. Clearly there was

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because what happened was iron ore fines that in the market was discounted, discount was taken away and we adjusted.

So simply, reduce the extent of equalisation reduces the extent of the distortions greatly. We would say reduce it even more, but the average would help quite a bit, and also the boom passing will help quite a bit. But I think there needs to be a consciousness on the Grants Commission to be observant, to be wary of shocks to the system and they could exist in the future. If every state is providing the same level of, more or less, service and same types of tax, almost the same tax rate, the equalisation process is not too bad in terms of distortionary effect. But when you get a shock, like we clearly went through, it doesn't fit. It doesn't work and it brings the Federation to the brink.

MS CHESTER: A couple of other things that would be helpful for us in finalising our thinking and looking for the evidence base that we need for our final report, any examples that you can point us to of where the current HFE arrangements have either precluded a development activity from occurring in WA or have distorted a royalty policy or a potential state revenue reform?

DR NAHAN: Not in recent times. They used to do it in Queensland, but that's history with the pricing of Rio facilities. That's an old story. In WA, honestly, we have had bipartisan pro-development governments. There is a – both an efficiency effect and an income effect. Okay. I struggle in Western Australia to identify an efficiency effect, but income effects I would. Firstly, if Browns Range came on now, which is a large potential project up in the north, and it would require hundreds of millions of dollars' worth of state expenditure, which it would, infrastructure, Aboriginal claim settlements, you name it, the state is not in a fiscal position to undertake that. It just isn't. It might bend over backwards for a high level spec to do it, but it would struggle.

If Onslow, for instance, let's say Chevron found another resource that unexpected, like Wheatstone, and the - they and us had to spend the billion dollars in onshore social infrastructure, we'd struggle, unless the Commonwealth came in. So there's an income effect because of the debt. I would argue that that same thing happened in Tasmania repeatedly when they decided to not build a pulp mill, or reduce access to their major resource was logging, or inhibit the development of mining. The - it wasn't – they knew – they didn't do that on the basis of the efficiency effect. They knew they would get partially compensated for their decisions to lock resources away through the Grants Commission process.

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At times during the 90s it was a Greens Coalition with the Labor Party and, I think you can find in Hansard, the Greens were particularly aware of that, whereas the Labour Party wanted resource development and I think their Green Coalition partners didn't. So you can see that it's not so much that people decide specifically to – at the margins, but the income effect is quite clear and obvious. Even though New South Wales and Victoria are donor states and will - always have been and always, for the foreseeable future, remain, they know that at the margin they are being compensated from Western Australia for locking gas into the ground.

MS CHESTER: Okay. I'm very conscious of your time and we do have one more participant to hear from. Is there a time frame in which we might expect to receive your post-draft report submission?

DR NAHAN: Yes. I would like - what - I do two things. I will send you the scheme of it so maybe you can model it, if you have greater access to modelling resources than we do, because I think you have to optimise this by saying make these assumptions, see how the estimates flow out to see if the degree of compensation is needed.

MS CHESTER: Well, I suspect on the forecasting of relativities and impacts, WA sort of is leading the pack at the moment, the WA Government. So you might ask for help from - - -

DR NAHAN: I'm not in government any more.

MS CHESTER: I know.

DR NAHAN: Yes.

MS CHESTER: But you could still ask them given I - - -

DR NAHAN: Yes.

MS CHESTER: We've been told by parties that reforming HFE is an area where you've all come together. But by all means, once we fully understand - - -

DR NAHAN: If that's the case, then I would probably – if in fact your statement is true and I can get the cooperation of Treasury, State Treasury, then I will - - -

MS CHESTER: I suggest it might be worth trying.

DR NAHAN: Okay.

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MS CHESTER: Okay. I might be wrong in saying so, but based on earlier comments today. Then the formal submission in a week or so, could we - - -

DR NAHAN: A couple of weeks, yes.

MS CHESTER: Okay. All right. Did you have any questions? Okay. All right. Well, look thank you very much for appearing this morning.

DR NAHAN: Okay, thanks.

MS CHESTER: We appreciate you making the time. I'm sure you, like others, will look forward to reading our final report early next year.

DR NAHAN: Yes. Okay, thanks.

MS CHESTER: Thank you.

MR COPPEL: Thank you.

MS CHESTER: Okay, folks. We just have one more interested party who'd like to be heard today. So if you'd like to just state your name for the purpose of the transcript record and then if you could talk for five minutes, then give us five minutes to ask any questions of you, that'd be great.

MR DAVIES: Yes, yes. Mr name is Eric Davies. I'm a - - -

MS CHESTER: Sorry. Excuse me. Guys, can we please have quiet. Thank you. Yes?

MR DAVIES: My name is Eric Davies and I'm a private citizen, but I represent a group of – and it's at this stage, an informal group of people who are looking at the politics involved in the GST situation. Sitting here through all these proceedings, I get a sense that you, the Commissioner, you don't really understand the sense of anger in Western Australia, the depth of anger in Western Australia over the GST carve up. It is palpable.

That has severe political implications for the situation going forward, because I get a sense that you people are going to have to go to other states and justify various positions that you might be wanting to take. There was - an example is this morning we've been – the proposal that resources royalties be discounted by 50 per cent and that equalisation goes to average rather than second or highest. I get a sense that it would be very difficult to

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sell that in other states, especially the recipient states and territories. I would like to make the point that the anger in Western Australia is such that it could bring a lot of political pain to the Commonwealth Government.

We heard yesterday from some political types who – WA First Party, where they were proposing some kind of political action. I have to tell you that what our group has got in mind is way more powerful than that. That is insipid compared to what we've got in mind. The advent of social media makes it possible for a group like ours to contact West Australians and present a very powerful political case. We believe that we would be quite capable of making Australia un-governable if we don't get a fair deal. I would like to make you aware of the fact that that is on the cards and that you might be able to use that when you're receiving submissions from – at other states. You might be able to use that to, maybe, ameliorate their demands.

There's a few other points that I'd like to mention very quickly, that the Commonwealth Grants Commission discounts income from other states for poker machine revenue. As you probably know there are no poker machines in Western Australia. Now it's been said that the Commonwealth Grants Commission doesn't want to influence policy. By discounting the income from poker machines in the other states, what they're doing is saying to Western Australia that, "Because you don't want to penalise your vulnerable citizens in the way that they've been penalised in the other states, we are going to take revenue from you because of that". In my opinion, that is a policy direction from the Commonwealth Grants Commission. That's one point.

You said earlier on also this morning, that you thought that resources, natural resources was a windfall from - the states have got from somewhere or other and you weren't sure whether that – whether they were the actual property of the state or the property of the whole of Australia. I have to tell you that it is the case that Western Australia joined the Federation on the understanding that the mineral resources of the state belonged to the state, to the people of Western Australia, not to the whole of Australia, and that's written into the Constitution. So to say that that it is a windfall and that all of Australia should share in it, is not accurate. That sums up the basis of what I wanted to say.

MS CHESTER: Okay. Thanks very much, Mr Davies. I think one of our toughest challenges with the role that we have at the Productivity Commission is when we are recommending change where they'll be winners and losers, one of the advantages that we do have, as an independent statutory agency is, and indeed under our legislation, that we

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try to view things through the lens of the economic wellbeing of all Australians.

So while we've talked this morning about the transition path being quite difficult because the GST pool is a zero sum game, that said we're very minded to try to be able to point out to other states and territories what economic benefits they are - there are for them in, perhaps, changing the current HFE arrangements in terms of the incentives that they face, to develop their own activities and resources and indeed to have a better reform revenue basis for their economies.

On the issue of the gambling, and this might ease some of your concerns there, the way the Commonwealth Grants Commission treats gambling revenue is to take it out of the equation when they're assessing the GST relativities. So it's not that WA gets penalised by getting less GST revenue, rather you don't get equalised to you some of the revenues that other states and territories raise through - - -

MR DAVIES: The bottom line is that Western Australia gets less cash because of that.

MS CHESTER: So you don't benefit from the revenues on pokie machines in other states and territories, that's right, because they take it out.

MR DAVIES: Yes. So the bottom line is what I said, we get less revenue because of that.

MS CHESTER: Yes. That's right. I thought you were arguing that you get money taken off you. So you're right, the net effect is I – I guess maybe I've construed too much into your comments that you think not having gambling taxes is a good thing and thus you wouldn't want the people from WA to benefit from that form of tax.

MR DAVIES: Yes. It wouldn't be a benefit, as I alluded, yes. Yes.

MS CHESTER: But you are happy to get the revenue that other states raise from gambling?

MR DAVIES: Well, it – because it's taxed revenue, it's taxed income.

MS CHESTER: Okay.

MR DAVIES: Yes. The point that I am making - - -

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MS CHESTER: If you're happy with that being a form of revenue, then wouldn't it then make sense for the WA Government – so if you're not worried about getting revenue from gambling, then wouldn't you then have the position that the WA Government should use that as a source of revenue?

MR DAVIES: No. What I'm saying is that by taking that policy, by basically taking cash off Western Australia because we don't have poker machines, because most of that gambling income is from poker machines - taking cash off Western Australia because we – specifically because we don't have poker machines is equivalent to policy direction, in my opinion.

MR COPPEL: But that's not how it works. Cash isn't taken out of Western Australia because they don't have poker machines. The whole thing's - - -

MR DAVIES: Well, cash – the – well, you've just agreed that Western Australia gets less cash because we don't have poker machines or because of the policy.

MS CHESTER: Because they've decided to take it out of the equation.

MR DAVIES: Correct. They've taken it out of the equation. It's still income of the other states. If it was put into the equation, then Western Australia would get more cash.

MS CHESTER: Okay.

MR DAVIES: Yes.

MS CHESTER: But you don't want to have revenue on pokie machines in WA?

MR DAVIES: No. The point that I am making, I – the point that I'm making is that by doing that it is a policy direction. It is influencing policy, because it is a policy whether or not we have poker machines. That is a matter of policy.

MS CHESTER: But it's a policy decision of the WA Government not to.

MR DAVIES: Yes, correct.

MS CHESTER: So CGC's guided by wanting to have policy neutrality. WA's chosen not to have policy neutrality. They've made a decision not to tax pokie machines.

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MR DAVIES: Yes. Not to have poker machines.

MS CHESTER: Yes.

MR DAVIES: Yes, yes.

MS CHESTER: Okay. Great.

MR COPPEL: You make the point, which I think we agree with, that the transition is a very big challenge.

MR DAVIES: Yes.

MR COPPEL: And that we've got an onus on us to demonstrate the benefits to the Australia community of a change. But in a system like we have, which is a zero sum game, it's very difficult to move away in jurisdictions that have a relativity above one. I think you were here yesterday and I made a point that that incentive is always there, but it shifts from jurisdiction to jurisdiction, depending where those relativities are.

There was an episode in the early 1990s where there was an opportunity to shift to a different system and one of the jurisdictions that was against that was WA at the time, because it had a relativity above one. Now I don't do that to point the finger at WA. It just underscores that that is the challenge that we face and we have to demonstrate that moving to a different system has benefits that go beyond what is lost, in terms of the impact of that on the GST distribution. I just wanted to make that point, because it's not something that is new. It's always been there and it's the way that jurisdictions will argue.

MR DAVIES: Yes.

MS CHESTER: Well, Mr Davies, we thank you for raising your hand and wanting to be heard here. It is part of the reason we have public hearings and we do canter around Australia, is that we don't only want to hear from government departments and politicians, we also want to hear from the people of the states and territories. I think you've tried to convey some of the sense of the feeling that WA people have towards the current HFE arrangements and we thank you for that.

MR DAVIES: Okay, thank you.

MR COPPEL: Thank you.

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MS CHESTER: Thank you. Terrific, on that note, I call our Perth hearings to a close and we will luckily, I think, resume this Friday in Melbourne. So thank you all for attending and we'll wrap it up there. Thank you.

MATTER ADJOURNED AT 11.48 AM
UNTIL FRIDAY, 17 NOVEMBER 2017

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Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO HORIZONTAL FISCAL EQUALISATION

MS K CHESTER, Deputy Chair
MR J COPPEL, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT 530 COLLINS STREET, MELBOURNE
ON FRIDAY, 17 NOVEMBER 2017 AT 9.00 AM

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RESUMED **[9.00 am]**

MS CHESTER: Good morning, everyone, and welcome to the public hearings for the Productivity Commission's Inquiry into Horizontal Fiscal Equalisation. My name is Karen Chester. I'm the Deputy Chair and one of the Commissioners on this inquiry and I'm joined by my fellow Commissioner on this inquiry, Jonathan Coppel.

I'd just like to begin the opening of these hearings by acknowledging the traditional custodians of the land on which we meet today, the Wurundjeri people of the Kulin Nation, and I would like to pay my respects to elders, past and present.

This is the third day of public hearings for this inquiry. We had two days in Perth at the start of this week and in coming weeks, we will also hold hearings in Adelaide, Darwin and Hobart. We will then be working towards completing a final report, which will be submitted to the Australian Government sometime early next year.

Before I just get into how we conduct our hearings, I am obliged by OHS legislation to say if alarms do sound, common sense should prevail. Don't use the lifts. Head to the green exited stairwells and follow someone wearing an unfortunate fire warden's hat and they will get you down the stairwell and take you down the road to Enterprize Park. I've done what I'm obliged to do.

Turning to the conduct of our hearings, I guess the purpose of our hearings are really to allow public scrutiny and feedback on the Commission's draft report and our workings, but also to allow public scrutiny feedback on submissions and commentary from other inquiry participants.

We like to conduct all our hearings in a reasonably informal manner, but a full transcript is being taken and thus we cannot entertain comments from the floor. At the end of the day's proceedings, we will provide an opportunity for anyone who wishes to do so to make a brief presentation.

Participants are invited to make short opening remarks. The debating bell will be rung at five minutes or so and the reason being that it does allow us then to actually have a frank exchange and to discuss the views of participants. Participants are not required to take an oath. All we actually ask is that they are truthful in their remarks. You are more than welcome to comment on the submissions and commentary of other participants to this inquiry. We encourage you to do so.

The transcripts from today's hearings will be made available from the Commission's website following the hearings, along with submissions to the inquiry that are already available on the website. For any media folk, and I

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think there might be one or two in the audience, you should know the general rules that apply. If not, please gently head-high tackle one of our staff and they'll share them with you. Most importantly, there's no video or audio recording of participants for broadcasting purposes from hereon in.

We can now move to welcoming this morning's first participants, the Treasurer of Victoria and representatives from the Victorian Government. Thank you very much for joining us and thank you also for your pre-draft report submission and the wonderful meetings that we've had with your representatives, Treasurer, and staff from the Treasury, but also for being able to get a post-draft report submission in to us in such a prompt manner which helps us today. If you'd like to each just state your name and where you're from for the purposes of the transcript recording, and then if you'd like to make some opening remarks.

MR PALLAS: Thanks very much, Deputy Chair, and other Commission members. I'd like to introduce myself. I'm Tim Pallas, I'm the Treasurer of Victoria.

MR MARTINE: David Martine, Secretary of the Department of Treasury and Finance.

MS AUSTER: Amy Auster, Deputy Secretary, Department of Treasury and Finance.

MR PALLAS: Thanks very much for the opportunity to present today and can I say that this will, of course, complement the initial submission to the Commission that the Victorian Government's made and also our response to the draft report. Both our submission and the response can be found on the Commission's website.

If I could go to the second page and the first slide, Victoria continues to be a donor. We consistently receive below our per capita share of Commonwealth State payments. We're the only state in the history of the Federation to have subsidised the Federation in every year since 1901.

Since Federation, that has meant that Victoria has received some 86 billion dollars less in total Commonwealth payments in 2016 dollars, than if the Commonwealth funds were distributed on an equal per capita basis, as shown in the chart. Much of that lopsided distribution of funds has been justified, based on need to address inequity between the larger States, such as New South Wales, and Victoria and smaller developing States.

On slide 3, we strongly support the principle of horizontal fiscal equalisation, and you might not hear that from all the States that you appear before. HFE aims to provide State Governments across Australia with the

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capacity to provide a consistent standard of government services with the same revenue raising effort.

Victoria acknowledges that some States incur greater than average costs in delivering certain services for sections of the population. Also, some States have greater capacity to raise revenue, compared to the average of all States. It's an important principle of HFE that these differences are recognised and taken into account. Crucially, HFE does not impose particular policy choices on States and each of them is free to make choices about how it raises revenue and its expenditure priorities.

This is in keeping with the desirability of State Governments being accountable to their own constituencies, rather than to some external body or mechanism. The draft report found that the equity objectives of the current system is important and should continue being the basis for GST distribution.

On page 4, as the State whose budget is most exposed to royalty revenue, Western Australia's fiscal position is closely linked to the fortunes of the resources sector. As a by-product of CGC processes of using lag data to escalate GST relativities. That means that the States exposed to the resources sector are at risk of decreasing royalty revenue coinciding with declining GST payments.

The effect of the mining boom on Western Australia's GST distribution was predictable and it was incumbent on the Western Australian Liberal Government of the day to manage its finances accordingly. The PC notes in their draft report that the Western Australian budget of 2011-12, predicted falling GST revenues in the years ahead.

On slide 5, the fact that Western Australia receives a lower share of GST reflects its general capacity to raise its own revenue. In 15-16, Western Australia raised $5,173 per head of population, significantly more than any other State. By comparison, Victoria raised $3,271 per head of population.

The next graph on page 6 shows that when Commonwealth grants are added to State taxes and royalties, Victoria is the lowest ranked per head of population, while Western Australia is the second highest. In 15-16, Victoria's grants plus State taxes and royalties were $7,184 per head of population, compared to Western Australia on $8,302.

As we can see on slide 7, in Victoria's initial submission, we've adopted a principle-based approach on HFE, rejecting the self-serving advocacy that has plagued much of the debate in this area. When viewed through an objective lens, Victoria cannot accept the PC's proposal to raise weaker States to the average or some alternative reasonable standard.

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The approach would be arbitrary. It would be designed to address the point in time fiscal concerns of one particular State and it would undermine the equity objectives of HFE. It does little to improve the transparency, simplicity, economic efficiency, or equity of the current system.

The PC's proposal to raise fiscally weaker States to the average fiscal capacity would see a shift in GST revenue from the eastern States to the west. The PC draft report estimates that its proposal would see Victoria lose $972 million in 17-18, while Western Australia gained $3.6 billion.

The GST on slide 8 forms a critical part of Victoria's budget. If GST revenue were to fall, the Government would need to respond by reducing services or increasing borrowing. The average fiscal capacity proposal highlighted in the PC's draft report, would see a reduction in GST payments to Victoria of $972 million a year.

A GST hit of about $972 million a year isn't an accounting change or a minor technical adjustment, it would have a major impact on this State's ability to deliver services for Victorians relying upon them. So, it's the equivalent of approximately 9300 teachers, 8700 nurses, 7700 police officers, or purchasing more than 100 E-class trams or more than 150 velocity train carriages.

In addition to the scenario on page 9 of raising taxes to the average fiscal capacity, the PC represents a number of other alternatives to calculate the GST distribution. One of those approaches is to raise States to the fiscal capacity of the second strongest State. Under this method, Victoria would lose $4.4 billion over the past five years, compared to the current method.

Victoria is already being short changed on infrastructure payments from the Commonwealth and GST payments for our growing population. We are 25 per cent of the population, yet we receive 10 per cent of Commonwealth infrastructure funding. The last census showed that ABS significantly underestimated Victoria's population over the five years to June 2016, while overestimating the population in Western Australia.

As the GST distribution method includes population shares, we estimate that Victoria received $420 million less in GST than intended over the five-year period 2011-12 to 2015-16. Our population continues to rise rapidly at 2.4 per cent a year, and all these factors place pressure on the Victorian budget and they further highlight why our GST shouldn't be cut.

On page 11, the inquiry has looked on whether or not HFE formula may act as a disincentive for a State to develop an industry such as mining, or to raise the royalty rate. We consider CGC current criteria to determine treatment of mineral resources is appropriate. The PC findings are consistent with Victoria's submission. The PC report found that there is no direct evidence

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that GST effects have influenced State policy decision making in relation to minerals and energy.

The report also notes that adding incentives for resource exploration policies would be an intentional breach of police neutrality in State autonomy, be a source of additional complexity, and at the expense of equity. States must be allowed to weigh up the broader social, economic and environmental effects of fracking, without Commonwealth interference. Victoria must not be punished for putting our farmers first and protecting their world-class produce in our environment.

The current GST distribution system doesn't deter States from implementing tax reform. Weakening HFE would act as a disincentive for States to manage their budgets appropriately, as States could expect additional GST revenue to fix the shortfall.

In conclusion, Victoria continues to support the principles of HFE. We accept that it is reasonable for a large, strong State such as Victoria to continue contribute to States with high needs and low revenue raising capacity. As our formal submission outlines, we also have a number of concerns with the Commission's methodology.

Fundamentally, Victoria does not agree with the PC's alternative proposals, as they represent a total departure from HFE for the benefit of one State, and the Andrews Government will not accept any proposal that would reduce our capacity to deliver the services that Victorians rely upon.

Thanks very much for the opportunity to address you.

MS CHESTER: Thank you, Treasurer, and thank you for managing to canter through your slide pack so promptly which allows us more time now to chat. Just for the benefit of the transcript and for those joining us this morning, the Treasurer has provided us with a slide pack which we will take as an addendum to your post-draft report submission, and that will be available on our website as soon as possible.

Let's open up with some questions then, and perhaps if we rewind the clock a little bit first to better understand how this inquiry came about. As I think I touched on, Treasurer, when we met and spoke at the CFFR meeting in Sydney, the sort of overarching theme of our report is that the HFE system now seems to be a world of outliers and there were three in particular that we identified, the first being the way Australia does HFE. We do punch above our weight globally and we said on the whole that's a good thing, and indeed we do support the equity and equality principles underpinning HFE.

The second outlier which is also how we deal with indigeneity and that's one that we sort of grappled with probably a little awkwardly in the report.

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The third one is the more recent outlier, being the royalties of Western Australia. I think, taken together and where the relativity band has gone, particularly in the last five to six years, we felt that the system was having difficulties grappling with that, not just in terms of public accountability and the pub test in the west, but more importantly, what impact that might have on incentives for States and impact on the real economy.

In that regard though, I guess one of the questions that we posed in our draft report was to what extent is the outlier of WA here to stay for the foreseeable future. To what extent is this a blip, or is this the new norm, because that in itself would inform our thinking around what changes might be needed.

Treasurer, I think you did touch on it a little bit in your post-draft report submission to us, but good to get your sense of whether you think WA being the fiscally stronger State is here to stay for the foreseeable future.

MR PALLAS: I suppose if you look at graphs 5 and 6, they sort of tell a story that I think demonstrates that the system works, even in the circumstances that we currently confront. As you can see, despite the reductions in commodity prices in 15-16, what we are seeing and what has, I think, held through to present day, is that there is a continuing capacity for the State of Western Australia to raise own source revenue, and that includes, of course, royalties. Even in circumstances where the commodity prices have reduced, Western Australia's revenue raising capacity is still greater than any other State.

Graph 6 to me really demonstrates the worth of preserving the principles of horizontal fiscal equalisation. Victoria could feel aggrieved as a State in the context of slide 6 to say if you looked at State taxes and royalty revenue and Commonwealth grants per capita, we are the lowest State in terms of receipts. I didn't have Northern Territory on this chart because it would distort the chart dramatically, so I apologise for that.

What this shows us is the States, all of the States, are in a band of $8500, let's call it, per capita in '15-16 and Victoria the downside outlier is in that $7000 plus per capita. The proposition I would put is what problem are we trying to fix here. Is it the capacity of the States to meet the embedded demand of their populations for budgets to be run efficiently?

Certainly, the share that the States have, both in terms of their own revenue raising capacity, as I show on slide 5, even in circumstances with a downturn in commodity prices, are up against the offsetting impact of Commonwealth receipts per capita. What we can see is that the States are within an acceptable parameter band to ensure that they can provide the services that their communities require.

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I don't think the first proposition I put is what's broken in the system, if you look at the receipts Western Australia are actually receiving per capita, are both in terms of their own revenue raising efforts, and that's taxes and royalties, or indeed the augmented per capita revenue coming in to that State through State and Federal provision.

MS CHESTER: I think we agree. Indeed, I think we're on the record in our draft report saying we don't see the system as being broken either. We just kind of see it struggling with the outlier, and the reason being that when you have such an outlier State, and it's not just the rubber band of the relativity stretching so far, it means the equalisation task within the GST pool itself becomes greater. And the more you move away from an EPC distribution, it's much more difficult to grapple with the trade off between equity and efficiency.

Just on the outlier point, I guess we did get evidence from WA earlier this week and not just from their Government but also from industry over there to suggest that the outlier story is probably here to say for the foreseeable future, and thus we're faced with a situation of a large part of that GST pool will be a redistribution and thus it strays from EPC.

Why does that kind of matter? It comes to this trade-off between equity and efficiency in HFE. Treasurer, as you would know, there's more than one principle that the CGC tries to follow. HFE through equity, but also the trade-off with efficiency and I guess that's where we're grappling a little bit. How do you see the CGC in an outlier world dealing with that trade-off between equity and efficiency, when they themselves have moved the objective to full equalisation?

MR PALLAS: Well, I suppose one of the points I make is the greatest thing that will facilitate equity is to make sure the capacities for raising of revenue by States in their own respective jurisdictions is taken into account. For better or worse, Victoria does not have a capacity to mine the sort of – or to get the bounty of royalty revenue.

If you look back over the last 10 years, let's say, in terms of revenue that the State of Western Australia has got from royalties, in 2004-05, it picked up about a billion dollars in revenue. It reached a high in about '13-14 around about $6 billion in revenue. That came off and by about '16-17, the numbers moving back up to that all-time high in terms of the royalty revenue.

It's true to say that they've gone from about a $4 billion receipt in GST, where I think they peaked out in about '07-08 and they're coming back down now to a number more proximate to $2 billion. But you need to look at that in the context of the great bounty that that State has received as a consequence of the royalties that they're picking up as well.

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From my perspective, what is the greatest impost upon the efficient delivery of services is that there has to predictability in terms of the revenue that's coming in. If you added together both State-based revenue and Commonwealth receipts, all of the States have a fair degree of confidence about what's coming on.

A large one-off hit by applying, let's say, one of the two options, a second-best horizontal fiscal equalisation methodology, if I could call it that, I think that system would massively disadvantage one State, in particular, the State of Victoria.

Most other States, as well, would be disadvantaged by it and Western Australia for a one out point in history would be massively advantaged. I'm not sure that that methodology would necessarily peter out over time, given that they could expect to continue to have a substantial windfall in terms of their royalty revenue going forward.

MS CHESTER: We might come back to metrics and the transition path a bit later. It's always fun when you're starting in a world of outliers and you've got a zero-sum game and a Federal Government that doesn't have too much money to help with transition paths.

I guess the two things that we're looking to focus on in our post-draft report stage are firstly the evidence base around the efficiency effects of the current way we're doing HFE. Then the second issue is if we do recommend moving to an alternative, what would be the best way of managing that from a transition path perspective.

Traditionally, people have focused on the efficiency effects of HFE in terms of the impact on interstate migration, and there we came to a landing that's not disparate from others that have traversed this path before as to say that it doesn't have a material effect.

The other thing we were focusing on and indeed our Terms of Reference asked us to, was what impact might HFE have on the incentives of State Governments to have in place good policies, and good policies in terms of their revenue bases and how they tax those revenue bases, and also in terms of decisions on development activities.

We understand your point earlier, Treasurer, that when a State Government makes these decisions, there's a multitude of factors on the Cabinet table and how it may impact the GST bucket may not be a primary consideration. It's just good to get your sense on that second stream of efficiency impacts in terms of development decisions and impact on tax revenue decisions.

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MR PALLAS: I think just to restate briefly, Deputy Chair, my principal observation that we support the approach that's been adopted by the Commonwealth Grants Commission, reinforcing the need for policy neutrality. Ultimately, States have to be held accountable to their respective constituencies for the decisions that they make.

The other point that I would make before handing over to the Secretary of my Department is, from our perspective, it is important to recognise that the choices that Governments make are not so much exclusively related to the state of their budget, because we have not only a responsibility to run responsible budgets and deliver the expectations of the community in terms of services, but also, we have a direct impact upon the way that the economy operates.

We're effectively a substantial player in the performance of the Victorian economy. What choices we make in terms of tax mix will have a direct impact upon those issues. From my perspective, you look at the way the Victorian economy is operating at the moment, it has massively improved its performance over the last three years.

We now have, if you look at State final demand, in '16-17 we're almost running at twice the speed of the rest of the nation at 4.7 per cent. All of that, of course, underlines embedded obligations upon the State. We've got 2.4 per cent population growth. We have to accommodate those.

The point just principally that I would make is, firstly, States should have the sovereignty responsibility that's been provided to them in the Constitution that respected and, therefore, policy neutrality should be the issue that the States themselves determine and they are accountable to their respective constituencies for the choices they make.

Secondly, I would say you need to recognise that every State makes a choice about the state of their budget, but also recognise their obligations in terms of the state of the State's economy, if I could put it that way.

MS CHESTER: Sorry, just before you hand the baton across to David, it would just be good to know, because this is an area where we've struggled to get evidence and I can understand why most State Governments are shy on this one, in your time as Treasurer and during Cabinet deliberations in any sort of policy matter, has the impact or the expected impact on GST relativities ever been a consideration in any of those discussions?

MR PALLAS: Well, I'm not allowed to talk about Cabinet deliberations, but I can tell you that it is very much front and centre of the Government's thinking, what the impact of GST projections will have upon our budget, particularly for the formulation, the bodies that assist in the formulation of the budget. We keep a close eye on where we see those projections going.

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Of course, as I noted in '11-12, I think it was, the Western Australian budget identified that they could see a shortfall in GST revenue coming through. All the States, all the States keep a close eye on how the methodologies are being applied and how the economic data being fed into that will impact upon State receipts.

MS CHESTER: We're very well aware that the States do keep a close eye on these things and I should have probably said, apart from our work. I guess I was more getting to when the state is considering issues like changes to tax policy or development decisions, or any other sort of policy levers that you're pulling, do deliberations ever take into account what the impact is on GST relativities?

MR PALLAS: For the purposes of appreciating what it will do to total receipts, I think the answer honestly would be yes. But do we gain GST funding on the back of decisions that the State makes? Absolutely not, because it's relatively marginal those decisions, their impact on our budget position.

So, yes, we're cognisant of the impacts that might accrue from it, but they tend to, when they play out, be relatively marginal in terms of the benefit or the disincentive that the State might receive as a consequence of those decisions.

MS CHESTER: We'll try to get to a better understanding of why you think they're so marginal in a moment, because we've had the benefit of reading your post-draft report submission, but I'll shush up now and let David speak.

MR MARTINE: Thank you, Deputy Chair. I just wanted to make a few very brief comments. Firstly, just going back to the first part of the discussion around Western Australian being an outlier, we actually don't see Western Australia as an outlier at all. Our view would be that that's HFE actually working. There's a very good reason why they're getting a very low relativity and, as the Treasurer indicated, it's because they're getting quite high royalties.

Now, whether that's temporary or long term, in our view it doesn't really matter. They're not really an outlier, it's HFE at work. If they continue to get a very high level of own source revenue, including royalties, then for HFE to actually work properly, you would expect them to have a low level of GST going forward.

Our view is we don't think the real issue is whether it's sort of long term or short term, or whether they're an outlier. You would have noticed there was a bit of those issues being picked up in other papers.

That's the first point. The second one - - -

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MS CHESTER: But you would agree, David, that having such a – sorry, for us I guess the outlier is we've never had a State be that fiscally disparate from other States in terms of revenue raising capacity in the history of Federation, and that changes the composition of how the GST pool is distributed.

MR MARTINE: Yes, it certainly means that more of the pool gets distributed than if they were at a much higher relativity, no question about that. The redistribution system has been in place for quite a while. There are some things at the margin that we and most jurisdictions have raised with the CGC from time to time when they do their methodology review, but fundamentally, the distribution system does work well. We don't see the WA situation as an outlier in that context.

Just on the question of the impact of HFE and efficiency effects. There's a little section, which I won't go into in detail, in the Government's report, but we certainly agree with the inclusion of the PC that there isn't really much evidence out there that HFE has been adversely impacting on productivity or economic growth across the economy, so we agree with that conclusion. Just on the question of - - -

MS CHESTER: Sorry, just so we're not mischaracterised, to the extent that there are disincentives for tax reform by the larger States - - -

MR MARTINE: I was just going to come to that.

MS CHESTER: Okay, good.

MR MARTINE: I mean certainly when bureaucracies, and I've had these discussions with my colleagues around the country and the States, if we're developing some policy options, whether it's tax or other areas of Government policy, and we're developing the costings, we don't – and no jurisdiction does this either – present sort of costings to Government saying, "Here's a tax reform on this part of the tax system and embedded in the costing is some sort of GST effect".

As the Treasurer indicated, most of those when you're talking about individual tax measures are very, very marginal. I mean you'd have to be thinking about some major significant rethink of a whole jurisdiction's tax system before you would start thinking about what does this do to the GST.

So, for most jurisdictions, when you're developing in the bureaucracy tax measures to propose to Government, you don't take into account the GST impact of that particular measure because it's just too insignificant.

MS CHESTER: I guess that's why we sort of developed some cameos around more significant revenue reform and we chose one in particular, because most economists will agree that that's a good change to a tax mix.

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That was what started us down the path. Indeed, we went and asked States and Territories for examples of cameos themselves, and we did get some evidence from other States. I think where we sort of found a large disincentive for New South Wales or Victoria from daring greatly and doing a revenue neutral switch between stamp duty and land tax, we found that having a more than immaterial impact on GST. Indeed, we ought to bank between $700 million and $1 million each year. I think you've suggested in your post-draft report submission that those numbers aren't right, that you see it being immaterial?

MR MARTINE: Yes. I'm just finding the right reference. I think it's in section 3, page 19, I think it is. I guess coming back to my earlier comments, the concern or the issue that we raised in our draft report is – sorry, in our response to the PC's draft report, is that's not the way that jurisdictions cost tax measures.

The PC's analysis that came up with the numbers, I think we talked about it at CFFR, makes a whole range of assumptions on elasticities. It's always a problematic area, as you'd no doubt be aware, in terms of costing, tax measures and tax reform, because you can get into a bizarre world where you could propose a reduction in tax and have it raise revenue.

That's that question of to what extent does the second, third, fourth order effects come into play. So, you cut taxes and the argument might be that it promotes growth and people are spending more and there's more company tax. Jurisdictions don't cost tax proposals that way at all. Once again, we would not see even what I describe as a semi-substantial tax reform, such as a stamp duty or land tax switch, as that decision being impacted at all by people thinking of what it might do to GST.

I didn't sit in on the ACT discussions obviously, but they've obviously gone down this path. I'd be surprised if they sat there thinking, "What does this mean for GST?" I think even the semi-major reforms - - -

MS CHESTER: I think in our report we make it clear that it's more an issue for the larger States and it is a first move of disadvantage. So, I wouldn't be surprised, having spoken with the ACT Government about it, and indeed on the public record they've said that (1) they don't have modelling capabilities, and (2) they're such a small jurisdiction that it wouldn't have been as material as it is. It's really for the larger States that we are concerned.

MR MARTINE: I think on page 19 we re-costed that scenario on how we would normally cost those sorts of measures and present it to Governments to show the point that what we would be presenting is actually quite a minimal impact on GST. In other words, it wouldn't be part of the consideration or

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advice from the Treasury of the jurisdiction to say, "If you did this, there'd be a significant impact on GST".

MR COPPEL: This is a really quite substantial change to the structure of taxation, reducing stamp duties by a factor, or by half, and replacing them with land tax. Can you really justify why you would expect to make those calculations on the basis of zero elasticity?

MR PALLAS: If I could just jump in while we get a much better economic response from the Secretary. We've already started a process of removing stamp duty. For example, we've taken the stamp duty off first home buyers acquisitions, up to $600,000, and progressively will introduce up to $750,000.

Putting aside the fact that we offset that with alternative taxing arrangements, that's an $850 million over four-year hit to the budget. If you walk down Collins Street and you bump into an economist, they'll tell you, even my Treasury tells me that a tax on transactions impedes economic activity.

Of course, governments have to not only manage budget and budget inflows and outflows of revenue, but we also have to be cognisant of where the community's appetite for taxation resides. In many respects, I think the idea of the modest reduction of burden on transactions is a good thing. Where we can and when we have budget capacity, we proceed down that route.

We also have to be very much focused on exactly where the community's appetite is prepared to go. Whilst the economists on Collins Street, or wherever else, might tell us that removing those transactions is a good thing, when you tell them the flipside of the equation and that is the family home would ultimately have to have a tax burden attached to it year on year, I think that certainly in the population at large the appetite for that would very quickly dissipate**.**

MS CHESTER: That's why our concern is so great here, Treasurer, because we know it's a political battle to dare greatly and do these good reforms and yet the calculations that we did, including looking at different elasticity effects with confidence bands, that's why we've got such a broad range, why would you bother if you're also going to feel the pain of a GST bill.

MR MARTINE: Just coming back to that particular point, we don't really see it as a key part of the HFE issue. I mean it's an interesting scenario. It's an interesting discussion. We could probably sit here all day talking about the Laffer Curve and elasticities, et cetera, but I don't think the scenarios, even if you accept the proposition that we should be taking into account elasticities, supports in any way the draft recommendations about, in a sense, going to the second or the average.

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In a way, that sort of argument would support a logical conclusion of going to per capita, because effectively what that scenario is saying is that HFE has some impact on – the distribution effect has some impact on how you think about policy. The natural conclusion would be the only way to remove that is a pure per capita system.

In a sense the scenario, whether you include elasticities or don't, and the point we're just making in our paper is jurisdictions don't take into account elasticities when you're costing tax measures. I can only probably think of one in my time in the Commonwealth, which was a very significant tax reform, that they included some of those effects.

Even if you do that, it doesn't really support the conclusions of the report, which is we therefore should extract out Western Australia essentially from HFE because that's the effect of going to the second strongest State. In a way, we sort of see it as an interesting conceptual discussion. We can debate it for some time, but I don't think it's front and centre for the issues at hand, which is whether HFE is working or we should go to the recommendation that the PC has come up with.

MR COPPEL: We're not suggesting that the proposals that are in the draft report would remove that in principle, disincentive. Really what we're getting at, and that's fundamental to the draft report, is a balance between some of the objectives that are being sought through the HFE.

We've certainly got the equity of equalisation objectives, to the extent that there are these disincentives at the margin to State policy, which may have implications then for efficiency. Can we give some weight to those? It's a balancing or trade-off to some of those objectives, which I guess brings me to the point about all of this discussion takes as a given that we've reached a state of full equalisation.

The CGC for about 40 per cent of revenues is on an EPC basis. Full equalisation is an aspirational goal. It's not always possible because there's limitations in data or there are effects that can't be sufficiently accurately measured, so they may be decided on an EPC basis, of there may be discounting.

When you look at it through that perspective and compare it with what we're proposing and we've got a number of examples that sort of illustrate what the changes would be, they're actually quite small across most jurisdictions. That is looking at it from the perspective of today. They would be even smaller when we start to think about transition paths or implementation phasing.

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I'm wondering whether, when you make comments like what we're recommending is a total departure from HFE, given that explanation, how can you justify such a comment?

MR MARTINE: Just a couple of points on that. We, as you would have picked up in the Government submission, we wouldn't see the draft recommendations of the PC as just tinkering at the margin. As the Treasurer indicated, depending on whether it was second strongest or average, it would nearly a billion-dollar reduction in GST revenue per annum, based on the PC's figure. So, it is a significant recommendation. The reason why - - -

MS CHESTER: That's only if we rewind the clock and unfortunately, we don't have the TARDIS. I guess maybe we should jump to transition path and we'll come back some more to the world of trade-offs because it is a very difficult one.

Actually, before we do and it's interesting, I think you sort of hint at it in your post-draft report submission, and it became a little clearer in the CGC's post-draft report submission to us, which I'm not sure if you've had a chance to look at, but it makes the point – it makes it very clear that it's not really around this whole issue, Treasurer, whether or not States have the fiscal capacity to meet their assessed expenses under the CGC's calculations.

But it's really VFI, vertical fiscal imbalance, that's the driver here because we know that even Western Australia, under the current arrangements, cannot meet its assessed expenses. When we equalise to the highest State, it still requires that third step in our little simple diagram of then doing the final redistribution on an EPC basis. Really, it's vertical fiscal imbalance that's driving the issue of State's fiscal capacity to meet their assessed expenses.

MR PALLAS: Well, talking about it to others, I think I could probably - more for Australia on the inappropriate nature of the way our tax system is structured, the disparity between the delivery of services and the capacity to raise revenue as between the Commonwealth and the States. That's absolutely the case and, of course, that situation progressively became apparent early in the years of Federation, but most notably with the Commonwealth using its defence powers to apply the income tax responsibilities from the States and never returning them.

History is history and we deal with the circumstances that we're in, but we are seeing this ever-increasing abrogation of Commonwealth responsibilities to the States in terms of service delivery, but in inadequacy, as it were, of Commonwealth receipts coming in to the States to make up that shortfall.

I definitely accept that VFI is a very substantial issue. For the purposes of the discussions we're having today, it's really around the GST and its

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contribution to horizontal and fiscal equalisation. I suppose the proposition is, what is the problem we're trying to fix here.

We've got a situation where one State is currently an outlier in terms of the aggrievance that they see. I think we've been able to demonstrate on per capita terms their revenue capacities are relatively strong by comparison to other States, whether it's in their own right or whether it's augmented by Commonwealth receipts.

The proposition I put to you, if you say that some States are having difficulty matching their ability to deliver services, firstly, that's choices that they have to make and on the principle of policy neutrality, I won't get involved in an argument about whether or not any particular State has managed those responsibilities well or poorly. All I'll say is that's their choice and they ultimately are held to account every three or four years for those choices that they make.

I do make the point that if you look at Western Australia and you look at the receipts that they have and will continue to get as a consequence of a proposition that's being proposed, particularly on the royalty side, they would have a massive windfall if, for example, we were to go through another mining boom and you had this commodity price spike come through on a second-best HFE principle.

They would be allowed to keep that and it would be literally – I think we did a calculation – be in excess of $3 billion per annum that they would see as the bounty and gift of the revised system and at a time when all States struggle with their delivery of services to the community, struggle with falling Commonwealth receipts.

No State falls or feels more aggrieved than that, particularly on the infrastructure side, than Victoria. The fastest growing population in the nation by quite some distance, but less than 10 per cent of national infrastructure allocations.

MS CHESTER: I guess the reason why I took the discussion there is even WA with its bounty, even they, when you do the first two steps of horizontal fiscal equalisation, when we take every State up to the fiscal capacity of WA, even then they cannot meet their assessed expenses. It wasn't until I read the CGC's post-draft report submission to us that that became apparent.

We'll come back to it because I think your submissions intimate some thinking about longer term Federal financial reforms that are quite - - -

MR PALLAS: Just on that point, I mean every budget that I produce I give an illustration of what our expenses growth is and what our revenue growth is. Over the term, over the fiscal cycle, I make it a very clear fiscal parameter of

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this State that we don't spend more than we earn and that could be hard. It means that you have to make choices, but that's the way that we choose to budget and we think that, ultimately, that is the responsible thing to do.

We also think that the electorate will recognise that economic responsibility is its own reward. Perhaps it's a political reward in the polls, but critically important, these are choices that every State makes, how they balance expenditure to revenue.

MR MARTINE: Just very quickly, if I could just follow on, Deputy Chair, to your comment and just as a reference, on page 12, figure 5 of the Government's submission where we've reworked "is equalised as proposed to the second strongest State", what you do see there is Western Australia's own source revenue, plus the GST requirement, therefore sits above the assessed expenditure.

MS CHESTER: Yes.

MR MARTINE: In other words, we look at that and we would say that doesn't look like HFE because, in this case, one State is receiving more money than they need to meet their assessed expenditure, and most other States are then worse off. So, we wouldn't see that as HFE.

MS CHESTER: Only HFE when it's equalising to the same standard, which means that that bar needs to be the same across, whereas historically the CGC didn't equalise on that basis. It was only more recently that they've moved to the same standard.

History actually reveals quite a lot in this area. We couldn't find any Government, Federal or State, that had ever sort of signed up for this form of HFE. Indeed, I think the CGC started doing it that way in 1981 but weren't on the public record as having done it that way until just prior to signing up to the GST deal.

But then when Victoria signed up to the GST deal, your predecessor, Treasurer Brumby, said we're not signing up with the way that they're doing HFE at the moment because we want to move to EPC. I think we need to be careful not to characterise HFE as a single way of doing it.

The adjective before standard has changed, only recently at the CGC's whim, not at a decision by any Commonwealth, State or Territory Government.
MR MARTINE: But it is the current system. Our counterfactual at the moment is that is the current system.

MS CHESTER: No, I can understand that because that's the starting point at the moment. If we take that starting point, and given some of the comments, David, that you made earlier about sort of the picture you're looking to paint

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about Armageddon for Victoria under moving away from equalising to the average or equalising to the second highest, by just going from same standard to reasonable standard, when you kind of look at that in the context of the Victorian budget, it would only result in about a 1.2 to 2 percentage point reduction in your GST as a percentage of State total revenue.

Then when you look at sort of what changes you've had in GST relativities historically, it's kind of within that bandwidth of change. Then if you actually have a look then at the difference between assessed expenses and actual expenses by the Victorian Government, it wouldn't really make any difference to what you actually spend on assessed expenses, if that makes sense.

I'm suggesting that the changes that we're recommending aren't really an Armageddon. Indeed, the Victorian Government would still be able to, given your current track record of what you actually spend on the assessed expenses, the actuals versus the assessed, there wouldn't necessarily be any less services for the Victorian people.

I'm just trying to do it in term of the contextuals. You mentioned a billion and that sounds like a big number to people, but when you take it into account with the total budget and then what you're actually spending it on at the moment, it's kind of not an Armageddon.

MR MARTINE: Well, nearly a billion out of total revenue for the state of a bit over $60 billion is pretty significant. So, if we did it based on the PC's own calculations, which we've checked, it is in the 900s that we would lose annually. Now, that is a significant number. Yes, we do receive revenues in total of about 60 but, as the Treasurer indicated, $972 million can actually achieve a lot of service delivery here in Victoria, so it's not an insignificant amount.

MS CHESTER: I guess it's coming back to the point, because I'm just conscious that this will inform the debate, the numbers and the suggestions, if it's going to cost this many teachers' jobs and these many police force, that when you look at it contextually and when you also look at what you've spent over time, indeed, over the past six years you've never actually spent your full assessed expenses.

MR PALLAS: That is, we haven't actually run a deficit.

MS CHESTER: Well, no, you've got the money to do it. You've gotten that money from the Commonwealth Government but you haven't spent that. You haven't reached your assessed expenses. You've actually been under it for the last six years.

MR PALLAS: We've managed them responsibly. One of the worrying elements of this conversation, I think, goes to the idea that a financial

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responsibility isn't an assessible goal, as it were in this process. If you look at the longstanding view of the Commonwealth Grants Commission around policy neutrality, it essentially says that governments make whatever decision they make. They are, after all, sub-sovereign jurisdictions who have constituencies that they have to answer to.

The Federal Treasurer who introduced the GST, to which we're arguing about the disbursement of, made it very clear that in his view that the GST was a States tax. In fact, he had a long-running argument with the Auditor-General who qualified Commonwealth accounts as a consequence of that dispute.

The point I make here is if you're effectively saying that States that don't concern themselves with the comparability between receipts and expenditure, who wait upon the bounty of international circumstances and the stuff that they dig out of the ground to provide the capacity for them to manage their budgets, well that's their choice.

I'm not being critical of them. I would just manage things differently and I would run my economy and the way my public-sector expenditure was going considerably differently, but they've chosen not to, and they should not be rewarded for it.

MS CHESTER: I think our draft report has a pretty frank and fair exposition of that. I only raise those points because people talk big numbers and translate them to jobs.

MR MARTINE: Sorry, Deputy, just quickly, just on that point. I think it's important though that the Commission thinks about the impact of its draft recommendations on State budgets, what would actually happen and how would Governments respond.

If we did go down the path of second strongest or average, it would be a matter of fact, based on the PC's calculations that the State of Victoria would lose revenue coming in to our budget in the 900 millions, so just under a billion dollars. Then it would be a matter for Government to choose how to take that into account

It can either, as the Treasurer indicated, cut spending on services and the Treasurer gave some metrics on what that might mean on health and education, or you're letting your budget go into potentially deficit, et cetera. Those choices would need to be made. But it is actually a real reduction in revenue coming in to the State.

MS CHESTER: No, no, and that's a perfect segues to transition path, David, so thank you for that perfect segues. We are very mindful and nor would we ever suggest, and we say that in our draft report, that we would never

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recommend Government do a sort of an overnight cold turkey and move to ETA or equalising to the second highest.

Indeed, when you look further down the transition path and WA, I don't know if you've had a chance to look at their post-draft report submission, but they've suggested a transition path that would sort of – and this is their longer transition path which they think is their generous transition path. It takes you out to 2026-27, so a nine-year period to help States with the transition and budget management, as you rightly point out, David.

That would only see Victoria actually as a net winner during that transition path period. There would be no impact on the Victorian Government for the first three years, just over 30 million for the next two years and then you're up above hundreds of millions positive beyond.

That's why we do want to focus on transition path in this stage of our consultation and just get your thoughts on what would be some guiding principles. We only touched on one in our draft report and that being making sure that the smaller States weren't materially disadvantaged. I note and would want to take into account any immediate budget effects.

This sort of transition path that WA has suggested, and it would be good to get your feedback on it, would address the concerns that you've raised with large number of 4.4 billion and one billion and the like. What would be the guiding principles that you'd want us to try to take into account if we are to craft a transition path for the Government in our final report?

MR PALLAS: The first proposition I put to you is we're not interested in a transition path. I think we've given you a pretty compelling case that the HFE principles underpinning GST actually achieve their stated objectives. There is no discernible reason in merit why the State of Western Australia should be given the sort of bounty that's been proposed here.

For them to propose a transition path to that bounty, I think just leads to the obvious conclusion that whatever – and I will be judgmental here on Western Australia – whatever bad choices the Liberal Government made in that State for many years, the size of their bureaucracy, the choices that they make in respect of where State gets involved in the delivery of services, there has been no imperative for them to make change and that is a decision that those Governments have had to live with.

We've taken a different path as a State, through consistent Governments over a long period of time recognising that we have to make choices. The idea that the State should be subjected to the uncertainty and, might I say, the unwarranted intrusion of a path towards a transition to a bounty for the State of Western Australia, is something we would oppose. We oppose it simply

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because what's broke in their system, in terms of a fair dispersal of entitlement to each State.

We're probably one of the few States that makes a contribution to the Federation who comes here and says we support the principle of horizontal fiscal equalisation. We're not talking about per capita shares. Our position has, in a nuance sense, changed over the years. We recognise our responsibilities to the Federation, responsibilities we've complied with each and every year of Federation.

But to now suggest that the process that the Commission is heading down is that the State should contend itself with a transition to a system that we see as being suboptimal, and certainly worse than the existing arrangement, I would simply say to you we are not interested in such a distortion and such a gift of bounty to the State of Western Australia, a State that has made little effort to address its underlying economic and budgetary providence.

MR MARTINE: Sorry, Deputy Chair, if I could just add one important point about the transition. To actually come up with those numbers you've mentioned, we're talking sort of nine years out, no jurisdiction has any revenue or spending forecast beyond a couple of years.

MS CHESTER: I know and that's one of our biggest challenges, so we've asked WA for the underlying metrics. Indeed, we'd probably want to talk to State and Territory officials around those projections to see what sort of confidence we could attach to them, albeit we know it's very difficult. I guess intuitively we kind of know, given Victoria's starting point, that if you get three or four years out and you're getting closer to EPC, Victoria is a net winner here in a budgetary sense.

MR MARTINE: The problem is most projections, and all State and Commonwealth Treasuries do longer term projections, but they all do the same thing, which they assume we all go back to normal. So, if the projections are all assuming that we all go back to normal, then it's not surprising that Western Australia's proposal, they would argue has minimal impact on the other States because the underlying assumption is that we're back into a normal world.

MS CHESTER: No, and we did ask them that very point because that was our thought as well. We know everyone normally goes back to historical trend. We do have them on the record as saying that they are forecasting their bounty continues. We'll look closely at those numbers, but intuitively speaking, medium to longer term, and correct me if I'm wrong, Victoria would stand to benefit from moving away from equalising to the highest State in a fiscal sense.

MR MARTINE: I can't see how that would be the case.

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MS CHESTER: Moving closer to EPC would always benefit WA, wouldn't it?

MR MARTINE: I'd need to sit down and – I don't quite understand the WA point, because I can't see how – whether you transition overnight or whether it takes nine years, to me the point is still the same, that Western Australia has a very significant own source revenue and royalties. So, unless, somehow, they're predicting that that's going to drop away substantially, then I can't see how we can end up at a substantially different end point to what we've got in the submission.

MS CHESTER: I think the starting date does matter a lot because of where we're starting at the moment with their relativities being so low. We know it takes three or four years for them to even get up to early 70s or late 60s. As you delay that starting point, the impact on other states like Victoria are less than the early years.

MR MARTINE: I guess the other point about transition is in 15 years, and let's say there's another mining boom and WA's royalties go back up to where they are now, and then they should have been down to 0.3 which would have been the proper outcome of HFE, if we adopted the PC's recommendation, then they wouldn't be. So, in a sense, Victoria would be worse of by the 900 million because the counterfactual would have been HFE would have been operating in 15 years' time under the current parameters.

MS CHESTER: I guess that gets us to the issue of we never know who the future outlier will be. Living in South Australia, it could be an outlier in 10 years' time.

MR PALLAS: I think we could take a safe guess that Northern Territory will be one outlier.

MR COPPEL: I'm conscious of time and in your submission on the draft report you make the point that if there are specific issues with the current process, it's better to adjust those directly. One area that has come up is the way in which the assessment is made for resource royalties. The CGC has proposed discounting 50 per cent of the increment of new resource revenues which is essentially also moving away from full equalisation. I'm wondering if you have a view on that suggestion from the CGC?

MR PALLAS: I think the first proposition I put before I answer that question directly but I'll give it a shot and then I'll ask David if he'd like to complement or add to that. The first point I'd say is have we started a process that we've become obsessed with getting a solution where there is no problem here.

Whilst Western Australia might be unhappy about the headline number of what their GST share is, their receipts per capita are considerably more than

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the State of Victoria. Let's be very clear about that, in terms of that they get from their State tax and royalty revenue per capita or in terms of what the total allocations that they get are from both State taxes, royalties and Commonwealth share. So, what's the problem we're fixing here, apart from a sense of grievance.

MR COPPEL: In this particular area, it's policy neutrality, because it's such a dominant iron ore producer that its decision can affect the average rate that's used then for the assessment.

MR PALLAS: When you say its decision, any decision it might make around royalty rates essentially. So, what we're saying is, despite the fact that they have a pretty clear projection in terms of where they think their revenues are going in terms of royalties and you say that you're satisfied with those observations, the practical consequence is if they were to choose to distort the projections, either by reducing their royalties or increasing their royalties, that that would distort the way that the GST parameters exist.

My answer to that would be, let's address that problem if and when it occurs. But at the moment, we don't have a problem. I think this is an inquiry in search of a solution to a problem that doesn't exist, quite frankly.

The second point I'd make is that so far as the Commonwealth Grants Commission was concerned, they I think pretty directly dealt with the question of whether or not they should move into the issue of policy neutrality around choices that States make around the extraction of onshore gas, for example. They made it pretty clear that they didn't see any role for themselves in getting in to the choices that the States make, because quite frankly, it's weighing up one industry, one economic opportunity against another in the mind of the State of Victoria.

In respect of the specific issue, I can't really add to my broader comments. David, you might have some observations to make.

MR MARTINE: I'll just make a quick comment, Treasurer. I'm sort of struggling to sort of understand the logic behind discounting one part of a State's revenue base. I mean it's a bit like sort of arguing that here in Victoria we should get a discount on our stamp duty revenue. If we're going to stick with the principle of HFE, then our view would be that the royalty revenues in a jurisdiction or stamp duty or whatever it might be, I mean that's part of the base.

MR COPPEL: I mean the CGC currently does discount quite a few specific revenues, own revenue sources, and they do that when they don't have full confidence in how they measure it.

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MS CHESTER: I think the important point here is this is where the CGC is trying to do the trade-off between equity and efficiency. Where they're saying there's issues of policy neutrality, with mining royalties for WA because they set the average, thus they won't optimally tax that royalty, that revenue base. Thus, they've now got a live recommendation in their current methodology reviews.

It's relevant to our inquiry because we're sort of saying we think the trade-off is not being managed well at the moment. Here's the CGC, with the only levers that it's got, pulling and pushing on them. So, that's why it's a really pertinent question to ask in the context of this inquiry.

MR MARTINE: Yes, but once again, similar to my comment about elasticities, I don't see that as really a logical then direction towards the PC's recommendations of we would argue, in effect, carving WA out, because there's no question that there are things that can be improved in the current system. We have continuing discussions with the CGC and we have good robust debates with them whenever we have the methodology reviews and all jurisdictions do that.

Fundamentally, the system is working, if you accept the principle of HFE, because the alternative is you're going to equal per capita, because I think the recommendations in the draft report I think are moving away from HFE, and we would argue is making the system actually worse.

So yes, there are things that in the current system need to be addressed and we have continuing discussions with the CGC, particularly on the expenses side and some of the discounting there. Those discussions will always occur and we'll always be having discussions how to improve the current system. Fundamentally, our view is the current system of HFE is actually working.

MR PALLAS: I'll just try to supplement that by making the point, I think you'll find to the extent that you speak to the other States, and no doubt you've got their submissions, if you've managed to find a proposition that's earned a far degree of chagrin from most states, but with one notable exception.

The point that I think the Secretary made quite clearly is there's a fair degree of acknowledgment of the way that HFE operates at the moment. If you change it in the way that you're proposing, you lose the buy in of the States. You lose one of the great supporters of HFE in the State of Victoria, and you end up in a system where all the States are just saying, "Give us back what we put in".

We will lose something quintessentially Australian as a consequence of that. We don't want to have States in this country operating like certain States in the United States, and I won't name them, for fear of getting into trouble.

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But their receipts are essentially substantially disparate from some of the other wealthier States.

We've made a genuine effort in this country to ensure that we provide an Australian way of life, and HFE is a key component to it. Whether or not the GST is the appropriate methodology for it, I think the debate's come and gone. From our perspective, we see that you need to tread carefully here because you will lose a large measure of consensus around the States, whether it's a robust endorsement or a qualified one that the GST has a role to play in HFE.

MS CHESTER: One way of looking at it is the HFE principle isn't just about equity and equality. The CGC actually does have other subsidiary principles and one of them is the efficiency and policy neutrality. We're now seeing a situation where the CGC is looking at turning on and off some of these levers that they previously hadn't contemplated. So, the 50 per cent discount on an increase in royalty rates for WA, taking CSG out of the GST pool consideration, similar to gambling for policy neutrality reasons.

What we're saying is that you're sort of presenting HFE as this equity and equality and the aspiration is fully achieved, whereas what we're seeing is it's not fully achieved for reasons Jonathan intimated before around discounting and the like, what's considered and what's not. Moreover, the CGC, because of the pressure on the system at the moment and getting that trade-off, they're starting to look at pushing some big buttons and making some material changes to the way that it's done.

MR PALLAS: I mean the headline that I got from the CGC's report was they remain robust supporters of the idea of policy neutrality. To the extent that they would move away from that, to the extent that they would actually advocate that the system alter, based on choices that the State make, I would oppose. I'd oppose it quite simply because where do we stop when we get into that area. Do we look at, for example, whether the leasing into the private sector of certain undertakings of the State should or should not be rewarded, a very hot political issue in the public discourse that's going on.

The point I make is if an administrative body is charged with the responsibility of ensuring that the tax base is operating fairly and the States are being given adequate opportunity and equity in the processes, as soon as you start getting into that space, how do you get out of it. Then the role that you perform becomes a political football with everybody arguing about whether or not their policy solutions are the right ones.

I've said some things today about what I think about the previous Western Australian administration. I'm sure there would be spirited debate from the contrary point of view. Really, all I'm giving you an insight into is the sort of slippery slope that I would argue strongly that this Commission, and indeed the CGC, should not be interested in getting involved in.

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If that really means that the CGC is looking to dissipate the concept of policy neutrality, all I would say is that the State of Victoria would argue very strongly against it. Our sovereignty is something that we value importantly in this Federation. Going down this path, I think, only gets us to a point where every point you make is essentially a political one.

MS CHESTER: I've got two more little questions and I'll get into trouble from the team if I don't ask them. I'm very conscious of time, but also, I'm very mindful that I don't want to be seen to have mischaracterised the CGC. They are actually trying to secure policy neutrality with the sort of recommendations that they're making.

The two other questions, Treasurer, and one area where we do agree because there's much that we do agree upon in our draft report and your submissions and feedback to us, is guidelines for quarantining Government grants to the States. We know that certainly in the case of Western Australia recently, part of dealing with the outlier situation and the relativity falling was the Commonwealth Government making some infrastructure transfers of funds to the WA Government.

Your post-draft report submission says that you would only want to see quarantining occur, so not taken into account for the GST relativities, in exceptional circumstances. We kind of said the same in our draft report but we'd like to know what you think the exceptional circumstances might be because we struggle.

MR PALLAS: For example, if the State were to sell an asset to the Commonwealth and the Commonwealth were to pay for it, we would not see that funds to be seen in any way as a grant or, indeed, incorporated into an assessment of GST entitlements, to give you one relevant and probably real example.

MS CHESTER: On what basis, because it does change the fiscal capacity of Victoria by having received those monies.

MR PALLAS: Well, we're a vendor, in practical terms, and the Commonwealth, if they want to purchase from us the asset base of the State, we're simply converting an asset of value into dollars. Nothing really changes in that respect on our balance sheet.

In practical terms, for that then to be used as a justification to reduce the State's entitlement to GST, I would see as being – well, that would be one of the principles that would stifle the exchange, economic activity. The sort of issue that you highlighted around stamp duty would be writ large in the context of that sort of transaction. Let me say, whilst I have one in mind, there would be many others.

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Let me be clear, I shouldn't be precious, the Snowy Hydro, the Federal Government are extremely keen to acquire it. I tell you, if, ultimately, I saw the State's entitlements in any way impeded out of the GST, well the answer would be "no sale".

MS CHESTER: To that extent, the HFE is an obstacle for your consideration of privatisation or the sale of assets? It is something that you take into account?

MR MARTINE: Only in the sense of if in the discussions with the Commonwealth, and it's quite rare – I mean the Treasurer made the comment about the Snowy, I mean we don't here in Victoria have – well, two issues, many assets left to sell. Secondly, it's quite a rare thing to be selling potentially, an asset to another jurisdiction. It only really sort of comes up in that particular context. It's a very, very rare unique thing, that particular example.

Your comment is quite right, it's a hard one to put a ring around what does "exceptional" sort of mean. I mean some times you may be in a situation where, for whatever reason, the Commonwealth Government of the day really wants to do something in a particular State and there's money available to it, to that particular State.

It can, in certain circumstances, be a bit unfair for the Commonwealth to come on and say, "We really want, Victoria, for you to do such and such and here's $200 million to do it and make a big announcement about it". Then over here you discover that you've lost a third of it through the GST over three years.

MS CHESTER: But isn't that HFE working like you want it to, David?

MR MARTINE: No, but in that situation, it's not necessarily the State making a conscious choice that it actually wants to do that. Some times it's the Commonwealth actually wanting to achieve its own objectives in the particular jurisdiction and so it's a hard one because sometimes you're quite right, the HFE should kick in.

But other times, you could argue that HFE shouldn't kick in because it's really only being done because the Commonwealth of the day, Government of the day wants to deliver on something that's quite unique in that particular State. It is really hard, I agree, to put a ring around it, which is why we probably used exactly your words, which is "exceptional circumstances".

MR COPPEL: There are some principles in it, typically to the extent to which the Commonwealth is trying to achieve some national goal, in which case you would treat that funding separately from own sources of a State revenue. For

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the case of an asset sale, I mean it's not an economic activity, it's just a transaction.

MR PALLAS: Let's give a real example around the interaction between the Commonwealth, the National Homelessness Agreement (NHHA), where effectively the Commonwealth have introduced legislation, the practical consequence of which is if the States don't make policy changes that have absolutely nothing to do with the Commonwealth. They are not within the Constitutional purview, then you will be compromised in terms of your entitlement.

Now, does that drive economic efficiency? No, and I think I run the risk of treading into political grounds here, but I think I would say the Commonwealth's interventions around housing affordability have been nothing but shambolic in this process and counterproductive. But to then try and use one policy level and a national partnership, which brings with it an implied loss of sovereignty that the States with open eyes go into, yes, we will contribute a certain amount of our funds in partnership with the Commonwealth within this area of activity.

For then the Commonwealth to say that's not all we're interested in, we'll give you the money and now we're going to go to the front of the bus and drive it and tell you what else you should be doing in order to get the money, that essentially the States could have become accustomed to receiving, because it may have been one or two or three iterations of national partnerships.

Changing the rules, the loss of fiscal independence of the States through the leveraging of national partnerships, all of that has a profound and negative impact upon the sovereign responsibilities of the States.

This sort of shambolic movement from one policy obsession to another, makes it incredibly difficult for States in the long term to manage budget planning. What we don't want to see at large, in effect, is this principle of policy neutrality starting to infect the GST.

MS CHESTER: I think that sort of brings us back to one of the earlier points and probably for us the more significant policy issue needing to longer term around vertical fiscal imbalance. If that were to be addressed in Federal financial relations somewhere down the track, Treasurer, do you see the HFE would evolve as well?

MR PALLAS: I suppose we're looking a fair way down the track in the future.

MS CHESTER: The Commission's in this for the long play, Treasurer.

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MR PALLAS: Good, good. I'm glad to see a sign of your commitment. My observation about that is the fundamental principle of HFE has to be I think preserved and that is the States have some sort of equity in terms of their per capita share of funding and for me, that's the final principle.

It's not just State taxes and royalties. Over time it will be that mix between State and Federal. If you went back to the earlier graph that I showed you, essentially identifying the State and Commonwealth totality of per capita allocations, once again, Victoria is down the bottom of that charge.

If, for example, that blue level, because it started to drop away even further, Commonwealth funding, because of variations to VFI, the advantages of States in their own revenue, I would not have a problem with that change in mix between blue and red, as it were, of funding source.

The principle that, really, we're seeking to preserve here is the idea that the States in a policy neutral sense can make decisions that impact upon the material circumstances of their populations, and that we've got an expectation that we can budget into the long term and have some confidence that our revenue base won't be eroded.

MS CHESTER: One final question before I allow you to escape. I know we've gone well over but it's been a very good session from our perspective and I hope from yours. On data, and I thank you very much for in your post-draft report submission agreeing with us about allowing the data that the CGC holds and their own calculations to be shared with the public. As we sort of grapple with the transition path, and this might be more a question for your Secretary, how far out do you forecast relativities at the moment for GST and would you be able to share those with us to help us with our work around transition path.

MR MARTINE: Essentially, like every jurisdiction, including the Commonwealth, our budget forecasts are only for two years. At the moment we've got '17-18 and '18-19. They are our genuine forecasts, and then beyond that, like all jurisdictions, we project and you project to sort of the - - -

MS CHESTER: Sorry, I should have used the "P" word, not the "F" word. How far out do you project and would you be able to share those with us?

MR MARTINE: Yes, I'd need to sort of have a look at it. I was going to mention before we finished that I'm more than happy to make my department available to the Commission, as I think we've already been doing, to flesh out some of the more technical aspects of our report, but let me have a look at that.

MS CHESTER: That would be great. We would welcome that help and involvement.

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MR MARTINE: Okay, thanks.

MR PALLAS: I think I should at least give my department some acknowledgment too, Deputy Chair, both for the presentation that they put together and also - perhaps I'm not allowed to say this, David, but I will. We did an assessment of our GST share, at the numbers that we would get in GST in '16-17 budget and when the final audited accounts came back – now, remember there's a fair bit of assessment and calculation – it came within a very small amount of being right on, right on the bullseye.

The point I make here is the fact that we could assess under the methodology of the GST where we were likely to land is not only a tribute to their skills and capacity, but also to the fact that that predictability helps us in terms of forward budget planning.

MS CHESTER: We've benefited from their very professional help with us during this inquiry and engagement and we look forward to that continuing as we try to get to the finishing line. Thank you very much, Treasurer. Thanks, David. Thanks, Amy.

MR PALLAS: Thank you.

MR MARTINE: Thank you.

MS CHESTER: Sorry, folks, we are running a little bit late. I'd like to call our next participant, Peter Brohier, to join us. Good morning, Peter.

MR BROHIER: Good morning, Ms Deputy Chair.

MS CHESTER: If you'd just like to state your name and who, if any, you represent. I know we've met before in my previous inquiries in Tasmania.

MR BROHIER: I'm a little bit hard of hearing and also sight but I am Peter Brohier. I'm not representing anyone but I chaired probably the largest commercial committee at one stage that convinced a couple of Prime Ministers to do something significant in relation to Tasmania and Victoria.

MS CHESTER: Peter, thank you very much for being a participant in our inquiry and thank you for your submissions that you've made to us. Jonathan and I and the team have read those in detail. Is there anything else you'd like to say in addition and briefly in addition to those submissions?

MR BROHIER: Yes, I would and I've heard the Victorian Treasurer this morning. It seems as though there somehow is an issue of dividing up an existing cake of GST revenue. I believe in the case of Tasmania that that cake could be grown very significantly very quickly.

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From my experience over the last 20 years, I've seen a massive Federal scheme able to drive the whole economy of Tasmania turned into subsidies. When added to other subsidies in ways that Canberra has benefited Tasmania, I could basically come to the conclusion that Tasmania is really run by subsidies. We gave, or my committees, gave Tasmania the opportunity of having an equal transport link, the sort of thing that was contemplated by federation. Federation was an idea to integrate the economy of this nation by linking the States and moving freight and people. Now, my focus is on people.

The idea was that our Bass Strait issue was to integrate the Tasmanian economy and allow virtually the Hume Highway to extend to Tasmania via Melbourne to Tasmania, but by using the ferries as though they were part of the highway system. That scheme, almost from its inception, but certainly five years later, had been turned into a subsidy arrangement. It was extremely hard to get a scheme put in place that would do that. Tasmania has, probably maybe since the shipping lanes of the world were discontinued, effectively, as connecting the colonies, Tasmania has gone backwards. It's gone backwards because it hasn't been equally linked. All the other States have enjoyed an integrated transport system that Tasmania hasn't.

It's my contention that right now, with the existing funding that we got 20 years ago, it's uncapped, demand-driven funding, dealing with Bass Strait. That funding could be used almost immediately to change the way that funding is actually applied by the operator who is owned by the Tasmanian Government to actually deliver that extension of the Hume Highway right down the Midland Highway, right to Hobart.

MS CHESTER: Peter, I might just see if I can pop in and ask a question here, because I know we dealt at length in a previous inquiry with the Bass Strait Passenger Vehicle Equalisation Scheme. I guess what we're focusing on today is horizontal fiscal equalisation. Could you just explain to us what change you think needs to occur to the way we do horizontal fiscal equalisation with respect to Tasmania. If you could just focus your remarks on that, that would be really helpful.

MR BROHIER: I'm happy to but I was just setting the scene because the scene is important. My contention is that the States ought to be treated equally first up. The idea of Federation was to link the States into this integrated national economy. I don't think Tasmania is integrated. It's operating virtually on a separate economy and we are funding HFE payments to Tasmania to help with that situation. The whole situation can be changed. We shouldn't be comparing Tasmania with Western Australia and South Australia and every other State. We should be making Tasmania an equal State in our Federation, which was the intent of Federation and, as I say, can be achieved by a very simple linkage of Tasmania to affect its whole economy.

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Once that economy is affected, then you can make the division of HFE in terms of how much should go to the Tasmanian people and how much should go to the Western Australians. Otherwise, what you've got is a State with virtually a self-imposed impediment to its development, right there with the opportunity to change it immediately and to increase its GST contribution, and to make HFE expenditure in Tasmania work much more efficiently, because you're spreading your Commonwealth HFE payments to Tasmania, or Grants Commission payments to Tasmania, where you've got a population increase.

You've got a viable movement of people within Tasmania and out of Tasmania. This is not a small thing. It's got the ability to drive maybe the generators of about 70 per cent of gross State product. Currently, I would suggest, with the present configurations of turning this equalisation scheme into a subsidy, you're driving about 7 per cent of the Tasmanian economy with a flow-on trickle effect maybe to some others. You can immediately change the size of the cake. HFE could be an overlay over that and I think your paper hasn't dealt enough with that.

You also, I think, suggest that there's no proof of things like that. Well, I've watched a massive scheme that can change an economy and did change an economy. When the scheme was first introduced, it changed it so much that the Economist magazine reported the changes worldwide.

MS CHESTER: Our main takeout from your submission and your opening remarks and thank you for those is you don't want to change HFE but you think before we overlay HFE, your longstanding recommendation for a land bridge between Victoria and Tasmania needs to be in place.

MR BROHIER: It needs to be in place and the psyche of Tasmania needs to change to have the same rights as Western Australia and other States. Once you connect them – so, I believe in transport equalisation. It's not just about my idea for Bass Strait. We were a huge committee and we convinced the nation to fund such a thing. I'm not here because of that. I'm here to say if you're going to start funding HFE contributions to Tasmania, get the platform right, based upon Federation, and then move to the second level of service delivery equalisation as part 2.

MS CHESTER: Did you have any questions, Jonathan?

MR COPPEL: Not at this point.

MS CHESTER: I don't have any more.

MR COPPEL: Maybe then I'll ask you a question about - - -

MR BROHIER: Sorry, could you speak up a little bit because I'm very hard of hearing?

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MR COPPEL: Sure. Sorry, I speak very softly, so if I speak louder I'll lose my voice, but I'll do my best. You make the point that the system of HFE is providing some form of implicit subsidy to Tasmania and that those funds could be better used, first off by making the Tasmanian economy more integrated with the mainland. My question to you is if there were this type of link between Tasmania and the mainland, would that itself provide that level of integration that you think would then be the sufficient step to then think about HFE?

MR BROHIER: Given that Tasmania's largely a service-based State that needs people, the movement of people between the biggest population centre in TT-Line has even made comment about that. So, it would drive a whole economy, set the right pattern or position for Tasmania, and would also benefit Victoria with the flowthrough of people through Victoria to Tasmania and back again.

This is not hypothetical. This has been an actual opportunity that Tasmania has had, but someone has fiddled with the system and turned it into another subsidy. If we keep doing that and then have Western Australian taxpayers fund Tasmania as though it was an HFE payment properly allocated, what we're doing is, instead of looking at bounties on one end, this is like a bounty for Tasmania that's an obligation under the deal they did at Federation.

What we're doing is we're not accepting that. We're taking Western Australia over here but we're leaving Tasmania here and not putting that rigorous obligation on them. There's no obligation for money. We gave them the money. The money's there. There's slight adjustments that need to be made that could be made overnight and you would have that Hume Highway flowing into the whole of Tasmania, and I'll tell you what, your GST take and everything else would change.

MS CHESTER: Peter, we thank you very much for your submissions and for appearing here today. We don't have any other questions for you.

MR BROHIER: That's good. Thank you.

MS CHESTER: I'd like to now say that we'll just take a short five-minute break and then we'll resume in five minutes. Thank you.

Thank you, Peter.

MR BROHIER: Thank you.

ADJOURNED **[10.38 am]**

RESUMED **[10.45 am]**

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MS CHESTER: Folks, we'll resume the hearings, and I'd now like to welcome Dr Vince FitzGerald and Jerome Fahrer from ACIL Allen to join us and welcome. Thank you very much because you've both been very generous during the course of our inquiry with meeting with us and also with the submissions that you've provided and the work that you've done with and for the New South Wales Government and we're very appreciative of that.

Just for the purposes of the transcript recording, if you could each just state your name and organisation and then if you'd like to make some brief opening remarks, that would be great.

DR FAHRER: I'm Jerome Fahrer from ACIL Allen Consulting. On my right is my colleague, Vince FitzGerald.

DR FITZGERALD: I'm Dr Vince, or Vincent if you prefer, FitzGerald, and also a Director of ACIL Allen Consulting.

DR FAHRER: Thank you, Commissioners. As you are aware, we have through this process provided some advice to the New South Wales Treasury, but I do want to emphases, and for the record, that we're here speaking for ourselves. We're not here speaking on behalf of the New South Wales Treasury or the New South Wales Government. Their views are their views. Our views are our views and, as they say, any overlap is merely coincidental.

It's not our intention to say much by way of opening remarks, just a few points and maybe we'll just tease out what we have to say through question and answer, because there's more topics than there is time to talk about. So, we'll concentrate on what you want to talk about, rather than what might want to talk about.

Just quickly, just by way of preamble and just to set the scene and our view on the system, the first thing you have to say is that the HFE system as it exists today is complex. It's overengineered and it's opaque. Very few people understand it at more than a high level. That, in itself, is undesirable because you can't have such an important system of fiscal transfers which hardly anybody understands. It's just undesirable for that reason in itself.

The second point is that while some horizontal equalisation is desirable, there's nothing in the theory or international practice of HFE to suggest that the Australian system of 100 per cent equalisation is optimal. This is a peculiarly Australian practice and institution and we shouldn't assume that it has to be this way. In fact, our view is that it ought not to be this way.

Third point is that you can't meaningfully talk about reform of HFE without talking about reform of vertical fiscal imbalance in Australia. If there

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was less vertical fiscal imbalance, which is to say the States could raise more of their own revenue, there would be less of a need for these equalisation payments.

The fourth point, and this is just a bit by the by, this inquiry and current national discussion has been driven by the Western Australia experience. I don't think we should get too hung up on that. What the WA experience is, is the residual effect of a once in a century mining boom which may never happen again, not in our lifetimes in any case.

What the Western Australian experience does show though, or brings into sharp focus, is the problems of the current system. The fact that it relies entirely on relativities and unilateral action by one State can have negative effects on that State's fiscal outcomes, although I think it can be shown that Western Australia's budget problems are largely of their own making anyway.

DR FITZGERALD: May I just interpolate that. Part of the roots of the Western Australian problem is the treatment by the Commonwealth Grants Commission of all tax bases as completely non-substitutable, whereas in my view every State and Territory, if it has modest or poor prospects of raising money from tax base A, has many other tax bases that they can look to to raise the money.

So, part of the Western Australian problem is that because it's the only State – give or a bit in New South Wales – that has iron ore, all the other States are treated as being completely bereft of iron ore, but ignoring the fact that they have other possibilities to raise tax.

DR FAHRER: The penultimate point I want to make is that the zero-sum nature of the system makes reform extremely difficult, if all you're trying to do is reform the HFE system because it means that any change which causes any State to lose one dollar can, in practice, be vetoed by that State.

That means that tinkering around the edges, equalising to the second highest State, rather than highest State, or giving discounts here or giving discounts somewhere else, is really not going to help you very much. It's just going to upset the status quo, which will make some State worse off than it would otherwise have been. They will say no, and that will be the end of the discussion, unless HFE reform is combined with other reform, in particular, VFI reform but, while we're at it, tax reform more generally. You've got to do them all together. But this is not news. We've had a go at it, Vince and I, in various roles over the years. It can be done.

As for the particular proposals put forward by the CGC in its submission and its principles paper and other technical aspects of the system, well perhaps we can just deal with them in question time.

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MS CHESTER: Great. Thanks, Jerome. Vince, did you have any other opening remarks you wanted to add?

DR FITZGERALD: I would just make this observation, that the philosophy of horizontal fiscal equalisation as it has been developed notably by the CGC itself in recent times is light years away from what was originally the genesis of section 96 in the Constitution, which said that, and it was actually in response to WA as well. WA was threatening not to join the Federation unless it was given special financial assistance because it was in fiscal difficulty at the time.

Hence, the founding fathers brought in section 96, which said that for a period of 10 years - it was supposed to be sunsetted - but thereafter until the Commonwealth other decides, the Commonwealth can provide assistance to a State on any terms that it sees fit.

In what I consider to be a bizarre interpretation by the Courts since, that condition has been judged to be legitimately a condition where the Commonwealth requires the States to forgo the exercise of a power that they have somewhere else in the Constitution. For example, their still extant Constitutional ability to raise income tax. The Commonwealth passed legislation during it, after the war, to make sure that any State that dared to raise its own income tax again would be severely punished by reduced grants.

What we had originally was something that was intended to be a fairly simple form of horizontal fiscal equalisation. Liberally interpreted, it was that if any State was in fiscal difficulty to the extent that it could not provide a reasonable level of services to its citizens, then the Commonwealth was empowered to give them assistance so that they could.

That is very similar to the philosophy of fiscal equalisation in most other Federations, that there is no attempt to comprehensively equalise, but to make sure that, whether it be a Prince Edward Island or some other poor province in the Federation, would be given enough assistance from the central Government out of its resources to be able to provide services that are reasonable or decent, minimum acceptable to citizens of the whole Federation.

That philosophy, it seems to me, would be a much better start than comprehensive equalisation, as we have now.

MS CHESTER: Thank you for those opening remarks. We might start where Vince has taken us and that is that history kind of reveals much here and, indeed, in our draft report we did touch on the evolution of the adjective and what adjective was stuck in front of the word "standard".

The reason I raise it is more in terms of what that might mean in an institutional and a governance sense, because the best that we've been able to

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untangle is that no Commonwealth or State or Territory Government ever sort of signed up to the same standard. It just involved by the CGC, which is a statutory agency. It was part of our report, the issue of what role should the CGC be playing here and what role, indeed, should the Commonwealth be playing here in a policy sense in setting the objective.

DR FITZGERALD: The CGC itself, if you go back to the reason it was established, was to ascertain when a State claimed to be in fiscal difficulty how much it needed and it wasn't done in the way that they do it now. I'm sure it was in a way that looked to some concept of reasonable or minimum acceptable level of services and how much they would need and for how long to be able to do that. I think that it would be a far better system if you stuck to that sort of philosophy, rather than to comprehensively equalise everyone to the average and to do so within the straightjacket of a zero-sum game, which, by the way, the Commonwealth could change if it ever wanted to, as long as it could get a majority in both houses which might be a bit difficult. It certainly would be a useful element of any attempt to reform to remove the legislated veto of any State over any kind of reform of the GST, even say broadening the base or raising the rate. That, in other words, means it's a big impediment to vertical fiscal equalisation or vertical fiscal balance reduction, as well as bedevilling attempts to reform HFE.

DR FAHRER: If I might add a couple of words on governance. The CGC does seem to have an extraordinary amount of discretion and power, if you like, in interpreting the general policy. It has this because (1) the system that it administers is so complex and, (2) because it's open to its interpretation. So, as we understand it, and we've heard this from more than one State Government, if they're considering some tax reform, in some cases they don't know how the CGC is going to interpret what they do, so complex and so uncertain are the CGC's processes, and that's quite an extraordinary situation.

MR COPPEL: On that point, we make in the draft report a recommendation that there should be the option or the possibility for a State to ask the CGC for a draft ruling, a bit similar to the ATO. I'm wondering if you had any views on whether that's a solution?

DR FAHRER: As long as it's a binding ruling, ATO-like, that would be a very good thing. There are genuine issues of interpretation about is this a new tax. Is this a new tax of an extension of an old tax? This makes a very big difference or can make a very big difference to the amount of GST that each State ultimately gets or loses from a particular reform. The CGC, I mean we're not going to say it's a law unto itself but it does possess quite a large amount of power and discretion and nobody seems to be able to do anything about it.

DR FITZGERALD: One of the most obvious cases is the reform which many economists, not only here but in the UK where I have been until late last night,

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the idea that instead of having a transactions tax on property transfers, there should be a land tax. All economists know the arguments for why that would be an efficiency enhancing reform. The difficulty is that on the most likely interpretation by the CGC here, any State which did that unilaterally on any scale, would lose most of the proceeds to the other States through the HFE process. So, the only way that could happen would be that if all or nearly all States did it together. Bringing that about is, again, subject to the bedevilling influence of the zero-sum gain concept, and the fact that any reform like that is going to be politically difficult anyway, whether you do it solitary or in company with a number of other jurisdictions.

DR FAHRER: There's other examples. The CGC decides whether a tax or a tax base should be distributed on an EPC, equal per capita basis, as it has done with gambling taxes. Now, I personally happen to think that's the correct decision, but it's their decision, and that makes a big difference.

MS CHESTER: Yes. Indeed, when you sort of look at it, the Treasurer can instruct the CGC at any time, but the Treasurer needs to have that predisposition and to be appropriately briefed.

DR FAHRER: Yes.

MS CHESTER: Thus, effectively take the CGC in the right direction where it is making policy neutrality decisions and they are policy decisions. I guess in our draft report, our answer to that was suggest Commonwealth Treasurer step up to the plate, and by default, Commonwealth Treasury stepping up to the plate and perhaps playing that role, a little bit more than they otherwise would.

DR FAHRER: Yes.

MS CHESTER: On this issue though of the policy chill and the point that you made, Vince, about why would a State dare greatly and reform the way that it taxes transactions versus land tax when it's going to get whacked by losing out on the GST. Indeed, we did some cameos because this has been an area where we've struggled to get any evidence from State Governments about to what extent does the HFE system at the margin or beyond act as a disincentive for you having in place good policies, whether it be digging stuff out from under the ground or from having the right taxation system at the State level.

Apart from WA and New South Wales that have a motivation to want to change the current system, everybody else says, "No, we've got it wrong". Indeed, we heard from the Victorian Government this morning and from their post-draft report submission to us that our numbers of losing $700 million to $1 billion a year from the GST for a large State is actually only $10 million, because they don't take into account the elasticity effects. It is an area we do

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want to tease out with you.

DR FITZGERALD: If you listen to a previous Victorian Government of the same colour, you would get a different answer.

MS CHESTER: Treasurer Brumby.

DR FAHRER: Elasticity effects, look no doubt somebody in the Victorian Treasury assumed an elasticity or got an elasticity from somewhere and worked this out, and that's probably the number that they came up with. Maybe they used the same right elasticity, maybe they didn't. Maybe their analysis was right, maybe it wasn't. Obviously, there's room to disagree, genuine room for disagreement here. The fact that it could be little or it could be large, the impact is in itself an important consideration, because it means the States don't know. I mean the boundaries of the possible effects could be very large. If I'm a State Treasurer and my officials say to me, "Well, we don't actually know what the impact would be. It could be small, it could be large, and the CGC won't actually tell us". Well, that in itself is likely to be a chill.

MS CHESTER: We heard evidence this morning that the Victorian Government use it as it's always small and thus it doesn't figure in consideration or deliberations by Cabinet when it comes to tax changes. I guess from your collective experience, you've worked with State Governments, we're seeking evidence that our cameos, which we think were reasonable cameos and, indeed, we had an interval of assumed elasticity effects, are reasonable in terms of saying, "Yes, this is an actual disincentive for States making those decisions".

DR FITZGERALD: The disincentive is potentially very large, only in the case of pioneering a new tax base. No one would suggest that it is a very large disincentive to altering the rate of an existing well-established tax base that all the States use. But it just so happens that some of the more interesting areas for potential reform that would improve the efficiency of the Australian economy generally, happen to be of the former kind, where someone has to plunge in and consider some real reform like the land tax instead of transaction tax to property.

MS CHESTER: Are there any cameos? Since we're not going to get this evidence base from the States, are there other cameos? We were a bit pressed for time in getting our draft report out. Are there other cameos that you think that we should be running to try to capture that disincentive effect?

DR FAHRER: Other than the ones you've already done?

MS CHESTER: Yes.

MR FARHRER: Well, that's a good question.

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MS CHESTER: You can come back to us on it if you don't have an answer on the spot.

DR FAHRER: Yes, okay. We might take that one on notice.

DR FITZGERALD: We did, using the best numbers we could, run a number of things. The one I've mentioned a couple of times now is the one which is the clearest. The others are fuzzier.

DR FAHRER: That's with tax where it's relatively easy to work out. With expenditure reforms, it's even more opaque and difficult.

DR FITZGERALD: To get numbers even, yes.

MS CHESTER: What would be some examples of, from an economist's perspective, a meritorious expenditure reform that a State could do where they really can't work through what the implications might be for the GST relativities? Again, you can come back to us.

DR FAHRER: We'll think about that.

MR COPPEL: You made the point that there are multiple tax bases and that should be a consideration in the CGC's process. One area that has been suggested many time is to rather than do an assessment on each revenue source, have some form of global assessment for revenue to be policy neutral.

DR FAHRER: Yes.

MR COPPEL: It's been looked at and never really concluded in a way that this would be a preferable alternative. Do you have a view as to what could be some other form of global measure or revenue capacity or partial revenue capacity?

DR FITZGERALD: A number of them. I guess the reason, to answer the second part first, the reasons why the global indicators approach has probably not been adopted is that if you take a Territory like the ACT, where the income levels and wealth, per capita wealth levels, appear to be well above the national average, global measures would have to somehow take account of the fact that the Commonwealth doesn't pay tax, doesn't pay payroll tax, which is an important tax for all the States and Territories. For the ACT it's pretty meagre because it's a company town and the company don't pay.

The Commonwealth doesn't pay other taxes to the Territory. If that were rectified by the Commonwealth making ex gratia payments in lieu of payroll tax and some other important taxes, then that would remove one of the biggest, obvious barriers towards going to that approach. Certainly, I think that the

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ideal system wouldn't treat every single little tax base, and even divide the payroll tax into a whole series of vertical slices as treating them as different tax bases.

There's possible reform without going to it completely to the global indicators approach like GST per capita or whatever it might be by, for example, in the case of the payroll tax and not treating all these slices as different tax bases. They're all the same. They're all part of the same tax base and the hair splitting that the CGC does in that case is a good example of, I think, what not to do.

MS CHESTER: Two follow-ons then. In terms of the way they currently dice and splice the revenue base, what impact is that having then on States getting the call right on the way they tax their revenue bases?

DR FAHRER: Again, this is a bit of a controversial, difficult area. What we've looked at closely is payroll tax, where the payroll tax reform would cause States to lose – unilateral payroll tax would cause a State to lose GSP revenue. Uniliteral payroll tax reform, it's the classic reform of lowering the rate and getting rid of the exemptions, not all of them.

DR FITZGERALD: Which would make the payroll tax similar to a VAT.

MS CHESTER: Yes.

DR FAHRER: Which just about everybody thinks is a good idea in principle. Again, there are genuinely divergent views from experts here about whether it actually would have that effect on HFE, depending on the CGC's treatment of how it all goes. It's not in itself very helpful, but the fact that the handful of people whose day job it is to work this out can't agree amongst themselves, I think is indicative in itself, and it's just unnecessary, this sort of finely diced overengineering of a system just to shift it at the margin a few dollars here and there.

MR COPPEL: This work you mentioned, is that recent work?

DR FAHRER: It's work we've done internally for ourselves.

MR COPPEL: Is that something that you could share with the Commission?

DR FAHRER: Well, we'll take that on notice.

MS CHESTER: I appreciate you might need to get clients' okay. On the revenue side then, if the primary obstacle is the Commonwealth not paying a payroll tax - - -

DR FAHRER: That's in the ACT.

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DR FITZGERALD: The ACT is the obvious blockage.

MS CHESTER: The outlier. If that's the key impediment, would one halfway house be actually moving to a broad-based revenue indicator like a GSP and then doing a one-off adjustment. Given the current fiscal position of the Commonwealth Government, instead doing a one-off adjustment to that calculation for States and Territories, where there is a significant percentage of their employment bases as Commonwealth employees.

DR FAHRER: Perhaps, but this only goes to the question of the ability to raise revenue.

DR FITZGERALD: It's not just that, it's that they don't pay any taxes.

MS CHESTER: Yes.

DR FAHRER: I mean this doesn't get to the question of disabilities and expenses. The Northern Territory has pretty high GSP per capita, I think. I haven't looked at the figures recently but that's my impression. It costs a lot of money to deliver services in the Northern Territory, especially in the remote Northern Territory. Global indicators might get you somewhere in terms of ability to raise revenue. They're not very helpful for the other side of the fiscal question.

MS CHESTER: No, and I was only looking at addressing the revenue side of the equation.

DR FITZGERALD: If the states were allowed to collect income tax again and back in the late 90s in debates – was it late 90s or late 80s? Nineties, I think.

MS CHESTER: It was late 90s, yes.

DR FITZGERALD: When there were those discussions that led to so-called a new tax system. One kind of option that was on the table was that the States would be allowed to re-enter the income tax system in one of two ways. Way 1, which I briefed a couple of States to push forward, was to have say the first 10 per cent or the States to get 10 per cent of the income of its residents about the tax-free threshold.

The alternative, which Commonwealth officials preferred in those debates, was that the States be given simply 10 per cent or some like number of the income tax raised in their territory. In other words, without sharing in the progressive structure as well as having a flat tax. In either case, States, it was envisaged, could be permitted to have a surcharge or a discount.

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It would never work unless the Commonwealth actually gave the States the tax capacity by reducing its own take to the extent that it gave the States that ability. It was, therefore, for the Commonwealth to get its books in order would need to, say, make uniform percentage cuts to what are now called partnership payments, SPPs then, or some other way to have a roughly zero effect on the Commonwealth's bottom line.

The idea was then that the States would be in their own hands to raise or lower their percentage and that would mean that, for example, if we had broad indicators approach, it would work a lot better in the ACT than the Northern Territory, because if they were short on some tax bases, they could have a, say, 1 per cent or 1.5 per cent surcharge on income tax.

Again, what this leaves you to is to see how solutions to HFE are bedevilled by the lack of VFI, or in the extreme, lack of reform to VFI.

MS CHESTER: Yes. Indeed, it was interesting looking at the CGC's post-draft report submission when they unbundled more about the different steps of HFE and what's required to get to assessed expenses. Even WA doesn't get to assessed expenses when you equalise to the highest. Because of VFI they still need that top up above their own current fiscal capacity.

This kind of gets us back to, I guess, Jerome, listening to you at the beginning around there's only so much you can do with HFE in isolation of not really dealing with VFI and Federal financial relations more broadly. We do countenance that in our report. We say longer term HFE could evolve in the context of changes to VFI and Commonwealth, State spending responsibilities. We're not in that world at the moment and nor does our inquiry allow us to get too much further into that world. I sort of got a sense from your earlier comments that we shouldn't even bother trying to look at some of the reforms to HFE that we're sort of contemplating in our draft report in the absence of being able to get into VFI.

DR FAHRER: I appreciate that you're bound by your Terms of Reference, but in the event, you've got to say something. Ad hoc changes to the existing system are not going to be very helpful and the CGC modelled some of these in its submission. What happens if you equalise 90 per cent, rather than 100 per cent? Well, why not 80 percent? Why not 70 per cent? I mean this is completely arbitrary and ad hoc and it adds even more complexity to an already complex system. But not just that, any change is going to create losers and the losers are going to say no.

MS CHESTER: If we park the losers for the transition path, moving to say equalising to the average and we're re-cutting the numbers to see what happens to our cameos. It looks like from the initial numbers, those disincentive effects are much less and you would intuitively expect that because, as you move more towards EPC, the disincentives dissipate.

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DR FAHRER: Yes.

MS CHESTER: I guess what I'm trying to say is are there still economic benefits, because I mean basically we've got to be able to prove in our final report that there are economic costs to the Australian economy to the way we're currently doing HFE, and thus moving away from it in the absence of VFI being fixed is still a net economic benefit.

DR FITZGERALD: I'd suggest that moving to the average, instead of what effectively is the highest as the standard, would be helpful because it goes nearer to the concept which I think the founding fathers, and there were probably founding mothers too, but that's a different matter. But the people who created the Constitution, and especially section 96, I believe if you read the history, had in mind giving a State that might temporarily be in fiscal difficulty the ability to deliver services at a decent, reasonable standard. In other words, not to the standard of New South Wales or whoever happened to have the most generous range of services at the time. It seems to me that equalising to the average is considerably closer to that than what we've seen the CGC do.

In my opinion, it would be even better if there were a process of assessment as there's already work that would be helpful to. For example, in health costs we have long had the system of looking at so-called diagnosis related bundles of services in the hospital system, and there's a methodology that's been used for years now to work out what's the efficient cost of delivering one of those diagnosis-related groups. You could, in principle, do the same in the other big bread and butter service delivery areas like education, law and order, and local roads or something like that. But if you don't really want to do all that work, then equalising to the average is getting closer to it.

DR FAHRER: There's some other relatively low-hanging fruit, if you're just going to be talking about reforming the existing system. I think serious consideration should be made just to take Northern Territory out of it, because it's such an outlier in terms of its relativities and its disabilities. Now, that doesn't mean the Northern Territory should get less money, maybe it should get more money. There's a merit in not having the Northern Territory's disabilities affect everybody else's relativities.

DR FITZGERALD: It's also worth commenting that the fact that indigeneity and remoteness mean that the Northern Territory is assessed as having a huge need to equalise for, say, welfare services and never spends anything like the assessed amount. In fact, in the past it's not even spent the national average.

DR FAHRER: To be specific, on the latest figures, the Northern Territory's assessed expenses are $1728 per capita and so it gets funded as if it would spend that much, but it only actually spends $1169 per capita. That's $559 per

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capita of money it gets, in effect, to spend on welfare services, it gets from the HFE system that it doesn't spend, and then it chooses to spend on other things like industry assistance.

DR FITZGERALD: Some other States do this on a lesser scale.

DR FAHRER: Yes, all States do this. I'm not picking on the Northern Territory in particular, but this is the exemplar. This is taking the policy neutrality and autonomy a little far, I think.

DR FITZGERALD: And frankly it doesn't pass the pub test, so-called, to give the Northern Territory money to spend to the national standard and it considerably underspends that serially and spends it in Darwin or somewhere.

MS CHESTER: That's kind of an area that we struggle with a bit in the draft report, given that the GST money is meant to be spent under the guise of State autonomy, albeit the assessed expenses are just that, assessed expenses. They're not actual expenses, the outcome. On indigeneity, we struggled about taking it out because doing that in the absence of having gotten Commonwealth and State responsibilities right in that spending area, we're not sure just taking it out was the fix.

DR FAHRER: I agree that you need to do other things, but it's our view that indigeneity, and this is largely a Northern Territory question but certainly not entirely a Northern Territory question, but the problems of indigenous people should be treated as national problems, not as State problems, and they should be sorted out with national money. Having indigeneity as part of the CGC process is just unhelpful.

MS CHESTER: Can I just come back to - a lot of the evidence and a lot of the feedback that we get from certain States and Territories is about what HFE is meant to be or how it's currently practised, and they all talk about comprehensive equalisation. CGC does also have some subsidiary principles and one of them is about efficiency in policy and neutrality. It would be just good to get your sense of how well they're grappling with that trade-off, given the way that they sort of implement HFE today.

We've seen more recently they seem to have a bit of an appetite in their most recent report to sort of turn on and off some of the levers that they've got. So, like potentially discounting by 50 per cent mining royalties for WA by an increase in royalty rates, taking coal seam gas out of the equation, like gambling. These are areas where we suspect they're trying to get that trade-off between equity, equality and efficiency right. I guess it would be good to get your sense of how well they're doing that and how well the system can do it.

DR FITZGERALD: Surely if you took policy neutrality literally to the final

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degree you wouldn't take out coal seam gas, if a State had that tax base and chose not to use it, that would be a penalty.

MS CHESTER: I think they're just stopping them getting a reward, Vince, by taking it out.

DR FITZGERALD: Yes, well, there you go.

DR FAHRER: What this shows is that the CGC has, in effect, become a policy maker. I mean these are really policy decisions. I mean they're in the guise of just technical implementation, but they're really policy decisions. I mean if these decisions are going to be made, they should be made by the Government. They shouldn't be made by the CGC. Now, maybe they're the right decisions, maybe they're not, but they shouldn't be the CGC's decisions to make.

Now, how they're grappling with these questions. Well, I think they're doing the best they can, I guess. But because the system is so complex, there's no right answer to that to your question and we don't know. They might not even know.

MS CHESTER: Do you have any other questions?

MR COPPEL: I'm good.

MS CHESTER: They're all the questions that we had of you for today. Is there anything else that you wanted to say or we haven't touched on that you thought we should have?

DR FITZGERALD: One leading question. What extent are you looking at the systems in other Federations and seeing to what extent that they could be adapted to our situation?

MS CHESTER: We did that as comprehensively as we could for the draft report, Vince. I think it's fair to say we probably got more insights of what not to do than what to do.

DR FITZGERALD: You don't have to look farther than here.

MS CHESTER: No, but that said, I mean it comes back to a point, Jerome, I think you made in your opening remarks. The fact that we do it differently and we do full equalisation, doesn't mean that it may be better and I think people say there's lots of other reasons why other international jurisdictions do it differently that are historical reasons. Nobody has ever tried to do it fully across both sides of the line on one side.

DR FAHRER: One final point, we didn't have time to discuss it, but this is

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the interaction of direct Commonwealth payments with the CGC process. Right now, they're for the most part counted as State resources and it affects their disabilities. You could certainly make a good case to say that that's not true. The Commonwealth gives money to the States directly to implement Commonwealth policies.

Now, it's not a clean split, as we know, because there's overlapping responsibilities in areas like health and education. But the interaction and the incentives created and there are disincentives that are created. There are incentives created for States not to participate in direct Commonwealth payments and this needs to be looked at carefully as well.

MR COPPEL: In our draft report we have an annex looking at those Commonwealth payments and how they interact and the rules that the CGC uses and other agreements. One of the defining features is the extent to which those payments are aimed at achieving some form of national objective policy or other State policy objective.

DR FAHRER: The answer is a bit of both.

MR COPPEL: In some cases, that's how it works.

MS CHESTER: Yes, but is taking it out of a HFE the right lever from what is really a Commonwealth State spending responsibility issue?

DR FITZGERALD: It might be better than not taking it out but the factor today is that whatever the Constitution may have said about which level of Government is responsible for the core services that households value most, health, education, welfare, whatever, they are really in the way the public sees them these days, areas of shared responsibilities. So, taking them out altogether might make HFE simpler but it's not quite the reality. It's messy, of course, to know how to treat them if they are regarded as areas of shared responsibility.

The CGC's approach of saying they're all untied money and unless, in the very rare case, the Commonwealth excludes them, isn't the right answer either. It sort of says that this is money the States could do anything with and the fact is they're not able to do anything with it, and in some sense, they shouldn't be able to do anything with it. There should be an agreement between the two levels of Government as to how they share that responsibility. That's not an easy one to get your head around.

MS CHESTER: No. Well, on that heart-warming note, we will thank you for joining us today and we will take you up on your kind offer of a couple of the questions we've planted with you. If you could see if you've got any other thoughts that you could come back to us on, that would be really helpful.

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DR FAHRER: We will send you something in writing, notwithstanding that we've missed the deadline, we'll do it as quickly as we can.

MS CHESTER: We're happy to take good submissions late. Thank you very much.

DR FITZGERALD: My final comment is good luck. There are few knottier areas.

MS CHESTER: We're going to have a participant join us by teleconference, if the teleconference and IT Gods bestow that great honour upon us, I say looking at Karl and Brad. Folks, go stretch your legs, three minutes, and then we'll see if we can get the IT working. Sorry for those that are next participant cabs off the rank. We're running a little bit behind but we'll get to you as soon as possible.

ADJOURNED **[11.33 am]**

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RESUMED **[11.36 am]**

MS CHESTER: John, thank you very much for joining us and thank you for your interest in our inquiry. We appreciate that you've been able to do this by teleconference, given that we had enough participants available in Melbourne but not quite there for Sydney, so we thank you for that.

I'm Karen Chester, I'm the Deputy Chair, and I'm joined by my colleague, Jonathan Coppel. John, just so you know, we're sort of sitting here in the Melbourne office for the Productivity Commission and you've got about 15 people in the audience listening to what we're about to discuss, so just so you've got a little bit a visual on that. You would be aware that we are taking a transcript. So, a little bit down the track you'll be able to get a copy of the transcript and remind yourself of the discussion that we've had and the evidence that you've given us, so we thank you.

John, why don't you just introduce yourself and then maybe if you'd like to run through some brief opening remarks and then we'll get into some questions.

MR McAULEY: John McAuley is my name. I wish you a good morning. My message to the Commonwealth Grants Commission is simply to give up the impossible task of using HFE to equalise revenue raising capacity and should confine equalisation only to services commonly provided. Now, this would be a substantial and welcome simplification of procedures. You can hear me okay?

MS CHESTER: Yes.

MR McAULEY: The Commission, as I say, should forget about revenue raising, trying to equalise that. The Commission already acknowledges that it is able to equalise only about 60 per cent of all State revenue anyway. Furthermore, some of this 60 per cent would have little effect on distributions or has doubtful validity, and therefore, in my view, should be wholly disregarded. Most of the residual would be, in fact, due to Western Australia. That's the big problem.

I would summarise the main reasons for ignoring revenue capacity for HFE purposes as follows. HFE principles provide no justification nor precedence for equalising revenue, as I first made the point. There are significant and accidental differences amongst States which inhibit estimates of revenue capacity, especially mining, oil, gas, coal, et cetera, and there are also differing policies on gambling facilities.

In some cases, Aborigine communities may have objections or interests in land use. Importantly, I think the main – I think the present system of sharing

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revenue acts as a powerful disincentive to investment, despite potential secondary benefit from higher employment, et cetera. My proposal to not equalise revenue would solve the Western Australia problem and it would simplify the Commission's procedures and be reasonably acceptable to the States. It would also enable the year 2000 agreement with the Commonwealth to be maintained. An alternative would be the more radical 2012 proposal of the Brumby Review.

In the year 2015-16, for example, there was only one State, Western Australia, which provided a surplus in total revenue for sharing with other States. This surplus represented an outrageous GST payment by Western Australian out of its GST of nearly $8 billion for the year. Except for this payment, Western Australia would have qualified to be a $3 billion recipient of the system, not a net payer. New South Wales and Victoria each have had to pay somewhat more into the system if then there's no HFE on revenue. I would note my view that the Commission has only a rough method of equalising services based on budget dollar costs, I'd say more later perhaps.

I also note my view that the Commonwealth ought to be a formal stakeholder in the year 2000 agreement and accept direct responsibility for deficiencies of its own creations, the Territories of Northern Territory and ACT. Also, that to avoid duplication, there should be closer coordination between GST subsidies compared to Commonwealth payments to and for the States and compared with the various long-term agreements in place for health and transport, et cetera. That concludes my brief summary and my views on HFE.

MS CHESTER: Thank you very much, John. Perhaps I might just start with an initial question just so I can make sure I understand what you're suggesting. We do know from looking at international jurisdictions that many just equalise on the revenue or the expenditure side, not many equally fully, let alone on both sides like we do in Australia. Are you saying that the CGC would come up with what the assessed expenses should be as they do currently, based on the average of what States do?

MR McAULEY: Would you just repeat that last bit? What was that?

MS CHESTER: At the moment, the CGC assesses what the expenditure side of the equation should be for a State, based on the average of what all States do and then adjusting for disabilities, factors like population – well, it's on per capita, so that's population – but remoteness and indigeneity and all the rest of it. Then on the revenue side, they do an assessed revenue position and then they work out what the gap is.

MR McAULEY: That's right, yes. They're the two main ones, aren't they? I'm saying that they should forget about trying to equalise revenue and concentrate only on the services, yes.

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MS CHESTER: If they just equalise on the services, so everyone's got their assessed expenses, how do we work out how much needs to be paid to them to meet those expenses if we don't consider their revenue capacity? Otherwise, you'd just be paying them the full amount and the GST pool wouldn't cover it.

MR McAULEY: They have to just simply pay whatever's required or receive whatever's calculated from the system. If they're a net payer, this would have to be an expense that they'd incur and it would be shown in their budget statement in the usual way. I don't see any point aligning it with revenue capacity. I don't think, in fact, the CGC does that, the Commonwealth Grants Commission. I don't think it really does that. It might claim to or might aim to, but I don't think it does that. In other words, it doesn't ensure that a payee, say, has the ability to pay it. It doesn't do that.

MR COPPEL: Who would pay? Who would pay for the services delivered?

MR McAULEY: I'm sorry, but your voice is cutting out. Some of the words have cut out and I haven't heard exactly what you've said.

MR COPPEL: The question was who would pay for the delivery of those assessed services provided by the States and Territories, the State or the Commonwealth?

MR McAULEY: Well, in the first instance I'm talking about not the Commonwealth coming into it. I would say as sort of an aside that my formal statement was that I thought that the Commonwealth should look after Northern Territory and ACT, because it created those two Territories, and if they're not sufficiently financial, it's the Commonwealth that should be picking up the tab, not GST.

MS CHESTER: What do you think the GST should be spent on then, John? We've got this $63 billion a year, what should it spent on?

MR McAULEY: There's no prescription now, is there, for GST. The States can spend the funds. They're not required to spend it on any special way, like on infrastructure or current expenditure. There's no requirement to do that. Let me not overlook the main point that I'm saying, the equalisation. This is an inquire into HFE, isn't it, which is horizontal fiscal equalisation. That's what your inquiry is about, is it not?

MR COPPEL: Yes.

MR McAULEY: I'm now saying that HFE should apply only to services for payment of stage 4 services and there should be no intent to equalise revenue. That's my main thrust.

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MR COPPEL: Okay. I've just got one more question and it relates to a comment that you made that the current processes used by the CGC act as a disincentive to investment. Can you explain how that works and do you have any concrete examples where that has acted as a disincentive to investment?

MR McAULEY: I can only say that if I was the Premier or Treasurer of Western Australia and they were paying something like $8 billion out of their GST and paying it to other States who didn't have any iron ore or gold or other sources of these funds, I'd be inclined to cut back on investment propositions. It may not be a paying proposition for Western Australia to put levies on these products when they have to share most of it with other States. I mean that is the basic problem that you are having to face, I think.

MS CHESTER: John, thank you very much for getting in contact with us and for participating in our public hearings and our inquiry. We don't have any other questions for you, apart from one actually. Before you retired, where were you working as an economist, John?

MR McAULEY: When I was a fulltime employee I was Chief Economist of the State Bank of New South Wales.

MS CHESTER: Okay, great. Thanks, John, it's been really good hearing from you and hearing from some folk from New South Wales. If you could just make sure that you hang up the phone now and we'll let you know when the transcript is up on the website.

MR McAULEY: Okay, all the best.

MS CHESTER: Thank you. Can we check that he's hung up, please? Thank you. We're having a public hearing. Terrific. I'll invite the next participant to come up and join us and won't be appearing as God but at the table here, from the Victorian Chamber of Commerce and Industry. So, please come up and join us. Welcome. Thank you for joining us this morning and appearing. If you'd just like to say for the purposes of the transcript your name and which organisation you represent and then if you'd like to make some brief opening remarks.

MR HORSFALL: Certainly.

MS CHESTER: Thank you.

MR HORSFALL: I'm Hugh Horsfall, representing the Victorian Chamber of Commerce and Industry and welcome the opportunity to appear at this hearing today. I suppose as Victoria's leading business organisation, we work with and service more than 15,000 businesses each year. Across the State, they encompass all industry sectors and span small, medium, and large size businesses. I suppose when you look at the split of our membership base, it's

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pretty representative of both the industry make up and size of Victorian businesses. I suppose to start with, horizontal fiscal equalisation - - -

MS CHESTER: Feel free to say HFE, it's easier.

MR HORSFALL: HFE is grounded in the concept that citizens in different States should have access to equal standards of Government services, recognises that States have different capacities to raise revenue and different spending needs and this is an important principle that is strongly supported by the Victorian Chamber.

The Victorian Chamber is a key member of the Australian Chamber of Commerce and Industry and we contributed to and support the initial submission that was made by the Australian Chamber to this inquiry in June. That was premised on the key arguments that the Australian Chamber did not find that there was evidence that the current system is detrimental to productivity or provides a disincentive for states to exploit their natural resources, and made the point that HFE should not be looked at in isolation, which I think has been discussed already today, and that proposed changes should be considered in the context of broader productivity enhancing tax reforms and associated reforms to Commonwealth and State financial relations that might address issues of VFI.

I think it's important to note that as a national organisation the Australian Chamber has looked at all the issues and spoken to its members and not found a significant problem with the way that the GST is currently distributed. The Victorian Chamber has also made a brief submission on the draft report and to speak briefly to the points that we've made there, I'll start with a comment perhaps on the low shares of GST currently being received by WA, which I think are a focus of this inquiry.

We think this represents the system working as intended. A lower share of GST to WA has been offset by very significant mining revenues. This situation, we think, was foreseeable and if WA's now facing budgetary issues, that is we think more a result of its own budget management and not of underlying problems with HFE or the way that the CGC applies it. I suppose furthermore we're arguing that in the grand scheme of things there are more important issues than the distribution of GST and that the actual amount of money that's redistributed as part of the process is relatively small in the context of the overall revenues of State and Territory governance, although it's obviously bigger for some than it is for others.

If you look at the distribution of GST in isolation, it's a zero-sum gain. You can't make one State better off without making another worse off. We would rather that Governments focus on broader tax and financial relations reform that can deliver real benefits for business in the community. Maybe just to chime in on the discussion that was happening earlier around

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disincentives for reform, I might comment that a case by case approach that looks at dealing with the issues around specific proposed reforms might be better than I suppose tinkering with the current formula to try and remove disincentives for reform that we're not sure actually exist.

Victorian Chamber considers that while the current GST distribution methodology is very complex, it's generally working well as intended and should be retained. Given this, we broadly support the recommendations made in the draft report, specifically that further simplification should be explored, that Commonwealth payments to the States should be treated consistently to avoid issues around payments for infrastructure being effectively equalised away, and increasing the burden on one State to fund that infrastructure, without the same treatment being applied to payments to another State.

We're happy with the Commonwealth Grants Commission providing a strong neutral voice in the public debate of HFE, although might argue that I think the people who need to understand HFE in the Commonwealth and State and Territory Governments do. The system is not so complicated or doesn't lack so much transparency that they can't. I think that no amount of additional communication to the public will be able to explain the current approach to the man of the street or person in the street. We're happy with transparency being increased through the publication of data and calculations used by the Commission and, certainly, that Federal and State Governments should work towards longer term reform of Federal financial relations.

However, we do take issue with and don't support the draft recommendation 2.1, that the system should aim for a reasonable, rather than full equalisation. It seems that this would not contribute to simplicity and would add another arbitrary layer to an already complex system. We would already do everything that we currently do and add another arbitrary adjustment on top of that. Further, we don't support the suggestion that the system equalise to the capacity of the second strongest State. Notwithstanding that it appears that such an approach would significantly disadvantage Victoria, looking at it we don't think there's a clear policy rationale for it as an alternative to the current system.

To conclude, the distribution of a fixed pool of revenue between the States is always going to be contentious and the Victorian Chamber would prefer that rather than arguing over a zero-sum gain, Governments focus on delivering meaningful tax reforms and reforms to VFI that deliver tangible benefits to business and the community.

MS CHESTER: Okay, great. Thanks very much, Hugh. We might start off first with how we do HFE and you mentioned that the Chamber supports the current way of doing HFE, which was a decision of the CGC, not only Commonwealth, State or Territory Government to do full equalisation to the highest State. Indeed, Victorian Governments of the past have not supported

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that way of doing it. How do you think it grapples with the trade-off then between equity and efficiency? The CGC itself has the objective of equity and they translate that to equality achieving full equalisation to the highest State, but then they've got subsidiary principles which matter for us, because like yourself, we're very interested in making sure that good decisions are made by States to develop activities and to have good tax bases and have them optimally taxed.

MR HORSFALL: I think we have a lot of evidence that we are achieving our equity goals, but I think that the evidence is lacking that we're not achieving the efficiency goals or that the current system is impeding productivity enhancing reforms.

MS CHESTER: I guess the question was the CGC is meant to do that trade-off at the moment.

MR HORSFALL: Yes.

MS CHESTER: I guess we found in our draft report, and it's only a draft finding, that if you're going to do full equalisation, it's really hard to get that trade-off. The CGC recently is sort of looking at dealing with that trade-off by making some changes within systems. So, for example, royalty rate increases in WA. They'll get to keep 50 per cent of the royalties, taking CSG out of the equation, similar to gambling. They're already trying to do those trade-offs in the current system which kind of adds to the complexity. How do you think they're going about grappling with that? I mean they wouldn't be doing those things unless they thought that there were problems from an efficiency perspective?

MR HORSFALL: I suppose I think that while it might not be the perfect system, it is the system that we have and that there are very significant impediments to change, being the zero-sum gain nature of the distribution and the fact that you can't make any State better off without making another State worse off. I suppose I'm comfortable with the CGC continuing to work within its existing framework to make adjustments that it sees fit and that are contestable by State and Territory Governments through their normal processes.

MS CHESTER: I mean the reason I ask the question is I think, if I understood correctly, you were suggesting that our draft recommendation to move towards equalising to less than the highest, which we do for incentive reasons, you say that's going to make it more complex. Whereas what I'm suggesting to you is the CGC at the moment trying to get the trade-off between equity and efficiency, is making lots of big architectural changes within the system that, in and of itself, makes it more complex.

MR HORSFALL: I think our primary objection to equalising to a different

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standard is not the complexity. Complexity is certainly an objection, but - - -

MS CHESTER: Sorry, how is it more complex, if it takes pressure off, if it allows the trade-off to occur.

MR HORSFALL: I suppose I'd take a step back and say that our primary objection to equalising to a different standard is that we don't think that there is a problem with equalising to the current system, and so that moving to equalise to a lower standard seems arbitrary. Then, as a by-product of that, you're doing everything that you currently do and then adding in a separate process.

MR COPPEL: I think that part is a misunderstanding. What we're suggesting is that there's a different benchmark that's used for equalisation which is less than full equalisation.

MR HORSFALL: In which case, I would I suppose certainly take the correction that it might improve the simplicity of the calculation but still it would seem to be a change that we don't think is warranted because the current approach is working effectively.

MS CHESTER: Your main problem then is because you are a fan of tax reform, you don't see that there's disincentives of the current arrangements to tax reform occurring?

MR HORSFALL: We don't see that there are disincentives to tax reform currently occurring and consider for the scale of a really significant sort of tax reform that would involve changes to Commonwealth and State financial arrangements that you could deal with disincentives or issues as they arise, rather than trying to pre-empt them.

MS CHESTER: The Chamber would be aware of the cameo that we ran for State-based tax reform, a significant one, of halving stamp duty and replacing it with a broad-based land tax on a revenue neutral basis, so not increasing the tax burden on the State. Is that a reform that the Chamber would support? I know economists agree on it but not everyone is an economist.

MR HORSFALL: I suppose we wouldn't be ready to put a position on that here.

MS CHESTER: Say we were to assume that you thought that that was a good tax reform, the cameo that we ran suggested that if a large State, New South Wales or Victoria, were to contemplate doing so, they would lose hundreds of millions of dollars each year in terms of their GST relativities.

I guess that's what took us down the path. I mean we already got it for controversial developments, where if you add another disincentive to that pile,

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you're asking for the wrong decision. But with respect to tax reform, we were quite surprised when we ran the cameos that such a disincentive arose.

MR HORSFALL: Yes. I suppose I'm probably not in a position to comment on the scale of those impacts, other than to say that I understand that the scale of the impacts is contested by the Victorian Government.

MS CHESTER: They are and we took them to task on that this morning because they've assumed away the reality of no elasticity effects which was quite bizarre, to say the least. Anyway, so I guess what we're saying is if there are these disincentives in the current system and the CGC is trying to get full equalisation, I'm just trying to grapple with if we feel there is an impact on – so, if there is an impact on the real economy, i.e. it is holding States back from doing such tax reforms, that would kind of seem to align with the position of the Chamber, wouldn't it, in terms of you want good State tax reform, you want economic growth and you want jobs, and I guess we sort of share that objective.

MR HORSFALL: Yes, I would agree.

MS CHESTER: I guess I'm struggling then as to why you would oppose the change, if we've run a cameo that shows that such a significant reform by a State or Territory Government – well, State Government moving first, there is such a current disincentive in the current system, because we've moved so far away with an outlier from equal per capita.

MR HORSFALL: I suppose it's difficult to say without being right across the detail, but while the extent of disincentives for a reform are contested, I suppose the Victorian Chamber is not in a position to support this particular change which would result in seemingly a big financial hit for Victoria.

MS CHESTER: On the financial hit to Victoria, it really becomes a transition path issue. The first few years, if we were to go cold turkey, there would be a big hit. We're still looking at these numbers to test their veracity, but indeed, some numbers that have been provided to us by one State suggest that Victoria ends up being a big net winner. I guess that's why in the past, apart from this Government, previous Victorian State Governments have been supportive of reform of HFE, indeed moving further than we've suggested, even going to EPC, because Victoria was a net winner.

MR HORSFALL: Victoria certainly has argued for an EPC distribution in the past but I think the big barrier to that is where would the money for the top ups that would be required for the losing States, where would that come from. In the absence of that, it's hard to see how moving to an EPC distribution is a realistic option.

MS CHESTER: Well, we're not recommending that. I guess what I'm trying

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to understand is you're arguing don't make this change because it hurts Victoria. I guess what I'm suggesting is medium to longer term it doesn't hurt Victoria. So, doesn't it then just become a transition issue?

MR HORSFALL: I suppose you're unpicking our reasoning, which is good, but I would clarify that we're saying don't make the change because we don't have a problem with the current approach. We are also saying don't make the change if it makes things more complicated, which perhaps it doesn't. A third point would be don't make the change because it appears to have a big financial impact on Victoria. I suppose if the States and Territories can agree on the rationale for change and on the financial impacts and a transition path, we would certainly be able to look at it again, but I think on the current evidence and on the current information, we don't have that sort of consensus yet.

MR COPPEL: Can I just pick up then in one of the comments you made on the draft report where we suggested further scope for simplification should be examined.

MR HORSFALL: Yes.

MR COPPEL: You've supported that. Do you have any specific areas where you think that simplification could be achieved?

MR HORSFALL: No, I don't. I suppose the in-principle comment that the system is extremely complex and that if you can achieve similar outcomes with fewer inputs and get everyone to agree on it, which I understand in the past have been very difficult, CGC should absolutely pursue those options.

MR COPPEL: I guess it's a general comment and it's not just with your presentation, but when we're speaking about a transition, the focus is always on fiscal impact vis-à-vis the current arrangements. The case that we're trying to make in the draft report is that fiscal impact is one consideration but really, it's a formal policy cost benefit analysis.

Can you improve on predictability of stability of the system? Can you give a greater weight to the trade-offs that are made between equalisation and efficiency trade-offs? It's really those other considerations, those other attributes that we see as objectives of policy reform. But the focus is always on what is the fiscal impact today, and I was wondering whether you had any comment on our goal to achieve some of these other policy attributes which we see as positive ones?

MR HORSFALL: I certainly support the goal and maybe referencing back to the previous discussion, I think part of the problem is that that goal is not best pursued by looking at HFE in isolation, that that goal is better pursued in the context of a broader discussion around tax reform, reform of Commonwealth State payments to alleviate VFI, as part of a broader

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discussion.

MS CHESTER: Just so we're careful we don't mischaracterise the earlier commentary, it was saying that, as we do in our draft report, longer term, there's only so much you can do with HFE today in isolation.

MR HORSFALL: Yes.

MS CHESTER: Of longer term, looking at VFI and Commonwealth State spending responsibilities as part of the Federal financial reform. I think we can all agree on that.

MR HORSFALL: Yes, certainly agree with the objectives.

MS CHESTER: I'll just be careful we don't mischaracterise the earlier participants, because they actually did say reforming the current HFE arrangements did offer a path and a benefit to the economy in the interim. Anyway, I just want to make sure we don't mischaracterise.

MR HORSFALL: Yes, certainly.

MS CHESTER: Then if we are to fast forward the clock and we've Commonwealth and States prepared to dare greatly and reform VFI and reform responsibilities for expenditure, what sort of change do you think that would mean for Victoria. What taxing powers do you think Victoria would have. What responsibilities would go back to Commonwealth? What would stay with Victoria, and then what would HFE look like in that new world?

MR HORSFALL: I suppose that's a very big question. I would probably say that HFE should be a secondary consideration or should be something that falls out of the primary parts of the reform, rather than be a driver of it.

MS CHESTER: Yes, and I think that's right, because when you look at the CGC's post-draft report submission to us, and when you go through the steps – you know how we've got the little simple equalise to the average, equalise to the highest and then the top up over the top.

MR HORSFALL: Yes.

MS CHESTER: When you actually even look at that, even WA with its bounty at the moment, when we equalise to the highest, which is WA's fiscal capacity, WA still can't meet its assessed expenses because of VFI. So, to some extent the HFE task will be much lesser for larger States.

MR HORSFALL: Yes.

MS CHESTER: Or those more fiscally capable States, than it would be. So,

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we then get to a point maybe of just dealing with the smaller, fiscally weaker States, that are structurally fiscal weaker.

MR HORSFALL: I suppose that brings you back to some of the arguments that have been had in previous years around equal per capita for the large States with top up payments to smaller States and some of the options that have been looked at before.

MS CHESTER: If we can deal with the transition path, could I suggest to you that moving to equalisation to the average or equalising to the second highest, is actually part of the path to getting to that longer term?

MR HORSFALL: I think it could be. It could be, but the nature of the current system means that you need to get agreement on that change to get there.

MS CHESTER: Well, we wouldn't be recommending anything to Government if that was something we took into account all the time when we make recommendations. Given the Chamber's view on the importance of tax reform, and we're thinking of other cameos that we might run to see what happens to your GST relativities if you dare greatly, what are some State-based tax reforms that the Chamber would like to see?

MR HORSFALL: I suppose the sorts of tax reforms that we currently focus on or advocate for are more within your adjustments to rates and thresholds and, in particular, on payroll tax.

MS CHESTER: So what, broadening the base and lowering the rate, or more exemptions? I'm just trying to work out how reformist the Chamber is.

MR HORSFALL: I suppose what we're saying on broader tax reforms is we want to have those conversations and we would like that to be part of a sort of better functioning relationship between the Commonwealth and the States, where they can talk about broader tax reforms without some of the brinkmanship that currently occurs, and have that conversation without advocating for specific swaps or specific changes.

MS CHESTER: There's nothing on the Chamber's shopping list where you want the State Government to change the way it taxes certain revenue bases at the moment?

MR HORSFALL: The current position on payroll tax is on raising the payroll tax threshold to reduce the impact on smaller businesses.

MS CHESTER: We might have to agree to disagree then on whether that's reformist or not.

MR HORSFALL: Yes, happy to do that.

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MS CHESTER: Did you have any other questions, Jonathan?

MR COPPEL: I haven't got anything, no.

MS CHESTER: We are done.

MR HORSFALL: Yes, thank you very much.

MS CHESTER: Is there anything else you wanted to say, Hugh, that we haven't covered off in our questions?

MR HORSFALL: No, that's good.

MS CHESTER: Terrific. Thank you for appearing today; we appreciate it.

MR HORSFALL: Thank you.

MS CHESTER: If you do happen to think of any other tax reforms, let us know. We're looking for more cameos.

MR HORSFALL: Certainly.

MS CHESTER: Terrific. Thanks, Hugh.

MR HORSFALL: Thanks.

MS CHESTER: I'd like to ask our last participant, and sorry we're running so far over, to come and join us, from the Victorian Trades Hall Council.

MS BOSLER: Thank you.

MS CHESTER: Welcome. You probably have an idea of where we might go with the questions.

MS BOSLER: I do.

MS CHESTER: So, you're well prepared. For the purposes of the transcript, if you wouldn't mind just by stating your name and the organisation you represent, just for voice recognition, and then if you'd like to make some brief opening remarks.

MS BOSLER: Yes. We'll keep it brief. My name's Danae Bosler. I'm the politics and research lead at Trades Hall, and I'm also supported by Ted Sussex, our research organiser at Trades Hall as well.

MS CHESTER: Sorry, Ted, can you just - - -

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MR SUSSEX: Yes, sure. Ted Sussex, research organiser, Victorian Trades Hall Council.

MS CHESTER: Thank you, just so they don't misattribute you to Jonathan which could be very problematic.

MS BOSLER: For the tone, yes.

MS CHESTER: Yes, for voice.

MS BOSLER: Yes. Thank you very much for hearing us today. I'll just do a brief introduction. Victorian Trades Hall Council is the peak body for unions in Victoria. We represent 41 unions in Victoria and over 430,000 union members. Those union members cover every industry in the State, both the public and the private sectors, and VTH and its affiliated unions have campaigned and won on a range of important rights and entitlements for Victorian workers, everything from the 8-hour day, through to health and safety.

Our appearance today is probably a little out of the ordinary, you might think. We're not economists, which might be refreshing for you, but we wanted to represent – no offence to the economists – representing the interests of Victorian workers in what is a genuinely, we would argue, complex issue, but we feel that the impact will be most felt by workers and by Victorian workers.

Our short submission is in support of what we think has been excellent advocacy work of the Victorian State Government to represent our State at a national level. I'll abbreviate HFE with your forgiveness, if that's okay. I guess we should start by putting on the record, we wouldn't be here without first making a comment about we've long held a view of opposition to the GST as we consider it a regressive tax that disproportionally impacts on our poorest. To speak to particularly your draft report and to what you'd like to discuss today, we have three brief comments, and that is that the objectives of the HFE are sound.

VTHC joins with others, and it's awkward to agree with Becky sometimes, but we agree with many others who have spoken to this in a more in-depth way than we can. VTHC advocates reposition of raising up all States to be equal. This is a principle we take to our industrial relations framework, for example, and we would argue that there is also little indication that the objectives of the HFE actually need to be changed.

We would see good policy. We argue that, not just because we're obviously going to talk about what would be the impact on Victoria and the detrimental impact on Victoria, but also good policy should be based, not just

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on economic outcomes at any given time, but on the principles and the values that rest behind that policy decision that's being made. We support good, sound, steady, predictable, reasonably economic management and a change to HFE, we argue, would not be that right now.

Number 2, our State at this point in time, which is what you've kind of alluded to, and some other States, but we'll focus on Victoria, as a result of some of your proposed changes would be huge and cannot be underestimated. I think some other folks talked about the redistribution and the numbers would actually not be that great, but we argue that it would be huge.

Your draft report talks about significant disadvantage during a transition period and I'm sure that the Commissioners have seen the raw figures of about $970 million out of Victoria and what that looks like for Victorian workers. We constantly feel the pressure of cuts and cuts to the public service and to public sector and cuts to public infrastructure. That translates for us into 3900 teachers, into 7700 police, into 8700 nurses or into 150 velocity train carriages.

Even during a transition period, we think the impact that would be felt by Victoria is just too great. We support excellent public infrastructure programs of the current Government. We don't want to see anything that would limit or hamper that.

We also support the commitment of this State Government to quality public services and we don't want to see anything that would hamper that. There is no role more central to Government than the provision of public services and infrastructure and time after time again, surveying of our members just shows jobs, health and education. That's it, time and time again for our members, as the most important thing. I think the final point I'd make which hasn't really been discussed at much but I'm always keen to discuss is the further attempts and efforts that need to be made to make economics and topics of this nature more accessible for workers and for their communities.

There were some recommendations in there but the recommendations of this inquiry would have a huge impact on Victorian workers and I'm happy to talk further about some of the ideas about how we can make it more easily accessible for workers to participate in these sorts of conversations.

MS CHESTER: Great. Thank you very much. On your last point of accessible, that's something that we try to work harder at. Our recent five-year productivity review, which we tried to make a very accessible and digestible read, i.e. we banned the team. There was a swear jar if you had techno jargon in there. But it's not easy and, indeed, in this whole world of HFE where even a lot of State officials did not understand the way the CGC does it. We had to explain to one jurisdiction that they do equalise to the highest. They weren't aware of that. So, we know we're sort of up against it and all feedback gratefully received on how we can do that better going forward and maybe we can have a chat separately. Just coming back though to the objectives of HFE

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and I guess people have sort of used, interchangeably, the term "equality" with equity.

MS BOSLER: Yes.

MS CHESTER: I think there's an important distinction to be made, in my thinking, but I'd be interested in your thinking of what the distinction is between equality and equity?

MS BOSLER: I would interpret equality as, and I can bring a gender lens to this and a whole bunch of other things as the inputs, but the equity is the outcome. We should come out as equals. Is that the shortest way to short of summarise it? Is it the end point that we end up at? We should come out on a level playing field as equals, and if that means that you, who have the capacity to contribute more, has to contribute more so that I can stand at the same height as you, that's the equal outcome that I seek.

MS CHESTER: Yes.

MS BOSLER: I'm putting on to it very - - -

MS CHESTER: No, and it's good to see it through different lenses. I guess here in this area of fiscal capacity, equality means everyone's the same, whereas equity might have two streams. One is what would be fair to make sure that people have a fiscal capacity that's not too different from others, such that a worker in Northern Territory should be able to get the same level of services in Darwin as a worker in Melbourne.

MS BOSLER: Yes.

MS CHESTER: That's kind of what I think HFE is meant to be about.

MS BOSLER: Yes.

MS CHESTER: That's one strand of it. At the moment, the fiscal capacity is to do it the same takes you to the highest, but even the highest doesn't get you to your assessed expenses. I'll come back to that in a moment.

The other side to equity is what's kind of fair – so, that's about the individual. The other side of equity is what's fair to a State or Territory Government, particularly when they make effort, where they implement a tax reform that's politically difficult, where they undertake a development activity that's politically difficult but they do it because they think it will be better for economic growth and for jobs. There's kind of these two lenses of equity when you think about the impact of HFE and how it's being implemented. The reason I touch on that is because I guess that's partly our motivation and indeed our Terms of Reference asked us to say what's the impact on the real economy.

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There's two strands there. One, and what's been focused on historically, is about is HFE making sure that interstate migration is not being motivated by different fiscal capacities. We found, yes, that's not a problem.

The other aspect though is what impact it has on the incentives of State and Territory Governments to undertake development activities and to do tax reforms and that for us is where you can connect the dots to the equity side. There is this little overlap between equity and efficiency, where having an efficient outcome, like a better tax base for Victorians that raises revenue more efficiently, that doesn't distort the economy and it's better for economic growth and productivity and jobs. That's the territory that we're in and it's not an easy territory because there's not a lot of evidence, so we went to cameos.

I know the cameos are disputed. I think the evidence is there on the development side but on the tax reform side, if we are right and our cameos are right and they are an obstacle to States undertaking tax reform, can you kind of see the link that there could be to an equity outcome?

MS BOSLER: Yes. I guess I'd make two comments which is firstly that I'm always cautious about talking about tax reform because usually the first thing that companies go yelling and screaming is that they need further tax reforms, and we'd argue that tax serves as a very - - -

MS CHESTER: I know. People use the term "tax reform".

MS BOSLER: Yes, it's used as a term for things that we disagree with.

MS CHESTER: Yes.

MS BOSLER: Then the second comment I'd make which is back to your first comment, is that if we are forcing – is that the best method to drive – is it forcing State Governments to have to come up with initiatives or, you've said, politically uneasy or politically not popular development strategies? Is that more of a stick than a carrot, if you're going to force us to have to go through these because this restructure might mean that we are going to have a gap of $907 million and that will force us to go seeking out. I don't want to be forced to seek out issues.

MS CHESTER: No, no, no. It's more just to make sure that if a State wants to do something that's politically tougher that they think is in the best economic interests of the State, be it a tax reform or a development activity, that there's not a disincentive that it's going to cost them GST relativities.

MS BOSLER: I would like to see an example. I'd have to take it on notice I'd like to see an example of what is – I would like to argue that any tax reform or initiative to make the State stronger would not be politically unpopular. We would argue that if it's going to make the State stronger, it wouldn't be – if

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something's politically unpopular and, for example, we're opposed to it, we would argue that it's probably because it's not going to make the State stronger and make the State better, a stronger economy, or do you want me to take that on notice?

MS CHESTER: No, maybe take it on notice, but I think there's lots of good policy changes that we would like to see and, indeed, your State Treasurer would like to see. But he, himself, said they're just politically difficult, and we know that. Say, for example, reforming halving stamp duty and putting a broad-based land tax which actually is very – from your perspective of equity, is actually a good tax policy change.

MS BOSLER: Yes.

MS CHESTER: It is really politically difficult, and the cameo that we ran suggested for a large State they're going to get whacked $700 million to a billion dollars annually in loss in GST relativities by doing that. So, that's where we're coming from when we're saying we think the way we're currently equalising could be having this impact on the real economy.

MS BOSLER: Yes.

MS CHESTER: Anyway, I know this is a bit more conversational than it probably should be. So, have a think about it.

MS BOSLER: Yes.

MS CHESTER: What would be good to know is at the State level, what tax changes the Council would be interested in, and for us to have a think about whether or not the HFE system is a betablocker or not. Just on the transition path issue, and I know everybody's focused on the big numbers, indeed, when I saw the Herald Sun this morning. Indeed, our report goes to great lengths to say we would never recommend or suggest an immediate cold turkey change. Indeed, it would need to be transitioned over an extensive period of time, given the broad relativities we've got at the moment. So, nobody from the Commission is ever suggesting that a State Government would be down $1 billion the next day. That makes us then think about if we do think there's this impact on the real economy and we do want to transition to equalising to something less than the highest, what would be the principles that might guide the transition path.

MS BOSLER: I'd first preference it and start by saying even a transition process, we still go back to the number one claim about let's go back to the principles of why are we even changing the system. Putting that aside, why are we - - -

MS CHESTER: Assume I've convinced you but I won't, but assume we

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have. If we were looking to do it - - -

MS BOSLER: Yes, what principles can we apply.

MS CHESTER: What principles do you think we should be applying?

MS BOSLER: The normal principles that we would say in any sort of downsizing or cut of public funding, because that's what it's going to be, a cut of public funding to Victoria, you have to protect frontline services and you have to protect frontline jobs. So, we'd never support any cut of public funding, but if that's the path we're going to go, if we're going to be forced through that transition path, how do we protect services, frontline services, and how do we protect as many jobs as we possibly can?

MS CHESTER: It might help you, and we haven't tested the veracity of the numbers, but we did get from the WA Government a transition path out to 2026-27, which would suggest that the first three years there's no impact on Victoria, the fourth year -26 million, the next year -8, and then your +100, +230, +413.

MS BOSLER: I think the Treasurer also probably alluded to this this morning as well, is that historically Victoria has always been more of a contributor than a benefiter from this process. That comes back again to the principles that we had at the start, is that we contribute when it's our turn to contribute, and when it's our turn to be on the receiving end, that's the way the principles are bedded down.

MS CHESTER: No, and indeed unless we all move to equal per capita.

MS BOSLER: Yes.

MS CHESTER: We say it in our draft report, that that isn't HFE in any way, shape or form.

MS BOSLER: Yes.

MS CHESTER: One other thing and the penny only dropped when we saw the CGC's post-draft report submission, and we started looking at assessed expenses, so under HFE at the moment there's sort of assessed revenues and assessed expenses and then we do the equalisation dance to get people to be able to meet their assessed expenses. That's making them able to. When you actually look at what Victoria's actually spent, so focusing on outcomes, it's actually less than the assessed expenses for those categories, and they've done that over the last six years. So, to some extent, we're equalising to a highest to give the States capacity but they have autonomy, so some of them will and some of them won't meet those assessed expenses.

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When you look at the relative order or magnitude of how much they haven't spent, it's not that dissimilar to the order of magnitude of what changes might be over the longer term for the changes for Victoria, in terms of - was it 1 to 1.2 per cent of all State revenues, if we were to implement moving to equalisation at the average immediately.

MS BOSLER: Are you saying they're not using all of our money? Is that kind of what you're suggesting, and not using - - -

MS CHESTER: I'm just saying everybody's saying you're going to be depriving us of how many numbers of State jobs and I'm saying, "Well, I look at what's currently being spent from what you're getting and you're not spending it at the moment anyway, and it's within the bounds of what you're not spending is what we'll be proposing if we were to do it immediately". I'm kind of just a little careful when people talk about big numbers and they're repeated by other people of what job losses might be. It's not necessarily the case if we were to transition, let alone if we were to do it, that equalising to anything less than the highest would actually result in the outcome of less being spent on those services.

MS BOSLER: Yes, I'm not going to challenge or question how our Treasurer is going about balancing the budget and choosing to leave – and balancing it out there.

MS CHESTER: But you're happy to use his numbers and quote what job losses might be.

MS BOSLER: Yes, for fear this will be a possible outcome and if they say, if the Treasury and if the Department says we will feel pressured to or we will feel this is a possible threat that could come our way, and this is a threat that we've experienced at a Federal level many times before, then we're happy to come to that defence of the decisions that the Treasurer's made.

MS CHESTER: Okay. I think it would be helpful if you're going to defend people, have a look at the CGC post-draft report submission and actually have a look at what happens, because we're talking about fiscal capacity and the ability to. We're not talking about outcomes here. I guess we're trying to make sure there's an informed debate about what would be the implications for real people of any of the recommendations that we make.

MS BOSLER: Yes.

MR COPPEL: That difference would be either spent on other areas that are not in the assessed expenditure or it could be running a budget surplus. Can I just ask you one question? We've heard a lot about the role that State Governments play in HFE, much less so on the role that the Commonwealth Government plays. It has probably withdrawn over the years from the debates

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that happen, particularly when you've got this period of more extreme dispersion of relativities. I was wondering whether you had any views on what role the Commonwealth should be playing in the area of HFE, what different role?

MS BOSLER: I'd have to take that one on notice as well about what more of a stronger leadership role you think the Commonwealth should take. I hadn't thought about it. I've been focusing on State.

MS CHESTER: Given your focus is at the State level and we don't expect you to be an expert. We don't expect anybody to be an expert on this stuff because it's so horribly complex.

MS BOSLER: Yes.

MS CHESTER: I still claim there's only 30 people in Australia that truly understand how this thing works. There's also HFE occurring within State Governments for their Councils. I don't know if you're aware of that because there is kind of like a vertical fiscal imbalance between State and Local Councils and particularly for those less fortunate, those in more difficult regions with less capacity to raise - - -

MS BOSLER: Smaller, remote rule.

MS CHESTER: Yes, yes, yes. It's kind of interesting when you look at that. State Governments don't equalise to the highest. They don't even equalise to the second highest. They don't even equalise to the average. It would be good to get your sense of – there seems to be an asymmetry here in terms of the way they implement HFE themselves within their own State borders.

MS BOSLER: That's another question where I'm going to have to - - -

MS CHESTER: I know and I'm only asking it now because I wish I'd asked it this morning when the Treasurer was here and I forgot to.

MS BOSLER: I'm happy to go and talk to the Australian Services Union, the union that covers local council, and take their – because obviously Local Councils are also under a rate cut pressure right now, which is the focus of what the ASU is concerned about, but I'm happy to go and ask the ASU for their feedback on that position too.

MS CHESTER: I am conscious from other inquiries that a lot more responsibilities are being pushed out to Councils and there seems to be a bit of an asymmetry on what principles are applied. I didn't have any other questions. Did you, Jonathan?

MR COPPEL: No, thank you.

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MS CHESTER: Is there anything else you wanted to say that we haven't covered through the Q and A and your opening remarks?

MS BOSLER: No, I think we're all covered. We're happy to provide a follow-up one pager.

MS CHESTER: If there's any kind of State-level tax reforms that the Hall supports, let us know.

MS BOSLER: Yes.

MS CHESTER: That would be great. Thank you very much for appearing today.

MS BOSLER: Thank you.

MR COPPEL: Thank you.

MS CHESTER: We are 40 minutes late but it's been a very good session this morning. We thank the participants and I now call our Melbourne hearings to a close. We will resume next Tuesday in Adelaide, if I'm correct, and I'm looking at my team to tell me that's correct. They're nodding, yes. Thank you very much everybody.

MATTER ADJOURNED AT 12.41 PM UNTIL
TUESDAY, 21 NOVEMER 2017 AT 9.00 AM

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Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO HORIZONTAL FISCAL EQUALISATION

MR J COPPEL, Commissioner
MS K CHESTER, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT MAJESTIC ROOF GARDEN HOTEL (NANDINA ROOM) 55 FROME STREET, ADELAIDE
ON TUESDAY, 21 NOVEMBER 2017 AT 11.22 AM

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RESUMED **[11.22 am]**

MR COPPEL: Okay, ladies and gentlemen. I think we will start today's public hearings. First of all, good morning. My name is Jonathan Coppel and I'm one of the Commissioners on the inquiry along with Karen Chester, who is also Deputy Chair of the Productivity Commission.

I would like to begin by acknowledging the traditional custodians of the land on which we meet today. I would also like to pay my respects to elders, past and present.

If we begin just by giving a bit of context and information about the inquiry hearings. We are today on the fourth day of public hearings into the HFE inquiry. We had two days in Perth and a day in Melbourne last week, and next week we will be completing the public hearings with hearings in Darwin and Hobart.

Once the hearings are out of the way we will be taking the information from those and from the submissions on the draft report into further analysis to complete a final report which will be submitted to the Australian Government early next year.

Those participants who have registered their interest in the inquiry will be advised when the final report is released by the Government, which may be up to 25 days, Parliamentary sitting days, after the completion of the report.

Just a little bit about the purpose of these hearings. It is to facilitate public scrutiny of the Commission's work and to get feedback on the draft report. So where you think we may have got it wrong, where we may have got it right, where we may have missed important aspects. That sort of feedback is very important to us.

We do like to conduct all hearings in a reasonably informal manner, but I do remind participants that a full transcript is being taken, and for this reason comments from the floor cannot be taken. However, at the end of the day I will give an opportunity for those who are not registered participants if they wish to make a comment before we close today's proceedings.

In terms of how we conduct these hearings, participants are invited to make short opening remarks. We would like to keep those brief, to five to seven minutes maximum, and this will allow us time to discuss matters raised in submissions and in your evidence today in greater detail. We don't require participants to take an oath, but they are required under the Productivity Commission Act to be truthful in their remarks. And participants are also welcome to comment on issues raised in other submissions.

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In terms of the transcript, it will be available from the Commission's website following the hearings. That usually takes a couple of days. And also on the website you will be able to find the complete set of public submissions to the inquiry, both pre-draft and post draft.

Are there any media in the room here today? We have a couple of ground rules, but if there are no media then I will skip those. The other requirement that I'm obliged to inform you about relates to the event of an emergency evacuation from this building. In that case you should follow the green exit signs which are not visible, but they're essentially out to the rooftop deck and over in the far corner there are fire stairs, and then follow instructions from fire wardens to the meeting point and avoid obviously at all times using the lifts.

So, let me now invite the first participants from the Australian Council of Social Service to talk. First of all for the purpose of the transcript if you can give your name and then, when you're ready, a short opening statement. Before you do that, let me thank you for your submission on the post draft report. Thank you.

MR WOMERSLEY: Thank you. Thank you, Commissioners. My name is Ross Womersley. I am the CEO for the South Australian Council of Social Service. So just to be clear, we're the South Australian Council rather than the Australian Council of Social Service. I am joined today by one of my colleagues, Dr Greg Ogle, who will speak to some of the issues, the more particular issues in a second.

But I think by way of opening what we would be saying to the Commission and what I think is reflected in our submission, is that in fact we should be working to retain the current patch of the objective. We think that equality remains the core and most - the highest principle that ought to be sought, and we would point in that instance to our colleagues at TASCOSS's submission in which they argue why GST is so important to States like Tasmania and South Australia. And note that in the South Australian context GST as a component of our tax base is about 33 per cent. So in effect it's a very substantial form of income that's available to the State and that supports that objective of equality across the States which we think is ultimately as important as fairness and economic efficiency.

We support the goal of equity in the current objective, but the suggested change we think takes us away from equality. We were pleased that the PC had rejected options that relied on per capita sharing and/or the Commonwealth top ups, but an objective of revenue sharing to some reasonable level of capacity we think falls short of equality and would leave the most vulnerable people in the fiscally weaker States worse off. And so on that basis we reject the idea of transitioning away from that objective.

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Most of the argument, we think, is about Western Australia as an outlier, and that's essentially the rationale for why the Commission has been charged with the job. We do note that our colleagues at Business SA - I'm not sure if they'll be in the room at the moment - but their submission provides quite a detailed history of State budget surpluses across Western Australia and we certainly support their submission on that point.

We do have some sympathy on the time lag part of the Western Australian argument, and Greg will say more on that. Overall though, we believe that when one State has massive mineral wealth this is how HFE was and is supposed to work to provide equality. Hence on that basis we support the current objective of equalisation. And I think Greg is going to talk to the issue of time lag and volatility and impairments to change.

DR OGLE: Thanks, Ross. I'm Greg Ogle. I'm senior policy officer at SACOSS. Yes, just those two issues. On the time lag, when you look at Western Australia and you just look at how the system is set up, I think the time lag is a real issue and, you know, we would support if there was a way to tweak that without increasing the volatility of the system. You know, if that was about, you know, potentially taking the last year of data as budget rather than waiting for the actual data to come in some time later, we might support that because we do recognise the issue the time lags are causing.

But what we wouldn't support, I think, is a shortening of the averaging period because that would simply see much more volatility in the system, that we're sharing the - extending the analysis over the period and averaging it out gives some level of stability to the system. So I think we'd support that, and because obviously the more volatility you have the harder it is to budget, and particularly for smaller States with limited revenue streams. And South Australia is already heavily reliant on conveyance taxes and land taxes, which are relatively volatile. If the GST stream becomes more volatile because of trying to fix other issues that creates even further problems for South Australia.

The other issue that we wanted to address that is possibly a bit different from others is just the idea of whether or not the current HFE arrangements are an impediment to change. And I know there's debates about whether the cameos that were in the draft report are appropriate or not, and pretty sterile debates in our view about evidence of change and absence of evidence, but it just seems to us it's pretty obvious that any Treasury should be modelling the impacts on GST receipts of any tax changes they're going to do. That's part of their job. And as such that should feed into the system. It might not be determinative, but a decision about a particular tax reform. But it should be on the table and it should be modelled.

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And therefore if there is an impediment that comes out from that then that could be a problem because our focus is actually much less about arguments about what's happened in the past and whether or not there's evidence, but looking into the future. And when we look at the implications of digital technology and the wave of technological innovation that's coming our way with the 5G networks and the next iteration of the digital revolution, that has serious implications for some traditional State tax bases. Driverless cars will mean the end of a huge wad of our current motor vehicle taxes. That's 13 per cent of the State's own revenue here.

The rise of the gig economy might undermine the payroll tax base. We've already seen gambling taxes declining in recent years in South Australia as the pokie industry flattens off. People are changing gambling habits to go online. That's a lesser taxed area and a more difficult to tax area.

So they're just some of the things we've been looking at, and looking ahead at what's coming, and so we need a system that can adapt to that. And yes, without an artificial impediment to change.

Having said all that, I don't think that any of that is actually addressed by a change to the reasonable standard of equalisation. I don't see that - yes, it just doesn't seem that that addresses it at all. If there are impediments to change and penalties for first movers, then I think they should be - the system could be adjusted for those particular things with particular adjustments to overcome those impediments, and probably now when you've got quite a different push is not the best time to be looking at that. But it's something that should be kept in mind.

But yes, when you've got pushers that are actually about mining and old industries it's probably - I think it's quite a different issue and a different problem. And because those changes don't address those issues about where the future tax base is, we don't see any real need to, in a sense, sacrifice the goal of equality in the interests of addressing those issues. That's the impediment issues. And we will leave it there.

MR COPPEL: Thank you, Ross. Thank you, Greg. Our inquiry Terms of Reference asked us to look at the impacts of HFE on the incentive for substantial tax reform, or reform in the State jurisdiction, the effects on efficiency, on migration. It still keeps the equity objective as the primacy objective, and our draft report has identified, particularly in the area of substantive tax reform, that there is a first mover disadvantage, which is particularly large for the larger economies, given the way the HFE works. Your submission also makes a number of areas where there may be a disincentive to consider new tax bases in the event of major digitalisation of the economy.

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What we're suggesting is that there is an ability for the system to give greater weight, relative weight, to the efficiency objectives of jurisdictions, and to that extent what we're proposing mutes that first mover disadvantage. Now, you and a number of others are saying that it doesn't directly target the problem of that first mover disadvantage.

So my first question to you would be that if you rule out a mechanism that provides greater scope for some form of trade-off between the objectives, what changes would you make to the HFE system that could address this disincentive for substantive tax reform?

DR OGLE: We don't have a shopping list of changes that we think would address that, but I think it just seems to me to be much more specific and if there is a first mover disadvantage then maybe it's something that looks more like a concession for that particular move for a very limited time, is a much more targeted response than a change in a sense to the way the system is set up. So in that sense it looks - as I say, I'm not - I guess I was less convinced about how the proposed changes would address that first mover disadvantage, but even if they did it seemed to me a fairly blunt instrument to change it in the sense that it potentially sacrificed more for what was, I think, a limited disadvantage of the current system.

MR COPPEL: So this is an argument that many have put to us and we sometimes struggle with that argument and the way in which within a State, State Grants Commissions try and equalise between different levels of Local Government where clearly they are not seeking to achieve full equalisation. I am wondering whether you have views on why within a State jurisdiction something less than full equalisation is appropriate, whereas across jurisdictions the goal standard of full equalisation and any movement away from that, even if relatively small, for other goals is a non-starter.

MR WOMERSLEY: I'm not entirely sure that we would be advocates of not full equalisation at a State level in that context. I think we've maintained the principle for the very same reasons, that ultimately - and the people, I guess when you think about the people that SACOSS worries about most, and they are the most disadvantaged citizens in the community, it's them that always are most likely to suffer if in fact resources aren't available to them. And one of the best mechanisms that we have for ensuring resources are available is through an equalisation measure. So I think in both instances we would be strongly arguing that equalisation is a relevant and important thing.

MR COPPEL: So on that point, the way equalisation functions is that it brings every jurisdiction up to a level where they have the same capacity to provide the average assessed levels of services, but there's no obligation on a State jurisdiction then to match the assessed level of expenditure with the actual level of expenditure. And there's been quite a bit of work looking at how those two travel across jurisdictions. And typically in the areas of

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community services, public housing, the actual level of expenditure, particularly in the case of South Australia, is quite a lot lower than the assessed level of expenditure. So I wonder if you have any views on that aspect of how HFE works because you say it guarantees, but my point would be that it doesn't per se guarantee.

MR WOMERSLEY: It makes it available, I suppose, to the degree that that can guarantee. And what you identify is that of course governments along the way make decisions about how they will spend, and that's certainly true. I guess what we are then able to do as an advocacy group on behalf of that part of the electorate is to be able to point to where those differences exist and to call on our State Governments to answer the question as to why there is such a disparity across, if that disparity exists, to call on them to explain why the disparity exists. Because we know that the money, in a broad sense of the word, is available.

So I suppose it's a kind of - it's not a sufficient mechanism for making sure that the States do actually deliver to the - and I think as a COSS network we have spoken at some length about the idea that around a whole series of jurisdictions it might be helpful to have a set of standards that all States were obliged to fulfil. I'm not sure that it fits necessarily in this part of the discussion, but it may - it is certainly a piece of work that we talked about, particularly when we were thinking about the potential for Federation reform.

MR COPPEL: What do you mean by a set of standards?

MR WOMERSLEY: Well, as service standards, I suppose, that each of the States would be expected to be able to deliver in providing those specified range of supports to people.

MS CHESTER: So Ross, do you mean there that there is an assessed expense that they should be making to be able to provide the average level of service standard to the citizens of South Australia as akin to the citizens of New South Wales that they're obliged?

MR WOMERSLEY: Broadly speaking, yes.

MS CHESTER: Because we didn't sort of stray into that territory because I guess we're quite comfortable with States having autonomy, and indeed this whole area is quite difficult. If you looked at the CGC's post draft report submission to us it actually points that HFE can only do so much of the heavy lifting. Indeed, WA with the highest fiscal capacity at the moment, even when it's equalised to the highest itself it can't meet its assessed expenses. And the real problem is vertical fiscal imbalance which comes to longer term Federal financial reforms around the taxing powers of States versus the Commonwealth.

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But the reason we go into the territory of what's assessed versus what's actually spent is because there's a whole bunch of commentary now saying, you know, that what we're proposing is going to cost 1,000 teachers' jobs and all the rest of it, but when you kind of look through to what happens, for South Australia it's only 32 per cent that's spent on public housing that they're assessed for, 80 per cent on services to community. And over the last five years they've been sort of three percentage points below what they've actually spent on their assessed expenses.

So when you look at the metrics of what we're proposing, going back to your 33 per cent which is a really important figure, South Australia under our two proposals would only lose 1.2 to 2.4 percentage points of revenue as a percentage of the GST's (indistinct) to the revenue. So when you look at that and then when you look at the assessed versus the actuals, you kind of think well, I don't see Armageddon here.

And I guess our whole perspective is really well, if it need not translate into lesser services, particularly if we get a transition path right and there's growth in the GST pool, but there are net economic benefits from not holding back - and it's not just tax reform, it's also development activities and decisions that States might make at the margin there - then that's where we're coming from, that perhaps there is - you can make a little bit more of a trade-off between equalisation and efficiency. Because the CGC do have efficiency as one of their subsidiary principles, but when you're equalising to the highest and it's such a high bar at the moment with WA there's just no wriggle room for efficiency.

And then we get into the world of sort of trying to do carve outs, and I guess we landed in our draft report on suggesting that that probably, that was quite arbitrary and would have elements of a symmetry across States. And I know this is bit more conversational, we're not just having questions but - - -

MR WOMERSLEY: No, it's an important conversation.

DR OGLE: But I'm not sure you can assume that because South Australia might be spending under its assessed expenditure for a particular area that that difference is not being spent usefully and productively somewhere else.

MS CHESTER: No, I'm not. I'm not, but I'm just saying when you look at the numbers and then you have people in the public domain now saying that this is going to translate to X less teachers, X less police forces, and then when you actually look at what the impact it has on SA's revenue as a percentage - GST as a percentage of its revenues, it doesn't translate to that.

DR OGLE: But if you assume that that money may be being spent productively elsewhere then that one percent-odd reduction in revenue has still got to come from somewhere, and that might limit the ability to provide

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tax breaks. So it might not be teachers and nurses that are the sort of populist response, but it still has a budget impact that we've got to address somewhere, and whether that's from the revenue side or the expenditure side. And, you know, for the poorer states like South Australia there's just not that much room, and we're already at a geographical disadvantage in a sense in terms of where head offices are located and all that sort of stuff. Our tax system might need to be better than other States, our services might need to be better than other States to make up for our climate and water et cetera.

MR COPPEL: In our draft report we did note that there would be fiscal impacts, and we quantified those fiscal impacts on the extreme assumption of a shift overnight. We plan to do a lot more analysis looking at issues of transition. But I just pick up a point that you made in your opening remarks. I think you mentioned that you don't believe in the notion of top ups from the Commonwealth, which would be one dimension of a transitional arrangement. Can you elaborate on why you don't see Commonwealth top ups as being part of a package?

DR OGLE: We'd be less concerned if it was a short term defined transitional arrangement, but as the general principle the Commonwealth top up funding, or Commonwealth funding, is inevitably - ends up in a political fight as to responsibility between State and Federal Governments. It ends up being tied, so that when we're having issues on the ground with, you know, service providers telling us that there's a particular condition that they're funding that's not working, we go to the State Government and they say, "Our hands are tied." It's just not as flexible and efficient a system as having one Government with its own bucket of money. As I say, less issues if it's transitional but as a starting point, as a building block for a system, it's not very useful.

MR WOMERSLEY: I mean, I think it also points to States not necessarily taking responsibility for all of the circumstances that they've got, and so the more those top ups are identified as a mechanism for supplementing or complementing other funds then the more States will seek to use it. And of course what we see, and again I'd go back to the Business SA submission, for that list of, massive long list of essentially surplus budgets that are being delivered in the west, and they're still asking for top ups. And so it's kind of a very interesting question as to how you arrive at what's a reasonable circumstance within which to top up versus what's not.

And I guess that goes back to Greg's point about if it's part of a designed transition and it's short term, then in fact that has a clear purpose and it's more evident and more transparent what it's there to do. It's much more problematic if we start to do this stuff on a, sort of every couple of years. One State says we're diabolical and being punished because we didn't do the right thing ourselves, we need to be saved. Now, I don't think we'd want a system that operated in that kind of way.

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MS CHESTER: And I think unfortunately some people may have mischaracterised our draft report and its reference to WA being an outlier. The problem with - because we had quite a frank exposition of WA's fiscal arrangement. It's because the equalisation task becomes so great when you have such a fiscal outlier, which - the Saul Estlake(?) quote is quite apt - you know, they're like the pensioner that won the lottery and doesn't want to give the pension back. But because it makes the equalisation task so great and it moves you even further away from EPC, which we're not recommending, it means that that scope for trade-off between efficiency and equity becomes even more difficult and amplified, and thus - and it's fair to say that we didn't have time before the draft report to model what would happen under the cameos if we moved to one of our options, and we're now doing those numbers to be able to sort of provide an evidence base that would actually address the disincentives as part of finalising our report.

MR COPPEL: I just want to come back to the points you make about digitalisation potentially having quite a substantial effect on State revenues. In your submission you talk about particular solutions associated with discounting or providing an exemption, which we considered in a broader sense. We considered a slightly different version of that which would be just discounting that part of the methodology, not some transitional period or fixed period of time of discounting or an exemption.

And one of the reasons that we were not in favour of those sorts of mechanisms was that it's quite ad hoc, obviously. Some people have made the same criticism of what we're suggesting. But it's also less transparent and it doesn't really provide a structure that may be able to anticipate the next source of stress, like you have done in your report. But above all they amount to something which is less than full equalisation themselves. So there's a tension between trying to be targeted and with achievement of a goal of equalisation.

DR OGLE: I understand that, but to be clear we're not suggesting that those incentives, if you like, are a permanent part of the system or a permanent carve out for a particular area or a particular tax base. We're simply saying that it might be that it's a one-off for a first mover, or something just to remove that first hurdle and then it would disappear. So it may still have the deficiencies you're pointing to, but it's much less than - and we're not proposing building carve outs into the system permanently.

MS CHESTER: But a State not pursuing tax reform, or a State not pursuing a controversial development activity, because of effectively being punished for the GST relativities for doing so is a permanent impact on the - it's an ongoing impact on an economy. It's not a one-off.

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DR OGLE: I guess - well, that's true for as long as that development happens. I think we were probably just more focussed on examples where if you're trying to develop a new tax base - and the point of consumption of gambling tax is one that comes to mind. South Australia was the first mover on that. Now, I know gambling tax is calculated differently so it's not a direct translation, but we're there. We've got this tax which is a response to a new digitalised gambling base. It's, in our view, a good tax because it actually taxes at the point where the gambling harm is done and that services are required, et cetera.

Now, you know, it hasn't gone to the High Court much against our expectations. It may well be that others will move, other States will move and we would anticipate that in the next few years other States will move in behind that. So that first mover difference won't be there in two or three years.

Now, as I say, it's not a great example in the sense that gambling is treated somewhat differently, but I think we were focussed on examples where a State is moving to create a new tax base or to make a change in relation to that where others will follow, and it's that transition bit that's the impediment.

MS CHESTER: Yes, and I think it's a really important point that you raised earlier on about revenue bases are changing with disruption and with new technologies, and I guess we do see a future where both Commonwealth and State are going to need to be a bit more nimble about what tax bases they have and how their optimally taxing them. So I guess in that context are there areas of tax reform from SACOSS' perspective now that you would want to see, and it doesn't need to be South Australia, but any sort of typical State or Territory Government pursue? Also in the context of longer term Federal financial relations, would you want to see greater taxing powers reside with the State such that they can have greater autonomy in managing their budgets, given the point the CGC quite eloquently make that even WA with all its mining royalties still can't meet their own assessed expenses?

MR WOMERSLEY: We've advocated for a number of reforms, and I guess - I don't know whether I'd name things like death duties.

DR OGLE: I was going to point out that even in a digital world we know that people will die, so the - - -

MS CHESTER: It doesn't have any elasticity effects, that one, I have to say.

DR OGLE: I mean, in terms of economic theory it's a good tax in the sense of not having fiscal drag.

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MR WOMERSLEY: It's a good tax in terms of it's the one time in your life where you don't actually need the money.

DR OGLE: From our point of view it's a good tax in terms of equality and fairness, but it may be - like, that's just an example of a tax that - you know, if we lose revenue bases that are traditional State revenue bases like payroll tax or motor vehicle taxes then we're going to need to have other alternative tax bases. That's one that has traditionally been a State tax. Logically it probably needs, given the demise of the inheritance taxes in the '70s, we would need a COAG agreement for all States to implement it. And that may well be true of a lot of new tax bases or else you end up with competitive disadvantages.

MR WOMERSLEY: I mean, I think we've seen - yes, whether it's disadvantage or the capacity to oppose. So I think the interesting thing is when we reflect on things like the introduction, or the proposed introduction, of mining tax, or indeed the bank tax as it existed in South Australia. I think what we've seen there is that the capacity to have a really informed, sensible conversation about tax reform is extremely difficult. And so what's happened is people that are cashed up and have been prepared to spend enormous amounts of money have won the day in both instances.

So that makes it very difficult for those of us that might be deeply concerned for a longer term equitable tax system to be available in order to deliver the services that we want. And I think it points to - while it's again not directly in the context of this inquiry - it points to the complexity of negotiating agreement across our nation at this point in time about what good reform might constitute. And just creates some extra impediments to us being able to advance those discussions in a way that enables us to arrive at something that is sensible.

MR COPPEL: I've just got one other question which is on a different area, and it relates to the public understanding of HFE and confidence in the HFE actually delivering on its objective. And intertwined with that is quite a substantial amount of lack of understanding of how the actual system works. And we've got a number of recommendations in the draft report that seek to address that particular issue, and I was wondering whether you had any comment on that aspect of the draft report.

DR OGLE: We did some research earlier this year on State based taxes and public knowledge and understanding of State based taxes, and the sort of balancing act of expenditures and taxes, and at the State level - and I think it's fair to say, you know, the understanding of taxes and the knowledge of the State tax base particularly is very low. The understandings of how the tax system fits together, even at the level of which level of Government levies which tax, is similarly low. So I think from that point of view it sort of - on the basis of that I find it hard to conceive that many people understand the

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HFE system. And that leaves open, unfortunately that leaves open the sort of populist rhetoric around sharing. It doesn't really address the equality goals or the range of goals even. It creates a very false debate.

So, I think without going into detail of the recommendations, I think frankly our position would be any recommendation and any move for greater public information and education would be welcome because I don't think - well, we know that the understanding of the tax system isn't high generally because it is complicated.

MR COPPEL: Do you have any specific measures that could be adopted to improve that confidence in the HFE system?

MR WOMERSLEY: Can we take that on notice?

MR COPPEL: Sure.

MS CHESTER: The other one you might want to take on notice because I'm conscious of time, but it's one that we struggled with and it's probably a more important outlier, and that's how HFE deals with indigeneity. And there has been quite a bit of work done by some academics drawing out that when we looked at assessed expenses they're adjusted for disabilities and then when you look at the assessed expenses versus the actual expenses there's quite a large gap.

We kind of struggled with that, whether HFE can really deal with that outlier issue, given the policy imperative. Some have suggested taking indigeneity out of HFE, but from our perspective we struggled with just doing that because Commonwealth/State responsibilities there still require some addressing.

So I'm not sure if that's an area of our report that you had a chance to focus on. I don't want to put you on the spot today, but it is an area where we'd like to get some feedback in terms of how we've dealt with it in the context of HFE, and it also overlaps with some of the recommendations in our five year productivity review about assessing Commonwealth/State responsibilities in some of those areas, and we sort of suggest that, given the gaps that remain and the difficulties in overcoming indigenous disadvantage, that was really our priority, first cab off the rank.

MR WOMERSLEY: We'll take it on notice and spend a bit of time with that. There is absolutely no doubt in our mind that the issues that arise for Indigenous Australians, while there are many people who are doing quite well they are vastly over-represented on a whole lot of measures that speak to poor life expectancy, poor outcomes, schooling, tertiary education, et cetera. So yes, we would be concerned that they are a group of people in the population who are very vulnerable and therefore removing them may

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actually be - or removing an acknowledgement of that may actually be problematic. But we will give it some more thought.

MS CHESTER: That would be great, thank you.

MR COPPEL: Well, that's all from us so thank you. Thank you both for appearing today. I now call on our next participant from Business South Australia, Andrew McKenna. Anthony Penney, sorry.

MR PENNEY: Good afternoon. Welcome to the promised land.

MR COPPEL: Thank you.

MS CHESTER: Hello. Nice to meet you.

MR COPPEL: Make yourself comfortable and when you're ready for the transcript can you give your name and then a brief opening statement, thank you.

MR PENNEY: Sure, very good. So it's Anthony Penney, Executive Director of Industry and Government Engagements at Business SA, Business SA being South Australia's peak business body, 179 years old with over 3,500 members, represented are everything from sole traders up to ASX 1 in 200 listed companies. So very much the voice of business, and obviously because of that this discussion, what brings us here today, is very topical and potentially very impactful to South Australia and South Australian businesses.

I guess as you can tell by my accent I'm not from here. I'm originally from Canada, the Tasmania of Canada, and I will weave that in a little bit later into my opening remarks. But having lived in WA, New South Wales, South Australia and spent an immense amount of time in Queensland and in Victoria, I can honestly say Australia is very much a lucky country, and it is very much built upon equity and fairness. And that is the underlying principle of HFE.

We're talking about a system that has existed for over four decades, and one would argue even longer before that, coming up to close to a century. So if it has existed for so long and it's put the country in such good stead, why make changes now? I will talk about HFE as a system, the WA example and then the opposition, or I guess the proponents for changes to HFE regarding it acting as a disincentive for governments to make change.

If we look at the Productivity Commission Act it's all about achieving higher living standards for all members of the Australian community, not just West Australians. If we look at the independence of the Commonwealth Grants Commission, it's a Government body that no one has heard of. And

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that's a good thing because it means that they're doing their job, and it means that up to this date HFE has worked, and it has worked for all of the States.

With the draft report in terms of adjusting HFE to a reasonable level, have you defined "reasonable"? For us, and for our members, opening it up to a reasonable level would be opening it up to political interference, which would undermine the concept of HFE and distort GST distribution across the country.

Changes to HFE could see South Australia $256 million worse off, and we know that governments are always about raising taxes to underpin the services that they provide to the constituents. But we have great fear that new taxes, inefficient taxes, would be introduced. The productivity mandate of encouraging the development and growth of Australian industries that are efficient in their use of resources, enterprising, innovativeness and internationally competitive, would not be achieved.

Business SA and a number of the other associations in the room have spent the better part of the last five months convincing the general population and the South Australian Government that the bank tax is bad for the State and bad for business. If there are changes to HFE we run the risk of more inefficient taxes being introduced, not only in South Australia but in any other jurisdiction that could be worse off.

The fiscal capacity of South Australia differs to other jurisdictions, including a number of factors such as demographics, density, urban distribution of population, and it is a known fact that the ageing population of South Australia - and we do have the oldest work force in mainland Australia - does contribute to the Government's and South Australia's ability for revenue raising capacity. If we look at the participation rate in South Australia, 61.8 per cent versus a national average of 65.1 per cent. So that puts us on the back foot.

If we look at WA, and I know that there's been a lot of information and a lot of, I guess, criticism levied towards West Australia Governments, and having lived in WA and having family there I've got nothing against West Australians, but when you consider they've had 14 consecutive budget surpluses totalling over $14 billion with only the last three years dipping into deficit territory, the misconception that WA has been stiffed by the HFE is just that. It's a misconception.

Budgetary mismanagement in the face of forecasted decline in GST revenue does not warrant a change in HFE. And if you consider how WA got into this pickle, the resources boom increased their capacity for revenue raising more than any other States quicker. The CGC reduced their GST share accordingly as far back as 2005. The WA Government and subsequent budgets took this into account in their forecasting, and I quote from one of

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the WA Treasurer's statements, "Although the State is expecting a significant penalty, $1.4 billion by 2010/2011, from a declining share of national GST revenue as a result of the laggard CGC process, surpluses are expected across the forward estimates period. These surpluses provide the capacity for the Government to continue a substantial level of infrastructure investment, with a capital works program worth a record $21.6 billion over the next four years."

There was a clear trajectory of a decreasing relativity for the WA Government, but yet they chose to ignore that and continue spending along the trajectory that they did. WA has received significant mining royalties, a primary driver of its low GST relativity. When GST payments are totalled with other forms of revenue sources, including payroll tax, and adding in mining royalties, a complete picture is formed, and the South Australian Government in their submission, I think on page six, did a very tidy graph on how combining the relevance of revenue sources equals out across all States and Territories.

If you consider there is a lack of evidence for change, particularly as Victoria, who has a lower per capita revenue than Western Australia, including the GST, is actually one of the States arguing the strongest for in fact no changes to HFE. And don't get me wrong, a prosperous WA is important for South Australia, and it's good for South Australia, but we are mindful of embedding long term changes to the HFE system which are reactionary to the commodity cycle.

WA too has benefitted from the longer term from HFE, and all States and Territories need to look beyond the existing GST distribution. If we consider HFE acting as a disincentive for governments and tax reform, it's no surprise that Business SA is not necessarily the best friend of State Government at all times, and I expect this Christmas we will receive fewer Christmas cards in light of the bank tax.

But we do have to give commendation to the Government in their efforts to try and reform the State. And if we look at resource development, for example, the so, the South Australian Government has actively and aggressively pursued the development of unconventional, onshore gas extraction and other resources.

As per our recommendation and our 2014 charter for a more prosperous South Australia, we lobbied for investigation into South Australia's role in the nuclear fuel cycle. Again, commendation to the South Australian Government for kicking off the Royal Commission into the nuclear fuel cycle, including mining, processing, nuclear storage and possibly even power.

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The benefits as outlined in that Commission report could have seen South Australia bear the fruits worth $51 billion. Now, nowhere in that discussion did HFE come up in the discussion as a possible disincentive for exploring this as an opportunity. Now, ultimately the citizen's jury stymied further conversation, but again credit to the Government for being as bold and pursuing it as aggressively as they did.

We reiterate that since 2015 the South Australian Government has abolished stamp duty on business transfers, and is part way through implementing the abolition of stamp duty on commercial property transfers. Given South Australia's move to abolish these business transfers and it is not recouped under HFE, it is hard to see how the current system of HFE acts as a disincentive for the Government to progress these tax reforms.

MR COPPEL: Can I ask you to - - -

MR PENNEY: Tidy up?

MR COPPEL: - - - tidy up in the next few minutes, thanks.

MR PENNEY: I'm almost done. I'm almost done. The Commission's draft report advises that there is scope for HFE in its current form to discourage major tax reform, but there is no analysis that we have come across where States like South Australia or even the ACT have actually implemented progressive tax reforms under the existing system. If the Commission is to recommend permanent changes to the current system of HFE which has served Australia well for decades, it cannot be on the basis of what might happen. It has to be on the basis and evidence of what has happened.

I opened up by saying I'm originally from Canada. Canada doesn't have full equalisation. It operates under a partial equalisation system.. And if you consider the States, it's similar but probably one would argue a worse system. And I know growing up in a "have not" province whereby our economy was founded on fishing and forestry compared to that of Alberta, which was mining, that the differences in services being able to be provided, net migration out of the province, and just the general overall wellbeing of people in the province, made a significant difference.

And that is why HFE, and again going back to the underpinning being equitable and fairness across all Australian States and Territories, is paramount. And therefore Business SA recommends no changes to the HFE system as it currently sits.

MR COPPEL: Thank you, Anthony. Let me just begin by making a couple of clarifications. You inferred that we were focussing in our draft report on just a sub-section of the Australian community in breach of our own Act.

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The point that I'd like to make is that the inquiry is looking at the impacts on the Australian economy of the HFE system and the economic growth and productivity, incentives for major reform like migration, and our analysis suggested that, particularly in the area of major reform, there can be a disincentive for a State to pursue, given the HFE impacts that would be a consequence of those. And it's from that perspective that we see a number of problems with the HFE system that bear on the national economy. That's one point.

The other is looking at the consequences of HFE for budget management and there, as Karen intimated earlier, we did have quite a bit of analysis in the report and concluded that the HFE system shouldn't be an impediment to sound budget management. Where there was potentially an issue is with the contemporaneity, and again there we judged that moving away from the averaging could have consequences of itself for budget management so we were a bit more agnostic on that and didn't recommend any specific measures. So I just wanted to make that point for the transcript.

MR PENNEY: Sure.

MR COPPEL: But it's also a good kicking off point for asking you the first question, which is we've identified at least in principle where the HFE system can act as a deterrent to major reform. You've said that we can't look at what might happen. But the nature of that impediment itself could prevent something from happening.

MR PENNEY: Sure.

MR COPPEL: So that's why we undertook that type of cameo analysis because it's trying to extract from that. I'm wondering whether you then have any views on that particular cameo analysis, and if you make the point that you make that you can only look at what actually happens my question to you is isn't that limiting the scope of analysis to examine the impacts, or the potential impacts, of HFE? How would you overcome that?

MR PENNEY: So if I consider my opening remarks in terms of HFE being a disincentive, and I provided three very sound examples of where the South Australian Government is trying to look at ways to increase its revenue raising capacity and capability, and it is looking to undergo tax reform by abolishing business transfers, it is trying to head in the right direction. So I would throw the question, I guess, back to yourself and say, "Where have there been clear examples and evidence of HFE acting as a deterrence in the past?"

MS CHESTER: Well, I mean South Australia and ACT doing tax reform is actually consistent with the cameo because they're smaller States and Territories.

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MR COPPEL: One example that was put to us, and it's a partial example, in our hearings in WA was the context of a change to the mining lease fee which was proposed by one of the parties in the recent election. That led to a lower commentary that 90 per cent of the revenue raised from that would be equalised through the HFE system. Why focus on this particular measure? We could pursue another tax base and the way the system works we would get a bigger share of that revenue back.

Now, I'm not saying that's the killer example, but I wouldn't say that pointing to particular - what we're saying is that it's not an incentive which would sort of kill reform over the head. So you can always point to examples where reforms go ahead and what we're suggesting is that the system is muting that incentive and the response that we're proposing provides more flexibility to look at multiple objectives. Governments always have multiple objectives. And it removes the primacy, if you like, of the equalisation objective.

Now, we're not proposing that we remove that equalisation objective. We think it actually should be quite the main objective, but it's just giving a little bit more weight in the system to provide that degree of flexibility. Can you then elaborate on what you think would be the consequences of a change in the objective of HFE for the State of South Australia?

MR PENNEY: Sure. If I consider the whole reason for Business SA's existence is to ensure that any impediments to growth for our members and for the larger business community put in place by Government, we lobby against it. So whether it's penalty rates, power prices or you name it, we do provide a voice for business. One of the things that we continuously have been lobbying against, or lobbying for, is portable, reliable, secure power. And granted this is a State and Federal Government issue and we're in the situation that we're in for a whole number of reasons, but to ease the transition for South Australian businesses the Government put in place an energy point to the program worth about $40 million?

MR McKENNA: About $30 million, yes.

MR PENNEY: About $30 million. Now, if there were changes to HFE that would make programs such as that much more harder for the Government to deliver, for businesses to be sustainable, to continue employing people and to continue to compete on a national and international level. So any changes to HFE which has a negative impact to South Australia and the Government is going to naturally just flow on to the business community.

MR McKENNA: I think we're also concerned about the fact that GST is an inherently efficient tax, and as soon as we start to adjust the system of HFE leading to States like South Australia having a substantial hit - let's say we're

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working on your basis that equalisation to the second strongest State, $256 million a year. No doubt every State tax is on the table. They're pretty much without fail more inefficient than the GST, with the exception of land tax which the South Australia Government already has a significantly higher land tax effort. It's about 1.31 on the relativity, so it's doing as much or more than it should be with a relatively efficient tax.

We're concerned about payroll tax changes. We're concerned about insurance tax, other inefficient State based taxes. We've only just had a battle over the bank tax here, and one of the threats was to unwind payroll tax changes that had already been locked into the previous budget. So there's no doubt that if your proposals are formed in your final report and adopted by the Federal Government that there'll be a lot of pressure on States like South Australia to reintroduce or increase less efficient taxes than the GST otherwise collects.

So our perspective is, as a business lobby who is looking for example for the ultimate abolition of payroll tax through increase in the GST, a position that we've made quite clear publicly, would find ourselves much further behind in realising those longer term aspirations.

MR COPPEL: Sorry to ask you this, but could you give your name for the transcript so that we don't get - - -

MR McKENNA: Yes. Andrew McKenna, Senior Policy Adviser.

MR COPPEL: Thank you.

MS CHESTER: Sorry, the position of SA Business is to abolish payroll tax?

MR McKENNA: Eventually to abolish payroll tax through the GST, in some sort of like holistic tax reform that we've been advocating for a long time, and like many other organisations we're strong participants in the State tax review, tax white paper processes that have obviously been at a Federal level cut short, but notwithstanding we continue to advocate these sorts of reforms which we believe are necessary, regardless of the political cycle and how palatable they are at any one point in time.

MS CHESTER: Is there other unfinished business that you see for South Australia in terms of how it uses and taxes its revenue bases?

MR McKENNA: As Anthony alluded to in terms of the national energy debate, we really have to be looking at a lot of these arguments from more what's most efficient in a national perspective, and looking at how can we best use national taxes which are inherently more efficient. So it's not going to be just a case of what South Australia can do, it's going to be a case of

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what South Australia can do with its COAG colleagues to implement efficient national base tax reforms like we have to implement efficient national base energy policies.

MR COPPEL: Your view is firmly that the system is working broadly as intended, and in light of that wholesale change isn't justified. Do you have areas where you think the system as it currently operates could be improved, maybe to address some of these issues that we've identified in the draft report or otherwise?

MR PENNEY: Specifically to HFE or overall?

MR COPPEL: HFE.

MR McKENNA: I think it probably comes down to the lag system, and we recognise that in your draft report at least you don't see significant value in adjusting that system for more contemporaneity. That has obviously played a significant part in WA's current situation, but the reality is Western Australia knew as early as 2005 approximately that the writing was on the wall, so to speak. How much should we change a decades old system because that State Government at the time wasn't willing to make difficult decisions that they needed to make in order to be in a position where they had sufficient revenues to cover their declining GST relativity.

I mean, we would argue perhaps that if you're looking at something that's going to mitigate against future possible scenarios, look at some sort of GST reserve type fund whereby if States go above a certain level based on a long term analysis that they're forced to essentially put away money in a GST reserve that can be there for the flip side of a mining boom, or whatever it might be, so that they do have that cushion against the way the current lag system works.

So our primary, I guess, concern would be that the system works in a way that can best help States like Western Australia or Queensland, or perhaps South Australia in future, on either sides of mining cycles. But we don't want to throw the baby out with the bath water of HFE, and we need to be realistic about why WA are in the situation that they're in and not make long term, structural changes to HFE which, as Anthony pointed out, in other countries around the world where they don't have a system that equalises to the degree that we do, they typically have much more disparity across states or provinces in Canada.

And we believe that's a highly valued aspect of living in Australia, being able to move around States and for businesses to move employees, et cetera, et cetera, and one that we don't believe the system of HFE needs to change to adjust to decisions that weren't made by the Western Australian Government when they clearly knew how the system worked at the time that they were

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lobbying for a relativity floor, and they didn't hedge their bets and why should South Australia pay for it?

MS CHESTER: So Andrew, if you have read our report, and I think you have from your commentary, you would know that we have that frank exposition of WA's fiscal management in there.

MR McKENNA: I know.

MS CHESTER: And indeed we have to be careful that we've identified a separate problem to WA's fiscal management in that the outlier being so great means that there is such an equalisation task within the GST pool at the moment. But where you might need to get a trade-off between equity and efficiency it's been amplified. And if we are to take the evidence that we're getting that the WA outlier is here to stay, that equalisation task will continue to be great. Thus if there are disincentives, and we pointed to some cameos, and indeed there's equally cameos and real life examples of where the current HFE arrangements reward what we would call poor tax changes, or non-tax reform, then that trade-off is never going to be reached if we continue equalising to the highest State when it is such an outlier.

So I just didn't want our report to be mischaracterised as a solution to WA's fiscal management problems which it was never meant to be.

MR McKENNA: But I mean WA obviously wouldn't be in the position that they are in now had they sort of swallowed the pill back in the mid to late 2000s.

MS CHESTER: But that's not the problem we're looking to deal with. We've dealt with that separately in the report by saying poor fiscal management explains that part of the story. But it doesn't change the story that they're going to remain an outlier for the foreseeable future, and thus the trade-off problem with the disincentives within the system for tax reform and for development activity remains suppressed.

MR COPPEL: One of the specific issues with WA, given 97 per cent of iron ore is found in Western Australia, is the revenue assessment for royalties of iron ore where the goal of policy neutrality is arguably not met for that particular assessment because it's quite a unique one. So that's one specific issue that's been identified with the HFE methodology itself. But that has implications in terms of the economic impacts of that can have implications for the WA economy. I've just got one final question. It sounds like you come from originally the far east of Canada.

MR PENNEY: Spot on. The Tasmania of Canada.

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MR COPPEL: But our understanding is that Canada equalises I think it's on the revenue side or on the expenditure side. It's not on both as in the Australian case. But I haven't come across any work that suggested that the provinces have, as a result of less than full equalisation, been exposed to inefficient incentives for movement to the relatively richer provinces. That's something that maybe you can take on notice, but if you can point us in the direction of work in Canada that would be helpful.

MR PENNEY: Sure, and I will do. And even if you consider net migration - and again, it goes back to the creation of have and have not provinces. And Atlantic Canada has always been a have not region, partially due to the lack of natural resources that they are able to mine out and export. And considering hospital wait times - and there's data around that, it's generally longer in the Atlantic provinces - if you consider net migration from Atlantic provinces to the west of Canada, whether it's Ontario, BC or Alberta, all of the measures do point that due to the lack of - to a component due to a lack of full equalisation that the provinces are left to basically fend for themselves to a degree. And you don't get that in Australia because of full equalisation.

MR COPPEL: Great, thank you very much.

MR McKENNA: Thank you.

MR PENNEY: Thank you.

MR COPPEL: Our next participant is Jim Hancock from the South Australian Centre of Economic Studies.

MR HANCOCK: Thank you.

MR COPPEL: So when you're ready if you can for the transcript give your name and a brief opening statement?

MR HANCOCK: Yes, okay. My name is Jim Hancock and I'm Deputy Director of the South Australian Centre for Economic Studies, and I'm also a PhD candidate in the Research School of Economics at the ANU.

So today the issue that I want to pick up on particularly is that I think the draft recommendation to replace full equalisation with reasonable equalisation isn't supported by fundamental policy objectives of efficiency and equity.

Now, the recommended alternative objective is described as reasonable rather than full equalisation, but I'd make the point that there are many people, including in submissions made to you, who feel that full equalisation actually is reasonable equalisation. So I think the terminology "reasonable equalisation" is not very informative, and you might consider instead

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speaking of either incomplete equalisation or attenuated equalisation, something that's sort of more descriptive of what it actually is that you propose and perhaps it's sort of less contentious in that wording.

Now, the basis for moving to full equalisation, which is set out in finding 2.1, is that firstly equalisation is always to the fiscally strongest State. Well, I'd accept that to be correct but it doesn't actually seem to me to be a basis for change in itself. Secondly, that the current system provides for limited consideration of efficiency, and I want to talk about that in detail. And then thirdly, that it results in a complex system and I want to talk about that as well.

But to summarise, I think that those two bases of argument don't give a strong case to move away from - well, they don't give a strong case to move to the models that are considered, such as equalisation to the second State or equalisation to the third State.

So in the report there are mentions of extreme GST distributions, and I accept that there are large differences in the relativities that apply from State to State. But it's important to recognise that these differences in the GST relativities are merely offsets to large differences in other parts of State budget circumstances. And so their effect is actually to reduce extremities in State fiscal capacity. If you look at State budgets in their entirety comprising their own revenues and spending, plus the GST, then these differences in GST relativities actually diminish differences in State fiscal capacity.

Now, a qualification to that obviously is the lack of contemporaneity between State circumstances and GST distributions, and the fact that GST sort of adjusts with a lag to changes in States' fiscal circumstances. And while I acknowledge that there are some difficulties around that, it doesn't seem to me that they're overwhelming. And I note the discussion that you did have of Western Australia's circumstances and you made the point that Western Australia was aware that its GST distribution would move in an unfavourable direction so it was able to forecast the direction of its GST movement. Not perfectly, but it had an idea of where things were going.

And so it doesn't seem to me that the lack of - well, it doesn't seem to me that a lack of knowledge was the fundamental problem. And perhaps in fact the issue was that Western Australia was pushing hard for a regime change and decided to behave in a certain way to promote that outcome.

So in terms of the mechanisms that you've talked about, equalisation to the second strongest State sounded to me as being very much like giving the strongest State a relativity floor equal to the second strongest State, and then equalisation to the third strongest State would be giving the two fiscally stronger States relativity floors equal to the third strongest State. So I think there is a different way to look at what those models actually mean.

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So coming to the efficiency issue, so there are essentially two efficiency issues here. They are location efficiency, so do we get labour and capital locating in the right regions of Australia. And for location to exist, locational efficiency to exist, you want to avoid a situation where there are particular regions that just have fiscal bonanzas or fiscal disaster situations that distort location decisions to sort of take advantage of that.

The other aspect of efficiency is that the equalisation system may impinge on the policy choices that States make, and the concern there is that then States change the way they behave, knowing that they can share the costs of their decisions with other States by the equalisation mechanisms.

Now, I'm not convinced that that second argument is very strong. There's not much evidence around it, but I note that in your report you said that an absence of evidence doesn't confirm that it's not happening. And I acknowledge that there is uncertainty around that. But it seems to me that there is still a way forward to address that issue.

So in most of the submissions that have emphasised these distortions to State policy choices - and I'll call it grant design efficiency. I think that's been used elsewhere that sort of captures what that means. So the grant design efficiency effects would arise when the GST distribution that a State gets is impacted on by the State's own policy choices. And in contrast to that any GST distribution that is invariant to State policy choices won't suffer from those design inefficiencies. The point being that a State, if a State has no power to change its GST distribution - and we can say that the GST formula is not feeding back on the State's policy choices.

So there are a lot of GST distributions that are invariant to State policy choices. So the one that has received most emphasis in your submissions is an equal per capita distribution, but there are a lot of others that could be used as well. Just to illustrate, one would be to freeze in the current relativities forever. If that were done then no State would have an incentive to distort its policies because its distributions would be set.

So given that there are a lot of GST distributions that avoid design inefficiencies, if indeed they matter, then which ones should be chosen? And I would argue that the desirable one would be the one that is likely to perform best on locational efficiency criteria and on horizontal equity criteria.

So what would that be? It would be the distribution that gives the best prediction of the future fiscal circumstances of the States. And if you adopt that model, then taking the current relativities, while it certainly won't give you a perfectly accurate prediction of what will happen in future, it is likely to be more accurate than taking something like equal per capita, certainly in

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the near term. As we move further into the future it becomes sort of less and less certain.

So I think also even if we push aside the case of an equal per capita distribution, which you have sensibly, in my view, rejected, and consider say equalising to the second State - so equalising to the second State would say that Western Australia effectively, as the wealthier State at the moment, as any disincentives to tax reform or mineral development are removed because it gets to keep the benefits that come from that. So if you want to achieve this outcome for Western Australia that could also be achieved by locking in Western Australia's current relativity. Obviously that wouldn't be popular with Western Australia.

MS CHESTER: You're not planning a trip to the west, Jim?

MR HANCOCK: Well, you know.

MS CHESTER: I'm just conscious of the time, Jim. Have you got much more to run through there? Sorry to interrupt.

MR HANCOCK: No, not very much.

MS CHESTER: Okay, good. No, I'll let you finish.

MR HANCOCK: If I can take another minute and a half? Now, so I think if you did put forward a model like this then some of the vigorous advocates of the view that the current system is inefficient, Western Australia and New South Wales, would not be at all enthusiastic about it. And okay, so that in my view reflects the fact that there probably aren't very big gains to be had from that.

But on the other hand if, as they suggest, there are a lot of dollars lying on the ground as a result of these inefficiencies, then you could say to them, "Well, here's these relativities frozen in. Go for your life. Now go and make all these choices that you were impeded from doing under traditional HFE and make up the gains in that way." And I think at that point you're going to find that they're actually not very enthusiastic about that scenario because I don't think that those gains are really there in a large way.

Perhaps I'll stop there and we can sort of open it up to discussion and see what comes out from that.

MS CHESTER: I'm going to kick off because Jonathan is just going to take a momentary break. He had an early start. And thanks Jim, and thanks also for your help earlier on at the meeting with us before we got anywhere close to finishing our draft report. That was really helpful.

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I guess maybe if we just kind of go back to an earlier point that you made about there are sort of the two forms of efficiency, that the HFE could impact the economy, the first being around interstate migration, and I think we all kind of came to a pretty good landing there. The second one, so the non-locational efficiencies are the ones that we kind of honed in on. Indeed, when you sort of intuitively think about it, as you rightly point out when you depart from EPC if there are those incentive effects you're going to get non-neutrality outcomes.

So I guess in that sense if we want to keep equity as the principal or primary goal of HFE, do you still see there's scope or a need for some trade-off with efficiency at their margin, akin to - I mean, the CGC's current definition of its objectives in addition to full equalisation to the same standard does have those subsidiary principles, and I guess we're trying to work out how you - one, do you need to have that trade-off and two, then how do you achieve it under the current arrangements?

MR HANCOCK: I think as I have indicated my belief is that the distortions to State policies around tax reform and development aren't very large, and so there really probably isn't very much to be gained from moving away from full equalisation, which seeks to achieve that in a sort of full horizontal equity.

MS CHESTER: So with controversial development activities or what I call daring greatly tax reforms by a large State Government where we set out some cameos, take us through the logic as to why you don't think they play out.

MR HANCOCK: Well, it is an impressionistic view. It's based on sort of observing the behaviour of State Governments over 25 years. And discussions around tax reform and development it seems to me within the States are very much motivated by community opinion about those reforms, and community opinion - most people sort of aren't aware of any sort of dilution effect from fiscal equalisation. They simply form their judgments about whether they think substituting a land tax for a payroll tax is a good idea, or whether allowing fracking is a good idea or not. And I don't have any sense that the community views that drive the Government really are distorted by the operation of fiscal equalisation.

MS CHESTER: No, we're not suggesting the community views are. Indeed, for a lot of these changes like courageous tax reform by a large State Government or undertaking a controversial development activity, those community views are probably the primary factors that will impact a decision.

MR HANCOCK: Yes.

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MS CHESTER: But where a State is penalised by the way the HFE impacts the GST relativities, it makes it even more difficult for them to dare greatly and undertake those reforms, if they are a reform minded government. So we're not saying that it impacts the community views or the impact that those community views will have on the decision, but at the end of the day would you agree that any sort of State or Territory Government would take into account the impact on GST relativities if they were material?

MR HANCOCK: Well look, I'd accept that in principle if a government thought that it was going to lose some of the benefits that it got from a reform, that it might be less inclined to make it than under a system where it knew that it wouldn't lose those benefits. As I said, my feeling is that that influence is not very large. But if it is significant then it can still be addressed in something sort of other than a system which delivers a large rearrangement of financial resources to Western Australia. So it could be like, for example, freezing existing relativities. So if we think about it in terms of - - -

MS CHESTER: But freezing existing relativities flies in the face of - you've got quality and equity as the highest principle, and that's one area that we can agree on.

MR HANCOCK: Yes.

MS CHESTER: Then freezing relativities would be nonsensical because effectively you're not allowing that principle to remain primary over time.

MR HANCOCK: Well, I agree. I think if you freeze any relativity then you start to move away from that.

MS CHESTER: So we've already said in the draft report equity is still the primary objective of HFE. So that's not something we would countenance as a way of trading off the equity efficiency because it's not a trade-off, it's an abrogation of equity. So I think it's a neat way of having - saying to WA, "Be careful what you wish for." But that's not consistent with our draft report or the direction that we want to go in. We are reasonably trying to look at what's a way of still having HFE and keeping equity as the primary objective, but still being able to have a little bit of wriggle room for trade-off with efficiency.

MR HANCOCK: Yes, well I think - I mean, looking at say the example of equalising to the second strongest State, then the change in incentives occurs for Western Australia and not really for the other States, I think.

MS CHESTER: No, that's right in the current circumstances. Indeed we're doing some more work now as to how much of a muting effect you would have on the cameos. I mean, intuitively by having less of an equalisation task

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overall there'd be a muting effect. Running it through the cameos will run through what impact that would have on the disincentives that we've calculated.

MR HANCOCK: Yes.

MS CHESTER: But I guess getting back to your point about the impact then on say South Australia, and I know a lot of people quote the larger numbers, i.e. if we did a cold turkey overnight and moved to equalising to the average how much is it going to cost the State Government? And that's not what we've recommended. We've talked about how we could go for the transition path. But even if we do get to a world of equalising to second highest or equalising to the average, the impact on a State Government I think from the calculations would suggest it's only 1.2 to 2.4 percentage points of the State revenues.

MR HANCOCK: I can accept that there are reforms that you can make that would have relatively small effects on certain States.

MS CHESTER: But that's the impact of moving away from less than full equalisation to - in terms of the GST revenues that a State or Territory would get, it would only decrease by 1.2 to 2.4 percentage points.

MR HANCOCK: And presumably the State with the large impact presumably is Western Australia who has a larger - - -

MS CHESTER: No, this is the decreases. So we're focussing - everyone is talking about what impact it will have on State Governments when you get to that point.

MR HANCOCK: Yes. Well look, I can accept that there are things that you do to have a relatively small impact. I'm still not convinced that that makes it a good idea to do so.

MR COPPEL: Can I ask you whether you think the CGC now achieves full equalisation in its processes for calculating the GST distribution?

MR HANCOCK: I think as well as we know. You know, the calculations require, or the CGC evaluations require judgments that are debated, and from time to time they change as the CGC accepts arguments that it could do better to get towards a truly equalising outcome. But I think that it does a pretty good job at the moment. You know, it has some caution. It generally speaking doesn't allow for elasticity effects. So where you have different State policies and therefore different sizes of revenue bases or spending bases, the Commission has traditionally been reluctant to make any allowance for that. Perhaps it could, but it becomes sort of a more speculative task to do so.

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MR COPPEL: Because it has been pointed out that for other revenues of jurisdictions it accounts on average for about 40 per cent of a State's revenues, and that other revenues because of the reasons you've just outlined are treated on an EPC basis. And to the extent that they can be quite a significant share across the jurisdictions, that in itself would be a departure from full equalisation for the CGC.

MR HANCOCK: Yes.

MR COPPEL: So, I mean we're trying to make the point that the goal as currently outlined is it's full equalisation, but it's more of an aspiration than a reality. And when you sort of look at it from that perspective, vis a vis what we're suggesting, the actual change may not be - I mean, the actual change is a matter of degree rather than moving from full equalisation to something less than full equalisation.

MR HANCOCK: Yes, well I think - I mean, there's a question as to whether you judge a model by whether it falls short of perfection or whether you judge it by performing better than the alternatives. And so I think that the efforts that the CGC makes are likely to take you closer to full equalisation than a model in which you have a different goal that's set out.

MS CHESTER: Jim, you touched on earlier on in your opening remarks about - and I think the wording that we're using is "equalising to a reasonable standard" as opposed - - -

MR HANCOCK: Yes.

MS CHESTER: - - - to the current which is "equalising to the same standard." And, given this is an area of your expertise, I'm going to bravely assume you've read some of our report closely. But if you look through the history of that adjective, "same", it's never been decided by a government. It's not in any government legislation. It's just the way the CGC started doing it.

MR HANCOCK: The CGC's objective?

MS CHESTER: So the CGC Act has the old objective which I think is not materially substantially different. So it was never defined by any Government, State, Territory or Commonwealth, to be full equalisation. Because once you've got it you've got to equalise to provide a fiscal capacity to provide services of the same standard, that immediately and intuitively means you've got to equalise at least to the highest fiscal capacity and then you can see above that if there's anything left, which there typically is.

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But so when we talk about it being what HFE is in Australia I'm just trying to work out whoever decided to do it this way.

MR HANCOCK: Well, I think you should probably ask Peter Emery who will be on a little later, who will be able to tell you - - -

MS CHESTER: We'll get a chance, and I'm sure South Australia has a good history here, but it is kind of interesting, and it wasn't even articulated by the CGC until about 10 or 15 years after they started doing it that way. And indeed when our draft report went out and we explained it in a heuristic sense, thanks to the CGC's help, that it is equalising to the highest then with an EPC above, we had calls from Government officials saying, "That's not how it works. It doesn't equalise to the highest." They'd understood that it equalised to the average.

MR HANCOCK: Well, I think - and I mean, I would have expressed it as equalising to the average, but I think that the term you use effectively means the same thing. And so I don't sort of want to get lost in semantics on that. My understanding - - -

MS CHESTER: No, no it's just that well you took us to semantics when you said reasonable wasn't good enough, and indeed you suggested we should use some other language.

MR HANCOCK: Yes.

MS CHESTER: So for us a reasonable standard of service would imply something slightly less than full equalisation, and so thus you could get the trade-off between equity and efficiency. Whereas if you're going to have equalisation for a fiscal capacity for the same standard it's going to have to be more comprehensive equalisation and there's no wriggle room. So that's why we went to reasonable.

MR HANCOCK: Yes, well what I'd come back to is I think there are many submissions that argue that full equalisation is reasonable, and I don't think you have that in mind. And so something that more accurately describes what you're proposing I would suggest is going to be more informative and sort of make the debate clearer.

MS CHESTER: So I just think we are getting into semantics now, but our term "reasonable" isn't about the overall system. It's equalising to provide a fiscal capacity to provide a reasonable standard of service, not the same.

MR HANCOCK: Yes.

MS CHESTER: Because same gets us to highest, and then gets us to full and comprehensive equalisation.

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MR HANCOCK: Yes, well I - - -

MS CHESTER: So that's the logic that we're kind of following.

MR HANCOCK: And I accept that there is a substantive difference between the two models. Now, the full equalisation model that we have at the moment as I understand it was really sort of nailed down in the late '70s. Prior to that there was sort of more ad hoc sort of claimancy adjustments, but around the late '70s - - -

MS CHESTER: So going to the system where nearly everybody was in, so moving on from the non-claimancy era that's right, that happened in the late '70s. But if you look at what was defined as the standard in the CGC Act and in all the other Government literature it was not to the same standard. It was just how the CGC started doing it.

MR HANCOCK: Yes, yes.

MS CHESTER: And it's just kind of interesting how that evolved without any Government decision or changing the legislation. So indeed at the moment the way the CGC is doing it is inconsistent with their own Act.

MR HANCOCK: Yes. Well, I don't know if it is inconsistent with their own Act, but - - -

MS CHESTER: Yes. The Act has the old definition of but not substantially different standard. It's not the same standard in the Act. I can't remember who it was, someone when we spoke to a lot of wise people early on, and who had been involved in HFE and Commonwealth/State financial relations, and one of them did say to us history tells a lot here. So the team actually went and dug through that history, and I think it's quite revealing.

MR HANCOCK: Yes, well I'm aware that the wording around it has changed a bit over time, but I think for quite a long time that certainly the way the CGC has expressed its objective, it is what you could describe as full equalisation. I had heard New South Wales protest to the Chair of the Grants Commission about that but these - you know, what the CGC does is also discussed in Heads of Treasuries and Ministerial Councils, and those bodies can direct it to do otherwise if they want to, and as far as I understand they haven't.

MS CHESTER: Well, I think only the Treasurer can direct them. And it might be that I don't think people anticipated when they signed up for the GST what was going to happen today with the breadth and the band of the relativities, and that's what I guess has gotten people to focus on this.

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MR HANCOCK: Yes.

MS CHESTER: Anyway, I will stop on semantics.

MR COPPEL: I've just got one more question to ask you which is quite a specific one. In the CGC discussion paper for the 2020 review of methodology they have a section that deals with this issue of policy neutrality with respect to I think mining royalty assessment, where the suggestion is that of a major new revenue stream 50 per cent would be discounted. My question is do you have any view as to the efficacy or the merit of that suggestion?

MR HANCOCK: I suppose it sounds like a large discount to me. The motivation for it I assume is sort of an efficiency related one.

MR COPPEL: Well, it gets back to these judgments that are needed when you're not quite sure whether you've got sufficient information to provide a comprehensive assessment, and that there may be substance to some of the arguments that are put that this is not treating one jurisdiction or a set of jurisdictions fairly. So typically what they do is they can apply a discount, and this is a new manifestation of that approach, but it is on the increment of new revenue which is a bit different from the way they've typically applied discounts.

MR HANCOCK: Well, I acknowledge that say for Western Australia there are costs that Government has to incur to get major mineral developments up, and so logically they would be sort of a deductible against a revenue stream but it has traditionally been hard to assess what those costs are that they need to calculate. So allowing a 50 per cent concession against the additional revenue, it sounds high to me but that's just speaking sort of on the run, yes.

MR COPPEL: Okay, good. Thank you very much.

MR HANCOCK: Thanks.

MR COPPEL: So we will take a five minute break and then we will reconvene with the Urban Development Institute of Australia, Pat Gerace, at 20 to 1.

ADJOURNED **[1.03 pm]**

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RESUMED **[1.10 pm]**

MR COPPEL: Our next participant is Pat Gerace from the Urban Development Institute of Australia. Welcome, Pat.

MR GERACE: Thank you. Thank you.

MR COPPEL: Like others if you can give your name for the transcript and brief opening remarks.

MR GERACE: Pat Gerace from the Urban Development Institute of South Australia. So good morning, and thank you for visiting Adelaide and coming down here. I represent the Urban Development Institute, and to be clear the UDIA operates under a Federated model and I speak on behalf of our South Australian members. Our membership represents most of the major developers and builders in South Australia and has been in operation since 1971, so I will make some statements and comments on the matter that relate to the property sector and then I'll do my best to answer any questions you have on the specific technical details of HFE.

But UDIA is always willing to provide encouragement for local State and Federal agencies to employ good policies to see South Australia and our country grow, and before speaking about the HFE specifically I just want to make a few quick remarks. We're at an interesting juncture in South Australia. We face the challenge of an economy that's in transition from traditional manufacturing to an advanced manufacturing focus, and there's no doubt there's many more challenges to come.

But a symptom and a cause of these challenges is the rate at which South Australia's population is growing. And we're seeing a declining population in certain geographical areas in particular age brackets as well as the overall share of the national total. And through a study commissioned by various groups, including the UDIA, the South Australian Centre of Economic Studies actually found that South Australia faces a triple challenge of ageing population, labour force, regional depopulation and a disproportionate reliance on owner/managers, which are on average older. And in combination these three lead to and accentuate the skill and general labour shortages, particularly in regional South Australia.

But over the last three decades the State's annual population growth rate of .74 per cent was roughly half that of Australia as a whole, 1.37 per cent. The study also concluded migration has a potential to assist. So we're very firm about that. The State Government's aspiration is to increase the number of people who live in South Australia to two million, but to get there we need a growth rate of 1.4 per cent. At the moment South Australia's fertility rate is well below the rate of population replacement. Our shared national

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overseas migration has declined from 10 per cent to 4 per cent, and over the last 40 years SA continues to experience high rates of net interstate migration.

Without growth in the work force population the taxation base to support Government will also decrease. In the 1960s the working age population was in the order of 63 per cent, and this has declined to less than 50 per cent today and it's projected to fall to below around 32 per cent by 2040. The net age in South Australia is 40, the oldest of any mainland State in Australia. We only need to look at the figure of 6.2 in your report to see the trend in the population of South Australia, which is a big matter for us.

In terms of the property sector, we congratulate the South Australian Government on a number of initiatives like the breaks in stamp duty, apartments, construction grants, but there's no doubt that we're over-represented when it comes to taxation, or so the members believe. GST, stamp duty, lien tax, Council rates, and then indirect taxes like payroll tax and company tax. We did some work in 2011 and estimated on a $400,000 house in the northern suburbs the tax incidence was about $85,000.

So why worry about HFE? Well, before I answer that specifically I want to commend Business SA for the work that they've done in this area. We agree that the fiscal (indistinct) responsibility for Western Australia is a significant enough reason to ban the principles of equalisation, and it doesn't seem fair that a State in the west with a significant amount of natural resources and revenue benefit can complaint later when the boom comes to an end. I won't go on any more about that. You've heard it all before.

But I would like to add that while changes, the report's findings conclude that changes to HFE are not likely to have any material impact on a State's propensity to initiate tax reform, what I can say through our recent observation is that a massive cut in revenue in South Australia is likely to have the impact of forcing the State to consider alternative revenue measures. With a population demographic that is ageing at a higher rate than others, and a shrinking tax base, it's entirely foreseeable to see more inefficient taxes with spurious policy rationale behind them to plug the gap.

Just last week we saw the State Government increase the foreign buyer levy on properties increase to 7 per cent from 4. We had asked the Government to provide reasons why they're doing this. They say it's an affordability issue. That might hold true in New South Wales and Victoria. We don't believe we have an affordability issue here. We believe the Government simply used this as a revenue measure, and that's the kind of thing that our sector faces as we stare down the barrel of a Government looking to try and find money from a shrinking tax base.

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So we believe that there are a number of other big policy matters that put South Australia on the back foot a little bit. Mega cities are the - all the research suggests that more and more people are wanting to be in the really big cities. We see Sydney growing exponentially, like a chemistry experiment. We know more and more people are looking to be in Melbourne and Sydney, in those big cities, and geographically that puts a challenge on South Australia. You only have to look at the discussions that happened around high speed rail along the eastern seaboard. Something like that happens and where is South Australia?

So I'm picking up now a little bit on the comments that you made before about it only being a small percentage of a State's revenue in terms of the impact even on the cameos that were provided. What I would say is that when a State is facing a population decline like we are and the challenges that we have got, that every cent counts and every dollar counts, and that I'm not sure there's as much discretionary revenue in the South Australian budget once you look at health and education and some of these things that we are facing. I think that the impact being the order of 1 to 1.3 per cent, I think you said, is a lot bigger than in real terms than what it seems.

So they are my opening remarks and I am happy to have a talk to you about any questions you have.

MR COPPEL: Thank you, Pat. I'd like to ask you whether you think that the issues that are acting as pressures on the South Australian economy, to what extent are they linked to HFE or are they really just contextual?

MR GERACE: I suppose there's two parts. Obviously the propensity for a State Government to make tax reform, or initiate tax reform based on the HFE formula, my gut feel is I think as one of the speakers from the South Australian Centre for Economic Studies said before is that generally the decision makers will have regard to the HFE formula, but a lot of the times it's the community acceptance of tax, particular types of tax reform, that drive them. We saw stamp duty on apartments in South Australia. The reason for that was a change in the way that they wanted the urban form to look in Adelaide. And I'm driving particular policy agendas like the 30 year plan.

So I don't always think that the HFE component has a massive impact on the types of reform, but I might leave that to more learned people to explain that. What I would say is that if we are talking about - and I know you said before it's characterised by - talking about doctors and nurses - what I can say is that my membership tell me all the time that in South Australia we are at a juncture that is really critical, and that things are particularly tough here as we look at the way that our economy transforms. And to lose a couple of hundred million dollars is a lot. And you can say it's a few per cent, but I don't think we've got any kind of spare cash lying around and we're facing a

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challenge in the future to service an ageing population. It's going to be a - I think it's important - we feel it's important to come here and say that what we were hoping the State Government would be doing is implementing policies that make South Australia a more attractive place to be, and differentiate from the other States.

So let's just assume it's $250 million as a hit to South Australia. Well, the first thing that happens, the foreign resident or foreign buyer levy that's just been introduced wouldn't have to happen. That was $80 million. We could tell the rest of the country that you can come to South Australia and buy and not have to pay a levy. But we can't do that now because the Government has decided to do the same as everyone else.

So it's those types of things that worry us. Unashamedly I will say a loss of revenue from any change to the calculation for South Australia I think is a bad thing for us.

MR COPPEL: So your main point is that you disagree with the recommendation of a reasonable standard for HFE equalisation on the basis that it would have a negative fiscal impact on the - - -

MR GERACE: Yes, I would say that but I also would say that personally I believe that the equalisation principle for me, from what I read, is the thing that - it should be the primary driver and I don't really - and I understand you have articulated a problem about equalisation versus efficiency, I would even say that I think the equalisation is more important.

MR COPPEL: Okay, but do you have any views as to whether the current, keeping within the framework of the current system, whether that leads to specific inefficiencies? Maybe you've mentioned the examples, or possible examples, linked to the design or the choice of tax bases, and do you have any views as to how then those specific problems could be addressed in a different way from what we've suggested in the draft report?

MR GERACE: I do have some suggestions about some of the tax reform that are probably not within the Terms of Reference of your report. I think that someone had - and again probably it might not be what you are considering - but I have the view that at some stage in the past somebody at the Federal level decided that tax reform was a great idea and the GST was an efficient tax and there was a program by our Federal politicians to get to that outcome. And we had a GST implemented, and there was a - a former famous Treasurer said something about a bucket of money and premiers.

But someone had some leadership to do that, and I think we're skirting around the edges when we look at the possible implications of HFE, in particular stamp duty is what we're worried about in the property sector. Yes, they will have some impacts on whether you might introduce a stamp

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duty reform, but I firmly believe - and I have already put this to a senior Minister in South Australia - that the States - and Federal Government should take the lead and talk to all the States concurrently about the abolition of residential stamp duty. And I think that's probably the way forward. But again, like I said it's probably not part of the Terms of Reference.

MR COPPEL: What would you replace it - I mean, that's quite a substantial part of a State's source of revenue, stamp duty. ACT has gone in that direction very slowly and it's replacing it with greater reliance on land taxes.

MR GERACE: Two years ago, I think it was two years ago or maybe a little bit more, the Treasurer announced here in South Australia with great fanfare that he was going to do a tax review in South Australia and look at inefficient taxes, and he did a roadshow and said that broad based land tax was efficient, and I think he even maybe even said payroll tax was an efficient type of tax at that particular time, and stamp duty was not. And I don't think it took more than a couple of weeks for it to be, for broad based land tax to be ruled out.

The propensity for a State Government - and I know there has been some glimpses of hope from some other jurisdictions - but the propensity for a State Government to go through that payment transition of a broad based land tax, the new tax all of a sudden becomes a really nasty thing that the public don't like and so governments just tend to walk away from it.

So when we saw that here I was hoping that there would be a reform. And it comes right down to the transaction, and I think that as soon as the Federal Government with the financial capacity, because of fiscal balance, can say right, we are - here's a carrot and here's a stick - maybe we might actually get some significant reform in that space.

MS CHESTER: So Pat, the issue you raised is actually - it's not tangential at all to our inquiry and where we're going. Indeed when our Terms of Reference asked us to ask and answer what impact, if any, does HFE have on the economy and you would have heard earlier there's kind of two impacts it can have. One is on interstate migration, locational decisions for people, and the second one - and capital - and the other one is how it might impact the decisions of States to do good policy. And that good policy can be either tax reform or development activities.

And it was indeed in the area of tax reform when we ran some cameos to have a look at what impact does HFE potentially have on the States making those tough decisions, the cameo we actually ran was halving stamp duty and replacing it with a broad based land tax. So it was revenue neutral, and for a large State to do that we identified that once you got through any transition path and they're in a state of equilibrium they could get hit by an impact on

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the GST relativity such that they lose $1 billion a year. So that for us was the efficiency, one of the efficiency arguments that we identified in the draft report.

So indeed when you say State Governments aren't daring greatly, we have identified that there is this potential trade-off between equity and efficiency.

MR GERACE: I did notice that and it made me think, ask a question about - and I don't know the answer to this - but what would be the impact if all of the States moved together at the same time?

MS CHESTER: And we ran that as well, and the disincentive is much less. The problem that we've got though is that States don't do that stuff multilaterally, and they would need to do it multilaterally.

MR GERACE: No, they do, and so this is where I go back to the leadership of the Federal Government saying, "Here's a bucket of money. You all do this together and you get it." Didn't John Howard do that?

MS CHESTER: Well, it hasn't happened since then.

MR GERACE: Yes, that's what I'm saying. So again, when I talk about the Terms of Reference of the Committee I'm maybe being a little bit more political than economic, but that's kind of why I'm saying that you can talk about HFE and you can talk about at the margins here and there and that, and I understand that proposition. And for me it seemed - and I'm maybe being a little bit focussed on stamp duty, but you can understand, but I'm thinking why wouldn't the Federal Government make that unilateral decision? But again, that's about the stamp duty and if HFE was a problem I would say, put on the record, that it should look at enticing all States together to move away from that so that HFE isn't an issue.

MR COPPEL: That's sort of one of the areas that has been raised in some of our consultations and submissions, the role of the Federal Government in terms of sort of leadership in the area of HFE and possible changes to HFE. Do you have any other specific ways in which that leadership could be brought to the debate? Is it just up to the Federal Government?

MR GERACE: Well, I mean what we've - a man I used to work for said that he thought it was a disgrace that countries that were at war with each other in Europe managed to nationalise and therefore harmonise the rail system across Europe before Australia could. So if you look at our track record and you think about the capacity for all the States to come together, even when they're all of the same political persuasion, for a short time nothing really happened, you wonder whether or not there's a capacity for that to happen.

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So I do say that Federal Government leadership and maybe - and you know, maybe if this - if what you get out of this review is one thing, and that's that, that the Federal Government says, "Okay, we have identified that tax reform is just not likely to happen because of these HFE impacts and that we're going to take the leadership role", then that would be great.

MR COPPEL: Okay, great.

MR GERACE: Thank you.

MS CHESTER: Thank you.

MR COPPEL: Thank you for your contribution.

MR COPPEL: Our next participant is Peter Emery. Thank you, and welcome Peter and Linda. If I could ask you for again the transcript to give your name and then a brief opening statement. Before you do that, I do appreciate that you are participating in these public hearings. I recognise even though you haven't put a submission into our particular inquiry, we have looked at your submissions to the previous review of HFE in 2012.

MR EMERY: That's good.

MR COPPEL: So thank you, and over to you.

MR EMERY: My name is Peter John Emery, and my wife?

MS EMERY: Linda Emery.

MR EMERY: I have foreshadowed with the Commission that my wife, Linda, will read my statement and I assume that's satisfactory.

MR COPPEL: It is.

MR EMERY: There's a couple of little things I wanted to say beforehand. First of all, I thank the Commission for organising this meeting on Tuesday and not Thursday. On Thursday, speaking for myself, I'm going to be more interested in the productivity of the Australian cricket team than the alleged inefficiencies in HFE. The other thing is that for blind people like myself these kind of gatherings can be awkward, and I appreciate the fact that both of you introduced yourselves to Linda and myself, and I thought that was courteous and thoughtful and I do appreciate that. Over to my wife.

MR COPPEL: Okay.

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MS EMERY: Let me begin my expressing my appreciation that the Commission has come here to Adelaide. South Australia has been involved in equalisation issues since the beginning, and I believe it has made an excellent contribution to discussions over the decades. I thank the Commission for permitting me to make a statement today. It is being read on my behalf by my wife, Linda Emery, the reason being that I have become blind.

It is pleasing to Linda, and it may be for others as well, that my statement is quite brief. I emphasise that this is a personal statement, and not on behalf of the Government of this State or anyone else.

I have been involved in this area of work since a few weeks after joining the Commonwealth Treasury in February 1967. I have been involved in a number of ways, including as a preparer of written Commonwealth Treasury submissions to the Grants Commission, as a witness at Grants Commission hearings, as an adviser to the Commonwealth Treasurer and other Ministers, as a senior officer in the South Australian Treasury, including a period as CEO of that department, as a consultant to the Commonwealth Grants Commission and the South Australian Local Government Grants Commission, and as an adviser in several countries in Africa.

I would like to think that my principle objective in all this has been not so much in advancing the causes of the Commonwealth or South Australia, but in doing my bit to support and improve the overall structure of arrangements in this area. I believe my main achievement in that respect was in initiating and implementing the move away from the old claimant State system to one which covers all six States and the two Territories. This has led to a fairer system, and in all probability the shares of grants going to New South Wales and Victoria has been higher than it would otherwise have been.

Like everyone else, I bring to this inquiry my own personal perspective, namely that of someone who has long understood and supported our equalisation system and who has a very high level of respect, and in some cases affection, for some of the members of the Grants Commission who have served us so well.

I mention Professor Giblin, Sir Leslie Melville, Professor Russell Matthews and Messrs Ron Lane, Roy Daniel, Ron Barnes, Fred Argy and Dick Cry **(? 1.33.32)**, men of great experience, intelligence and wisdom. I hope that in its final report the Productivity Commission can find room for some appropriate tribute to the work of the Grants Commission over its many decades of service.

I mention that although I do not read as much or as speedily as I used to, I am aware of the background to the current inquiry and of the principal views which have been expressed by, and to, the Commission, including in

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relation to its draft report. Let me concentrate on two aspects of the background.

First, the complaints by Western Australia about what it regards as an unduly low share of the aggregate of grants being paid to the States which aggregate is equal to the GST revenue. Western Australia has advanced its cause by quoting the ratio of the grant it is receiving for the GST revenue coming out of Western Australia. I note that Commonwealth Ministers and media commentators appear to regard this low figure as itself demonstrating that Western Australia's share is too low and that the system needs to be changed in some way. This is, of course, quite wrong.

The low figure reflects the very high revenue capacity of Western Australia compared with the other States and Territories, and the very purpose of our system is to take account of differences of this kind so that States and Territories can all provide similar standards of services without imposing higher rates of taxation. The low figure quoted by Western Australia merely reflects the fact that the differences being dealt with by the Grants Commission are large. To those of us who understand the system, all this is of course elementary.

In this context I and others have been intrigued by the contents of box 2.4 in the Commission's draft report. It begins with this sentence, "Concerns that Western Australia's GST allocation is unfair are not invalid." What, I wonder, is the significance of the double negative? Is the Commission saying that the concerns are valid, or that it is not sure whether they are or not, or that they are valid in some respects but not in others? I believe it would be useful for the Commission to clarify this point.

I also take this opportunity to express my dismay at the way Mr Fred Argy has been quoted in this part of the report following the sentence I have quoted. His words have been taken completely out of context and misused to support something which I know he would not support. I have written to Ms Chester on this matter and she has promised that she would respond.

The second background issue is all about the relationship between the equalisation principle and the way it is being implemented, and questions of economic efficiency. These issues are by no means new. There is a theory that fiscal equalisation as currently implemented might somehow be inconsistent with economic efficiency or incentives faced by States and Territories to encourage the development of mining for other industries. The key word here is "theory". No evidence of a concrete kind has been put forward to illustrate, let alone prove, that this theory has any practical relevance.

I know from my own involvement in the massive Roxby Downs development here in South Australia that Grants Commission type

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considerations have played no role in economic development decisions. There has been discussion about the reluctance of governments to accept advice that they should replace stamp duties on property purchases with general rates on property values. Take my word for it, this again has nothing to do with Grants Commission or equalisation, but rather with the politics involved with the fact that in any period there will be fewer voters buying properties than those who own properties.

Our fiscal equalisation system provides economic efficiency in the same way as do uniform Commonwealth Government taxes and expenditure policies across the country. The notion that economic efficiency would be improved if the less financially advantaged States were forced to have higher taxation or lower standards of service than other States is ludicrous. At the risk of stating the obvious, I note that the proposal to base the equalisation system on the financial position of the second best top State or Territory is completely arbitrary and rightly has attracted no general or useful support.

Conclusion. Karen, you and your Commission colleagues have a tremendous opportunity in front of you. Mainly as a result of the Western Australian situation there has been, and remains, confusion amongst senior Commonwealth politicians about our system of fiscal equalisation. They want something different. You and your colleagues have the opportunity to explain to these politicians and everyone else that we have a very sound system in Australia of which we should be proud. It promotes both fairness and economic efficiency. We have avoided the huge inequalities between parts of our country that exist in the United States, by way of example.

I can understand that in some sense the Commission may be reluctant to reach the conclusion that no fundamental change in our current system is either necessary or desirable. However, I believe there is sufficient brainpower within the Commission to come up with a wholly convincing report along the lines I have mentioned. This opportunity is unique to the Commission. We here in little old South Australia can toil away for decades in researching, thinking and writing about the virtues of our current system, and we can do so with a good appreciation of the facts and with clear conviction.

However, it will always be possible for such work to be regarded as merely self-serving. Your Commission does not have this problem. It is my firm belief that if the Commission's final report were to be at all similar to the draft we are now considering its reputation would be diminished. At this stage there remains open the possibility of a different approach being taken by the Commission which will enhance its reputation for strong, independent thinking.

Thank you again for the opportunity to put forward my thoughts. I would be more than happy to elaborate upon them if the Commission wished.

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MR COPPEL: Thank you. Let me begin by just picking up on one of the points that you made and then Karen will pick up on the other, and that's the role played by the Grants Commission which has been tremendously helpful to the Productivity Commission in the draft report, and we expect that that cooperation will continue through to the final that comes in the terms of providing us with data and advice on the actual methodology and how it works. So that is recognised in the report. We think it is important to have an independent Grants Commission, and what we are proposing is to strengthen the role that the Commission plays in terms of informing the broader public and our political leaders, which I think gets to the point that you make about confusion as to how the HFE system works. And I'd be interested in your views on whether those sorts of recommendations, for example the CGC playing a greater role in public communication, would serve that particular goal.

But before I give you the floor to respond to that particular question let me just hand over to Karen.

MS CHESTER: And Peter and Linda, thanks for both being able to come today and Peter, we are very aware of your very longstanding history in matters of Commonwealth/State relations going back to Commonwealth Treasury, and then right up to and including some very fiscally challenging times as Under Treasurer here in South Australia.

I did manage to respond to the issue that you raised around box point 2.4, and I might just share that with everybody else for the purposes of the transcript. So I won't go to the nice salutations, but I did say that our draft report's citation and references to Fred Argy's good work and published works in the field of equity and fairness are intended to be read as separate to the opening sentence in box 2.4, and we will certainly ensure in finalising our report that any inferences, as you have obviously drawn, cannot be made. And that was certainly not our intention. So we will make sure that that inference can't be drawn, Peter, when we finalise our report.

MR EMERY: Well, I'd appreciate that. What you told me in your recent email I found odd, to be honest, that the material that followed that opening sentence was not related to that opening sentence. Which I obviously haven't seen the bit that we're talking about, but Linda and other people I had talked to had seen that it couldn't reasonably be interpreted that way. But anyway, I will follow up the correspondence.

MS CHESTER: The inference was never our intention. It's not how we meant it to be drafted or read, and we'll fix it in the final.

MR EMERY: Better still, you may want to remove it altogether might be more appropriate. But anyway, that's a matter for you.

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MS CHESTER: Yes. I think if we just get rid of that first sentence the problem will be solved.

MR EMERY: Well, I think you should - in the meantime it would be useful if you would clarify what that sentence meant. I mean, to say that the Western Australian concerns are not invalid, what does that mean? I regard myself as fairly good with words. I'm not sure what you meant. Anyway, that's probably a peripheral issue, probably.

MR COPPEL: Okay.

MR EMERY: But it happens to be important to me.

MR COPPEL: Okay, well maybe if you would like to come back to the role that the CGC can play in terms of informing the broader public about how the system works, how the system achieves its goals and the value that comes from that?

MR EMERY: Well, I should say it's several years since I've studied the Grants Commission report or their worksheets, you know, which add up to some inches of material. I have often expressed, including to the Commission, a view that it could be more forthcoming, including explaining to people why its work on horizontal fiscal equalisation is good, that is the positive effects that come from that. And I would have no problem with the idea that it should produce annually or whatever a simplified version of how it goes about its work. I would support a greater role for the Commission in this sort of thing. It has, I think, been unduly modest in explaining itself. I don't know whether that answers your question or not. Does it?

MR COPPEL: Well, I think it goes in the same direction to what we're proposing in the draft report.

MR EMERY: Yes. I think some of the references - I've heard people refer to the Commission's work as being a black box. I don't know whether you've heard those comments.

MR COPPEL: We've heard that, yes.

MR EMERY: Which I think is silly. I mean, you have to make - if you're interested then you have to make some effort to understand it, but I don't think it's as bad as that sort of terminology implies if somebody is prepared to make a bit of small effort. But on the other hand I agree that the Commission could produce some perhaps simpler and briefer material which explains its work.

MS CHESTER: And I think, Peter, they are making some efforts in that

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area and we give them credit for that in the report.

MR EMERY: Yes.

MS CHESTER: I think the one area where - and we did have a recommendation around this in our draft report - is that the data that the CGC uses and their actual calculations using that data aren't made available in the public domain. And I know we've had submissions and we heard from a number of academics who - to some extent being able to use that data and do further work and analysis around it would, I guess, one, wide and enhance research in the area but two, also enhance an understanding of the work.

MR EMERY: Has the Commission ever, to your knowledge, ever refused a request for access to some of the budget detail? I have in the past been involved in things where I did request more material and talked to the staff there in Canberra et cetera, and I never had any problems of that kind. I'd be surprised, but I don't really know that they would go out of their way to refuse such a request.

MS CHESTER: I think the stumbling - and look, we've had terrific working relations with the CGC throughout our inquiry and they've been very helpful for us, and so we've been able to get access and their help with modelling to the extent we've needed, but I think the issue is around the data that some of the States then provide the CGC, and to be able to replicate and do the calculations you need to have access to that as well. I know, it's really just something that we heard from, largely from academics.

MR EMERY: Yes. Okay, well I would be in favour obviously of everyone having access to whatever data they like, unless there was something genuinely confidential about something the State had provided, which I suppose is possible.

Let me just in a very brief time comment on some of the discussion that's taken place before. I think the material that you have heard from the parties, that's been I think very commendable. I think it illustrates that it's not just a matter of self-interest that people here are talking about. The issues have been thought about very carefully by the bodies that were represented earlier. I almost felt redundant at one stage.

The other thing is you referred at one point to the system of Local Government equalisation that exists in all the States, and said that no attempt is made to fully equalise by the States. Now, that's not a good representation of the situation. The reason we don't fully equalise in that area is first of all there's a severe limitation on the amount of money which is far insufficient to fully equalise. And the other aspect is that there is a requirement in Federal legislation for a minimum grant so that even the best off Councils get this minimum grant. So the implication was that States don't try to fully

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equalise within their sphere - well, that's just not a useful way of looking at the facts.

The other thing about this trade-off between equalisation and efficiencies, and that sort of phrase has been used quite a bit here, a consultant's report was undertaken in the context of the inquiry that was initiated by Julia Gillard which, to my mind, demonstrated very clearly that equalisation had pro-efficiency results. Now, I've forgotten the name of the firm or the individual who prepared that, but you would have access to it.

MR COPPEL: I think it's Chris Murphy. Is that the one?

MR EMERY: Exactly. Sorry I had forgotten his name. And that's not a surprising conclusion. We take for granted that Commonwealth tax policies and Commonwealth expenditure policies are uniform across this country, and that that is economically efficient. We sort of take that for granted. And what our equalisation system does is sort of approximate that to suit a Federation, so that there aren't huge differences between tax rates or expenditures between the States.

Now, there are some differences as a matter of policy, but the notion that to dampen the effects of what equalisation does for you away from let's call it complete equalisation would promote the possibility of economic efficiency just is away from the truth. We have a system, and as Chris Murphy I think proved - and he quantified what the effects of this pro-efficiency, effects of equalisation are. So I just think that discussion is just not, is just the wrong angle all together and I would hope that in your further, or your final, report that can be dealt with in a quite different way than it has been in your draft report, and indeed in the discussion this morning.

MR COPPEL: We did earlier on in the inquiry consider whether we would conduct general equilibrium modelling for the purpose of the draft report, and we did look at the 2012 report and most - the reason that we haven't pursued that is that for the 2012 report by Greiner, Brumby and Carter, there were two types of general equilibrium analysis and each essentially assumes the outcome, to put it very crudely, of an efficiency gain or a lack of an efficiency gain linked to HFE and migration decisions, for example.

And that doesn't provide - it doesn't take you very far. It can look at some of the sort of broader implications across the wider economy, but the actual mechanism that leads to an efficiency gain or efficiency losses is essentially set up by assumption, and that's why we took the alternative approach of working more with cameos that can, I think, pick up more of the detail of the HFE system itself.

MR EMERY: Well, are you asserting amongst other things that the Murphy analysis was wrong?

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MR COPPEL: I'm saying that in the analysis it's important to make assumptions. They need to make assumptions, and some of the critical assumptions are ones that drive the results.

MR EMERY: Well, one of the assumptions that your Commission appears to be making is that there could well be distortions in, for example, tax policy as a result of the HFE system we have. And that to me is more of an assumption than anything is proven or even likely to happen. I mean, personally I've been involved in probably hundreds of public finance decisions of all kinds, including mining royalties and taxation and all sorts of things, and it's just not the case that Government decisions at the State level are influenced by what HFE calculation effects might or might not be. That's just not - and I don't believe your Commissioners have any evidence to the contrary on that.

And in the statement that Linda read I commented on this thing about stamp duties on purchases of properties and the fact that people think it would be better if we had a general land tax. I mean, that's just not the case that any of those decisions have been influenced by HFE calculations. If, by the way, there are such examples then the States who are putting them forward as examples can, and should, refer them to the Grants Commission which can take them into account in its normal, careful, methodical, wise way. Really, I think your Commission is way off track on this matter of efficiency.

MR COPPEL: Can I just pick up on your last point? Given your work in the past with the CGC you are very familiar with how the processes work and I ask you the same question that I asked one of the previous participants as to whether you think that the CGC methodology is successful in achieving full equalisation?

MR EMERY: Yes. I mean, subject of course to the fact that necessarily, if you went to one of the Commission's reports for any year, they have to make judgments because data is inadequate or there are questions that are slightly hypothetical so that no one, as I think Jim said quite straight forwardly, no one could suggest that it's a perfect system because it's not possible to be perfect because of any imperfections in data and judgments. But the Commission has over the years been very careful in explaining, in my view, what its judgments are and what they're based on.

So that what people like myself are suggesting is not a perfect system, but one that does achieve to the best possible degree a system of complete equalisation. And I believe that very firmly.

MS CHESTER: So Peter, just coming back to your remark before where you said so if our cameos which show the impact on GST relativities for a

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large State embarking on first mover tax reform, so say if New South Wales were to go cap in hand to the CGC and say, "We actually want to do some half stamp duties in replacement of broad based land tax, but we've worked out by the time we've implemented doing that it's going to cost our GST relativities of $1 billion a year", what could the CGC do with that? How would they deal with that, if that caused a neutrality issue?

MR EMERY: I wouldn't off the cuff be prepared to suggest what they should write or say in response. But I would be happy to consider that sort of hypothetical question. As I said, what's happened or not happened in that area has not - the State Governments haven't given any consideration in practice, in their practical decision making, to what the HFE effects would be.

Now, what the Commission might say, or what the Grants Commission might say if this hypothesis was put to them I'm not sure. I'd be happy to draft something up for them if it ever became relevant, which it is not at the moment. I mean, I know damn well as I said - sorry, I know darn well why we haven't made that move here in South Australia, although there has been something of a move sort of in that direction through changes with respect to business or commercial properties, as distinct from residences, which I think some of the earlier people explained that I think, or referred to it, the chap from the Business Council. Interesting.

MR COPPEL: Okay, thank you for that. I am conscious of time and we have one other invited participant.

MR EMERY: Sure.

MR COPPEL: So again, thank you Linda, thank you Peter, for your participation in today's hearing.

MS EMERY: Thank you.

MR EMERY: Thank you particularly for your attention to what we're trying to say. Thank you.

MR COPPEL: Good, thank you.

MR EMERY: I look forward to your final report.

MS CHESTER: Thanks, Linda.

MS EMERY: Thank you.

MR COPPEL: Our next participant is Shaun de Bruyn, if I can get that pronunciation correct, from the South Australian Tourism Council. Make

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yourself comfortable at the table and when you are ready if you could give your name for the transcript and a brief opening statement?

MS CHESTER: Thanks for bringing your own ruler.

MR DE BRUYN: No worries. Thanks very much for the opportunity. My name is Shaun de Bruyn. I'm from the South Australian Tourism Industry Council and I'm the Chief Executive Officer.

Yes, thank you for making the opportunity available to receive our presentation. I must disclose up front that I'm not an economist and so I'm probably the least smart person in the room. So I won't focus on the detail of the work that is being done around the distribution of the GST and all the rest of it, but what I wanted to focus - I've got three key points I wanted to focus on. One is to represent my tourism business members and make you aware of who they are. Two is to support the Business SA's position and throw my association's support behind their position and the submission that put forward, both I assume verbally earlier today and the written submission that I have received a copy of. And thirdly, just to talk about some of the larger factors that are playing out in the economy here in South Australia that are impacting tourism businesses.

So the South Australian Tourism Industry Council is the peak body for tourism businesses across this State. We have just over 900 member businesses that work with us around business development and industry advocacy, and that's what sees me here today.

The tourism economy here, or the visitor economy as we sometimes refer to it, is significant for South Australia. It's about $6.3 billion at the moment and we're looking to grow that to $8 billion by 2020. And at the moment it employs 36,000 South Australians directly and there's a bunch more indirectly. And we're hoping to grow that to 41,000 by 2020.

The other really important thing to mention about tourism is that it's not just a capital city activity. Approximately 28 per cent of our population is based outside of Adelaide but 42 per cent of the tourism expenditure that happens, happens in those regional areas. So for many of our regional communities it's a very important part of their local economic activity and the things that create opportunity for young people to stay in those communities.

In terms of our Government's approach, over the last two to three years our Government has really focussed on tourism, and our Premier most recently at one of our functions talked about how they saw the transitioning of the economy. Clearly the downturn in manufacturing, that's been going on for several years but accelerated through the Holden situation. The Government had to find new areas of opportunity to keep South Australia

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ticking, so to speak. And they made a deliberate decision to invest in tourism. Prior to that it wasn't one of the economic priorities, but the Premier came out and announced tourism as one of the State's five economic priorities.

And so in doing that we have seen the South Australia Government have invested in infrastructure that supports tourism activity to a degree that we've never seen before. And that's particularly evident with the Adelaide Oval redevelopment, with the whole riverbank activity that's happened down there. Most recently the convention centre, there was a $400 million project to upgrade the convention centre and that was around a business event market, a business incentive market that is fantastic again for creating jobs, creating economic opportunity.

But we've also seen the Government invest in the arts. There's been strong investment in the arts. There continues to be more investment in the arts with the Festival Plaza upgrade. But also the concept of the Royal Adelaide Hospital that was relocated, as I'm sure you're aware. And there's a three year project that's been initiated that is still ongoing to look at a contemporary arts museum, and potentially a significant investment in infrastructure that would again help tourism and provide cultural opportunity.

And also our Government has invested strongly in airlines. A key factor in driving tourism is access, and it's one of the things that is really challenging for our State is that we're not as easy to get to as other parts of Australia. And they worked hard to attract international airlines, and most recently we've had Qatar Airlines and China Southern come in, and obviously there's agreements that require resourcing to see those things happen.

So the correlation is hopefully obvious, but the investment that State Government has provided into tourism has obviously - part of that has been through the redistribution of GST revenue. And should our State receive a reduction in GST revenue to the order that's been discussed, several hundreds of millions of dollars, it's obviously going to impact future projects and future opportunities for investment, and Government investment in the tourism sector that will ultimately damage tourism businesses. So that's really my first point.

The second point that I wanted to just re-emphasise is the Business SA position, and having met with Business SA and received a briefing from our South Australian Treasury and being an interested observer in these issues over many years, I fully support Business SA's position and my association fully supports Business SA's position. And I think it's interesting that they led with the key issue of lag of payments clause issues. And to me that is an obvious thing. It's clearly - and again, I'm not an economist so I can't, I won't try to make an argument around the detail, but clearly there's a

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significant lag that I understand between two, three, maybe even more time than that - between what's actually going on in economic activity and what GST is being redistributed. And that's caused some of the political anxiety that is being obviously generated, particularly in Western Australia. And to me that seems like an obvious issue that needs to be looked at and could potentially be addressed so that there is less lag in terms of what's going on.

I think the other thing which is really relevant is that this system has been in place for decades and it's worked well, and we see a level of consistency across the Federation through States and Territories that most other countries would be envious of. We don't compete at State level in a detrimental way around tax regimes and things like that because of the system that's in place.

I think the other argument that was made, and again all the arguments I've seen, is that the HFE actually acts as a disincentive for States to invest in future activities that might see their GST share reduced. That's certainly not the case here in South Australia. Our Government has aggressively pursued mining and gas development projects because clearly there's not just a Commonwealth revenue opportunity. There's State revenue opportunities around those sorts of economic activities.

And lastly it's a point that Business SA finished with, and we recognise and acknowledge the independence of the Productivity Commission and appreciate the work that you're doing in what is a difficult issue across the nation.

So the last point that I wish to speak to is the business environment here in SA, that in South Australia we've had a challenging few years with our State economy. We have slower population growth than most other States, particularly the eastern seaboard and I'm sure probably Western Australia. Our power costs are more than anyone else in the known universe if you read the paper, but that's a reality that at the moment businesses are being hit with 50 per cent price rises in terms of power. February earlier this year, our reliability of power was questioned and the place that we're sitting in today, you can imagine what happens when the lights go off in a place like this, the chaos that it causes for visitors and the visitor experience that we're trying to present.

I think it's also important to recognise that our regional cousins - and the Murray River challenges that were faced not so many years ago with the drought. What did they say? A 1,000 year drought or a 100 year drought. It was extremely tough for our river communities and they're only just now starting to recover from some of those difficulties, and some of them there'll always be scars in terms of what happened in those communities and the economic activity that was taken out of those communities.

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We're an ageing population. We, as I understand it, have the oldest demographic in terms of age. And as I earlier alluded to, we are an economy in transition that - you know, Holden has closed down a few weeks ago. Prior to that Mitsubishi went the decade before. We have significant unemployment, although it's dropping, but I think what you'll find if you really looked at that issue, the under employment issue here in South Australia is significant. And so the unemployment, the headline number - you know, it's at 5 point something which is positive, but the under employment is a huge issue for us as a State.

And then the last point that I alluded to previously as well was access. So we do have challenges with people accessing our State. You know, Qantas recently announced flights out of Perth direct into London. They're going to hub out of Brisbane as well. Sydney airport, you know, they can hardly fit another plane in there. And so we have got some disadvantages when it comes to just being able to access us.

So in the business community, as I'm sure you know, confidence is everything and we're starting to build confidence again here, and the last thing we need is to see the Commonwealth take GST revenue away from us that will dent confidence and further make the business environment here challenging.

So yes, hopefully my presentation in terms of some of the external factors that are happening here in South Australia are useful. We understand that it's obviously a very complex area, but as an association we fully support the Business SA position. Thanks very much for the opportunity to present.

MR COPPEL: Thank you, Shaun. So if I were to summarise in two sentences your view is that the HFE system as it currently operates is doing a good job and that you're against any changes to the system along the lines that we're proposing because that would have a negative implication in terms of the fiscal - in terms of the GST distribution for South Australia.

MR DE BRUYN: Yes.

MR COPPEL: Which would then have follow on consequences for the broader economy.

MR DE BRUYN: Yes, and obviously that will see, as I understand, several hundreds of millions of dollars go out of State Treasury and then they'll be looking to recoup that money, either by raising taxes or reducing services, and tourism will be hit.

MR COPPEL: Do your members have any issues that they raise vis-a-vis their business and how the HFE system impacts on their businesses?

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MR DE BRUYN: Individually, no. I have not received any individual feedback from them. It's more about the business environment, and the fact that if Treasury has to run a budget with less money they'll make choices that will impact tourism businesses.

MR COPPEL: One of the points that you made is not too different from some of the arguments that have been put to us in WA, that the cost of natural resource development to the Government, maybe some infrastructure requirements, is one thing that's not recognised in the HFE process yet the revenues that come from that through mining royalties are largely equalised away, particularly with respect to iron ore. And you made the point that one of the implications of a change would be less revenue for South Australia and that that could bear on the resources that the South Australia Government puts for economic development of the tourism sector.

They're a little bit different. One is sort of a consequence and another is an implication. But do you have any sympathy for that, given you've mentioned that point because of the South Australia tourism development? Do you have sympathy for that argument that economic development does involve some up-front investment by the Government which is not recognised in the HFE system?

MR DE BRUYN: Again, I can't debate the detail and obviously I'm a passionate South Australian. But I am a political observer and I have looked at this issue over a number of years, and I think - and all the information I've seen is that the system works. Don't fix it. To me I think that if the Commission wants to take my advice, I think you should look at this lag issue because clearly that's where the political hot button is. Because what's - you know, WA as I understand it, while the boom was cranking up they were receiving, you know, they were almost double dipping, if you like. Not that that's a correct term, but they were receiving good distributions of GST at the same time as they were receiving significant royalties because the economics of exactly what HFE should be were two or three years down there - you know, were taken from two or three years previous.

But then coming out the other side, it plays out as a double negative for them, I guess. So they had a double positive up front and they got a double negative at the other end. So I think you could make that argument and go well, they've had to invest in rail and roads and airports and harbours and all those things, but I would also make the argument that a lot of that infrastructure is used for other activity. It's not just for helping mining companies make royalties off that.

I think in South Australia we see that the advent of mining activity in some of our remote areas has very positive outcomes for tourism. It allows us to get people to places that we otherwise couldn't get them to easily and comfortably and affordably. The commercial air services into Roxby Downs

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is fantastic. It really helps us open up the north of the State, and that's only there because there's a mine there otherwise they wouldn't be there.

MS CHESTER: So Shaun, just coming back to your point then about a few people today have suggested to us that the problem in WA, well the purported problem in WA, the political problem, can be fixed by changing the averaging provisions under the CGC. I guess our motivation for our draft recommendations are disparate from what you referred to I think as a political button.

Our primary focus here is making sure that we manage if there's any negative impacts on the economy of HFE. So it's quite distinct, and indeed most of the other State and Territory Governments are comfortable with the current averaging provisions. Indeed, our Terms of Reference ask us to look at what impact HFE has on budget management, and in terms of budget management the averaging provisions actually work pretty well. So we're not looking at changing the averaging provisions for those two reasons.

You mentioned earlier on that you'd had a briefing from Treasury on the draft report and the implications for South Australia. Do you want to just talk us through what insights that gave you and how that helped you form your views that you've shared with us today?

MR DE BRUYN: It just - again, I disclosed up front that I'm not an economist. I'm not going to delve into the detail because others can do it better than me. What it did was it allowed me to actually ask them questions. It allowed me to ask things like the lag. You know, I've seen that report in the media. It allowed me to ask three or four questions around assumptions that I've seen reported in the media, and I've been able to ask them about what is this lag issue. Clearly it sounds like it's a - why does it exist? Why can't distributions be worked out more timely? Is there some way that payments can be adjusted or whatever.

So I've been able to - so rather than them provide a hive of information for me to then regurgitate - and that certainly wasn't what happened. It was more an opportunity for me to hear, to actually ask them some questions about things that I didn't fully understand, in a layman way.

MS CHESTER: How do you understand - you mentioned I think before the $255 million fiscal impact on the South Australian Government. What do you understand that to be because there doesn't - - -

MR DE BRUYN: I didn't mention that number. I haven't mentioned that number because I was told that - - -

MS CHESTER: Sorry, you mentioned the previous submission that - - -

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MR DE BRUYN: Several hundred million to - - -

MS CHESTER: - - - you supported. Several hundred million, yes.

MR DE BRUYN: Yes, so that was what I - yes, and so Business SA have that number and we fully support that. Yes, just that it's going to have an impact on how State Treasury works and then that will have a - - -

MS CHESTER: So your understanding is if our recommendations were adopted by Government there would be a loss to the South Australian finances of $255 million or something like that?

MR DE BRUYN: Yes.

MS CHESTER: Because that's not what our draft recommendations would actually result in. That number would only occur if you did a cold turkey immediate implementation of equalising to the average. Indeed, one of the things we did want to engage with the smaller States on, which we haven't been able to very well, is what transition path we could pursue. One of the principles we identified in the draft report was actually ensuring that a transition path to anything less than full equalisation to the highest State, we would want to make sure that it didn't materially disadvantage the smaller States like South Australia, Tasmania and the NT.

MR DE BRUYN: So that's very helpful to understand. If I could ask another question, why change it? If it's been in place for so long and it's worked, from what I could tell, well over that period, why make a change?

MS CHESTER: Have you read any parts of our report?

MR DE BRUYN: No, I haven't. I've only read the first few pages of your report.

MS CHESTER: Okay.

MR DE BRUYN: But as I understand it, the system has been in place, the Grants Commission has been in place for many years and the way in which they implement the GST revenue, that was obviously happening prior to GST through wholesale tax and all those sorts of things.

MS CHESTER: I'll give you the readers' digest, but it's only 22 pages so it might be worth your while having a little read of it, but basically the nub of it was that the Terms of Reference asked to say what impact does HFE have on the economy? And we've heard earlier about there's two streams of the efficiency impact. So we all agree that equity is the top objective and the primary objective of HFE, and indeed we endorse that and that's why we don't recommend going towards equal per capita as some others have

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recommended.

But in terms of the efficiency impacts, we did identify that there were disincentives for particularly larger States embarking on serious tax reform, and there are some disincentives as well for States undertaking development activities, especially those that are controversial. So it was very much minded of the economic impact that HFE might have on those incentives facing State and Territory Governments, and making sure that we get the trade-off right between equity and efficiency.

MR DE BRUYN: So how long has the HFE system that we currently have been in place?

MS CHESTER: As we currently have it since the last '70s, with all the States in.

MR COPPEL: '81.

MR DE BRUYN: So I go back to my original question. Why if it's been in place and it's worked for 40 years, why is it being relooked at? Is it because of these new opportunities around tax regimes?

MR COPPEL: What we're saying - we're saying clearly that the system isn't broken, but we're saying that there are a number of issues that have been identified where there is scope to improve how the system works. Now, you can then think about those improvements in terms of making specific changes to the CGC methodology, which is something that the CGC is currently looking at, or you can look at something which is more aimed at the system as a whole, and that's the direction that we've put forward in the draft report.

But it really is to address some of the effects that the HFE system can have on efficiency, with a view to improving how the system works overall.

MS CHESTER: And if you use some of those efficiency effects, particularly for the larger States and cumulatively over time, it can have quite a material impact on the economy.

MR DE BRUYN: Thank you.

MS CHESTER: I don't have any other questions.

MR COPPEL: Great.

MR DE BRUYN: All right, thanks very much.

MR COPPEL: Thank you, Shaun.

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MS CHESTER: Thank you.

MR COPPEL: So that concludes the registered participants for today's hearings. But before I close I would like to give the opportunity if there's anyone else here in the room that would like to make any brief remarks? Jonathan?

MR PINCUS: Now?

MR COPPEL: Yes, you may. I do put the emphasis on "brief".

MR PINCUS: Sure.

MR COPPEL: So just a few minutes, and like with previous participants your name for the transcript?

MR PINCUS: I'm Jonathan Pincus and I'm representing myself. Central to your work is the question of does a trade-off exist between equity and efficiency and, if so, how large it is. And I have to say I congratulate you for entertaining that seriously and making it such an important aspect of what you did. One of the disappointments of the Greiner report was their unwillingness to accept this as the central issue. I want to just make comments on that quite briefly. Not a large number.

First of all on modelling, all the models as Commissioner Coppel suggested depend on assumptions, and for the Greiner review Chris Murphy assumed away exactly the incentive effects that you are considering, both - they're not in the model. So it could not have had any negative effect because it's not there.

As you do know, because of the HFE workshop that was held in Adelaide recently, Chris Murphy has actually changed his tune a little bit by modelling a different way, and now has concluded that of all the things that the Grants Commission equalises for, not all of them act to improve efficiency. In fact, equalising on costs is a disadvantage and shouldn't be used. So that full equalisation would be better from his point of view that - sorry, less than full equalisation would be better than full equalisation.

The second lot of comments I want to make is just to say I don't actually agree on that line with your comment on page 14 that fiscal differences by jurisdiction are unlikely to play a significant role. I picked a single sentence in a context and I don't want to misrepresent you.

But I do find it terribly hard to believe that HFE for over 70 years hasn't made a significant difference to the size of the Tasmanian population. We get two sorts of stories. Tasmania would be the Appalachia of Australia, or

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as we had it earlier it would be the maritime provinces of Canada in Australia, on the one hand and on the other hand it doesn't make any difference to where population goes. I just don't believe both of these could be true. Either HFE has had a significant and a large effect on people's population decisions, taken over the long term period of time, or it hasn't.

For the efficiency and equity both to operate you have to consider two separate sorts of populations. For the efficiency side, the population has to be mobile. For the equity side, the population have to be immobile. And obviously there are parts of populations which are mobile and parts that are immobile. Over time the parts that are immobile turn out not to be so immobile. Elderly people were allegedly flocking to Queensland when Bjelke Joh abolished death duties. So we can't assume that elderly people are immobile, and yet most of the equity arguments relate to immobile people who are like elderly people.

So my quick comments are I'm very pleased that somebody has taken seriously the possibility that there are disincentive effects. I think that scenario modelling is the appropriate way to go because there are no coefficients or elasticities that you could drag and put into a CGE model which relate to the behaviour of Governments in very unusual circumstances. And the trade-off between efficiency and equity is the central issue here.

MR COPPEL: Thank you.

MS CHESTER: Can I ask one question?

MR COPPEL: Go for it.

MS CHESTER: So Jonathan, it is a tough gig for us to try to unbundle the possible efficiency trade-offs and the incentives that the States face, particularly in the context within which we're doing this inquiry at the moment. It's kind of like dammed if you do, dammed if you don't. When you look at how we've approached it through the cameos, and that's the only way we could get our head around doing it because of the evidence base and the disparate views, did we miss any buckets of incentives that States might face? Were there other areas of revenue reform or development activities? Are there any other - because we have to put a great amount of stead into these cameos - - -

MR PINCUS: Sure, sure.

MS CHESTER: - - - we want to make sure that we've done them as well and as broadly as possible. One way of thinking about it would be we've focussed pretty much on good reform that's discouraged, but maybe we should also look at bad tax policies that are encouraged by it.

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MR PINCUS: Yes.

MS CHESTER: But this is an area that you've spent a lot of time looking at and examining. Are there other avenues we should have pursued which we should now between draft and final?

MR PINCUS: Reading your report - I thought you picked the two most significant ones. When I say that I think there are some other insignificant ones. There's numbers that I could come up with so I will think about it. There are a lot of myths going around. The Commonwealth gave the States land tax. The Commonwealth gave the States payroll taxes. They had been competed away not because of HFE. So at least in my opinion that wasn't the reason they were competed away. So I'm struggling to find other than the development of new resources or similar things which have great political costs on one hand and dramatic change on large tax bases on the other - they seem to me to be the two things that I am mostly interested in. I can't think of anything else. If I do I will let you know.

MS CHESTER: Good.

MR COPPEL: Is the example of death duties being abolished in Queensland an example then of HFE competing away a tax base?

MR PINCUS: I had never considered it. I thought it was Queensland thinking that we can attract people by reducing a tax. Whether it's a good tax or a bad tax is - I don't think that the HFE was a big driver for it.

MS CHESTER: Heaven forbid we would suggest a death tax to fund the transition path. Sorry, just a moment of mirth and frivolity at the end of the day.

MR PINCUS: No, no.

MR COPPEL: I always wonder whether the additional health costs were taken into consideration, but that's another matter.

MS CHESTER: Second round effects.

MR PINCUS: So just to make - sorry, the response I want to make, if it's been alleged more than once that State Treasury officials don't tell their governments what the HFE consequences of substantial changes are, and therefore they're never taken into account if the State Treasury officials don't do that, then they're remiss in their duties and I'm astonished to hear that they're so remiss.

MS CHESTER: Well, read the transcripts from our Victorian public hearings because we were told that there's no elasticity effects therefore

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they're immaterial, therefore we don't need to (indistinct) upon them.

MR PINCUS: Yes.

MS CHESTER: It will be good reading for you, Jonathan.

MR PINCUS: Thank you.

MR COPPEL: Okay, thank you Jonathan.

MR PINCUS: Thank you very much.

MS CHESTER: Thanks Jonathan.

MR COPPEL: Are there any others who would like to make a brief remark before we close today's hearings? So if not, I do close today's hearings and the Commission will reconvene next Tuesday in Darwin. Thank you all.

MATTER ADJOURNED AT 2.32 PM
UNTIL TUESDAY, 28 NOVEMBER 2017

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Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO HORIZONTAL FISCAL EQUALISATION

MR J COPPEL, Commissioner
MS K CHESTER, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT BROLGA ROOM, NOVOTEL CBD, 100 THE ESPLANADE, DARWIN, NORTHERN TERRITORY
ON TUESDAY, 28 NOVEMBER 2017 AT 12.28 PM

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RESUMED **[12.28 pm]**

MS CHESTER: Okay, folks. We might get underway. Good afternoon, all and welcome to the public hearings for the Productivity Commission Inquiry into Horizontal Fiscal Equalisation, or better known as how we divide up the GST bucket across the states and territories.

My name's Karen Chester. I'm the deputy chair of the Productivity Commission and a Commissioner on this inquiry and I'm joined by my fellow colleague and Commissioner, Jonathan Coppel. I'd like to begin in opening these hearings by acknowledging the traditional custodians of the land on which we meet today the Larrakia people, and I would also like to pay my respects to elders past and present.

Now this is the fifth day of public hearings for this inquiry. We've held hearings in Perth, Melbourne and Adelaide, and we're here today and tomorrow in Darwin and then we'll be heading to Hobart at the end of the week. We'll then be working towards completing a final report for government which will be submitted to the Australian Government next year. Participants and those who've registered their interest in this inquiry will be advised when the final report is released by the government.

Now before I sort of run through why we hold public hearings and how we go about doing them, I am required by a piece of legislation to say, if some alarms go off let's all follow common sense and head out the door. Fire wardens will tell us how to get out, and don't use any lifts. I think that covers that off.

Now in terms of why we hold public hearings, for the Commission, public hearings are a really important part of our consultation process. It allows there to be public scrutiny of our work, our draft report, and to get feedback on that draft report. But importantly, it also allows public scrutiny and feedback on the submissions and the inputs that are made by others to our inquiry.

Now we like to conduct all hearings in a reasonably informal manner, but I do remind participants that a full transcript is being taken. For this reason we can't take any comments from the floor. But at the end of today's proceedings, if there is anybody who's not a registered participant who would like to be heard, then we will be able to make them do that.

Now participants are invited to make some short opening remarks, and we'll just ask if you can leave that up to five minutes, just so it allows more time for us to have a bit of a conversation, to make sure that we better understand your views and thoughts on this inquiry. Now participants are

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not required to take any oath. We just ask you to be truthful. You are also very welcome to comment on the submissions or views of others that have been made to this inquiry.

Now the transcript that's being taken by Peter today on our behalf will be available from the Commission's website following the hearings, as are participant's submissions and our draft report. For any media representatives that are here today, and I think we have a few in the back row, and I think they know the rules of the game.

So I'd like to welcome our first participants for the public hearings here in Darwin, the Yothu Yindi Foundation. Thank you very much for the submission that you were able to give to us, so we get a better understanding of what some of the views and issues are you'd like to discuss with us today. But just for the purposes of the transcript, if you could each just state your name and organisation, just for recording purposes, and then if you'd like to make some brief opening remarks. Thank you.

MS MUNUNGGURR: Hi. Good morning, Commissioners. My name is Yananymul Mununggurr. I'm a director for the Yothu Yindi Foundation. I'd like to make a bit of a statement. I was flown out here yesterday from Yirrkala, a place called Yirrkala, north east Arnhem Island, to provide this presentation on behalf of the Yothu Yindi Foundation. I live at Yirrkala, but I've also got a homeland which is Garrthalala the homeland, and it's a remote outstation, south of Yirrkala and the Gulf Peninsula. And today is the first time that I've been to such an inquiry like this. I've come here to try and give you a better understanding of life that I live in.

The Yolngu people within our region are borne into two moieties, Dhuwa and Yirritja moieties. I come from a clan group of Djapu clan nation and my mother's clan nation group is Gumatj, (indistinct) Gumatj. I speak Gumatj, but traditionally I speak my father's language which is the Djapu. That's my first language.

There's more than 15,000 Yolngu people living in the East Arnhem region and more than 2000 that lives on homelands. Eight out of ten Aboriginal people in the Northern Territory lives in rural or remote like we do. So we are a long way from places like Darwin, Katherine, Alice Springs where the power lies within Australia. And the Yolngu seem to be the last to have our voices heard when it comes to expenditure of government money.

Over the last few decades, we have found that we miss out just about everywhere. We know that we have been neglected and this effect - we know that the system is against all Aboriginal people across the Territory

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and across the nation. Our communities have never been probably funded when leading – when funding itself never seems to reach the people that it is meant for. And honestly, we blame both governments of the Territory and the Federal Government and politicians from both sides has let us down, let all the Aboriginal people down when it comes to funding for our communities. And the submission, the Yothu Yindi submission is all about that.

Health issues, education issues, children's issues, family issues, all suffer because of all the failures, of all these failures. Our towns and living areas look nothing like Darwin or Alice Springs or Sydney, wherever. And we never get the support we need to develop our land and our waters. At the end of the day, this neglect causes human suffering and real people, like my people, get hurt. And we see it every day. It's happening right before our eyes.

These are the issues that the government, the Commonwealth Grants Commission needs to hear, because we need these funds to hit the ground. We need the funds to get into our communities. We need it to be rolled out to our organisations, so we can look after our own issues on the ground.

How can the Commission guarantee to us that we will get our fair share? Your recommendations need to address these issues. We look to you to reform this system so that it works for our people. People like myself and many others are tired. We are very tired of being given the crumbs of the table. There's not a fair share that's being given to our people when it comes to funding from both governments. And we'd like to see positive reforms happen in the future – in the near future that will deliver real benefits to our communities and to our people. Thank you, Commissioners.

MS CHESTER: Thank you very much for those opening remarks, and also thank you very much for making the journey to come and be here today at our hearings. I might just invite your colleagues to each just say their name and organisation for the transcript recordings and then we might – and did you have any other remarks that you wanted – just introduce each other first.

MS BOWDEN: Denise Bowden, Yothu Yindi Foundation.

MR HANSEN: Barry Hansen, Yothu Yindi Foundation.

MR BEADMAN: Bob Beadman, the same.

MS CHESTER: Thank you. Denise, did you or any other colleagues have anything else you wanted to say before we get into some questions.

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MS BOWDEN: We do.

MS CHESTER: Thank you.

MS BOWDEN: We have prepared a few pieces for your today. Thank you, Yananymul. Commissioners, thank you for the opportunity today to present before you. My name's Denise Bowden. I'm Chief Executive Officer of the Yothu Yindi Foundation.

For the past decade, the Yothu Yindi Foundation and our Chairman, Galarrwuy Yunupingu, have raised concerns as to why indigenous communities in remote regions and Aboriginal people in general, are disadvantaged by the way government spends money that is earmarked for our benefit. We complain always about the hindrance of red tape, about government inefficiency, and about the way government prioritises the urban areas over the bush. We have highlighted that this means that we will fail in our joint policy of closing the gap.

As Yananymul has said today, and Galarrwuy has said on many occasions, the end result of this failure is human misery. Aboriginal people in the bush deal with constant illness, death and heartbreaking loss. We suffered third world such as rheumatic heart disease, Machado Joseph Disease and we have epidemic levels of diabetes. Aboriginal people are at the bottom of the social and economic hierarchy and we suffer as a result.

Now we understand that government must provide hospitals and police and prisons and we understand too that we're terribly over-represented in those places, but we won't excuse the failure to tackle the front end by spending government funds properly and fairly. As we have pointed out in our submission, this applies specifically to the way the Northern Territory Government spends GST revenue. The Productivity Commission has an opportunity to make a difference to this state of play.

I wish to highlight six points in particular, (1) State and Territory Government spends GST revenue as they see fit and there is limited transparency and limited accountability, especially to Aboriginal people. (2) State and Territory Governments are rewarded for disadvantage with a payment of extra GST revenue. In the Northern Territory this is particularly the case where the Northern Territory Government receives a greater amount because of the disadvantage of Aboriginal people. Yet, as I have just said, there is no obligation to spend the money on the root causes of that disadvantage and the disadvantaged have little or no say in this process.

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(3) The Commonwealth Government is as responsible as the Territory Government for this state of affairs. The current GST formula, at best, tries to maintain the status quo. The status quo is not good enough. The formula must tackle and address the disadvantage, not maintain it. The Commonwealth should not be able to continue to avoid its obligations to the Territory's disadvantaged regions.

(4) The Commonwealth formulas that go to local government funding are scandalous as we point out clearly in our submission. (5) We are plagued by public servants who mostly live in Darwin and we are forever strangled by red tape. Our submission points out that more money just seems to mean more public servants. (6) It seems more and more people in the south are identifying as "Aboriginal". These people usually live in urban or semi-urban areas, yet they are treated the same in the terms of the formula as Aboriginal people who live in remote areas. This is a serious disparity that needs to be addressed. My colleagues here to my right will touch on this briefly.

Commissioners, the Northern Territory is different and these issues are not going away. Indigenous matters are front and centre for we Territorians. We urge you to make recommendations that address the issues that we have identified, and not just make a scapegoat of the Northern Territory. The NT has great need and to address that need, we require a new manner of doing business that sends government funds direct to the point of need and addresses the issue of the disempowerment of Aboriginal people.

On my last point, I take this opportunity to recommend a model based on the work of Empowered Communities, and I table a copy of that report for you here now.

MS CHESTER: Thank you.

MS BOWDEN: And with me are two important advisors to the Yothu Yindi Foundation. Barry Hansen here, is a former chairman of the Northern Territory Council of Social Services, and Bob Beadman a former chairman of the Northern Territory Grants Commission. They're going to speak for a small amount of time and then, perhaps, we might take some questions. Thank you.

MS CHESTER: Thank you.

MR HANSEN: Thanks, Denise. Commissioners, Denise has mentioned and Yananymul has mentioned "underspending". Now to put some numbers to it, and I'll go back to – it might seem like I'm going back a number of years, but I'm going back to 2006/7 to show a pattern of working

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through of underspending against Commonwealth Grants Commission assessments. And that's a relevant year because after that a number of categories of expenditure got conflated and the patterns were not quite so clear.

But back in 2006/7, in our submission, there's a range of – number of social welfare categories of expenditure where the combined actual expenditure was $522 million less than the Grants Commission assessments. Probably most notably, Family and Children's Service where the assessment was 179 million, actual spending 43 million. Corrective Services 133 million assessed, 68 million spent. Services to indigenous communities 218 million assessed, 110 million spent. Roads 250 million assessed, 122 million spent. These are all areas of vital importance to remote communities. What can you say, these are the assessments that the Grants Commission make to - under Horizontal Fiscal Equalisation, allow equal capacity to do things in those areas.

Now in the Northern Territory there was a further complicating factor that when self-government came in 1978, there was a very big infrastructure deficit in existence. And the HFE system doesn't allow catch up. It simply allows maintenance of the status quo. So there is a major problem with an inherited infrastructure deficit, whether that be roads of systems. This systemic pattern of underspending which we've identified and traced through from the 90s through. In more recent years, the severity of that underspending has diminished, but it is still accumulative deficit that has occurred.

Those things interact and compound one another. And there's further factors which will also identify in our submission, one of which is what appears to be, quote possibly, a very significant undercounting of the indigenous population in census data. All of those things work together to prevent indigenous communities from recovering from their extreme state of disadvantage and therefore, we believe, that there needs to be a fundamental reform of Commonwealth/Territory financial relations as they specifically relate to indigenous communities and indigenous disadvantage. Thank you.

MR BEADMAN: Hi. I'm Bob Beaman. And I want to simply talk about population. The Territory has got a population problem. Growth has slowed enormously. I think we've got negative inter-state migration. And the only reason the numbers are going up is because of high birth rates in remote Aboriginal communities. Overall, it's believed that the Territory has about 30 per cent of its population made up of indigenous people.

If you move to school age children, the figure is in the order of 40 per cent. And, until recent times, we believe that loading through the

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indigeneity factor in the Commonwealth Grants Commission formula has worked to the Territory's advantage.

But, when we look at the growth in numbers of indigenous population in the states, and we take note of what the ABS has said consistently now that that growth can't be attributed to natural increase, we've come around to the view that probably indigeneity is now working to the Territory's disadvantage. But when you do the analysis of the numbers, unbelievably, we've got a declining share of the national indigenous population.

There are several explanations as to why that comes about. I think the first is, as has been alluded to, I don't think the ABS does a very good job of counting in the bush. We think there's probably a cohort in the 15 to 20 year age bracket in most Aboriginal communities that's gone under the radar and not counted at all. We believe that self-identification provision in census is encouraging people to come forward when – for reasons of their own. Some of those reasons might be to do with the work of genealogists in universities who comb back through family trees and find that there was an indigenous ancestor there 200 years ago. Suddenly, an entire new family appears on the census data as indigenous.

We note from census data that 80 per cent of indigenous marriages interstate are to a non-indigenous partner and the kids of that union that become indigenous. So we look on with horror at fraud too, over the question of identity and are concerned that all of this growth in numbers is drawing money away from the Territory. The ABS's remarks about this growth in numbers not being able to be attributed to natural increases, seem to us to be a plea to other arms of government to address this anomaly, but nothing has happened.

And as a consequence, we believe that if other arms of government are not going to address that exponential growth in indigeneity arounds the states which has led to the Territory having a declining share and thus a drain away from our GST share, then it's incumbent on the Commonwealth Grants Commission to go to greater efforts to distinguish degrees of need amongst Aboriginal populations around the states.

It seems to me, for example, that a double university degree, double income family in their own house in Parramatta would have less of value – should have much less of value in the weighting that the Commonwealth Grants Commission would give to an indigenous family with several inter-generational levels of welfare dependency, all unemployed and in a humpy in a remote community like Papunya.

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We are aware of some attempts by the Commonwealth Grants Commission to distinguish between degrees of need. But when you take quintiles of the Australian population, it doesn't get anywhere need to addressing the difference in relevant need that I've just pointed out. Thank you.

MS CHESTER: Thank you very much. And there's lots of ground we want to cover with you with some questions, so Jonathan and I get a better understanding of the issues that you've raised. I guess going to the first one that really you've highlighted in your submission and in your opening remarks today around the way HFE works at the moment, people bandy around the term "equity". And I guess one way of viewing equity and probably the most important way of viewing equity is equity for an individual, regardless of where they live.

HFE is really about giving the states and territories a fiscal capacity and this is where we see the disconnect that you're talking about between the Northern Territory's assessed for disabilities and disadvantages around indigeneity and remoteness, and the two kind of work together, given where indigenous peoples live in the Northern Territory. But that just allows a fiscal capacity for the Territory Government. Overlayed with all of that is the states and territories have the autonomy to spend that money as they see fit.

And so we can look at the numbers that you've shared with us today and we'll talk a little bit about those and some of the good work of people like Professor Neil Warren, at the University of New South Wales, who's looked at some of the CGC data and looked at what money has sort of been adjusted for that fiscal capacity based on indigeneity and remoteness, and then where it's actually spent, which is the outcomes. And that's what's kind of, at the end of the day, linked to equity. So that for us is a difficult area when the whole system has evolved towards giving the states and territories greater autonomy.

But you rightly pointed to the issue of, and I think it was in your remarks Denise, about transparency and accountability. And I guess there's two angles there: one is on the issue of accountability, to what sense do you feel there are clear lines of delineation and understanding of funding and delivery responsibilities between Commonwealth and Territory on indigenous policies and programs?

MS BOWDEN: Commissioner, that's a very good question because I think it's fairly clear as mud sometimes. You're in a system of election campaigns that often change every three years and with that does change policy too. So I think also in terms of very remote people, I don't think that

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that is communicated well to the people on the ground. And, in fact, you know I think it would be fair to say that there's been such a sort of frustration over this that there's probably a lot of people that have turned off, to be quite honest.

I'll go to the Empowered Communities' component, because it does talk to the need for an independent umpire to I guess, you know, monitor things such as making sure there's transparency and clarity in how funds are distributed and also to alleviate any congestion. And the Empowered Communities' model also talks about real engagement with indigenous people as to how you know the priorities of funding are set and future growth, and we're talking five to 10 years not you know when government seems to need it. Does that answer your question?

MS CHESTER: No, it does. And indeed, some of the issues we're touching on too will go well beyond, as I'm sure you'll appreciate, this inquiry. But that's fine. The Commission's always happy to go a little bit further than our Terms of Reference at times when there are important issues. And indeed, some of our commentary around how indigeneity is treated in HFE and the need for longer term reform in our report, do kind of go beyond our Terms of Reference.

Before we get to the transparency side of it, just on this point of accountability, the way the HFE works by saying, "We've assessed your fiscal capacity and this is what the NT needs", that kind of works in principle if there is - in terms of being accountable to the electorate on the Northern Territory, so your Territory Government, if people do understand who's responsible for what. But we, like yourselves, struggle with the HFE system in itself is incredibly complex and then there doesn't seem to a be clear understanding of which level of government is really responsible for and the funding of different policies and programs in the indigenous area.

So I think that's why we struggled a bit with, how do we deal with it within HFE? Some people just say just take it all out of HFE and don't have it as a disability for the assessment of fiscal capacity. I guess where we kind of landed was fixing up the broader accountability first, who is responsible for what and that's well known and understood, and then revisit is it still appropriate to deliver it through HFE with states having autonomy on how it's spent or, given we know from our work on overcoming indigenous disadvantage, our report, the gaps not reducing in most areas, do we need to deal with it differently? And that's an area where we do have a draft recommendation and a finding in our report.

I don't want to mischaracterise your submission, but I think from reading your submission that would make me think that you do need to get

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the longer term Federal financial relationships and accountability right on indigenous policies and programs before you can really then address making sure that the money is spent appropriately.

MR HANSEN: I think it's fair to say that there's a number of issues that could be addressed simultaneously, but that is certainly one of the key ones, yes.

MS CHESTER: And we're conscious that all of that takes time. So in the interim focusing now on the current HFE arrangements, what could we do to make them more transparent? So a couple of things come to mind. So firstly, the data that you shared in your submission, so that's CGC data from 2006/7.

MR HANSEN: Yes.

MS CHESTER: But you can't do that sort of analysis now given the way the CGC - - -

MR HANSEN: You can, but it's not as clear because – and it's also we started from there. But you'll see further down that by 2009/10 that deficit had reduced to 356 by 14/15 and came in at 334 million.

MS CHESTER: Yes.

MR HANSEN: But that's now down to about 130 million, that deficit. But there's this accumulative effect of underspending over many years, which we suspect goes back to 1978, but possibly a little bit more recently but certainly back to the early 90s.

MS CHESTER: Yes.

MR HANSEN: And you've got that accumulative effect of underspending so that if, for example, in children's – Family and Children's Services where you were spending say 30 or 35 per cent of the assessment year in year out, is it any wonder that you have youth justice issues?

MS CHESTER: And it might sound like it's not directly relevant, but it does actually go to the heart of this. So there are a bunch of academics out there who do a lot of good work in this area, and they want to have greater access to the CGC data. And Neil Warren does come to mind. We had a couple of meetings with Neil. He's done a lot of good work in this area about looking at what you're assessed for and then what you actually spend the money on and then linking it through to what's happening to policy outcomes in those areas. So one of our recommendations was that all the

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CGC data and workings, the data they get from the states and territories, all their workings should be in the public domain to allow the academics to do that good work and analysis.

MR HANSEN: We would support that.

MS CHESTER: Yes. So we don't have all the states and territories agreeing to that yet, including the NT Government, based on their post-draft report submission, but we'll ask them about that tomorrow. I guess in terms of within the current system, there's the current methodology and how it's applied. And I am aware that in the 2015 CGC Review, and I think you touched on it, there was a sense of trying to get some improvements and making sure you're not comparing apples and zebras in terms of indigenous people based on their socioeconomic position and also where they're located.

So the way we understand it kind of works, there's the remoteness factor, then there's the indigeneity. And they've tried to go more granular with the indigeneity index by using a socioeconomic status as an index for then applying that to different populations at different locations which I thought would go park of the way to addressing your concern about you know Parramatta versus Borroloola. So does that not go far enough in terms of what's needed to get that sense and sensibility in terms of how indigeneity is adjusted for fiscal capacity?

MR HANSEN: It definitely doesn't go far enough. And, as Bob pointed out, the socioeconomic status is divided in quintiles, so you've got four and a-half million people in the lowest 20 per cent, the lowest quintile, and they each get equal weighting. So the person who is 2 million in the – you know, at the median of the low quintile bears no comparison in terms of socioeconomic status with somebody in a remote community.

And there's other factors which we haven't mentioned, which come into that. So, for example, the cost in a remote community might be double what it is in Darwin, which might be 20 per cent higher than it is in, say, Sydney or Melbourne. But there is no adjustment, for example, in Social Security benefits for purchasing power. So a person in a remote community might have half the purchasing power of somebody in Melbourne or Sydney in the same quintile. And then you've got all these other compounding disadvantages thrown in on top.

MS CHESTER: Okay.

MR BEADMAN: The quintile of 4 million people, the Territory's entire population, is 240,000, so it doesn't rank.

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MS CHESTER: And I guess what the HFE mechanism – because it doesn't get to individual equity, it doesn't sort of flow through – it's really just looking at cost to government of providing services.

MR HANSEN: Yes.

MS CHESTER: So to some extent, you're right, the socioeconomic is a higher level measure of the circumstances of the people in those communities because it's not taking into account the cost of living. But it is taking into account the cost of service provision with the remoteness factor. So to some extent, it would be partially built in there. So were you involved in the 2015 Review? Is this an area where you've had interaction with the CGC on how they've – because they seem to be sort of evolving and trying to improve the methodology in this area?

MR HANSEN: Yes. Well every five years they update their methodology. No, I've just been an observer of what they do and - - -

MS CHESTER: Because they've got another methodology review underway at the moment.

MR HANSEN: Yes.

MS CHESTER: And I'm thinking, there's only so much we can do in our inquiry. Methodology issues like that, I mean we can convey back to this to the CGC and we can give them copies of your submissions, but I think it would be good for you to have some direct input into that as well.

MR HANSEN: Yes. That's our intention.

MS CHESTER: Yes. So then in terms of the future reforms, and I think that's the hardest area, I'm not sure how much more prescriptive we can be for government, but it would be good to get your sense of have we got the sequencing right, i.e. we've got the get the accountabilities right first between Commonwealth and Territories here? And then decide, is it best done through HFE where the states and territories have full autonomy or do we need to move to a system where what's identified as the funding that's required is - actually then flows through to actually what's spent on the ground, which doesn't dovetail with how HFE works?

MS BOWDEN: I think the latter. I'll just go back to Empowered Communities, for example, it talks about pooled funding for issues of disadvantage that may be a five to 10 year trajectory. However, the pool funding component won't really be liked by the Northern Territory

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Government because it obviously takes a bit of you know power away from how those funds are distributed. Nonetheless, we're here today because we can't touch the money on the ground. We can't see the money hitting the ground. We can't taste it or hear it. And as a result, people such as Yananymul have got you know family in the communities that - as we say every day, this is a struggle for everybody. So we're here to try to force that change to happen.

MS CHESTER: So the other area where there could be greater insights on transparency is – and I'm not sure how familiar you are with some of the work that the Commission does. So separate to this inquiry, the Commission does – I think you'd be aware of our Overcoming Indigenous Disadvantage Report. We also where we reported I think it's 52 indicators of wellbeing within indigenous communities. As part of that we've also got the Indigenous Expenditure Report.

But another one that many people don't know about is the Report on Government Services, ROGS, where it actually looks at State and Territory expenses and performance outcomes by different responsibilities. And I actually think that is a very powerful transparency mechanism. It's not one that is probably as well known as it should be. So we'll get you in touch with that team and that work and get you a link to where it's on the website.

MS BOWDEN: Yes.

MS CHESTER: But I think that, coupled with what we're suggesting on the data that the CGC have, will help on the transparency side. I think the issue we still have to grapple with is the accountability side and then how we deal with indigeneity within HFE.

MR COPPEL: Can I just pick up on some of the problems you identified? You picked up accountability issues. You picked up sort of broader concerns of Commonwealth/Territory financial relations. And in both I heard you say, "There's a need for fundamental reform". Can you share with us any specific ideas of how you would make reforms to improve accountability and how you would make reforms to improve Commonwealth/Territory financial relations?

MR HANSEN: I think the first point is information. Nobody has a clear understanding because there is no correlation between the Commonwealth Grants Commission assessments and the NT Government budgetary allocations. Because they, the NT Government, slice and dice it in a different way to the Grants Commission, so there is no correlation between that. And that is, I think, the first and fundamental point to get that – access to that information, which is why we've recommended or suggested that the

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Productivity Commission itself adopt the role of independent arbiter – not arbiter but umpire and a reporter of those things.

I think the other fundamental aspect is there's no getting around the fact that there was a major, major deficit in infrastructure when the NT got self-government, and nothing's really ever been done to bring that into line. So that is something that needs to be separately assessed and dealt with.

MR COPPEL: On that point, are there not separate funds from the Commonwealth for infrastructure?

MR HANSEN: Not in a systematic way. They're ad hoc. So, for example, you might get a program to improve indigenous housing, but that's not a 20 year or a 30 year or a life time program. Well, for example, a few years ago there was the SIHIP program and there's been subsequent other programs. But there is no guarantee. There's no ongoing thing to say, "Well, this is how we're going to do it" and take it through to completion. It's really pretty much a political football, in my opinion.

MS CHESTER: And is that a function of how the CGC does assessed expenses, by applying average costs against population and need in the Northern Territory and then adjusting for the disabilities?

MR HANSEN: That's my understanding.

MS CHESTER: I'm just trying to work out, if the infrastructure spend was way behind in the NT, as you suggest in your submission and from remarks today, how or why that would not be picked up in the assessed expenses? I'm just - - -

MR BEADMAN: The CGC consistently says that people oughtn't look to them to address overcoming backlog of need. That their whole effort is about equalising the delivery of services for the current financial year, not about addressing what wasn't there at the start of that financial year.

So the reality is that the inherited deficit at the time of self-government, has been addressed in an ad hoc way by various Commonwealth programs, but never, ever, in my (indistinct) of an exercise that goes to a proper assessment of the totality of need and a coherent plan to address that over a period of time. Even the ad hoc approaches to say addressing a housing backlog, has been gone about in a way where the money seems to drain away into the pockets of consultants and builders. Much fewer houses end up on the ground than were originally envisaged. And done by a process of fly in fly out contractors, when Aboriginal people are sitting on the ground

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in the bush keen for employment and training opportunities that never materialise.

So this is sort of the order of things that's envisaged in this empowered communities, an entirely different way of doing things. I think the writing's on the wall indelibly, that both governments have failed over the years to effectively address the backlog of need, whether it's a social need or a capital need. And maybe we need to rethink, fundamentally, the way we go about service delivery.

MS BOWDEN: Commissioners, I also think it's worth mentioning that traditionally elections were won here in the Northern suburbs. But given the kind of population changes, governments are now elected by the bush constituency very much so. So the dynamics there even change. So that favour type of approach is very much a different picture that we're having to kind of see here today.

MR HANSEN: Sorry. I just want to also say a fundamental assumption of the CGC assessments is that equal starting point.

MS CHESTER: Okay.

MR COPPEL: So just coming back to a point which we touched on, which I think also relates to fundamental reform of the Commonwealth/Territory financial relations, and that's the point we discussed in the draft report about whether the indigeneity as a factor be in or out of HFE system. Do you envisage that as being part of a fundamental reform or do you still see indigeneity as being something that should also be built into the way in which the CGC calculates its relativities?

MR HANSEN: I would think it's all on the table. I see no reason why you would exclude indigeneity from that review.

MS CHESTER: I just have one more question, if I may, and it's for Bob because given you've got a background with the NT Grants Commission. So we have, at the Commonwealth and state/territory level, this system of HFE which is full equalisation to the fiscal capacity of the highest state, and at the moment it's WA, what's the trickle down level? What happens with the NT Grants Commission? How does the Territory Government do it here? And is it a form of full equalisation? Is it partial equalisation?

MR BEADMAN: The title is probably a little bit misleading. It's Northern Territory Local Government Grants Commission.

MS CHESTER: Yes.

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MR BEADMAN: But in legislation it disappears as "Grants Commission".

MS CHESTER: Yes.

MR BEADMAN: Oddly, the Commonwealth cuts the pool of national local government money on a per capita basis. So there's no catch up for local government either, notwithstanding that the Territory started about 100 years behind the states.

MS CHESTER: So that's - - -

MR BEADMAN: And then, having given us a per capita share, the Commonwealth principles stipulate that 30 per cent of it needs to be allocated to each council in the Territory on a per capita basis, which means that the lion's share goes to the Darwin City Council, notwithstanding that on any needs assessment basis they would get nil. So it's very much a partial HFE system.

But the anomalous outcome nationwide of the per capita cut between jurisdictions of the pool of money, uniform national principles, and then states having the opportunity to devise their own methodologies in compliance with those national principles, produces outcomes like the highest per capita funded council in the Territory gets about $300 per capita, the highest per capita funded council in WA about $18,000 per capita. A totally anomalous outcome through a Commonwealth approach to a per capita split of funds between jurisdictions for local government.

MS CHESTER: And the reason I asked this is it's kind of relevant because we know that councils on the ground in remote communities are doing a lot more service delivery. Is that peculiar to the Northern Territory that it's done on that way, Bob? Is that something that's a Territory decision or a Commonwealth decision because we know from some of the states that we met with, and we've met some of their Grants Commissions, it's actually a state decision as to what form of equalisation they do with councils?

MR BEADMAN: No, it's not. It's an outcome that perverse Commonwealth principles overlaid on the per capita cut of available funds. But to take it to other extremes, Geelong, through the Victorian Grants Commission process, gets an allocation equivalent to the entire amount that we get through the Commonwealth's per capita split of the national pool.

MS CHESTER: Yes.

MR BEADMAN: It's totally anomalous.

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MS CHESTER: Okay. We've covered a lot of ground and we didn't have any other questions of you today. Is there anything else you wanted to say while you've got us?

MR BEADMAN: Yes, just a quick one. We've got a table in there that shows anomalies of funds from assessment of unemployment levels. Now a few years ago, in another capacity, by remote community, remote community, I got the total statistics on those in receipt of unemployment benefits, those in receipt of Newstart Allowance, and was foolish enough to believe that that total would be equivalent to the total number of unemployed in that location. And then I learnt on community by community, the numbers considered unemployed were only about 10 per cent of the numbers in receipt of welfare benefits. So there's a massive understatement of the true levels of unemployment in the Northern Territory thought published Commonwealth data.

MR HANSEN: And the population.

MR BEADMAN: And the population, Barry says is relevant.

MS CHESTER: Okay.

MR BEADMAN: Yes. So we you know – numbers are distorted in a way that disadvantage us on every spreadsheet.

MS CHESTER: Was there anything else you wanted to - - -

MS BOWDEN: No. Thank you for the opportunity today.

MS CHESTER: Well, thank you for coming and joining us today and for travelling. We thank you and we'll pass on some of your stuff to the CGC and we'll get you some links to ROGS work.

MS BOWDEN: That'd be great.

MS CHESTER: Because there's a lot of data there that I think – around those expenditures by line areas.

MS BOWDEN: Terrific. I'll leave this for you.

MS CHESTER: Thank you. I'll grab that. Thank you.

MR BEADMAN: Thank you.

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MR HANSEN: Thank you.

MS CHESTER: Right. I'd like to invite our next public hearings participant, the Australian Education Union NT to come join us. Good afternoon. Welcome. And if you wouldn't mind just stating your name and who you represent, for the purposes of the transcript recording. Then if you'd like to make some brief opening remarks.

MR RYAN: Certainly. My name's Jarvis Ryan. I'm the president of the Australian Education Union Northern Territory branch, a position I've held for about three years. Prior to that I worked as a teacher for two years at Yirrkala School in North East Arnhem Land. Our union represents about – we have about 2000 members in the Northern Territory, so we're one of the larger unions. We have members in pretty much all of the 150-odd government schools or public schools across the NT and that is the perspective I'd like to bring to bear today. So it's looking at the particular challenges that we face in delivering education at a high level of service or standard to students across the Northern Territory.

I'm not sure how familiar you are with our sort of demographic landscape, so I might just give a few comments on the particular make up of our schooling system. So we have over 33,000 students in those 150, or thereabouts, public schools. A very large proportion of those schools are very small. Many of our schools we have members that are one, two or three teacher schools scattered across the very broad expanse of the Northern Territory. You know, we have kids who live on rural properties who attend school of the air type scenarios. We have students, Aboriginal students, who live in homelands. They're not even designated communities were teachers are based in a home location and in many cases fly out to those homelands several days a week in charter planes or drive great distances.

So the starting point is that, once we talk about beginning to try to provide a service to students, in some cases, the costs are astronomical. It's not unusual in some of those very remote schools that the cost of providing education is in the realm of 30, 40, $50,000 per student per year. And I guess the concern that our union has, based on information we've received from the Treasury and the Education Department here, is that if there's a significant change in our GST as allocated, that will have a direct impact on our government's ability to continue to provide that service to those students.

A useful properly indicator here to talk about is the school resourcing standard. Now after years of sort of back and forth between the states and the Commonwealth, under the previous Gillard Government, as you'd be

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aware, there was agreement made around a Gonski funding arrangement. And the critical agreed standard there was at SRS which talked about ensuring that all schools were resourced to an appropriate level.

Now in our case, just where we're at currently is the combined sort of contribution from the Territory Government and the Commonwealth is, as I understand it, around about 89 per cent of that SRS. And the agreed outcome we're trying to get to is 95 per cent. Now under the previous arrangement with the Federal Government, there was an expectation there'd be significant additional funding forthcoming from the Commonwealth. As a result of legislation that was passed in June, the Commonwealth has now said it's going to cap its contribution to public schools at 20 per cent of the SRS.

In most jurisdictions, that would still mean that public schools will see their funding increase over a 10 year period because the Commonwealth funds public schools currently nationally at about 17 per cent of the SRS. The problem we have in the Northern Territory is that the Commonwealth currently funds 24 per cent of the SRS. So you know, without some arrangement being reached between the Territory Government and the Minister, what we're actually going to see is a 10 year reduction in Commonwealth funding.

And at the same time, the Northern Territory Government which currently funds about 65 per cent of the SRS, under the terms of this agreement - legislation is much stronger than an agreement, it's actually legislated, so there could be substantial penalties if the government doesn't comply - they will be expected to increase their contribution to 75 per cent of the SRS to get up to that 95 per cent figure. So lots of sticks, no carrots really for the government here.

I would concede I think there have been issues in the past in how the government has allocated that funding and perhaps not made use of it. I definitely think though there's a commitment from this government at least to ensure that money is used effectively. And, from what I understand, it would place a significant fiscal burden on the Northern Territory Government. So one estimate is that the government here would have to allocate about a billion dollars additionally in the budget over the next 10 years to meet that shortfall from the Commonwealth.

So as far as GST relativities and all of these things go, if we're talking about one of the assumptions, I understand, in the reduction in relativities that affected the Northern Territory earlier this year, was there's an assumption in that CGC report which stated that – and I don't really know where they got this from – but that the cost of providing education in the

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Northern Territory was deemed to have become significantly cheaper. I don't know what that assumption is based on.

But nonetheless, that first reduction has already affected the education budget. It means there's less funding now available to provide those core services to schools. A further reduction would place more strain on the budget. And our concern is that when that education funding is reduced, it is always the most marginalised and disadvantaged students who are the worst affected. They are, of course, also the students who cost the most to educate up to what we deem an acceptable standard.

One of the problems of course, and I'm sure you'd be aware of this, is that poor education outcomes feed directly into poor employment outcomes, poor health outcomes. We've just had the Royal Commission findings have been released where those Commissioners there have sort of actually said to the government, "Look if you have a better approach to managing these issues, you'll actually save money". Fundamentally, we believe that the current state of education is such that we're not getting enough kids through into a scenario where they emerge work ready. And year 12 rates – completion rates are increasing year by year, but off a very low base. So not being able to fund education, there clearly will be flow on effects that will hit the budget in other areas.

So look that's the sort of broad overview I guess of what our concerns would be and we'd be happy to try and field any questions to provide more clarity.

MS CHESTER: Thanks, Jarvis. And you've raised a bunch of policy issues.

MR RYAN: Yes.

MS CHESTER: And we'll try to touch on most of them if we can.

MR RYAN: Sure.

MS CHESTER: But am I right in saying that your primary concern, and why you wanted to come and appear today, is really the suggestion that our draft recommended changes to – and there are draft – that's a draft report.

MR RYAN: Sure.

MS CHESTER: Changes to the HFE system, so moving away from equalising to the highest state to equalising to something less than the highest state, would strip a billion dollars in the next 10 years out of NT

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budgets. That's the primary concern that you've got that that will then directly flow on to what the spend is in education in the NT?

MR RYAN: Yes. And with that figure, that's been providing to me by the Education Minister's advisor, and she stressed it's an estimate. I can only go on the figures that are provided.

MS CHESTER: Yes. Okay. That's good.

MR RYAN: Yes.

MS CHESTER: And we'll be asking them about that tomorrow.

MR RYAN: Yes, okay.

MS CHESTER: That's a new number to us.

MR RYAN: Sure.

MS CHESTER: And I suspect that number, and this might help in terms of contextualise your concerns that that number is probably assuming that we do what - a cold turkey policy change, so we move to that new system tomorrow.

MR RYAN: Right, yes.

MS CHESTER: And there's no transitional phasing or compensation. So in our draft report, one of the biggest challenges we've got in this phase of the inquiry is whenever you make a change to something like the HFE, the key formula, which is how we work out the relativities, and particularly our starting point is we've got a really wide relativity band of you know WA down in the 30s and the Northern Territory off the scale.

MR RYAN: Yes.

MS CHESTER: That to move to such a change, you would need to do it very gradually over time, such that it you know doesn't materially disadvantage particularly the smaller or the fiscally weaker states. So that's one of our guiding principles for the transition part that we wouldn't want to see the fiscally weaker territories and states materially disadvantaged. So that's in our draft report.

And so part of our priority now is to try to consult with the states and territories on what would a transition path be that would ensure that? And to some extent, the way the GST pool grows over time and if you transition

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it slowly enough, you could see that the NT, at least in nominal terms, may not be disadvantaged. But we've still got a lot of work to do on that.

MR RYAN: Yes. And look from my point of view as someone who we kind of see how things play out a bit, but the Territory is very subject to sort of vicissitudes of changing Federal Government fortunes and flavours and there's a whole other funding stream that's earmarked for – specifically to do with indigenous disadvantage that is also – as I understand it, that broadly speaking is declining over time as well.

MS CHESTER: And I don't know if you were here when we had the Yothu Yindi Foundation here before, but one of the key issues, and it's a question I have for you, is that you know you touched on Gonski 1, Gonski 2.

MR RYAN: Yes, yes.

MS CHESTER: What comes through the Territory and fiscal capacity through HFE, which is assessed based on assessed expenses for education including in remote communities and the cost of service provision. How much of that is really accountable in terms of who's really funding and who's responsible for what, in terms of education on the ground for the students in the Northern Territory?

MR RYAN: Look that's still an area where I think more work needs to be done as far as - you know one of our criticisms, under the previous government there was an arrangement whereby the Commonwealth essentially gave the Northern Territory a lot of funding with no agreement really on – in a binding sense, of how they'd be held accountable for that funding. And there's been issues about, in the past, the Territory received a lot of money from the Commonwealth to address indigenous disadvantage and its – does that money really go where it was intended? And I think that is an issue in education as well.

So I think it's quite right the Commonwealth would put in place requirements that you are accountable for the funding you receive and – but at the same time, an overly prescriptive approach is not likely to work either. So everything we know about education is that given the maximum amount of autonomy at a school level to make decisions based on what works in their local context tends to achieve better outcomes, but you've got to have some quality oversight as well of how the money's being spent, how Commonwealth money is being acquitted, things of that nature.

As we understood it, that architecture of how that Gonski model, if you like, was built, was designed to ensure it was a needs based model. And that architecture, by and large, is still there. The Territory Government

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itself has moved to a needs based funding model as well. So there's base load funding on a per student basis with loadings for geography, indigeneity, things of that nature. So over time the trend is, I think, for that funding to become more transparent and needs based. It's not where we would like it to be, particularly in terms of the overall level of resourcing. But I think it's better than it has been in the past.

MS CHESTER: Yes. Because when you look at the numbers in terms of that point that was raised earlier about where assessed expenses are decided by the CGC, looking at disability like indigeneity, remoteness, and then what should be spend on schools – the two categories are schools' education and post-secondary education. The Northern Territory Government is basically putting the money where it's meant to be, so it's close to 100 per cent for schools' education against what the CGC assesses.

MR RYAN: Yes.

MS CHESTER: And it's actually 210 per cent for post-secondary education.

MR RYAN: Yes.

MS CHESTER: So that money is flowing through. I think it then comes back to the point of there's other policies and programs on top of that.

MR RYAN: Yes.

MS CHESTER: Be it the Gonski funding, and also there's other – as I'm aware, much more targeted programs for indigenous educational outcomes, particularly in remote communities.

MR RYAN: Yes. The way it's sort of been characterised to me is a useful way to understand it is what we call "inside the school gate" versus "outside the school gate" expenditures. So that SRS issue looks only at really your core provision of we've got a teacher in front of the classroom, their salary and on costs are covered, all of your staff, basic upkeep and maintenance of the school, things of that nature. The outside the gate costs can be very significant. The big one there is infrastructure.

And we've got – there's huge on-costs with – you know, we're employing a teacher in a remote community. Let's say their salary is $100,000 and if you factor in the various other allowances and things on top of that, that goes up to probably $150,000. And then you're putting that person up in a house which needs to be built, which needs to be maintained.

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So the – just the – I know this government is trying to dramatically expand the provision of housing and, for the first time, to extend that housing to local recruits. So for the first time we'd see Aboriginal staff gain access to housing as a condition of their employment. And certainly, if you talk to people in the Territory, they'll tell you getting housing right is probably one of the most fundamental things we could do to alleviate the problems, associated health problems, et cetera, to do with overcrowding. There's a huge cost associated with building and maintaining that housing stock.

In addition to that, there are programs. There are targeted programs. So that government here funds universal access to preschool. It receives some money from the Commonwealth. I believe it overwhelmingly funds that component itself, because all the evidence shows us that it's very important that, particularly, disadvantaged children get early access to education. So it's 15 hours of guarantee preschool education per week for four year children at no cost to families.

And then we've got specific programs in remote communities, probably the most well known and well regarded would be the FAFT program. So it's a program that involves working with the parents of very young children aged zero to three, providing – then providing children with early access to educational facilities. It's run by a qualified teacher in concert with local Aboriginal staff. So that's a direct Commonwealth funded program. So they're the - all the sorted of deemed outside the gates expenses.

MS CHESTER: Yes.

MR RYAN: All the discussions I have with principals are, "Look we can't get by with just those inside the gate expenses", like we've got to do a lot of work on capacity building within our community, building links with various community bodies and agencies, other government agencies. So you've got to have enough capacity in those schools to do those things and do them over a period of time to get results.

MS CHESTER: And I guess that kind of raises the issue then, to what extent is HFE suited or well equipped to deal with the outside the school fence versus targeted and tailored programs which may be Commonwealth and Territory funding but are hypothecated for those particular programs and then can be subject to sort of evaluation. So when you've mentioned before about the cost of provision of schooling in the Northern Territory, you said that the CGC had changed their view on what their cost was and it's gone down recently?

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MR RYAN: Yes. Just I had a look at their – sorry, go on.

MS CHESTER: No, no. I'm assuming that – and it's a good distinction you made. It makes a lot of sense to me. So that's the sort of the inside the school gate. So the fiscal capacity of the Territory would need to sort of provide the basic – well, the average school policy adjusted for indigeneity and remoteness. But you're saying that you're not happy with how that cost index has moved for the – how it's been assessed for the NT recently?

MR RYAN: Well, it's just having a look at this CGC Report, and I've not read the report in full, but in the – its summary on page 14 of the Northern Territory it states that, "There's been a decline in population growth", but it also says "There's been declining relative costs in remote areas mainly in community health and education". So I'm not aware of what the assumption that sort of underpins that is.

I mean, I think the – one of the big issues is that in – and I know Barry Hansen here before who I've spoken extensively on this, and I've spoken with him, is that I think many of the assumptions around the actual cost of service delivery to remote communities tends to understate the true cost of providing a service to those communities. So there's nothing that I would see that would suggest that the real cost of providing those services in remote areas has declined. I mean, it might be just to do with assumptions around inflation and other things, but I - - -

MR COPPEL: The systemic facts (indistinct) from those specific concerns and even HFE is providing every jurisdiction the capacity to provide the same level of services and other jurisdictions and taking into account cost factors. Do you have views on how well the system is meeting that goal of Horizontal Fiscal Equalisation?

MR RYAN: Well, I think the – you know if you look at those key indicators in the Northern Territory, they're very poor. They're very poor compared to the rest of the country if we look at year 12 completion rates and things of that nature. The previous government took a view that that justified them engaging in quite deep cuts to our public education system.

You know, I believe they're now playing out in even worse outcomes, lower attendance, because these things take a while to filter through the system. And you know the point we made was there was not a mature discussion about whether things were done well or efficiently. They simply took an axe to it. And that certainly doesn't get better outcomes. What it leads to is what we're dealing with now, which is an overstretched and quite burnt out work force in many places, which doesn't have the capacity to build community partnerships and engage.

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You see, in these remote communities, what people are used to is "Here's the new set of white faces that have come in". And you know it takes actually quite a long period of time to build up trust, to build up relationships, for people to think, "Right, these people are authentic". I know this is a long way removed from what you've got to look at in terms of dollars and cents, but it's difficult to put a price tag on this kind of thing.

What we've stressed is the need for certainty. So whatever the final amounts are, you know, rapid changes – and this goes – if we suddenly received a large amount of additional funding, that would create its own chaos as well with lots of new people coming into our system, into our schools. What our schools most need, and this is what the whole Gonski thing was meant to resolve, was just certainty about funding into the future.

We end up with a lot of administrative chaos here because you get to - even to this time of year and a lot of things aren't resolved, a lot of funding's not resolved. There's a lot of uncertainty, a lot of anxiety for people knowing whether they have a job next year. And every year I've been in the Northern Territory, this is what I've seen. So what we'd like to see is certainty about what our funding would be in the future. And your comment earlier about not being – subjecting jurisdictions to rapid or dramatic changes is a critical one.

So with the Commonwealth funding, I think there's that issue that we might be looking at a reduction over a 10 year period, and I understand the governments in negotiations so that it's not a precipitous drop, but there's – it can be managed, because otherwise there's too much uncertainty for schools and knowing you know how many teachers can we afford to employ next year or the year after.

MS CHESTER: Well, we're trying to engage with state and territory jurisdictions on a transition path.

MR RYAN: Yes.

MS CHESTER: But it's a little difficult when people don't want any change to engage on how to implement that change.

MR RYAN: Well – yes.

MS CHESTER: We'll see how we go. I guess the other issue, and I think it is directly relevant to what we're doing here because, to some extent, when we're looking at the broader issue of indigeneity and how it's dealt with through HFE, well indigeneity and remoteness, not having that sort of

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accountability to which level of government's doing what and do you have funding certainty and do you have program evaluation, all those sort of things sort of bundle in together in terms of whether HFE is the right mechanism, because it does require states and territories to have autonomy on how the money is spent. But then there's a lack of accountability over who's funding it and who's responsible for it.

I think indigenous policies and programs there where we've done a little bit of work at the Commission is the one area we're really struggling with and, indeed, in our Overcoming Indigenous Disadvantage Report where we looked at things that are working well, we identified some case studies of programs that are working well and are changing outcomes in different communities or indigenous people in metro and regional areas. There weren't a lot that we could identify that had actually been evaluated. But then you hear stories of good programs being axed and bad programs that aren't evaluated, continuing to get funding.

And I just thought you might be interested in knowing that the government has actually announced that we will have a role in setting up an approach and a process and a framework for better evaluation on an ongoing basis, of indigenous policies and programs across Australia, which will get us into the area of education because, as you rightly point out, indeed when you look at our indicators on Overcoming Indigenous Disadvantages, it sort of connects the dots to housing and how that's linked to you know school attendance and health in communities. Education will be front and centre there.

So it is all kind of relevant to where we land in our final report on how we deal with indigeneity within HFE.

MR RYAN: Yes.

MS CHESTER: And there is a big link then to the issues that you're raising about outside the school gate for education. The other thing I just thought I might mention, because I think you'd be interested in it, we did a report and unfortunately we launched it at a time when there was some other political fiasco happening. It's called the Indigenous - - -

MR RYAN: They're happening all the time at the moment.

MS CHESTER: I know. I know. If we only released things when things like that weren't happening, we wouldn't release anything. But it's called Indigenous Primary School Educational Outcomes.

MR RYAN: Okay.

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MS CHESTER: IPSO, for short. And it was the first time where we got access to the Yirrkara data and we actually linked across every school in Australia NAPLAN results for years three, five and seven, against educational – against all school and student level characteristics that we had the data for. I think you'll find it really interesting reading, because it did attribution by geography, including right down in a granular sense for the Northern Territory in different regions in terms of what's happening with performance and what sort of attribution we've got the gap of education outcomes, because some of the indicators as you said, high school attendances are going up, but it's not translating across to economic participation and you know getting through university and all the rest of that and socioeconomics. So I think you'd be really interested in that.

But the one thing you'd be even more interested in, and it's something you might want to raise with the Territory Government – I know New South Wales is doing something – is we were able to identify outlier schools, so schools that when you correct for the student and school level characteristics are punching above their weight, the kids are doing better than they should.

MR RYAN: Yes.

MS CHESTER: And so one of our recommendations from that report was to say "Territory Government, you can go and identify those schools based on our analysis. Go lift the bonnet, see what they're doing that's different, and then see if it's something scalable". Anyway, I just thought I'd mention it while you were here because - - -

MR COPPEL: We can send you the link for that.

MS CHESTER: Yes. We'll - - -

MR RYAN: I would appreciate that, thank you.

MS CHESTER: Yes. Okay. Great. Well, Jarvis, thanks very much.

MR RYAN: Thank you.

MS CHESTER: Is there anything else you wanted to say?

MR RYAN: No. Look I think that about covers it. Thanks for your time.

MS CHESTER: No, thanks for coming along today.

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MR RYAN: Appreciate it.

MS CHESTER: Cheers. Okay. So we'll ask our next participant to come and join us, the Minerals Council NT and Bespoke Territory. A double act, I think. Drew Wagner and Paul Henderson? Okay. We do CPSU NT and ETU if they're here, Kay Densley and Dave Hayes? Okay. Time for a break, folks. We're going to take a 10 minute break. There's beautiful tea and coffee, I think, at the back. No food, we're being stingy. So we'll resume in 10 minutes. Thank you.

ADJOURNED **[1.45 pm]**

RESUMED **[1.50 pm]**

MS CHESTER: We might get underway then. I'd like to call our next participants to join us up at the table here. We might just actually – you got some clean glasses though before we do start? So we've got the Minerals Council NT and Bespoke Territory; is that right?

MR WAGNER: Okay. I didn't realise it was in tandem.

MS CHESTER: Sorry? That's both of you, isn't it?

MR WAGNER: No, we're both from the Minerals Council.

MR BARBER: No, both from the Minerals Council.

MS CHESTER: Okay. Well, Bespoke Territory is not here, so it doesn't matter. All right. Just Minerals Council NT then. Terrific. Thank you. So, gentlemen, if you wouldn't mind just stating your name and the organisation you represent for the purposes of the transcript recording. And then if you just want to some brief opening remarks and then we can get into a bit of a chat.

MR BARBER: Certainly, John Barber from the Minerals Council of Australia.

MR WAGNER: Drew Wagner from Minerals Council of Australia.

MR BARBER: Thank you. Well, on behalf of the Minerals Council, we'd like to thank the Productivity Commission for taking on this challenge.

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Certainly there have been many reviews into the GST distribution. Not always been successful, so we do thank you for taking on this body of work.

The GST distribution is an important pillar of Australian fiscal policy. It is one that provides funding for essential services in some states. But also it has become a source of great frustration for many others. In many ways, it is a fiscal policy that was intended to deliver equality and equity, but it is now derided for the perceived lack of fairness. Reform is required to the GST distribution and has been for some time.

As highlighted by the Minerals Council in its submission to the inquiry, these reforms must address both policy and practices of the GST distribution. The Minerals Council welcomes the Productivity Commission's acknowledgement of the policy issues with the GST distribution and agrees that more formal definitions are required to properly state the objective of the GST.

The core problem with the GST distribution is that many of the government agreements do not properly define what it is intended to achieve. The Minerals Council recommends that a definition of "fiscal equalisation" is required as a starting point for any further policy objectives for distributing the GST. The Minerals Council knows that the Productivity Commission's main recommendation for its review has recommended setting the objective for fiscal equalisation to be giving states a reasonable level of equity or fiscal capacity to deliver services.

The Minerals Council recommends that equity still remain the principle objective for fiscal equalisation. But also, we must recognise mutual obligations for states to achieve equity on their own. Perverse incentive structures in the GST distribution have rewarded the indolence of some states but punished states that have prioritised economic development. The Minerals Council recommends that the policy reforms must include addressing the incentive structures in the GST distribution. And, as with any fiscal program, the objective of the GST distribution should be to incentivise states to maximise their economic potential and properly address any areas of social disadvantage.

Reforms to the practices and methods used to asses the GST distribution are clearly needed. As is often noted, including by the PC, Australia has the most comprehensive system of fiscal equalisation in the world. But this often gives the false impression that we are already achieving full equalisation when we are not. The complexity of objectively assessing states revenue capacity and expenditures, means Australia still, at best, achieves only partial equalisation. A raft of reforms are needed to

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address this deficiency. But it is the focus of the Minerals Council to address issues around mining revenues today.

The problem with assessing state's mining revenue potential is well documented and acknowledged in the PC draft report. While some states claim to support mining and point to many of their mining policies as evidence, a true assessment of mineral revenue potential alludes the Grants Commission. This is because mining activity is the result of a combination of overlapping policies on land rights, environment management, energy and industrial relations.

Despite this uncertainty as to how to best analyse the complex methods of the interconnected policies, the Productivity Commission has recommended against the Mineral Councils discounting state – policy to discount state mining revenues in the assessment of the GST. The Minerals Council and the mining industry urge the Productivity Commission to reconsider this position.

A mining revenue discount offers an incentive for states to take greater responsibility for their own economic performance. It deals with the uncertainty in assessing state effort to support mining and addresses another area of policy non-neutrality, that is the policy choice as to what type of revenue a state could raise. As highlighted by the Minerals Council in its submission, not all state revenue is assessed in the GST distribution and large amounts still fall into the miscellaneous category known as "other revenue".

Other revenue has no impact on the GST distribution and states with lower proportions – assessed proportions of it in their budgets, typically received greater GST revenue. For example, whereas WA raises a large portion of its revenue from mining sources which is redistributed, New South Wales and the ACT raise large amounts of gambling revenues. This is not redistributed.

A mining revenue discount is a simple way to account for this policy choice and improve equalisation. The Productivity Commission reason for opposing the mining revenue discount, that is because it does not sit well with the broad objective of fiscal equalisation, is not justified when the bias of all the current partial equalisation methods are properly considered.

Furthermore, as noted by the Productivity Commission draft report, a new objective for fiscal equalisation is needed to fill the definitional voids we have. The one recommended by the PC, it should be noted, moves even further from the current assessment of equalisation than any mining revenue would.

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In closing, the Minerals Council supports all efforts to reform both the GST distribution policy and procedures. But we urge the reforms deliver incentives for states to grow and prosper together, rather than simply allocate funding in different and sometimes less equitable ways. The Minerals Council, like many others, support the idea that the GST reform needs to be considered in the context of all Federal/State financial relations and supports a broader review of the full system. Thank you.

MS CHESTER: Great. Thank you very much. I think we just had someone join the table, and for the purposes of the transcript, we need to know name and organisation. And I'm assuming it's Paul Henderson from Bespoke Territory?

MR HENDERSON: Yes, correct.

MS CHESTER: Okay. Because – sorry?

MR HENDERSON: Yes, I can sit back and you finish with these guys first.

MS CHESTER: I think that's a good idea.

MR HENDERSON: Yes.

MS CHESTER: Let's do that.

MR HENDERSON: Yes, sure.

MS CHESTER: Terrific. Thank you very much, Paul. And we're running a little ahead of schedule, so we'll have time to do that. So perhaps just going back to I guess the fundamental concern of the Minerals Council and, as you touched on it, in terms of the perverse incentives the current HFE system may be creating and imposing on decisions for development activity and in particular controversial development activity across states and territory jurisdictions, that was an area where we struggled at times to get a comprehensive evidence base.

So one of the things that would be helpful, if you can talk us though some of the examples that you're aware of in the NT or more broadly from your work with the Minerals Council, of - examples of where HFE has created those perverse incentives and where development activity hasn't gone ahead that would have otherwise have gone ahead.

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MR BARBER: Certainly. I think in terms of dealing with this question of the perverse incentives, it can't be analysed in terms of a narrow scope of a single project or in a short-term analysis. What needs to be considered is the suite of state mining policies that I've talked about.

What we tend to see is that the entirety of the HFE assessments system, which mining revenue is one of the large drivers of the GST distribution, is supporting several states to implement less than supportive mining policies, to turn their backs on mining or any form of resources development, because the efforts of a small number of states, namely Western Australian, the Northern Territory and Queensland, enables them to receive funding through the HFE system. They can prioritise greater environment amenity because they are receiving more funding than they otherwise would've through the HFE system.

There are many lower level methodology problems that the Commonwealth Grants Commission has, for example, in assessing mining revenue – mining policy neutrality. Our position is it's difficult to really assess the incentive structures of any single project going ahead or not going ahead, but rather that some states were allowed to have or do have that greater policy priority of environment amenity when they have the luxury of funding outcomes coming from the Federal Government via the HFE system.

We believe that allowing states to keep or not have as much revenue redistributed through the system, they would be required to take a greater role in their own economic development, not just through the funding that fiscal transfers, such as HFE, would provide but through the economic benefits the resources industry does deliver in terms of local jobs, regional development and even then, as a secondary consideration developing state royalty basis.

MS CHESTER: Okay. I guess in our report, we identified two streams, two key streams, of where we thought there might be – where the system's struggling with policy neutrality, so not impacting the incentives that states have to make more policy choices. So one stream was development activity, the other stream was state's approach to tax reform of the revenue bases. If we were to move to your form of partial equalisation, which is discounting mining revenues, how does that address the second stream of perverse disincentives?

MR BARBER: Well, if I could just add to that? We already have a system of partial equalisation. What our recommended discount to the mining revenue does is balance the playing field of that partial equalisation which doesn't address some of the other revenue sources. The Grants Commission

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have identified they can't find ways to assess properly or fully, that that is the bias in the current system that moves a lot of the dollars around in the GST.

But to go back to the point as well that are those sort of incentives restricting development of any form? No. There's no single project that has ever been knocked back because a state was concerned about the fiscal equalisation implications of getting more mining revenue. But we do believe certain states have been able to not meet the same standards of resource approval, because they have the luxury of greater transfers coming to them from the Federal Government.

MS CHESTER: Okay.

MR COPPEL: Is that something which is unique to natural resources? It's an issue that's been brought up in some of the hearings in other jurisdictions that other major projects - - -

MR BARBER: Yes.

MR COPPEL: But a lot of the emphasis is on natural resources and the mining discount would be (inaudible) of that.

MR BARBER: Very much so. Because I think the economic and even the revenue gains to states is far greater from a resources project. As was raised, I think, by several states in their submissions, there should be no difference between trying to promote a tourism or agricultural sector or manufacturing base.

But the evidence I think is clear that the mining sector generates far more revenue. If you look at those states with strong mining sectors, they tend to have the greatest payroll capacity. They do raise the mining royalties as well, whereas agriculture, for example, doesn't even attract land tax. The payroll taxes collected from the tourism sector are much lower.

There are far greater regional benefits to be had. But there also comes greater regional costs for the states who are trying to develop their resources sector. So that's probably one of the other reasons we support the mining revenue discount. The minerals industry supports the states that are making the effort to attract the investment from our sector, but they should be keeping a greater proportion of the benefits.

MS CHESTER: So just maybe if we can tease that a little bit further. So if, as you put it, a lot of the revenue raising capacity of certain states and territories, and WA being the outlier at the moment, is driven by what's

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under the ground, that then is a key driver of their fiscal capacity. So if HFE is about assessing relative fiscal capacity and equalising it, why would you take out of the equation one of the biggest drivers?

MR BARBER: Because for some states, even bigger proportions are taken out as well. If you considered the Grants Commission assessment of the ACT Government budget, nearly 60 per cent of their assessed revenue falls into the other revenue category and is not equalised. If you looked at the - - -

MS CHESTER: So doesn't it then just add – so I guess where I'm coming from is, as we called out in our report, it is not full equalisation at the moment for those reasons that there's – swings in roundabouts, things that are included already discounted where data problems – your answer to that is to take it further away from any chance of equalisation by taking mining royalties out?

MR BARBER: Well, again in terms of equalisation, it's already not occurring. As you've said, partial is already the norm. But there is bias in the policy choice between states of what sort of revenues they raise and how that is then handled in the current system because there is no way of – as the Grants Commission acknowledge, properly identifying the assessment of gambling revenues, of user charges, or returns on assets, financial assets that is. To level the playing field and measure that or at least bring about a solution to some of those non-neutralities of policy sort of choices there, we do recommend that mining revenue needs to be discounted.

MS CHESTER: Okay. So the CGC in trying to – so I guess there's two issues. So firstly, there's the overall balancing act between equalisation.

MR BARBER: Yes?

MS CHESTER: And the subsidiary principle of policy neutrality. And the way that we kind of viewed it in our draft report, because you have such an outlier state at the moment, the degree of equalisation within the GST redistribution is increased so much that the first disincentives are greater. So one way of suppressing that, getting a little bit of a trade off into the system, is to stop equalising to the highest state because that makes the equalisation task greater.

MR BARBER: Well, if I could go back to one statement there, that we have a state that is an outlier? One of the main reasons they are such a strong outlier is they have the lowest proportion of state government revenue falling into the other revenue category that's not equalised. Only 30 per cent of WA's own source revenue, as assessed by the Grants

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Commission, falls into the other revenue category, whereas the ACT is about 60, South Australia 45 about, Tasmania 45 as well. The different proportions of state revenue being equalised are driving a very strong bias in the system towards the states that do have high proportions of their revenue that is assessed.

MS CHESTER: Okay. But if we're looking at trying to get the trade-off between equalisation and policy neutrality and within the GST pool at the moment, what is – of the equalisation task and I think we can agree to agree that it's not full equalisation for them as you've outlined – is greater when you're equalising to the highest. If you then reduce that equalisation task by taking it say to an average or to the second highest, you do improve those incentives.

MR BARBER: Not so much because they would still be based on a flawed method. They would still be using the same flawed methods to deliver the equalised level of equalisation, whether it's to an extent of full equalisation as we're aiming for, for the equalisation of the strong state say with the highest fiscal capacity or whether it's the state with the second highest fiscal capacity, that level would still be mis-measured.

MS CHESTER: Okay. So you're saying because everything's not included at the moment and we're not getting full equalisation, we should depart further from partial equalisation to less partial – to more partial equalisation by taking mining royalties out altogether?

MR BARBER: Not taking them out altogether. We do recognise as a source of – a large source of state income. It does need a partial equalisation on that front. Our position is that to actually acknowledge the different policy choices of various state governments. And, as acknowledged in the Productivity Commission Report, there are problems with measuring state new policy neutrality when it comes to mining, not just on the individual mining policy of land access, but on the environmental, on the energy, on the industrial relation side. We do think that states are given revenue that they are not bound to reciprocate in the development of their own resources for in that regard.

MR COPPEL: Does that number of a 50 per cent discount come from – yes, what's the - - -

MR BARBER: Well, we've recommended 25 per cent as an effect of – we do recognise the severity of the impact of discounting mining revenue. We don't want to see a move away from states having sufficient resources to still deliver equitable outcomes. We, however, assess that the level of equity we're aiming for right now is not being appropriately assessed

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because not all states are having all of their revenue. And those policy choices are affecting how much GST they are receiving. And it's not just in Western Australia for the mining revenue. Look at the three states with the lowest proportion of assessed other revenue. In order it's Western Australia, New South Wales, Victoria, who are all of the states that are – well, some refer to as the "donor states" in the system.

MS CHESTER: So what would be the impact on the NT of that proposed change?

MR BARBER: The Northern Territory, as assessed by the mining revenue assessment is losing GST revenue. So the Northern Territory, under our system, would gain additional revenue.

MS CHESTER: And what quantum would that be? What would happen to their relativity?

MR BARBER: I mean, it would not be large. Based on current data, you'd be seeing our estimates, I think, in the Northern Territory getting approximately in the order of $20 million, 20 or $30 million.

MS CHESTER: Annually?

MR BARBER: Annually.

MS CHESTER: Okay. And it's because it's taken out, of course. All right.

MR BARBER: Sorry, if I've misquoted that. I'd have to double check in our submission where we ran those estimates.

MS CHESTER: Okay. Then so going back to the earlier question I asked, I'm not sure – and maybe I missed it in your answer. So we had the two streams of policy neutrality concerns, one around development and the other one around state based and territory based tax reform where we had some cameos which show what happens to relativities if states dare greatly and do such reform. Doing your further partial equalisation through the mining royalties, how would that address that efficiency problem?

MR BARBER: In the second aspect of your question there?

MS CHESTER: Yes.

MR BARBER: Well, I guess directly it wouldn't. It's not going to be a key driver in helping states move from inefficient stamp duties towards land

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tax. But I think it needs to be acknowledged that in that policy space with respect to certain commodities, there is opportunity to gain in the system, that if certain states decided to reform their – and I think it is acknowledged in your draft report, that if West Australia were to change its royalty system, it could effectively reduce the GST or change the GST being received to the other states just by the size of its dominance of Australia's iron ore production. So it wouldn't have much impact on say Tasmania's decision to distinguish between stamp duty or land tax or to conduct payroll reform.

But in the case of mining royalties, we believe the incentive effect, so following through, that the economic development can come from states having to prioritise economic development, perhaps open themselves up to greater resources investment, the royalties would be of large benefit of those states individually.

MS CHESTER: Yes. So you can see why we're approaching it in a different way than you are, in terms of we're trying to address all the perverse incentives that created in the system, not just one stream of them.

MR BARBER: Well, not really, because your system is still not recommending a change to the methods that are delivering the perverse outcome. It's just muting the effects on certain states.

MS CHESTER: So it does - - -

MR BARBER: The methods to assess GST are not changing.

MS CHESTER: It does significantly reduce the disincentive effect by reducing the equalisation task though.

MR BARBER: But still based on a biased method. The methods to assess the GST distribution would not have changed, just an after assessment event decision to equalise to say the second state, rather than the first.

MS CHESTER: Well, we can all agree that it's not a full on comprehensive equalisation based on what's in and what's out at the moment. But that given, reducing the equalisation task within the GST pool, so having a greater element of EPC does improve those incentives at the margin for both streams.

MR BARBER: Well, not really. It's really just trying to minimise the symptom rather than address the core problem of why there is bias and only partial equalisation on some fronts anyway.

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MS CHESTER: So if we were to extend your logic then, shouldn't we be improving the flawed base and making sure that it is full equalisation and then we could talk about what the reasonable objective is.

MR BARBER: Correct. But that would be another alternative. Personally, I'm not sure if the full spectrum of how a meaningful tax base could be implemented for the user charges, the gambling revenue. The Grants Commission has, I understand, considered those issues at length over time. You do mention in your report the global revenue assessment, something being worthy of further consideration. I do believe that is one way to proceed.

MR COPPEL: One of the suggestions that the CGC has put on the table for its 2020 review is similar to what you're advocating for, which is a 50 per cent discount for additional revenue on changes to the royalty tax rate.

MR BARBER: Well, with respect, it's not what we're talking about.

MR COPPEL: No, but - - -

MR BARBER: It's a very different concept. It again acknowledges there is a policy with policy neutrality but is only willing to acknowledge the symptom of any further increases in royalties which still doesn't change the other proportion of existing royalties which is still going to be subjected to the full equalisation assessment methods.

MR COPPEL: So your view on that would be that it would be certainly inferior to a discount - - -

MR BARBER: Correct. It is again dealing with a symptom, not trying to address the underlying problem of how to assess mining royalties.

MR COPPEL: They both deal with a symptom.

MR BARBER: Well, no, the mining revenue discount we're proposing will be addressing all mining revenue, not just revenue that's then additional. The discount deal with policy or data uncertainty is an established method by the Grants Commission. We're recommending that it apply to an area policy uncertainty which everyone has acknowledged in most reports and even the Grants Commission has acknowledged but still not come up with an appropriate system to deal with.

MR COPPEL: Do you have any views on the other aspect of the GCG discussion paper relating to gas, coal seam gas?

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MR BARBER: Being the Minerals Council, we have focussed on the hard rock minerals. Of course, we have opinions on many elements of fiscal or other resources. But for the purposes of today, we'll just keep it to the hard rock resources.

MS CHESTER: Okay. So from the Minerals Council NT perspective, in terms of the perverse disincentives, which are kind of the symptoms of the system not getting the trade-off right between equality and policy neutrality, did you agree or disagree with our report sort of characterising it as there is the two streams, there's development activity and tax reform?

MR BARBER: Sorry. By "development activity" do you mean broader economic or just within the mining sector there? I'm not sure to what you're referring.

MS CHESTER: Well, any controversial development activity. At the moment we're focussing on the mining industry because they're the current contemporary examples, but it could be anything in the future, who knows.

MR WAGNER: "Controversial" is a very interesting concept up here in regards to when you're looking at the mining sector versus a number of other sectors operating at this point in time as well. It would be hard pressed to look at "controversy" as far as it being a financial decision in regards to revenue streams and royalties when, in actual fact, the predominant system being utilised at this time is probably more on approvals or environmental systems being utilised to identify what a controversial project is rather than a financial controversial project is.

MS CHESTER: Okay. So I think that kind of addresses part of my question. But where we identified problems around the incentives at state and territory space around reforming their revenue bases have had a lot more tax policies in place. That was another – so you're talking about addressing the symptoms of the problem. The symptom that you're focussing on is the incentives that are created for some states to not dare greatly and do development activities and be supported by other states and territories that do dare greatly and do those things. So that's one of the symptoms.

The other symptom that we did a lot of cameo analysis around was around what incentive states based have optimal tax bases and optimal tax policies. So I just didn't know if the Minerals Council had a position on that. You don't have to.

MR BARBER: No, we don't.

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MS CHESTER: Okay. That covers all the questions we had, gentlemen. Is there anything else you wanted to say?

MR BARBER: Great.

MR WAGNER: No. Look, more than happy to provide the information at a later date if there's any more NT specifics or industry water(?) specifics that the Commission would like. We're more than happy to have direct contact.

MS CHESTER: Great. Thank you very much.

MR BARBER: Thank you. And good luck with any reforms.

MS CHESTER: Okay. Well it's very easy for me to ask our next participant to join us at the table. It's just a shift across, from Bespoke Territory. So welcome. And just once you've had a chance to settle in, if you wouldn't mind just stating your name and organisation for the purposes of the transcript recording so we've got voice recognition happening. And then if you wouldn't mind making some brief opening remarks and the debater's bell goes at five minutes.

MR HENDERSON: No worries. Well I'll be very quiet in coming in (indistinct) myself. And it's nice to meet you.

MS CHESTER: Thank you.

MR HENDERSON: Thank you very much for coming to the Northern Territory.

MR COPPEL: Thank you.

MR HENDERSON: It's great that you've made the time. Paul Henderson, managing partner of Bespoke Territory. But I'm really presenting here today as the former Chief Minister of the Northern Territory from 2007 to 2012, and also I was a senior Minister in the first two Clare Martin Governments from 2001 till I became Chief Minister until 2007.

So my contribution today is not going to be a very technical contribution. It will be through the prism of being at every Cabinet meeting for 11 years on a weekly basis bar the Christmas break, being at every COAG meeting for five years through you know extraordinary reform, and through the prism and the challenges of the Northern Territory as it is a completely different jurisdiction to all other jurisdictions. And the

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challenges of any government here in the Northern Territory to be able to pursue - and I go to the Terms of Reference here, "The inquiry consider and influence the current system has on productivity, efficiency and economic growth" - so enormous challenge for the Northern Territory to diversify and deepen our economy "the incentives for the states to undertake fiscal reforms that improve the operation of their own jurisdictions, and the states' abilities to prepare and deliver annual budgets".

So the challenges for this in the Territory are extraordinarily complex. I think your draft report does acknowledge – and I don't have it in front of me, so I apologise if I've taken - the words aren't quite right - but acknowledges that the current system of HFE has served Australia well and is seen as a bench mark for equalisation. And I absolutely understand the political challenges of the West Australian and Commonwealth Governments in terms of dealing with the issues that state has in terms of the current methodology and how it serves them.

I'd just like to put some real issues here in context, in regards to the Territory's difference. So our indigenous population in the Northern Territory, as of 30 June 2016, was 74 and a-half thousand people, 30 per cent of the Territory's population, which presents a range of challenges that no other jurisdiction has to deal with. Based on the 2016 census, the vast majority of that 30 per cent, so 79.3 per cent, 80 per cent, of our Aboriginal population reside in remote and very remote areas. And of that population, the vast majority of people have English as a second or third language. And so the challenges of providing services that are at an equal level of other jurisdictions, is extraordinarily challenging in a range of contexts.

Also, when the Territory achieved self-government in 1978, there was an extraordinary deficit, I suppose, in remote and regional parts of the Northern Territory in terms of infrastructure, in terms of housing, in terms of education facilities, in terms of health facilities, that you know the Territory has struggled to upgrade since self-government. And you know the current system recognises the challenges in terms of service delivery and we're compensated for that through the equalisation formulas. But it really doesn't tackle the infrastructure deficit that the Territory inherited at self-government.

I'd just like to go to a couple of examples of the extent of the disadvantage here in the Northern Territory. And I see we've got the AMA who will talk about health. But if we just talk about housing, for example, again based on the 2016 census, 69 and a-half per cent of all social housing and dwellings in the Territory are occupied by Aboriginal households. Nationally it's 16.3 per cent. And in terms of the proportion of social housing dwellings occupied by Aboriginal households in the Territory

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combined with the relatively high number of people per dwellings, the vast majority of social housing temps, in the Territory, Aboriginal people at 85.3 per cent.

If you then look at the backlog in regards to housing infrastructure in the bush, again in 1978 when the Territory achieved self-government, one of the things the Territory didn't take on board was the responsibility for remote community housing. At the time, there was something like 73 remote community government councils. There were 73 – I think it was 73, I'll correct if I'm wrong – housing trusts that the Commonwealth allocated funding to. And there was very little in terms of additional capital investment over time. So we had extraordinary overcrowding in housing.

It wasn't until a bilateral agreement between the Territory and the Commonwealth in 2008 where finally the Commonwealth set up, with an National Partnership Agreement on Remote Housing, I think it was 1.3 billion over 10 years. And it was then the first time that the Territory Government committed funding from unsourced revenue to support a massive housing program in the bush. That was a significant policy reform. It was combined with, around the same time, significant local government reform where 73 remote community councils were collapsed into 12 regional councils.

And at the time, the agreement with the Commonwealth was as the housing stock was built or upgraded to Territory housing standard, the Territory would then own those assets by Territory Housing. But there's still an enormous deficit out there of houses that haven't been brought up to standard that is still the liability and responsibility of the Commonwealth and the reform agenda continues in a very complex way to address that backlog, outside of the HFE equalisation system.

I just give you some numbers, because it is quite extraordinary. Around 34 and a-half thousand remote community residents live in 4600 homes, an average of around eight people per household. The Territory's population is predicted to grow at 1.6 per cent. This will see the number of bedrooms needed – required to bring our housing up to a national occupancy standard, additional rooms at the moment - today, 34 and a-half thousand. With population growth projections between now and 2028 we'll see that number grow to 42 and a-half thousand new rooms. At the current cost estimates for building those rooms, the deficit in terms of our housing infrastructure is between 2.2 and $2.9 billion dollars.

So again the Territory really struggles in terms of understanding all the determinants of people's condition in terms of being able to participate in education, to live healthy outcomes, all of the issues in terms of health

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service delivery, education service delivery, that is equalised to enable the Territory to try and provide those services. In terms of outcomes for Aboriginal people, unless housing issues can be dealt with, from a policy objective, doesn't meet any outcomes that we're trying to achieve.

I'll just go to education as well, because this is something I'm particularly passionate about.

MS CHESTER: Paul, I might just – I'm very conscious of time.

MR HENDERSON: Time.

MS CHESTER: And we're well past the five minutes already.

MR HENDERSON: Right.

MS CHESTER: But if there's anything that you wanted to draw our attention to that's directly relevant to sort of the HFE inquiry that would be helpful.

MR HENDERSON: Yes, all right.

MS CHESTER: If not, we might get into some questions, if that's okay.

MR HENDERSON: Okay. Just very quickly, it is relevant to the HFE Inquiry, is the ability for the Territory to actually improve outcomes for Territorians who live in remote communities, and we are equalised to that effect. I'll just show you one slide and this is from the Closing Gap Report 2017. That actually talks to the NAPLAN measures are on track, not on track by State/Territory 2016. So this is for students for reading and numeracy years 3 to years 9. And there's a table, and I'll table this for the Commission, that shows that the Northern Territory in indigenous remote areas isn't on track for any of them.

So in terms of any changes to the current formula that provides some level of certainty and the principle of an equity in terms of service delivery, for that to be watered down in any way will materially impact on the Northern Territory Government's ability to actually provide the services to remote Territorians and to enable all levels of government and community to work together to close that gap on indigenous disadvantage. The challenge for the Territory is unlike anywhere else and the formula has provided some stability. Any reduction in that formula that will reduce the equalisation measure for the Territory, will be felt first and foremost by the people who can least afford to see a reduction in service delivery in the Northern Territory.

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MS CHESTER: Okay. Great. Thank you very much, Paul. And thanks for being so succinct there. Just before we get into some questions so we can get a better insight into your thinking around HFE and the issues that we're sort of grappling in this inquiry, and more just for the transcript record, so today you're representing Bespoke Territory?

MR HENDERSON: I'm not representing. I'm here as a former Chief Minister - - -

MS CHESTER: Okay. All right, cool.

MR HENDERSON: - - - of the Northern Territory.

MS CHESTER: No, no. I just wanted to make sure.

MR HENDERSON: Yes.

MS CHESTER: All right. Well, I guess just kicking off from your opening remarks of all those Cabinet meetings that you've sat in on, to what extent did HFE and the GST relativities figure in any of those sort of discussions and deliberations around policy decisions?

MR HENDERSON: Well, it was understood that the importance, the absolute criticality of the Grants Commission Relativities Review that occurs every four years, in terms of looking at the relativities - - -

MS CHESTER: They do a methodology review every five years.

MR HENDERSON: Every five years. So an absolutely critical understanding of the importance of that and of the Northern Territory being able to demonstrate the challenges of providing an equal level of service in regards to health education, law and order services, to people who live in the remote parts of the Northern Territory, and the absolute sort of priority that the Treasury had in terms of demonstrating to the Grants Commission the challenges and maximising the equalisation effort out of those reviews.

They were critically important in the same way as the census review that's conducted were – is critically important, because so much of the formula is applied in terms of on a population basis. And actually understanding who's living out in the bush and being able to capture people in those census counts was a very real challenge. So an absolute understanding of the criticality of maximising that equalisation share through those reviews.

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MS CHESTER: And when Cabinet was looking at any issues like how you might frame policies or go about the Territory Government supporting particular development activities, be it mining or anything, did – the impact that that might have on the GST relativities, did that ever figure in those deliberations?

MR HENDERSON: Absolutely not. And I find that like a really bizarre suggestion that's been sort of put forward by various you know interests in this whole debate. Never once in my time, was "We shouldn't be doing this because that's going to impact on relativities and allocations from the Commonwealth". You know, for five years I was at COAG, there was never any assertion by anybody at those COAG meetings that some of the states were laggards and gaming the system to maximise you know their share or to minimise making hard decisions around you know environmental issues. So from where I sat, you know I think that's a pretty spurious argument that's run by vested interests. It wasn't my experience.

MS CHESTER: Okay. Because I guess there's kind of two streams to it, the one stream that we touched on just with the participants that were at the table just before yourself.

MR HENDERSON: Yes.

MS CHESTER: But in terms of - - -

MR HENDERSON: I'll get in trouble from Drew for saying that.

MS CHESTER: - - - states having incentives to sort of dare greatly and do you know like coal seam gas in the southern states and things like that where it doesn't – they benefit from the GST relativities in terms of other states that dare greatly with development activity where they don't.

MR HENDERSON: Look, I think the whole issue around coal seam gas, and you know we've got the issue here in the Territory where the moratorium on fracking is - it's entirely political. It's got nothing to do with budgets. It's a completely political issue whereby you know politicians and governments are under enormous pressure from well organised, well financed MGOs who campaign against the resources industry. So I see those issues as political issues, not as issues that the states are trying to turn to their advantage to game the system. They're purely political, as far as I'm - would say.

MS CHESTER: Let's go to the heart of HFE which is equality and equity. And I guess there is an important distinction to be made between equality and equity. I guess we've heard earlier today, the Yothu Yindi Foundation,

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around where there's a bit of a disconnect between the way equity is viewed, because the way the HFE doesn't – and I'm telling you what you already – this is your bread and butter of past.

MR HENDERSON: Yes.

MS CHESTER: But it's about equalising the fiscal capacity of the state or territory jurisdiction because we have state and territory autonomy in how the GST dollars are spent. You can see that there's a situation of, at time, a disconnect between what are the assessed expenses that the CGC derives for a state or territory, and then what's – and that's the basis of getting their GST relativities, versus what the actual expenses are and in particular in the area around indigenous communities and particularly the welfare community spend where there is a disparity between what's the assessed expenses for the NT and what the NT Government historically has actually spent.

MR HENDERSON: I'm well versed for this argument and disagree on so many levels. So I understand the presentation that you've just received because I live through this politically. So when this assertion was first made, probably back in around 2008/2009, the Territory Government of the day under myself as Chief Minister, we commissioned the Northern Territory's Auditor-General to look at those assertions and allegations and report their findings. That report came down and actually showed the Territory Government spent more on the indigenous population than it what it received through the equalisation measures. I think the Northern Territory Auditor-General reported twice during my period.

The issue was raised at COAG. There was a COAG process that actually looked at indigenous expenditure through those allegations across all jurisdictions during the time that Kevin Rudd was Prime Minister. And I'm not if it was the Productivity Commission who actually did that particular piece of work, but that again showed that the Northern Territory Government spent, I think my memory was in - you know 53 per cent of its budget on 30 per cent of the population and that was greater than the equalised share.

So the assertion being run is that you know X amount is allocated for welfare services that's explicitly what you need to spend things on, would essentially mean that the Territory Government would have very little discretion to make priority decisions around where funding needs to be spent. So I think if - people can use the welfare line, but I think if you look at health expenditure, you'll see the actual health expenditure is way in excess of what's been equalised out because of the complexities and challenges and the realities of delivering health services.

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So when you're sitting around a Cabinet table, you've actually got to make the decisions that are in the best interests of the Territory on a whole range of policy parameters and requirements. And the Territory Governments have decided that you know the health crisis in terms of renal disease means that we've got to accelerate the amount of remote dialysis clinics ahead of where we forecast that three years ago, then that's the decision you make and the money's got to come from somewhere.

So overall the Territory, I'm very confident in saying, has proven we spend in excess of what's been the equalised share for – to deal with indigenous disadvantage. It doesn't just neatly fall in the slots that people would want it to fall into. If you just wanted it to put them in the slots well you'd run the whole show from Canberra. And I don't think that's the way we want to go in terms of accountability for government service delivery.

MR COPPEL: Are those reports you mentioned from the Auditor-General in the public domain?

MR HENDERSON: Yes. Yes. They were all tabled in the Territory Parliament and I'm sure if you go back through the COAG Secretariat, they're all public domain documents. I'm sure our Treasury people can deliver them to you.

MR COPPEL: Yes. Thank you.

MS CHESTER: And Paul is that looking more broadly or was it just in terms of assessed expenses and actual expenses for the NT through the HFE lens or was it more broader than that?

MR HENDERSON: Look I can't recall the explicit Terms of Reference but they're be there.

MS CHESTER: Okay.

MR HENDERSON: It was an extraordinary political problem for me. If you go back and look at the politics of the – here, you know we had four indigenous sort of members of our Parliamentary team, and we had people who split and made all sorts of allegations based on this information. As the Chief Minister, I wanted to know if there was any veracity in this, because I know that for 11 – you know for all those years previously, and every Cabinet meeting dealt with the indigenous disadvantage, remote communities, what could we do policy-wise, budget-wise to improve outcomes, where we could find the money from. This notion that somehow

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you know the Territory was – written off Aboriginal people in remote communities to fund wave pools in Darwin, was completely offensive.

MS CHESTER: It's just kind of when you just – and you're right, it's difficult to unbundle and we're relying a little bit on the work that was done by Neil Warren of UNSW who's looked at this more closely, at the CGC data and from its perspective indigeneity.

MR HENDERSON: Yes, yes.

MS CHESTER: And I think he'd sort of respectfully agree to disagree with you.

MR HENDERSON: Yes.

MS CHESTER: But I suspect he's just looked at the HFE part of the equation, not more broadly. But even if you just look at the HFE over the past six years, and this is based on CGC data and calculations, welfare is the area where – so on the whole you're right, the NT is 1.04. So your assessed expenses and your actual expenses, you're about 100 per cent on.

MR HENDERSON: Yes.

MS CHESTER: But when you unbundle that, the one that's really underspend, compared to assessed, and appreciate state and territory autonomy, is welfare.

MR HENDERSON: Yes.

MS CHESTER: And that's you know basically 67 cents in the dollar over last six years.

MR HENDERSON: Yes.

MS CHESTER: And I'm assuming that would largely be - welfare spend would largely in the NT be indigenous population concentrated spend, is that right?

MR HENDERSON: Look I'd be really interested. It's a while now. I've been out of the business for five years.

MS CHESTER: Yes.

MR HENDERSON: So understanding in that category of "welfare" what we're actually talking about here, because "welfare" in terms of

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unemployment benefits and a whole heap of stuff is a Commonwealth (indistinct).

MS CHESTER: No, no, no. This is purely assessed expenses for Territory expenses.

MR HENDERSON: Yes, I get that.

MS CHESTER: Yes.

MR HENDERSON: But I don't know what is in the bundle of "welfare". So are we talking about housing? Are we talking about transport? Are we - - -

MS CHESTER: No, no. That's all separate.

MR HENDERSON: Yes.

MS CHESTER: So the bundles that the CGC looks at are the high level ones, the schools, education, post-secondary education, health, housing, welfare, service to communities, roads and transport.

MR HENDERSON: Yes. So I don't know what's in that bundle of "welfare". It's just a word. Like what services are they talking about in that bundle?

MS CHESTER: Okay. Well, I think that's what the Neil Warren analysis has done.

MR HENDERSON: Yes. All I do know - - -

MS CHESTER: But maybe if we get back to – sorry?

MR HENDERSON: All I do know is that this issue was scrutinised to an nth degree. Like my government wanted to get to the bottom of it. And it was certainly an issue at COAG and it was a very thorough COAG process that basically said that you know the Territory spent more than it was allocated for and there was no criticism through that process of how the Territory was spending that money or acquitting that money that was equalised to it for indigenous disadvantage.

MS CHESTER: Yes.

MR HENDERSON: And it was a very thorough process and all those documents are on the public record.

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MS CHESTER: Okay. So I guess if we look then more broadly, and touching on what you said before around some accountability, good to get your thoughts on where we landed on indigeneity in our draft report. A lot of folk have suggested taking indigeneity out of HFE. That's not where we landed.

MR HENDERSON: No.

MS CHESTER: We had a more longer term reform process in mind around indigeneity as it relates to HFE and more broadly with Commonwealth/State/Federal relations. So it'd be good to get – fiscal relations. So it'd be good to get your thoughts on where we landed there and whether we're heading in the right direction or not.

MR HENDERSON: If I can take it up another level, because I've done a fair amount of thinking about this sort of life post-politics and it's about the architecture that we use to actually improve indigenous outcomes. So I think at the high level, everybody agrees, Aboriginal people, the nation seems to have locked in on the closing the gap targets, so the right targets that we should be striving for. And addressing those targets is a standing item on the COAG agenda and there's a whole heap of policy reform around that.

I think what we need to do is to basically take those targets and, rather than having a top down sort of national and state approach in terms of what are we doing to improve education outcomes, health outcomes, housing outcomes, employment outcomes, we need to take that down to a place base level and actually understand in the Northern Territory, in Manangrida and Papunya and Walker River where those communities sit against those outcomes, and then having a real process to engage with those communities and some flexibility in terms of allocation of expenditure in terms of what is the community going to do with all levels of government to work towards improving those outcomes and those closing the gap targets, because at the moment I think it's too much of a top down approach. And my assessment is that out in communities there's no real understanding of that.

The thing that continues to challenge me that I wanted to talk about is the very poor attendance rates in remote indigenous schools, and the fact that until we have Aboriginal kids leaving our education system with the same abilities and outcomes as non-indigenous kids you know from a Grants Commission and government process, we will continue to see bad outcomes.

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And so challenging communities at a community base level, you know "What are we going to do to improve education outcomes? What are we going to do to improve health outcomes"? There's enough expenditure in – apart from infrastructure going in by way of service delivery. But unless we can actually get a real conversation going on the ground where people are actually owning the challenges with government of improving outcomes, I think we're going to continue to play around the edges.

So for me, it's about getting the architecture right. We could always do with more money. We certainly need a lot more money in terms of the deficit in infrastructure. I'll give you one example about education. From 1978 at self-government through till around 2003 or 3 in the Northern Territory, education was provided to a year seven level in remote communities. To get to a high school education, people had to come into town or go interstate. And guess what, very few people did that.

So it wasn't until 2002 that the Territory Government stepped up to the plate and actually started delivering a year 12 you know high school curriculum out in communities. And it wasn't until I think around 2006/7, that we had the first student actually graduate from the remote community with a year 12 outcome. And that's the deficit that we have. So top down has got us so far. But I think in terms of architecture, unless we can engage communities in terms of lifting communities, we'll be fiddling on the edges, is my assessment.

MR COPPEL: In our report, we make a number of recommendations that relate to the role that can be played by the CGC in terms of explaining the outcome of the HFE process to improve public understanding. We also talk about making the data that the CGC uses available in the public domain. Do you have any views on those recommendations, those draft recommendations?

MR HENDERSON: Look I think, per se, transparency is good. And an understanding of a system that has served Australia very well and it's an egalitarian society, is something that you know should be celebrated. But most Australians know zero of - and even sort of practitioners like me, the technicality of those assessments and what have, I leave to Treasury officials to work that out. So any transparency in terms of how those decisions are made, has got to be a good thing, more broadly.

MS CHESTER: Okay. Just one other thing, but totally just not relevant to this inquiry, but what you might be interested in. So you'd be very familiar with our Overcoming Indigenous Disadvantage Report.

MR HENDERSON: Yes.

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MS CHESTER: And a lot of the things you said about "place base" and "local engagement", they're critical sets of factors that we point to in those reports.

MR HENDERSON: Yes.

MS CHESTER: But given your interest around education, there's a report that we did that was actually quite ground breaking. It's the first time that we actually looked at – we looked at current data on NAPLAN results for all students across Australia and did – looked at it non-indigenous versus indigenous and did analysis around school and student level characteristics.

MR HENDERSON: Yes.

MS CHESTER: To get a better understanding of what's the attribution for the educational gap at the moment and what's driving it. And indeed we identified some positive outlier schools, so schools that are performing, getting better at educational outcomes for indigenous students that they would otherwise get when you corrected for all the sort of student school characteristics.

MR HENDERSON: Yes.

MS CHESTER: So we'll get you a link to that one.

MR HENDERSON: Yes. Yes, I'd really - - -

MS CHESTER: I thought you'd be interested in it.

MR HENDERSON: I'd really be interested and I can give you some feedback. There's some other thinking that I've done, but we don't have time today. But until those issues are addressed you know – I was saying to somebody today, I'd like to look down in 100, 200 and 500 years' time and see what's changed, and I hope a lot will change. But the pace of change at the moment is glacial.

MS CHESTER: No. And for those sort of fundamental reform issues that you're talking about accountability and the whole architecture around indigenous policies and programs, is the reason why we struggle with the recommendations to take it out of HFE.

MR HENDERSON: Yes.

MS CHESTER: Taking indigeneity out.

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MR HENDERSON: Well, I support you in that.

MS CHESTER: But that's where we landed in our draft submission.

MR HENDERSON: I support you in that.

MS CHESTER: Good. All right. Well thank you very much for your time this afternoon, Paul.

MR COPPEL: Yes, thank you.

MR HENDERSON: Thank you.

MR COPPEL: Thank you.

MS CHESTER: All right. We'll ask our next participants to join us and, if I'm correct, it's the CPSU Northern Territory and ETU.

MR HENDERSON: Good luck with it.

MS CHESTER: Thanks very much, Paul.

MR COPPEL: Thank you.

MS CHESTER: Thanks for your time. Just while we're waiting, can I just check our next participant is here from AMA?

MR PARKER: AMA, yes.

MS CHESTER: Good. Okay. We'll get to you next then. Trying to do the day job outside as well, I can see.

MR HAYES: You wouldn't believe today.

MS CHESTER: Well, welcome. If you just wouldn't mind – we might just ask people to quieten down a bit so we can hear the participants. Thank you. Thanks, Jonathan. Welcome. And if you wouldn't mind just stating for the purpose of the transcript recording, the name and the organisation. You name and the organisation that you represent, and then if you'd like to make some brief opening remarks.

MS DENSLEY: Yes, sure. My name's Kay Densley. I'm the NT Secretary of the CPSU, Community and Public Sector Union. Did you want?

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MS CHESTER: Yes, please.

MR HAYES: Yes. And Dave Hayes, Northern Territory Organiser for the Electrical Trades Union.

MS CHESTER: Thank you. Did you have some opening marks to us, Kay?

MS DENSLEY: Certainly, yes. So it's great to have the opportunity here to be in Darwin. So we're very happy that you're here. So the CPSU in the Northern Territory represents over 2 and a-half thousand public servants, both in the Australian public service and in the Northern Territory Public Service. So our members do very important jobs, servicing the population in the Northern Territory from child protection to rangers to pretty much everything that people need.

Some of the things I guess the potential of an additional cut to the GST – and we note – and we have noted in our submissions that we already copped a cut and that's a projection that is going to really affect the finances of the Northern Territory and hence the services that can be provided to Territorians.

So we've had four years of fairly chaotic, if not hilarious, government up here where a lot of decisions were made. And I think one of the problems with our public service and trying to provide services is the change of governments and the different agendas that they have and the different priorities that they have, which can have an affect on the services that are delivered.

With the Australian Public Service for example, and we have noted in our submissions that since 2013 there's been 504 Australian public service jobs cut in the Northern Territory. So whilst Ministers are – and the government is actually looking into more regionalisation of Australian Public Services jobs, that's not happening in the Territory. In the last Federal budget, for example, we lost 12 staff in the Australian Electoral Commission just in – basically in the budget cuts. We don't have a tax office up here anymore. So you have to go to Centrelink and talk to someone who's trained in tax, sort of, to be able to do that. So you can't even go face to face.

And the issues that we have up here of course, is you know the many different cultures and the many different languages, especially with our Aboriginal and Torres Strait Islander peoples and the – being able to

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understand what the hell's going on sometimes when they get letters or phone calls.

So along with those 504 Australian Public Service jobs, of course, their families went as well, so that ends up being a lot more. And this is the reason why we have a declining population, or one of the reasons. So the public services makes up – the Northern Territory Public Service makes up about 20 per cent of the Northern Territory population. And, of course, they all have their families, both you know children and mums and dads a lot of them up here. There's a high cost of living. There's also a high cost of getting out of here, so flights, for example, and availability of those is difficult.

We also note in our report about the availability of medical services. And whilst we have first class hospitals such as RDH and Alice Springs, there are problems providing all those services that we need up here. And it's quite often that expenses have to – it's an added expense, so people have to be transported down to Adelaide, for example, or Brisbane for some of those things, such as you know a couple of cases that have come up with our members lately, one was a tumour in the brain, so that needed to go to Adelaide and this is repeated visits to Adelaide and back, and also a premature birth where they had to go to Brisbane. So, of course, that's an additional cost and the Territory Government assists with that.

It's also a higher cost because of our remoteness to deliver any services. Child protection, for example, have to go visit communities. A lot of the time during the year they can only get to those places by charter flight, and even more so in the wet season where your – a lot of places you just can't get to. So they have to do welfare checks and, unfortunately, you know pick up and deliver back children along the way.

So you know things like housing, child protection, education, health, all of that is - the remoteness and the inability to be able to access some places except by expensive charter flights or long four wheel drive trips, is a high cost to the Territory that doesn't really occur in many other states. I'll probably stop there. That's a brief overview of all of that.

MR HAYES: Thanks, Kay. Would you like me to add to that? So I'd just like to read out something I've prepared first, and then go into a bit of discussion. So the Electrical Trades Union is the Electrical, Energy and Services Division of the Communications, Electrical, Electronic, Energy, Information, Postal, Plumbing, and Allied Services Union of Australia, the CEPU.

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The ETU represents approximately 65,000 electrical industry workers around the country and the CEPU represents over 100,000 workers nationally, making us one of the largest trade unions in Australia. The ETU currently represents the interests of over 1500 workers who reside in many towns and communities of the Territory and work across many different industry sectors, including mining, construction, house supply, generation, maintenance, training and manufacturing.

The ETU is opposed to the proposed changes in the Productivity Commission draft report and believes the current process of full Horizontal Fiscal Equalisation needs to remain. In our view, that the referral of this issue was simply politically motivated at the time of referral. We had a Federal Liberal Government trying to be seen to supporting a failing WA Liberal Government who subsequently lost the state election. And having an inquiry established and solutions proposed to address the self-inflicted fiscal concerns of one state does not make a sound basis for reform.

If the Productivity Commission was to mind – was of the mind to continue to promote its draft recommendations and in the unlikely event the Federal Government adopted them, then there would be catastrophic impact on the Northern Territory. On saying that, probably one of the big points of the GST funding and the way it's distributed, is to maintain a national average of services.

And the NT, as Kay has alluded to, is quite a different place than many of our other states. So per head of population, it takes a lot more money to maintain those services. And so removing any more funding, the effect that would have on people is massive up here. Really it's big, and especially our members. Do you want to add to that a little?

MS DENSLEY: Yes.

MR HAYES: Thanks. So health, infrastructure, all those kinds of things, you know we've got a major project here in the NT at the moment with INPEX happening. And a lot of families would love to stay in the NT and we need to have the services here to keep those people in the Territory. So what we're finding is that people are talking about what's going to happen in the future up here. There's obviously already been the announcement of the funding cuts. And that's taken the confidence out of people to stay in the NT. A lot of these people have moved up here, their kids love the schools, they love the lifestyle, the whole lot. But they can't see a positive and a stable future for themselves. And I think you know if we're talking about multi million dollar cuts coming forward in the future, it just takes that confidence out of people.

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The NT itself is working hard to look at ways to generate more income, you know with tax – potential tax reforms, consultation in those areas, many other bits and pieces. So the NTV – the NT is working very hard to try to generate and do more for itself. And if we rip you know multi million dollars out now, that's just going to make it so much harder to take that extra step that we're trying to make with this government.

So, yes, it's be just hugely damaging to lose more funding when we're trying to build and build and build. We're trying to promote infrastructure. We're trying to get the right people here, and people who are happy to live here. It'd be nice if we had a big air conditioner built over the place, but - - -

MS CHESTER: I'm with you on that.

MR HAYES: Yes. But so in saying that, the NT's got a lot more to offer you know that people enjoy in their lifestyles. And if we can provide the right services and things for those people, the right health care, the right infrastructure, we'd go a really long way to keeping people here. And then step by step, we'd build on ourselves and on our own merits anyway. But to lose more funding now with the momentum that's currently in place, is really going to take us back a long way. And I'd hate to see that happen to a lot of families up here.

The other thing, that Kay mentioned was our indigenous communities and things like that and, obviously, the remoteness. And I agree, the remoteness and all those kind of things, it does cost more money per head of capita. But everyone deserves – it's Australia. Everyone deserves the same chance and I think we've got to do our best to maintain that.

MS CHESTER: Okay. Great. Well thank you very much for appearing and for sharing your thoughts and remarks. So I guess from what you've collectively said, I think there's two primary issues and concerns that you have. Firstly, is what you anticipate or think the fiscal impact might be on the Northern Territory of any of our draft proposed changes to the way we do the HFE relativities, and secondly, how maybe the NT's cost disabilities with remoteness indigeneity dovetailing with the HFE system and the relativities. Am I right in saying that they're kind of the two buckets?

MS DENSLEY: Yes.

MS CHESTER: So maybe if we go to the first one. So in terms of what do you understand from our report to the fiscal impact of what we're proposing, because we heard earlier today that there was a suggestion that it was – what was it, $1 billion over 10 years had been suggested to some

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stakeholders like yourself, might be the impact on the Northern Territory's budget position of what we're recommending. So I'm just trying to understand what you think when you say it's "catastrophic", what you think the "catastrophic" is?

MS DENSLEY: Well, I'll admit to not reading all your report, sorry about that. But - - -

MS CHESTER: No, don't apologise. I wouldn't put that on you.

MS DENSLEY: But we're already facing a cut already and the Northern Territory is the only one at the moment that is facing a real cut. And we just know that we can't afford anything less. So - - -

MS CHESTER: So sorry, Kay, when you say "cut" is this from the Northern Territory budget or is this from where the relativities are with the HFE?

MS DENSLEY: It's previous to that and I'm going to look at Treasury people now to help me out of this. But my understanding is that we've already – there's already a proposed cut and this inquiry would be an additional cut.

MS CHESTER: Okay. So in our draft report, we talk about changing the current way we equalise. At the moment, we equalise to the highest fiscal state and then there's a little bit on top of that. So we make sure that it's – so at the moment, WA with the mining royalties is the highest fiscal state. And in doing that with such an outlier state, the equalisation task has become so great and that has problems with the trade-off between equity and policy neutrality in states and territories space.

So what we recommend is moving to something less than equalising to the highest state. Now in doing that and given the starting point we have today, we realise that you'd need to transition to that very slowly over time such that you don't get an Armageddon situation of you know hundreds of millions of dollars of impact to state and territory governments immediately. And indeed, the way the GST pool grows over time, that can actually help us with the transition path.

So in looking at the transition path, and that's what we're trying to consult with states and territories on at the moment, one of the issues is well, what should be the principles that should guide that transition path? And the principle we identified in our draft report was that any of the fiscally weaker states - of which Northern Territory is one at the moment

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based on assessed disabilities - any of the fiscally weaker states wouldn't be materially disadvantaged and we'd need to get that transition path right.

So I'm not sure that's been conveyed to you in the briefings that you may have had, given I wouldn't have expected you to read our report from cover to cover. So we are very much focussed on making sure that if we do make these changes to the system for other policy objectives of getting that trade-off between equity - which we still say is the primary objective of HFE - and these policy neutrality issues which are also important for growing the economy and for jobs and growth, then we need to make sure that we do it very gradually over time such that there's – we don't materially disadvantage any of the weaker states. I'm not sure if that's been conveyed to you or - - -

MR HAYES: My comment would be that probably not fully. We're looking at figures of big cuts as what's been conveyed. And I think for us up here even over time, if cuts come into play, it's going to see us in a bit of strife. You know we're not in the best position at the moment and really any cuts currently or in the foreseeable future are going to be a detriment to the NT and how it operates and its ability to move forward and get better and then to stand on its own two feet.

So you know if you looked at – if you look at the projected cuts now of $2 billion over four years with the GST funding currently, I believe they're the figures that have been portrayed or $579 million, was it, in this budget - if you look at those blows that we're already dealing with in the NT, even to have a consideration of further, is very detrimental.

MS CHESTER: Okay. We might just need to check those numbers for the purposes of the transcript.

MR HAYES: Yes. Yes, that's fine.

MS CHESTER: Because they don't align with my understanding of changes to GST relativities as they impact the Territory and you might be talking about other budget cuts that – and we can catch some Treasury officials later who might be able to point us in the right direction there.

On the second issue of the cost disabilities, and again I'm not expecting you to have a detailed understanding of the way the CGC methodology works. Indeed, we sort of joke to ourselves that we think only 30 people in Australia really understand it. But they do at the moment, when they do the assessed expenses for the NT Government and the fiscal capacity that's required, they do already adjust for issues like remoteness and indigeneity. The NT Government then would be involved in processes that the

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Commonwealth Grants Commission has every five year to review the methodology in case they're not getting those disabilities and the indexes right.

Is that something that you get involved in or – with the NT Government or are you leaving it to them to have those interactions?

MS DENSLEY: No, we don't get involved in that. But we note that in the – and I'll just read it out, it's actually in our submission, "The 2017 update from the Commonwealth Grants Commission indicates the Northern Territory is the only jurisdiction that will be receiving a reduction in 17/18". So the point that we're trying to convey to you and you know how you work out your equalisation is you know, obviously, the reason for this inquiry.

But we're just saying people are doing it tough and the government's trying to provide improved services to you know what has been happening over the last few years, and they're putting money where they need to. There's also money that needs to be spent. For example, we've just had a Royal Commission. So that was from the CLP Government and the Federal Government. It's going to cost a lot of money to put those things in place. The ALP were already trying to put a youth justice unit in place you know prior to – back in 2011, they started that process which was then stopped.

So there's all this stuff that they've got to do to improve things now and to get things running on an even keel again. And so you know what we're saying to you is that you know we're already getting a cut from the Commonwealth Grants Commission. Any further cut compared to other states – other states can – you know if other states have got a population of you know a few million or hundreds of million, then – sorry, it's not that much, is it? But you know they can tax people a bit extra. They can do a lot of things that you can do with a smaller population. So with a population of, I think, about 220,000 or something that we've got here, you know any additional taxes or expenses that people have to pay really hurt. So that's the point that we want to give to you.

And, obviously, we work with government to try and ensure that the services are provided and we work with our members to make sure that those services are provided efficiently and effectively and you know to - not to the detriment of Northern Territorians. So the government has already cut public services in the last budget. So there was a large amount of money taken out of that.

We have efficiency dividends and have done every year, and you can only cut so much. And the same thing happens, obviously, to our Federal Australian Public Service colleagues. So you know you can't take away

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money that is providing basic services to people. And the Territory is in a position where those services cost a lot extra. So you need to take that into account.

MS CHESTER: Yes. And indeed, we heard quite a bit earlier, our first participant for the public hearings here in Darwin was the Yothu Yindi Foundation who gave us quite a substantive submission as well.

MS DENSLEY: Yes.

MS CHESTER: And I guess their concern is what the Commonwealth Grants Commission assesses at the assessed expenses for the Territory and what the Territory actually spends, doesn't always line up, especially as – from their perspective on indigenous needs. And that's a given in the system where the state or territory has autonomy to spend the GST money however they want to.

But in their submission, they did make a really interesting point and I'm just wondering whether this relates to what you're talking about now with cuts in public sector numbers. So this is from page 6 of their submission, they said, "One major contributing factor in these inequities is the continued growth of the Northern Territory Public Service". And they say, "In 2003 the public" – "NT Public Service was supporting 14,538 FTEs on a population of 201,725. By 2016, it had gone up to 20,596 on a population of 244,900".

So the point they're trying to make is that public service over that time period went up 41.7 per cent, but population only went up 21.4 per cent. So I'm assuming that's part of the context of the current cuts that you're experiencing in the public sector.

MS DENSLEY: We're not experiencing so much cuts to staffing, but cuts obviously to budgets and the way that it's done. And they are correct in those figures, but you have to look at what services were provided you know up to 2003 when those figures were there. So you have to remember that the public service you know includes teachers and nurses and you know it's not all – I shouldn't call them pen pushers, but it's a name that often speaks with public servants. But you know they're the rangers. They're the child protection workers. This government has put on additional jobs, for example, our Youth Outreach workers you know for a program to be able to – you know will pre-empt the Royal Commission recommendations but fit in very nicely to what they are.

So there's a lot of services that need to be provided, and improvements, and that's why these things are built up. And you'll notice over that period

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that was an ALP Government. The public service wasn't cut too much with the CLP, but obviously the priorities were different. And certainly, you know the priorities weren't put into things like youth justice you know where – which is another reason for the Royal Commission. So when you're talking about that sort of thing, it's a matter of looking at the need and the services that provided. So I think you need to compare the services that were provided before.

MS CHESTER: Yes. And I think that's the context in which they raised it because they've got concerns that some of the services that matter to them are not being fully funding or provided.

MS DENSLEY: Yes. Yes.

MS CHESTER: Yes.

MR HAYES: No, that's okay. I won't comment. I was going to say, yes, it probably – the growth in public service probably reflected - problems had been identified in areas and those areas needed more people to change some of the things that were happening in the NT that – whether it be antisocial or areas like that.

MS DENSLEY: I did skim through the Yothu Yindi submission and a couple of others. I don't think they mentioned CDP, for example. So if we're talking about services to indigenous Territorians you would – there's a lot of them here on CDP, which is basically slave labour. So there's been a number of programs, CDEP was the one before it. CDP though, it's forcing people to work 25 hours a week. No holidays, no sick days, no superannuation paid. They're paid for pretty much the dole. CDEP they used to get additional money to do that. Sometimes they have to travel a fair distance to get to that job as well. And there's also issues with the program and I know that there's a Senate Inquiry been – into that.

But you know I think you just don't look at Territory services that are provided. You look at what the Federal Government has been doing as well. A lot of our money to provide services are from programs from the Federal Government. And whilst you know a few years back they started funding, is it five or 10 years, which is a – it's not that you don't change the program if it needs doing, but it gives a bit of surety then to both employees doing the service and also the people who are getting the service provided for them.

So you know that is a big factor in providing services up here because we never know what the government is going to do and what their priorities are going to be. And you know as part of the ACTU, of course, with our

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unions, we're running information I guess about CDP and trying to stop that. So Yothu Yindi need to have a look at those Federal ones as well as the you know NT Public Service about what services – what schemes I guess and assistance people get. So CDP, for example, you can work for - a private employer can employ you and it's below award wages and you know certainly the CDP participants' wages aren't topped up at all.

MS CHESTER: Yes. Well Kay and Dave, we didn't have any other questions for you.

MS DENSLEY: Yes, sure.

MS CHESTER: Is there anything else you wanted to say? Okay?

MR HAYES: No.

MS CHESTER: All right?

MS DENSLEY: No.

MR HAYES: Yes.

MS DENSLEY: Cool.

MS CHESTER: Okay. Well thank you very much for appearing today.

MS DENSLEY: Thanks very much.

MS CHESTER: Appreciate it.

MS DENSLEY: I'll read your next report.

MS CHESTER: You're on the transcript record of having said that now, Kay.

MS DENSLEY: Thank you.

MS CHESTER: Thank you.

MR HAYES: Thanks.

MS CHESTER: All right. I'd like to invite our next participant from the AMA to join us please?

DR PARKER: Hey, Commissioners.

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MS CHESTER: Welcome. Welcome. If you just - - -

DR PARKER: Thank you.

MS CHESTER: Once you've had a chance to make yourself comfortable there, if you wouldn't mind just stating your name and the organisation you represent for the purposes of the transcript. And then if you just want to make some brief opening remarks.

DR PARKER: Yes.

MS CHESTER: We do have your slides and we have read them.

DR PARKER: Okay. My name is Associate Professor Robert Parker. I'm the current president of the AMANT. Before I start, I'd like to acknowledge the Larrakia people on whose land we are having the meeting today.

And I know you've got the stance, but what I'm going to do is open with a story - and I may become a bit tearful in telling this - what this actually means on the ground. A friend of mine from the Tiwi Islands, a long-standing friend, a very good woman, a spiritual woman, has had renal failure and I just was reminded of this by Paul Henderson's presentation. She has been kept away from her country and culture for three years in Darwin because of the lack of resources to provide renal dialysis on the Tiwi.

That's not a criticism of the NT Government, because they've got to divide the pie like anything else. But it gives you a real understanding of what this means that this woman cannot actually access her family or culture because of health disparities, which I've demonstrated to you in this document. And again, I think in terms of equality, you know I can't think of people who live in Perth, Sydney, Melbourne, who had that sort of predicament that's sort of affecting a lot of Aboriginal people in the Northern Territory currently. So just I think it's an example of the significant disadvantages that I've heard in the previous speakers, but I think you'd also be aware of on the figures. But it's a real life example of what this means for people on the ground, not just the reports and the figures in the sky.

I suppose, just the report that you've got, it's sort of – what I tried to do is it's very easy to sort of think of broad economic figures. But I really wanted to make you aware of the cost on the ground. And I really think in terms of equality – and I picked two fictional people, Gina and Brenda - but really for Gina to virtually have no impost on the New South Wales

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budget at all in her – in the cost of her chronic illness, and for Brenda to be costing the NT Government over $100,000 for a similar cost impost, I think is a significant inequality.

And I'm certainly hoping that in any of the consideration of the HFE equation, that this is taken into account. Really, that's money that New South Wales doesn't have to spend because it's got a good healthy market, lots of GPs who can provide services for people such as Gina. There's market failure in the Northern Territory. We don't have the same level of market.

And I mean, again I'm sort of – I haven't read the Yothu Yindi report, but I think it's a bit pejorative. As pointed out by the previous speakers, a lot of public servants in the Territory are nurses, doctors, teachers, child protection workers. As they said, they're not pen pushers sitting in an office. So you know the Territory has to cover a lot of this ground because of market failure, because of the inability of the private sector to provide services. And the cost of running services often, in providing all the relevant support you need to do to give people the appropriate training, skills, accommodation, in a remote and rural areas really can only be supported by government because they're – and I mean the other thing to note is that Brenda and Gina potentially have a whole range of other illnesses.

When I focussed on this report and I noted that it cost the NT over $133,000 to treat one small medical condition which is a diabetic foot ulcer in Brenda compared to Gina, where the whole cost was covered by Medicare. Brenda, particularly, may have cardiac disease. She may have renal failure. She may have chronic obstructed airways disease. She may have a mental illness. She may have substance abuse. So if you're looking at the one cost of that and then the amplified affect on one individual and the community, the cost is massive. Again, if you look at the prevalence figures, I mean for every one Gina, there's three Brendas or over three Brendas in terms of prevalence.

So the Territory, you know you're dealing with a very – a distant population often with significant health inequality where the market cannot address their health needs, such as they can in the other states. And I think that's – you know in terms of equality, the Territory is certainly extremely disadvantaged by these areas. And I mean again, I'm very concerned by any talk of a loss of income. You know my friend has had to stay in Darwin for three years. It's just a good example of why we need more. You know why we need at least the money we've got rather than money being taken away because of the significant disadvantage faced by Territorians and their health.

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MS CHESTER: Okay. Well, thank you. And thank you for your submissions. I guess, and I – like with others, I don't expect people to have read our report, but with the way the CGC does assessed expenses across different state and territory jurisdictions, they have these disabilities that they apply and the two large ones for the NT and remoteness and indigeneity. So what they're trying to do is to actually add in to the assessed expenses what is the cost disability of providing services in remote communities or the costs when people have to be transported from remote communities for hospital services that can only be provided in Darwin. So I guess my first question is, have - is that something you have a bit of an understanding of or with?

DR PARKER: Yes, I understand that, Commissioner.

MS CHESTER: Because the way you described it by comparing the – I'm not going to try to pronounce it because I'm going to get it wrong, with the suburb in - - -

DR PARKER: Ramingining versus - - -

MS CHESTER: Yes.

DR PARKER: Ramingining versus Campsie.

MS CHESTER: Yes. So if we were to distribute the GST pool through the HFE, and it wouldn't be HFE then, on the basis of equal per capita, you would get that perverse outcome that you're talking about. But the assessed expenses are trying to imbed into them those cost disabilities. And so I guess the issue then is before we even talk about any changes to the system that we're looking at, are they getting that right at the moment?

DR PARKER: I don't know, Commissioner. I haven't actually seen the formulas for those costs disabilities. But I think they have a really hard time comparing $600 to, I think it was, $30,000. There's no cost equivalent to compare and equivalent cost of $600 for Gina for three months and hospital care versus $33,000 for Brenda in Ramingining, or over a four years care zero for Gina versus $133,000 for Brenda.

And I must admit that's really – those – that's probably understated figures. I mean the report I used is actually a 2004 report and they actually used 2004 figures for doctor's salaries, nurse's salaries, cost of attendance. And I would've thought there's probably – with the awards that have happened since then, there's possibly even a 50 per cent increase in the cost of attendance. So we're looking at a 2004 figure for health and it's – so

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basically, even if the costs for Gina was $1 in New South Wales, you're looking at a figure 133,000 times the cost of the treatment of Gina, on Brenda. And I don't feel there's any cost equivalent that you could argue would – that would account for that.

The issue is what I was trying to make is the Northern Territory Government has to make up for market failure, so they have to spend $133,000 purely for the care of Brenda's diabetic foot, whereas in the larger states the Commonwealth, through the Medicare Funding Agreements – so because there's a healthy market, a healthy market for health care in those states can actually accommodate that. So the Territory's had to, basically, spend an extra $133,000 purely to care for Gina's – Brenda's diabetic foot. And I don't think there's any cost equivalent you could account for that would measure that.

MR COPPEL: So what's happening there is that in Sydney there's a patient with that condition would see a private doctor, get reimbursed through Medicare, whereas here you're saying that there isn't that provision, they'd have to go through the public hospital system?

DR PARKER: Or the public health system, the community health system, yes.

MR COPPEL: The public health system.

DR PARKER: No, I've actually put the cost equivalents for Royal Darwin and Canterbury Hospitals are probably equal, although the cost in Royal Darwin is probably more than the Canterbury because of the Aboriginal health input and whatever so – but I've actually put them as equal. The actual cost, you know the cost for Gina in Campsie where they've got a healthy system with a number of general practices who can attract Medicare funding, is quite different to Ramingining which is way up – I've just given you a photograph of it in the middle of nowhere.

And you can't, you haven't got the market to attract that same market capacity for health care as you have in – which is why the NT Government has spent an awful lot of money providing health care for these individuals, which the other states don't. I mean, the other states don't have that impost on their budget. I mean they've got the same – they've got other imposts on their health budget. But they don't have the same sort of community health spend the Territory has to do.

MS CHESTER: Sorry, go ahead.

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MR COPPEL: The CGC approach makes three broad assessments. It looks at sort of the capacity of the jurisdiction to raise revenue. It looks at the grants that come from the Commonwealth for specific purposes. And then it looks at the expenditures that are needed to provide the average level of services provided across Australia. And for the Northern Territory, it's not the revenue side that really changes the relativity, it's really all on the expenditure side. And it's largely driven by the – or virtually entirely driven by these factors that add to the cost of supplying that average level of services in the Northern Territory.

From what I'm hearing from you, it seems to suggest that you think that those assessments probably are underdoing it, rather than fairly getting it right. Is that a fair assessment?

DR PARKER: That's right. Well, yes, I'm not – haven't read those documents. But I would think they're not getting it right, certainly with these figures. And this is just – I mean, I'm a simple doctor. I'm just looking you know my expertise is in medicine rather than economics, which is why I picked a particular medical condition to actually try and work out what the cost was rather than worrying too much about the other things. But it was fairly – I was actually astounded by the difference in cost eventually.

MS CHESTER: Yes. So part of the reason the HFE system is so horribly complex is because there's a bunch of very hard working and diligent staff at the Commonwealth Grants Commission in Canberra that are trawling through this kind of state and territory very minutiae level data to try to understand how these cost disabilities play out.

And then every five years, separate to our inquiry, they go through a methodology review where NT Government would roll up the sleeves and go into for bat for NT and say, "No, you've got those costs" – "You've underdone those costs disabilities and here's our evidence". So there is this process that I hope is dealing with the disparities that you're talking about. And indeed we can ask the NT Government tomorrow whether they've got sort of any material outstanding concerns in the current CGC methodology review process that's underway on these very issues. Robert, we didn't have any other questions of you.

DR PARKER: Good.

MS CHESTER: But thank you. (1) it's good to hear the real-life stories, and (2) appreciate you having taken the time to give us an example of what those cost disparities are and how they play out from your perspective in the work that you're doing here in the NT.

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DR PARKER: Again, the AMA was very concerned to hear there was a potential – going to be a potential loss of income from the GST. And I mean, we think where - again where one of our major concerns is the health of indigenous Territorians and we're very concerned about the potential impact on that on the health of all Territorians, but particularly the most disadvantaged, the sickest of the sickest as my predecessor, Dr Paul Bauert said, living in the remote and rural areas and the impact of this loss of – potential loss of funding is going to have on their health and welfare.

MS CHESTER: Yes.

DR PARKER: And I mean, all the issues we've talked about are all related, you know child welfare, overcrowding in houses that Paul Henderson referred to.

MS CHESTER: Yes. I think I saw you sitting in the audience before that you heard what I said about transition path and the principles that are going to guide that.

DR PARKER: Yes. Yes, and I heard that. But I still – I think the AMA along – yes, are very concerned and hope we - you know that we're given adequate funding so my friend in Darwin could potentially one day go and live on Tiwi and have the renal service she desires or she needs.

MS CHESTER: All right. Well, thank you for presenting today.

DR PARKER: Okay, thank you.

MS CHESTER: Okay. I'd like to invite the next presenter to join us from the Northern Land Council.

MR VALENTI: Good afternoon.

MS CHESTER: Good afternoon. If you wouldn't mind just stating your name and organisation for the transcript. And if you'd just like to make some brief opening remarks.

MR VALENTI: Sure.

MS CHESTER: Up to five minutes, if possible.

MR VALENTI: Okay. Thank you. Yes. My name's Joe Valenti. I'm from the Northern Land Council. Hopefully, I've got a brief opening

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statement here which will just give you a bit of context around some of the work that we do at the Northern Land Council.

MS CHESTER: Thank you.

MR VALENTI: The Northern Council is an independent statutory authority. It was formed under the Aboriginal Land Rights Northern Territory Act and then, obviously, is one of four land councils within the Territory. Essentially, we are responsible for assisting Aboriginal people to acquire and manage their traditional lands and seas in the top end of the Northern Territory.

The Northern Land Council has roughly around 36,000 constituents which make up roughly half of the Aboriginal community within the Territory. So we do represent a fairly large indigenous community sector. We manage just over 550 square kilometres of the Northern Territory, which is the largest council within the Territory. That sort of gives you a bit of a context of what we do.

I guess, from the Northern Land Council's perspective, we certainly support the notion of the HFE, that is equality and that's a really big fundamental principle that we certainly rely on. And the access to comparable government services is really fundamental to our beliefs as well. I mean, I think from some of the other presenters here previously, that has been an issue that you know whether the services that are being received by rural and remote indigenous communities and people are actually at what I would call a comparable level. I mean, there's many examples that I've heard here today.

But just being on the ground and seeing some of the services that they are receiving, you would have to ask the question whether the assessed expenditure is equivalent to the actual expenditure of the Northern Territory Government. I think there is a gap there. The issue that I believe is one of the major issues that we have here is how the hell do we – how we do follow that money through? We can't follow it from start to the end. And I think that is a major problem for this – for the HFE for this government in that we can't – cannot get accurate details of where that funding has been spent, how it has been spent.

I mean, one of the issues for me if I look at the Closing the Gap Report, and I think again this was mentioned earlier, we're really not on target on closing the gap. That tells me that you know the funding that is being poured into that and HFE being part of that, it's obviously not working or the policies are way off the mark. The fact we have not made an indent into closing the gap is a real indictment as far as I'm concerned. So I think you

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know, I certainly would question because the difficulty of the money flow of whether the assessed expenditure is actually equivalent to the actual expenditure. So I think that, for me, is certainly a real problem.

If we look at you know real life examples for – and I look around health, for example, you know we have constituents who come into Darwin from remote areas for – to stay at – to go to hospital for renal issues, and they're not staying within the hospital. They come here for treatment. They don't have the funding to stay anywhere. They don't have family here. So they stay in what we call the "long grass" out in a park or out in the edges or fringes of the CBD because they just don't have anywhere to stay.

And there's not the facilities there for them when they come in from – you know, when they come in from the Tiwi Islands or where they come in from you know Ramingining, all those type of places. When they come into here to access these services, what happens to them? What happens to themselves and their families, because a lot of the time they travel with their family? They stay in the long grass. And that's a realty. That's not something that is an exception or an unusual event. It happens. It's reality. It's on the ground.

And if I look at you know around education and the poor attendance rate, you know really nothing has happened there. And I think you know if we're serious about having you know a – let me get it right – the equalisation fund, it must address some of these issues. I mean that – you know I'm using the closing the gap as an example, but it - to me that highlights that you know there is issues and we do need to address them.

One of my recommendations and this is you know something that I think is really important, that the disadvantaged here within the Territory is so great that the HFE model can't address all of the issues. And I think you know the Territory Government along with the Commonwealth Government really do need to be very specific and targeted as to how they address these issues. And maybe it sits outside of the HFE model. Maybe it does, because I believe it's not being addressed. And you know I always come back to the same point, that of equity and that of assessing you know a comparable level of government services. I don't actually believe that is actually happening. I'll probably leave it there.

MS CHESTER: Great. Thanks very much, Joe. So maybe just if we start where you finished off on this issue of equity versus I guess the equalisation of fiscal capacity.

MR VALENTI: Yes.

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MS CHESTER: And I think when we think of "equity" it relates to outcomes for individuals, whereas the HFE system is about equalising a fiscal capacity which would give a state or territory jurisdiction the capacity but there's no obligation for them to actually spend that money according to the disabilities or to get the right policy outcomes, because we know there's a lot of heavy lifting around getting the right policies and having them evaluated and all the rest of it.

MR VALENTI: Agreed.

MS CHESTER: So if we turn to that distinction first then and your other comment that we can't expect the HFE system to resolve closing the gap in and of itself, it's just one small part of the whole suite of expenditures and supports to the NT Government. I guess if you look at it from that perspective, should we allow the NT Government to have autonomy on all the assessed expenses if there are policy imperatives like closing the gap, because when I kind of look at some of the numbers, some of the good work of Professor Neil Warren where it looks at what's the assessed disability by the CGC and then what's the assessed effort made by the NT Government, there are some big gaps in terms of what's assessed and where the money actually goes.

MR VALENTI: Yes. Look it's a difficult question to answer. I guess the – you would expect that the Northern Territory Government is well placed to manage their own backyard and you would think that they have the best, you would expect, understanding of how they manage the Territory. But in saying that, it feels like I'm sitting on the fence here. But in saying that, certainly the input, the knowledge of a broader Commonwealth Government certainly needs to come into play. I think what has to happen, it really does – from where I stand, it really does need to be certainly a combined effort, a team effort, I think.

Look I find from one point of view that I think if you've got an NT Government in place, that they have to have that autonomy to manage their finances and they have competing – well, obviously they have competing priorities as well and so therefore that – those management of those priorities should be left up to the NT Government. I think that's valid.

In saying that, there is that overarching Commonwealth oversight, I guess, and I may not be using the right terminology here. But I think there's the betterment of what we – of the nation I guess, where we do expect that certain groups – well, no, we expect that all Australians have – there is a level of equity there. And I think if that's not being achieved then there needs to be that – some oversight I guess. And so what those checks and balances are, look I don't know what they are. But I think there needs to be

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a set of checks and balances to say look if the money that we – is not being directed into where – exactly where we want it to go, there needs to be some reassessment there.

MS CHESTER: Okay.

MR COPPEL: So in your statement, you said there was a real issue about the mismatch between actual expenditure and assessed expenditure. How do you square those two? Are you - - -

MR VALENTI: Yes. Look that's a difficult one. Now and having - and I guess my – do I have any data to support that? Look there is - there's been some independent analysis of that and I could – I think it seems to be on both sides of the scale you know, depending on which report you want to have a look at. I guess, so there is those reports out there. I guess you know what I'm looking at is, at the coal face, I can clearly see that the level of service, the level of support to some indigenous groups is not there. You know in some of these remote areas, it is not there, and that is very clear.

And any time when anyone goes to one of these communities or some of these communities, they can clearly see for themselves that level of support is – I come back to that closing the gap and I'm sorry to focus on that a little bit, but I guess that tells me that you know this has been in place for some time. And the fact that there has been no change, we haven't achieved those targets, tells me that something is not working. Now whether that is the assessed expenditure and the actual expenditure or whether in fact it is that the funding sources, the funding – the revenue is not being directed to where the expenditure is, you know again that could one of the issues as well. And I don't know what the answer to that is.

MS CHESTER: I think common to the questions that you're raising, is this issue of accountability.

MR VALENTI: Accountability, yes.

MS CHESTER: And where we landed in our draft report around indigeneity, because some people have suggested taking indigeneity out of the HFE system, for different reasons. So some are saying it because – like Professor Neil Warren, he looks at the disparity between a lot of the higher relativity that the NT gets is because of indigeneity remoteness.

MR VALENTI: Yes.

MS CHESTER: Yet when he does his detailed assessment of how those moneys are spent, he sees a mismatch between the assessed disability and

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the actual effort of the NT Government. So that's one reason. Another reason is that some have suggested that closing the gap, or what I would call overcoming indigenous disadvantage, is a national issue.

MR VALENTI: Yes.

MS CHESTER: It's not a state and territory issue. And because we don't have clear lines of spending responsibilities and accountability, Commonwealth, state and territory on indigenous policy matters, take it out – where we kind of landed was we struggled with HFE being the right lever to deal with overcoming indigenous disadvantage. We don't see it really helping the system, but we don't see it being a lever.

In the absence of those reforms occurring on Commonwealth state responsibilities and accountabilities around indigenous policies and programs, taking it out would achieve nothing unless you've got those foundations right. It'd be good to get your thoughts on that and what you see longer term, would be beneficial in terms of delivering that accountability, in terms of who's responsible for tailored policies and programs for indigenous Australians in overcoming that disadvantage.

MR VALENTI: Okay. Look accountability is really at the crux of all this because I think you know where you – and where you want to go and search, as I mentioned earlier, the flow of money and where – and what that is delivering. You know that, to me, is the essence of finding out where some of our flaws are. So accountability, number one, is of great importance to me.

Number two, who is responsible for this? Well I think it's – you know, you're right in that it is a national issue as well. But I think the management - as I mentioned earlier, the management of a state or territory you know must be left to the state and territory, I think. I think there has to be that autonomy. I think you need your checks and balances in place. I think the overarching national policies do need to dovetail into the policies. Look it's not uncommon now for the Commonwealth to – and I know it's going on transcript – but to exert some pressure on state and territories when they want certain things done, so why not in this case?

So I guess my view is state and territories do need that autonomy. I think there needs to be accountability. But I also believe the Commonwealth has an oversight and overarching policy where states and territories must fall into.

MS CHESTER: So what needs to change?

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MR VALENTI: It's accountability. I mean, if there is – you know in a private sector for - - -

MS CHESTER: But what needs to change to current responsibilities, funding versus policies versus outcomes, to inject that accountability?

MR VALENTI: Look I don't come from a political background. But if I was to say from a business point of view, you know you set your targets, you set your KPIs and let's review them on an ongoing basis and then let's – and every year let's say, "Right, have you achieved those or haven't you achieved those", and let's really have an assessment.

I think the Commonwealth does have a role to play in overseeing in the Big Brother role. I think they do. I mean it's one nation. And I think we do need to look at it as that. You know you have your separate states and territories which we form that one nation, but I think you know that oversight, that Big Brother view I think needs to come into play. "We will leave up to manage your own affairs, but there needs to be accountability to those KPIs as such that you need to report to". Yes. Which is what we said we were going to achieve.

MR COPPEL: You said earlier that you'd come back to closing the gap and in some of the earlier participants to the hearing today and then hearings in other capital cities, we've heard that the HFE system will provide the capacity to give the average level of services. And if you start with a disadvantage it won't compensate to close that gap whether it's on infrastructure or indigenous disadvantage. Do you have any views on whether HFE has a role to play and how it could play that role in pursuing that particular objective?

MR VALENTI: Well I think it does have a role to play. I think you know if we look at you know the major principles is a comparable level of services across all of Australia. So to me, it has a large role to play, I think. So, yes, it does have a role to play. Some of the issues I guess, are larger than HFE. I think that's maybe the point I wanted to make is that you know some of these issues are not going to be fixed by HFE. That is one component of it. And you know providing where we believe, you know if this is working in a perfect world, that we all have that same level of service and there is equity across the nation, well that's great. But I think there's issues which are larger than HFE and it's not - that one that is one aspect of it and it's not going to solve the problem.

MR COPPEL: Yes.

MS CHESTER: Okay. All right. Well, thanks very much, Joe.

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MR VALENTI: Great. Thank you.

MS CHESTER: All right. I'd like to invite our next participant to join us from AMSANT, the Aboriginal Medical Services Alliance NT. Welcome, gentlemen. Please take a seat and make yourself comfortable.

DR COOPER: Thank you.

MR PATERSON: Thank you.

MS CHESTER: And when you have, if you'd like to just each state your name and organisation, just for the purposes of the transcript voice recognition.

DR COOPER: Sure.

MS CHESTER: So we don't confuse you in the transcript. And then if you would like to make some brief opening remarks, we'd welcome that.

MR PATERSON: Thank you. John Patterson, Chief Executive from the Aboriginal Medical Services Alliance Northern Territory.

DR COOPER: Dr David Cooper. I'm manager of research and policy at AMSANT.

MR PATERSON: Okay. Deputy Chair and Chair. Thank you.

MR COPPEL: Thank you.

MS CHESTER: Just Karen and Jonathan's fine.

MR PATERSON: Okay. Yes. First of all we'd like to thank the Commission for this opportunity to present on behalf of AMSANT to this important inquiry. AMSANT is the peak body for Aboriginal Community Control Health Services. In the Northern Territory, that provides over half of all primary health care to Aboriginal Territorians. We are a significant sector and significant employer of Aboriginal people.

The thrust of my presentation is to outline the expected impact of an abandonment of an equity base of Horizontal Fiscal Equalisation to Aboriginal people in the Northern Territory. In short, it can be anticipated that any reduction in GST from such an approach, would disproportionately impact on Aboriginal people in the Northern Territory who make up about

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30 per cent of the Northern Territory population and harm efforts to close the Aboriginal health and disadvantage gap.

We're also aware of the relative disadvantage of Aboriginal people and the statistics that go with this disadvantage. The conditions of Aboriginal people in the Northern Territory are such that unless we continue with equitable needs based investment into the future, we will struggling with these same issue, even worse, in 10, 20 or 30 years' time.

I will outline here some of the reasons why, (1) life expectancy gap for Aboriginal people in the Northern Territory is the widest in the nation being 16.3 years for men and 14.4 years for women compared to national indigenous rates of 14.4 years for men and women. The largest component of this gap is chronic disease which is at epidemic levels in the Northern Territory. Underlying the slow improvement is poor social determinants including, poor housing, low levels of employment and educational achievement, high food prices, et cetera. The implications of these figures, means that closing the gap in the Northern Territory is a long term project that will need elevated levels of funding over a long period.

(2) A longer term view of the health gap shows major improvement between 1967 to 2012 with a 7.5 year increase in life expectancy for men and 14 years for females. A significant factor in this increase as been improvements in both acute and particularly primary health care. The improvements took account of evidence concerning the much lower levels of primary health care funding accessed by Aboriginal people in the Northern Territory.

The Commonwealth's Primary Care Access Plan or otherwise known as PCAP, used a multiplier of three times for Aboriginal people's increased level of illness and lower access to Medicare and three times for remoteness. That is a level of funding six times the national average was required in order to provide equitable primary health care to Aboriginal people in the Northern Territory.

(3) It needs to be noted that the Northern Territory Government provides significant funding for Aboriginal Primary Health Care. The Northern Territory Department of Health Aboriginal Primary Health Care Clinics provide just under half of all Northern Territory Aboriginal primary health care and a significant commitment in funding Allied Health Care. It also contributes to come costs for Aboriginal community controlled health services.

(4) Some of these primary health care costs of the Northern Territory Government are towards the transition of government clinics to Aboriginal

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community control. The importance of community control to Aboriginal health gap is significant and includes an improved and a broader range of services based on confidence in primary health care including services relating to alcohol and other drugs, mental health, and social and mental wellbeing, and early childhood services. This is critical for continuing progress on closing the gap.

(5) A further important reason for the need for improved primary health care services. is the epidemic of chronic disease that disproportionately impacts on Aboriginal people. Without concerted effort and resources, chronic diseases have the potential to reverse progress on closing the gap and to overwhelm the health systems with expensive tertiary treatment needs. For example, in 2016, the number of people on dialysis in the Northern Territory was 614 and has increased by 30 per cent in five years. The rates of patients on dialysis is 4.8 times higher than other Australian's rate due to a large excess in Aboriginal patients. This is incredibly expensive treatment with over 77,000 dialysis treatments being provided over the last financial year and rising.

(6) The NT Government also faces higher costs in providing tertiary health, particularly to Aboriginal patients in remote communities. This includes the Patient Assistant Travel Scheme, otherwise knowns as PATS, specialist outreach and hospital services. Around 70 per cent of hospital patients are Aboriginal, typically from remote areas with high costs including the need for interpreters and reduced ability to send home early because of the lack of specialist facilities in remote regions. The cost per person in the Northern Territory was 3.1 times higher for Aboriginal people than non-Aboriginal people.

(7) It is particularly important for the Commission to note that a significant reason for the continuing health gap is the social determinants of health, the everyday conditions faced by Aboriginal people. Addressing this will require significant long term resourcing in areas such as education, housing, employment, early childhood, and support for adult literacy. In employment, for example, only 49 per cent of Aboriginal adults in the Northern Territory are employed versus 61 per cent at the national.

The impact of housing on health and wellbeing has been increasingly recognised and is one of the most significant challenges in the Northern Territory. The rate of homelessness in the Northern Territory is the highest in the nation with the rate of people accessing homelessness services more than three times the national rate. The rate of overcrowding for Aboriginal people is 53 per cent in the Northern Territory versus 21 per cent nationally. And the proportion of Aboriginal housing of unacceptable standard was 32 per cent in the Northern Territory versus 17 per cent nationally.

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The Aboriginal housing crisis in the Northern Territory is a result of legacy issues of inadequate housing and infrastructure, particularly in the remote communities, that date back decades and have never been adequately addressed. Even with elevated funding over the past decade, the Aboriginal housing shortfall remains stubbornly present. The 1.1 billion commitment over 10 years by the Northern Territory Government is significant and welcomed, but it may not be anywhere near sufficient to address the shortfall.

(8) Implementing the recommendations of the Royal Commission into the Protection and Detention of Children, will require significant commitment from the Northern Territory Government. What is required is a major overhaul of the juvenile justice and child protection systems, including long term investment into prevention and early intervention.

(9) Educational attainment for Aboriginal children is still much worse for the Northern Territory than elsewhere in Australia. 44 per cent of Aboriginal children met year 3 writing standards and 29 per cent at year 5 in the Northern Territory versus national figures of 85 per cent at year 3 and 74 per cent at year 5. Numeracy levels were also significantly below the benchmark.

(10) Early childhood is the most effective investment governments can make. However, to realise these savings requires significant evidence based investment. Evidence based programs, such as the Nurse-Family Partnership Program and the Abecedarian Program are available to only a small minority of parents and children. The Northern Territory Government has prioritised an early childhood strategy. But to realise its vision of improved social determinants for young families, will require increased investment over a long generation period of time. We're talking about generations.

(11) The Northern Territory, probably more than elsewhere, has suffered from disempowerment and the loss of Aboriginal organisations delivering local services. However, evidence shows that empowerment and Aboriginal control of services leads to better health and wellbeing outcomes and contributes to the sustainability of communities.

The Northern Territory Government has committed to a 10 year local decision-making policy aimed at building Aboriginal service delivery and local control of services. And the evidence shows this can be delivered, long term benefits in Aboriginal health and economic outcomes. For example, the Aboriginal community controlled health sector has a much better record in Australia in Aboriginal employment than government and

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main stream, and a much better record in employing Aboriginal people in senior positions and providing career development. Just over half of the employees of our services are Aboriginal.

To realise this potential, more broadly requires additional funds to do the required capacity building over the long term. It is impossible to imagine how the Northern Territory Government can adequately address these multiple areas of acute need, should the GST allocation to the Northern Territory be reduced. I have outlined a number of areas where abandoning a system of funds allocation based on equity and evidence, would disproportionately impact on Aboriginal people in the Northern Territory and harm efforts to close the Aboriginal health and disadvantage gape. We urge that these matters be carefully considered by the Commission. Thank you.

MS CHESTER: Thanks very much, John. So your opening remarks raised I guess, bigger and broader policy issues than just the HFE system and we're happy to sort of try to talk through some of those as well. I guess if it was to try to characterise and understand your primary concern, is it a generic concern about what you think might be the fiscal impact on the Northern Territory in the event there was a change to the way the HFE system is done, i.e. the way the relativities are derived at the moment being equalisation to the highest state? Is that - am I right in – apart from the other policy issues you raised, in terms of our inquiry, that's your primary concern?

MR PATERSON: Yes. Without being too biased, I think out of all the states and territories, the Territory is you know – and given its capacity to generate its own revenue, it's similar to those of other states and territories due to population sizes, I think is probably the most needy you know jurisdiction in the nation and should be supported accordingly because of the high – you know this disadvantages to Aboriginal people, the high costs of delivering services to some of those remoter isolated communities and you know the – and all those other social determinants.

I mean, we really need a huge investment based on need and equity, basically, to really get on top of some of these underlying causes that are – if we don't address in the near future, we're going to have a much – a needier investment, financial investment from somewhere, preferably from the Commonwealth, to try and get on top and close some of those you know terrible statistics that we're obviously seeing at the moment.

MS CHESTER: Yes. And so in terms of what you understand the fiscal impact will be on the NT of our draft report, and I think we – the issue is kind of left open for us because we're looking at trying to do a transition

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plan guided by the principle that it wouldn't materially disadvantage the fiscally weaker states, and NT is there when you look at the relativities up above 5 versus larger states floating around 1 and below 1. What do you understand to be the fiscal impact on the NT then? I'm just trying to understand?

DR COOPER: I guess, our concern is that there will be fiscal impact on the NT that would reduce the resources coming to the NT and therefore impact on services and the quality of services.

MS CHESTER: Okay. So anything less than what you're currently getting is – yes.

MR PATERSON: Anything less than we're currently getting would be detriment – would have a detrimental and you know huge impact on the Northern Territory population and more so the Aboriginal population of the Northern Territory.

MS CHESTER: Yes. Because when you look at the way the Commonwealth Grants Commission does the HFE at the moment, when they – the main driver of the high relatively for the NT is indigeneity and remoteness. And that's then imbedded in what they say are your assessed expenses. We've had other participants, both in the NT and outside of the NT including some academics, who struggle with the way the HFE system does that because the equity issue is really about what the individual gets, at the end of the day, not the fiscal capacity of the state.

The fiscal capacity of the state allows the state to, if it choose to, spend it on those assessed expenses. But where there's a disparity between assessed expenses and actual expenditure, particularly in the area of indigenous, that then brings into question accountability and should the states and territories have autonomy in an area of intractable policy like indigenous disadvantage.

MR PATERSON: Yes.

MS CHESTER: Is that a concern of yours or is that an issue that you've got views on?

MR PATERSON: Absolutely. Absolutely. It's been a major concern for the Aboriginal leadership here in the Northern Territory for quite a while now. And our view is that I think until we really get on top, and I think the earlier speaker alluded to, that the accountability and knowing exactly where the Aboriginal you know extra dollars, the extra financial investment that the Northern Territory gets on the – for the Aboriginal population,

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where that is actually expended is really, really hard to get to the bottom of. And we've been asking for you know some sort of you know financial statement that can demonstrate where you know dollars have been spent.

It's a shared view of the Aboriginal leadership that until we do get to those satisfactory financial process of accountability and knowing where the dollars are expended, that we would prefer any dollars coming in that's earmarked for Aboriginal you know services or programs or whatever, it might be from the Commonwealth, that it needs to come by a quarantine or a discrete bucket to the Territory, so that we know exactly what's in that bucket. Preferably, it's all pooled, you know. I mean, I don't want to go into too much detail on whether it should be you know broken up into housing, education, or put in a silo, sorts of allocations.

But if we were able to get that quarantine and you know good frameworks, terms of references, priorities around what that expenditure is for, I think that would ease some of the concerns that the Aboriginal leadership has in the Northern Territory at the moment. There has been a perception amongst the Aboriginal community and the population here in the Northern Territory that you know governments in the past have received - and you know I can't tell you what that amount is. I wish I could. But I wish I was able to push a button and it would tell me that information.

The amount of financial investments that's come into the Northern Territory for Aboriginal specific programs has been channelled off into other priorities of government expenditure. And there's always been a perception that you know a couple of major precincts, commercial precincts buildings around the place, have been built you know on the use of Aboriginal dollars that should have been expended for Aboriginal communities and other priorities, programs, housing, education, those sorts of things.

MS CHESTER: So I guess the issue I'm raising is so there are lots of reports, like there's the Indigenous Expenditure Report, there's the report on government services, there's the CGC numbers that actually show exactly what the assessed expenses are by different categories and then what's expended. And then you've got the good work of academics that do further digging through the data to try to differentiate what's assessed versus what's actually spent. So I think that's all in the public – most of it's in the public domain.

The issue that I'm kind of raising though is that with HFE, the deal with HFE is they get the money, they get the fiscal capacity and then the state and territories have autonomy in terms of how it's spent. And as you said, there's competing priorities. I guess the issue then is should we leave

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indigeneity in or out of HFE given that autonomy's there and given we have this policy of overcoming indigenous disadvantage and we're making a bit of traction on some of the indicators that – on 53, that we look at for Overcoming Indigenous Disadvantage Report versus them not.

So is that something – because part of our report is raising the issue of doing – leaving indigeneity in the HFE for now, because we think there's fundamental reform that's required on accountability and responsibility for funding indigenous policies and programs, Commonwealth, state. So that's kind of where we're heading in the report. I'm just wanting to get your sense of if that's kind of in the right direction.

DR COOPER: Well, there are - you know there are in the Territory some significant planning health – Aboriginal health planning structures and the principle one being the NT Aboriginal Health Forum that the NT Government and the Commonwealth Government are members of, along with AMSANT, the community controlled sector, and other health players that have emerged, the PHN, and Prime Minister and Cabinet seeing as they – the roles that they've taken on as well. And that has worked very effectively, in terms of a high level health planning body and in terms of directing the Aboriginal health dollars, if you like, into evidence – in evidence based ways and according to need. And it's been operating for a significant period of time.

So there are elements, good elements of joint planning that do have within them elements of accountability with the Territory. And it's not to say that you know that those things can't be strengthened. But I think you need to acknowledge that it has – that those things exist and they do need to continue.

MS CHESTER: Our inquiry is much narrower in its focus but, to some extent, because indigeneity is driving so much of the HFE outcome for Northern Territory. Some people have suggested should we leave it in, should we take it out. And I guess at the end of the day we said, "There are all these other things happening. There's broader issues of accountability and thus let's leave it there for now and work out what else needs to be done".

And your comments about evidence based programs and community involvement, kind of resonate with us a lot because of the work we do in overcoming indigenous disadvantage and our report last year where we actually wanted to tell positive stories of things that work. So the team went out working with the Commonwealth, State, Territory Governments to try to find examples of things that worked. And across the thousand plus policies and programs, they could only find 34 that had been evaluated,

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which kind of suggested to us that that sort of coal face level of accountability needed some further work. But we're actually going to be doing some work in that are with Commonwealth, State and Territory Governments.

MR COPPEL: There's a lot of material which demonstrates that in the Northern Territory there is a huge gap, indigenous community. And we mentioned to the previous participant, when the CGC does its assessment of revenue raising capacity for the Northern Territory it comes closer to 1, which would mean equal per capita. And that reflects the fact that Northern Territory incomes are relatively higher. There's that potential to raise revenue which then leads to the question, what stops the Northern Territory from raising its own revenues higher to work towards, for example, addressing this gap? Is there anything in the HFE system that would act as a deterrent to taking that initiative on its own?

DR COOPER: Yes. I'm probably not really sort of qualified to comment really in relation to that question.

MR PATERSON: Yes.

MS CHESTER: Well maybe one area - - -

DR COOPER: I guess you know raising revenue from the population is very difficult, particularly in the indigenous population where you know it's a very high relative disadvantage so there might be very high levels at one extreme, but very low levels of income at the other.

MR COPPEL: I'm talking about taxing capacity of the NT Government raising revenues.

DR COOPER: Yes.

MR COPPEL: It can choose to do that in many ways, from an equity perspective. But it does have a strong capacity, according to the calculations of the CGC.

DR COOPER: I can't - - -

MR COPPEL: It struck me as a fair question.

DR COOPER: No, no. But I just can't comment on their calculations. I don't know what they're based on. But you know I mean the fact that a third of the population is Aboriginal and you know on average has a much

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lower level of income, we'd suggest that there's limited capacity there for - - -

MS CHESTER: So given your focus is probably more on the service delivery side of things and the expenses side of the CGC's work, so when the CGC does do the assessed expenses, they try to take into account what they call the disabilities and the two key factors we've touched on before were remoteness and indigeneity. Is that an area where you've got any views or thoughts in terms of how they're doing that today and whether that's capturing the costs disabilities as you see them playing out?

DR COOPER: Again - - -

MS CHESTER: Again if it's not an area that you have - - -

DR COOPER: Well it's not an area that I understand the detail of in terms of how those are calculated. But I mean I will say, because we have been involved in looking at detailed health funding according to need, and to try to establish what those factors are, and it is incredibly complex particularly dealing with you know multiple issues, remoteness, and a whole range of things, and how you – so it's a very complex task.

MS CHESTER: And does the alliance get involved in evaluations of health related indigenous policies and programs? Is that something that you've had input and involvement in?

DR COOPER: Sorry, do we – what's it?

MS CHESTER: Do you get involved in evaluations of current policies and programs, health related programs or indigenous Northern Territories?

DR COOPER: We do. But there is you know, as you mentioned, there is a lack of evaluation of programs and it is something that we've constantly – yes, we do constantly advocate around, the need for evaluation to be built into any sort of you know delivery of services. And really, services on their own should be evidence based at the start. And you know, at the moment, there is a good environment in the Territory around looking towards reform and towards bringing in evidence based reforms, particularly on the back of the Royal Commission.

And also I guess, from our point of view, there are issues around you know addressing indigenous disadvantage, particularly in terms of redressing the disempowerment that's occurred over a very long period of time and how that could occur and what needs to be done in order to achieve that, which again is a very long term task. But the NT Government, the

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present NT Government, has a policy that is oriented towards returning you know control to Aboriginal communities around service delivery and increasing those areas of control. And they're incredibly important in terms of what they achieve in terms of building Aboriginal wellbeing and sort of benefits in terms of health and economic areas and sustainability.

MS CHESTER: Yes. No. And they are sort of the key factors, the whole part of that Overcoming Indigenous Disadvantage Report that we expanded on last year, when we looked at the 34 that had been evaluated and 24 of them were good evaluations and they showed programs and policies that were working on the ground, the top of the pops for the critical success factors was that sort of local engagement and drive from the local communities in what those – how they're to be delivered on the ground there.

But I think for the PC it's an example of be careful what you wish for. So after we made that the theme of that report, we've now been given by the government the role of actually developing a more robust framework for assessing indigenous policies and programs across Australia and we're getting – and we'll be hopefully welcoming in the next few months the appointment of an Indigenous Policy Commissioner at the Productivity Commission which will help us do this work a little better than we would otherwise do.

MR PATERSON: Can I just go back to the earlier question around the – we're currently reviewing in the Northern Territory, well nation wide actually, how Aboriginal medical service or the Aboriginal and community – controlled health services are being funded by the Commonwealth.

And so we've been looking at different tiers of how would you distinguish between urban – and I think it was the old – is it the old RRMA? Was that the Commonwealth Grants Commission they used? I think there was about seven of them from urban to very remote or – and there were five others in between, semi-remote, semi-rural, you know. And they're looking at – there was a school of thought that that should be reduced to maybe three, maybe urban, rural and maybe very remote. I'm not sure what the other one – it might've been remote, very remote. There might've been four categories.

But look, we believe to get a real true picture and measure of what the actual investment is required in each of those – particularly in the remoter regions – parts of the country, I think you need to have at least those – I just forget the name of it. I always thought it was RRMA, remote regions, some sort of formula. I don't know how – and that's how the funding was allocated through the - I'm presuming it was the Commonwealth Grants

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Commission, some years ago. I'm not sure what – how they're based on now.

But we would be supportive of retaining that - you know, that seven sort of categories because that way I think you get a real understanding of the actual need, particularly in the remote, very remote services that have high costs of living. You know it's just – it just costs an arm and a leg. It's not like you know your eastern bullet capitals where you can just jump in a car and drive down the highway for half an hour and you're – you know you're at your destination.

I mean you'd go for a drive down here to your nearest destination, it'll take you, you know, four to five hours on a dirt road, bumpy corrugated road, wear and tear on your vehicle, the fuel costs. I mean all those factors, you know I mean, need to be taken into consideration to get a real understanding of what that real cost of service delivery in some of these areas actually tally up to.

MS CHESTER: And what's the objective of that review? John, what's the - - -

MR PATERSON: Yes. Look for the Commonwealth I think over the years, over the last 40 years since they've been funding Aboriginal community controlled health services, they're obviously wanting to know what is an actual cost. And I think what they're looking is how they – how do they allocate funding to urban Aboriginal community controlled health services to a very remote – and what are those factors, you know? Is it the very remote, it's obviously language, like I said you know, high cost of travel, the service delivery as opposed to those in the urban.

So I think they're looking for a – because it's obviously been asked in Parliament, you know politicians obviously asking, "Why is the Aboriginal community controlled health sector getting millions of dollars? How are we justifying that? So I think that was part of the exercise to address some of those questions that were being asked.

MS CHESTER: Okay. The cost service. Yes. Yes. They're all the questions that we have for you, gentlemen. So unless you have anything else you wanted to say?

MR PATERSON: No. Look if there's any reduction in the current allocations, like I said it'd be – it'll have a huge detrimental impact on the Aboriginal community and the population here in the Northern Territory specifically.

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MS CHESTER: Well thank you for presenting and appearing today.

MR PATERSON: No worries.

MS CHESTER: Thank you. I'd like to invite our final public hearing participant this afternoon to joint us, Terry(sic) Wood. Good afternoon. If you just want to make yourself comfortable.

MR WOOD: Saved the best till last (indistinct).

MS CHESTER: Well, we'll wait and see.

MR WOOD: You might be - - -

MS CHESTER: We'll wait and see.

MR WOOD: You might be worn out by then.

MS CHESTER: Would you like a clean glass? Are you - - -

MR WOOD: No, I'm fine.

MS CHESTER: You're fine, okay.

MR WOOD: I've got an Estimates Committee meeting to attend.

MS CHESTER: All right.

MR WOOD: But they won't miss me. Don't put that on the - - -

MS CHESTER: Well, thank you for joining us. And if you wouldn't mind just stating your name and who you represent for the purposes of the transcript recording for voice recognition and then it you could just make some brief opening remarks.

MR WOOD: Gerry Wood, independent member for Nelson. So I'm an independent member in the Northern Territory Parliament. I've got a prepared few lines there, but I'd rather just comment on some of the other things that were said because my – part of what I was going to talk about today was local government funding which is also an important part of the development of the Northern Territory.

I've said this in Parliament actually, I think it's great that you have having an inquiry because I think it's a bit of a wake up call for the Northern Territory. I've lived here since I was 19, so worked on Aboriginal

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communities, worked locally in the rural area of Howard Springs. And I do think that we need to sort of start to look at ourselves as a territory. How long can we depend on government funding? A lot of the community groups you see funded by the Commonwealth, many of our Aboriginal communities, rely heavily on their economy based on either directly or indirectly, Commonwealth funding through the NT or directly.

Much of the Northern Territory itself is Commonwealth funded. Defence is one of our biggest areas of the economy. Administration. And below that you get mining. So you've got to go down three places before you get to a point where the Territory is actually producing money. And I'm not expecting that that will change overnight. But I think it's given us a moment in time to say you know, "Have we developed to some extent a cargo cult mentality that there will always be Commonwealth funding. The Territory will always be special and all the other states will be nice to us and give us a big chunk of money". The reality is, I think with this inquiry and the issues that have been raised, that it might not always be the case.

And my understanding of the HFE is that it is not bound by anything more than a Parliamentary piece of legislation which could be changed overnight, regardless of what the states think. So we are, to some extent, I suppose left to the great charity of the rest of the nation to make sure that we get the funding we need. And I'm not here to argue that we shouldn't get the funding because you've heard AMSANT and Robert Parker and other groups tell you that providing services out bush requires a lot of money.

And it is, to some extent, about equity, because I was just reading the original agreement about the practice of HFE in Australia and it says "State Government should receive funding from the pool of Goods and Services Tax revenue such as, after allowing for material factors affecting revenue and expenditure, 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". So that's the way it's been put forward of course, and that could change. So I presume part of what you're talking today is should it change, and you have raised what I think are some important issues.

My wife is Aboriginal. She was born at Bulgul or Channel Point, which is down near the mouth of the Daly River. She has a grade 5 education. That's probably as far as she got. She can read and write. She can do all the crosswords. She can beat me at Scrabble. And my daughters, the three of them, would regard themselves as Aboriginal, all got good jobs with the Commonwealth Government.

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The issue that I wonder is what – and AMSANT mentioned it before, whilst it's nice to talk about Aboriginality and I understand that's part of our culture, we should be looking more at what the needs of individuals is. I'll give you a classic example. We have two forms of help for kids at school, I presume it's still there, ABSTUDY and AUSTUDY. So one is for Aboriginal kids and one is for AUSTUDY. Some of my kids got help through the ABSTUDY. But should it actually be help based on a person's needs. You can have a poor non-Aboriginal person who can need help, as much as you can have a richer Aboriginal people that doesn't need the help.

So if we've got issues in the Territory because of remoteness, should it be because it's a remoteness rather than because there's certain people in there? So to provide services to that particular community, do we base it on Aboriginality or would it be based on the need of that population, which may not all be Aboriginal by the way. Some of our small towns are mixed groups of people. So should we be looking more at that?

And should we be also saying that by lumping everything in to Aboriginality, are we losing the equality you might say? So people who are of Aboriginal descent in Sydney may have a pretty reasonable lifestyle. My daughters, they don't need any assistance. They're on good wages. So is that formula uneven across Australia, simply based on "That's my classification", rather than "Who actually am I? What is my background? What is my income? Do I live in a nice three bedroom house or do I live on an outstation where I've got a tin hut?" And so I think we need to look at things a little bit better. We need to think about what we're trying to achieve.

I think as well, this is an issue that again I was listening to AMSANT there, I think all governments have got to think about why they should spend money on Aboriginal communities and there's two ways, do you just let these places drop off and services diminish and people drift into town and then we've got more and more problems in town with people drunk, people homeless, people getting disease, or do we understand that people have a strong connection with their land and that we should help fund some of those communities that are outstations?

But at the same time, we've also got to make sure people have got pride in themselves. And one of the things that's annoyed me for so long is unemployment. I started off at Daly River and then I started off at Bathurst Island. At Bathurst Island I worked for the Nguiu Shire Council which was the first Aboriginal council in the Northern Territory. We employed at that time every man, because that was mainly what my – the council employed.

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And then about 1978 the Labor Government decided to introduce unemployment benefits and that on, that time on, we have many people in our community that are basically dependent on the CEP or unemployment benefits. So we've lost that employment, you might say, culture which I think is important that people work not only for the benefit of themselves but for the benefit of their community.

Now I'm not saying - there's a lot of good people out there, and you've got to be careful when you generalise here. There's a lot of good people that work and there's a lot of good communities. But as someone said before, we have some of the highest unemployment in those communities. So I think the government has got to keep funding going, but I think it's also got to support not just the physical, that is we've got a good health clinic here or we've got something over there, but also find ways of overcoming those social issues.

People talk about overcrowding. Now I've been following the SIHIP program for many years. I was on a committee that our government tried to keep track of all those houses. And there have been many, many new houses built but in a lot of cases it never caught up with the overcrowding because they had to knock down the old houses, they were in such a bad state. So when you look at the pluses and minuses, it hardly achieved anything. It is still going.

But where do we keep saying that – where's the responsibility of people to sort of get to the point where, "I spend my money on buying a house". So if you want people to have – Aboriginal people to have self-determination, where's the effort to say, "You've got to make an effort. You've got to try and buy your own" – "build your own house. You can't rely on the government forever and a day to do it". So how do we give people that ability to be able to do that as well? Otherwise I think we will continue with the cargo cult mentality, "I'll be fine. The government's going to provide us with houses".

So I just think that what you're doing is good. I don't think we're going to get – I would hate to see this change happen for a while yet. I think the Territory Government has not got a lot of ability to raise taxes, I heard before. And one of the reasons is because we've got nearly a negative population growth. Now as soon as you start taxing things, whether it's a land tax or increased payroll tax and you've got an economy that's basically not growing, I think the reverse will happen, you'll have a bigger drop off in population and you'll have less economy and therefore there'll be less GST. I think it will actually work in reverse.

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When the economy's booming and I know we've got impacts – but impacts have limited effect on the economy of the Territory. It had an effect, but once they're gone, which will probably be in the next two or three years, that is the major development, we'll go back to what we used to be before.

MS CHESTER: Okay. Well, thanks Gerry for those opening remarks. We might try to bring it back a little bit more to the specifics of the HFE Inquiry that we're tackling at the moment. In your opening remarks though you did say that you wanted to talk a little bit about local government or local council funding.

MR WOOD: Yes.

MS CHESTER: And as we understand it, I mean our focus is on the HFE as it applies between the Commonwealth and State and Territories. But below that there is another level of HFE in terms of the territories and the states allocating funding to local councils. And we heard earlier from an inquiry participant that they thought, in the Northern Territory, that it was sort of done on an equal per capita basis with some sort of adjustment above that.

MR WOOD: Yes.

MS CHESTER: Is that your understanding from your background?

MR WOOD: Yes. I've spent 13 years on local government as well, so I – this - - -

MS CHESTER: So what form of equalisation, if any, occurs at the Territory level from Territory Government down to local councils?

MR WOOD: Well - - -

MS CHESTER: And who decides that policy?

MR WOOD: Well, there's a couple of revenue sources for a local government. One is it gets – the local government in the Northern Territory gets its money based on population. So straight away instead of Horizontal Fiscal Equalisation, so out of the GST bite, the one bit that is not given the same is local government funding. So it's purely based on population.

And I just can give you a couple of examples to show you the difference. So if you took the shire of Longreach, 40,000 square kilometres, population 4092. It gets $5.5 million in general purpose grants. The

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Barkley Shire, just over the other side of the border more or less, has an area of 323,514 square kilometres, 42 per cent bigger than Victoria, has a population of 8000, double, received $1.8 million in general purpose grants.

In road funding, the ACT, big old ACT has 1837 kilometres of roads and gets $21 million. The Northern Territory local government area has 13,872 kilometres of roads and gets $15 million. There is a vast difference between the two. Even my own local council, which is Litchfield, population 23,000, area square kilometres about 3000 square kilometres, we get $497,000. Ararat in Victoria, 4200 square kilometres, population less than half of ours, $3.3 million.

So from a local government perspective which also very much affects Aboriginal people especially in the Northern Territory, because those large areas like the Barkley, like McDonald Shire, they are mainly Aboriginal people living there who, as AMSANT said, they travel those roads and we don't have a lot of funding. The Territory Government does give them some funding but not a large amount.

So the system at the moment, when it comes to local government is – it doesn't work for the Territory. We certainly miss out. And if you wanted to look at it – if you weren't going to change that, then don't make it less in the new policy, because we are well and truly disadvantaged from that point of view. So if you give us that dose, then we are further behind the eight ball, because we have you know very big challenges in the wet season.

If you want to travel in the Northern Territory, sometimes, especially remote communities, you just simply can't, either the roads are out or there's no bridges across some of the floodways and that. So you know, transport is a – travelling by road is something that we try and do but then you have to use an aeroplane in the wet season and immediately the cost of travel, the cost of patients coming into hospital, all that sort of thing, the cost of people working, teachers going out early in the wet season to start the school year, all that is more expensive because we don't have a road system that's equivalent to a lot of the other states.

MS CHESTER: Well, maybe if we then bring it back to the HFE story then and we'll leave local council alone.

MR WOOD: That's all right. Yes.

MS CHESTER: But we just wanted to try and get an understanding on what version of HFE occurs Territory to local council because it's – as we understand, pretty dissimilar to HFE Commonwealth to State Territory. But just on the point that you raised about sort of the cost disabilities for

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remoteness and then another point that you mentioned earlier about making sure that any adjustments for indigeneity in terms of cost disabilities are relevant adjustments in terms of – so I'm not sure if you're aware though, the way the CGC does it at the moment for indigeneity, it's not sort of on a one person NT versus one person New South Wales. There's the remoteness factors, but there's also an index based on socioeconomic which it's kind of a little bit more of that look through that I think you're - - -

MR WOOD: I think I was talking about the total pie, and if the pie is being reduced by people who live in New South Wales claiming Aboriginality that, as I said, perhaps don't need it. In other words, we should be targeting the people that really need it, not the people that don't need it. Just because they're called Aboriginal, doesn't necessarily mean they're poor. They could be quite well off living in a nice house. Is that the people we're targeting, or we people – or are we targeting the people who have low health outcomes, overcrowding, remoteness, et cetera, et cetera?

So should we be targeting the people that we need to, rather than just having this blanket, "You're Aboriginal, therefore we'll cut the pie up this way". And what happens there is the people who need the help don't necessarily get the help because some people who don't need the help are getting funding and that's probably what I'm looking at.

MS CHESTER: Yes. Well I think that's what the CGC are trying to do with those indices.

MR WOOD: Can I just say one other quick thing? I know that it was mentioned about, I think it was Yothu Yindi. I wasn't here when – and they were talking about how the money that they believe the Commonwealth gives is not adequately spread out to the people it's targeted at, and I heard Paul Henderson talking about it. Could I say one of the – to me you know, it – we can get a bit silly about this. The hospital in Darwin is built for everybody and so about 70 per cent of the people who use that hospital are Aboriginal people. The road that was built to take those people from the hospital from their community there was built for everybody. And if you wanted to get technical you say "Well 70 per cent of that road is built for those people that have got to go to hospital".

The schools, there was – my areas has got about 10 per cent Aboriginal people. So 10 per cent, do I charge 10 per cent of the building and the running of that school, to Aboriginal? Who does all that sort of work? So sometimes I think you can get saying, "Well, this money must specifically be used for that". Well, we don't live in a sort of split society. We've got areas in the Territory where we all live together. So how do you work out whether that amount of money went to those sort of people exactly? It beats

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me. I think that sometimes you can get a bit simplistic and you know, as Paul Henderson said, there was a auditor's report and it came out that you know it's wasn't the case. So I think - - -

MS CHESTER: So I think you need to be careful firstly not to mischaracterise what the Yothu Yindi Foundation said.

MR WOOD: I was only hearing what Paul – what you said at the table, so maybe I misinterpreted that.

MS CHESTER: No. So I mean and it's not just Yothu Yindi Foundation that have raised that us. We've had other submissions from academics and people that have been involved in Commonwealth State relations over many, many years, that raise the issue of the way HFE works is that there's cost disabilities and for the NT the biggest one is indigeneity and then remoteness. But when you do a look through as to how the money is then spent, the cost disabilities don't align with the effort, i.e. what's actually spent by the NT Government. And they just raise issues of "Well is that really fair and should there be autonomy".

MR WOOD: And I think you get that – the hard thing is, you're trying to mix things together. We're a mixed society and money gets mixed between the groups. So how you filter that out to say, "Well, that's that bit and that's that bit", I'm not sure and I'm sure that it really achieves a lot of things either. Yes.

MR COPPEL: Well that's the task that the CGC tries to perform and that's one of the reasons why a number of participants have said that you know the goal is full equalisation practice and we fall a bit short of that because it's not perfect.

MR WOOD: Yes. And that's why I'm saying need, I think is something we should aim at. We need to focus the money where it's most needed. And just lastly, you mentioned about taxation and this probably won't be the most popular thing, but you know I think Aboriginal people, just like the rest of us, have got to try and develop an economy. Now how that's developed, because again if you want self-determination, the best way of self-determination, you have control over your life your economy rather than relying on.

Now there are royalties in some areas. Now those royalties generally to the TOs because that's the way that legislation is. But it seems to me that we perhaps need to look at seeing whether royalties also can be spent for the benefit of a community. I'm not - and some people do. I gather dialysis machines are funded by community, which I think is fantastic. But I do

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think we need to look at that as well. That's an economy that sometimes only goes to a fairly narrow group. Other places, it certainly expands, but it's an income.

And my concern is that we can't continue to presume that we will live on you know money from the Federal Government. That's a presumption that we think might happen. But the Territory is very small. It's only a Territory and it won't even – it probably wouldn't even make a difference if it was a state. But it get outgunned by the rest.

So I think we have to make the effort to try and grow an economy both - Aboriginal people as well. They own 50 per cent of the land. They have native title interests in the rest. They have 35 per cent of the population. We need to make sure they grow with the Territory, they are part of the economy, otherwise you'll have "us" and "them" type. But I think we also have to say "You have to make an effort because there's no guarantee that this money is going to come forever and day".

So I think that's why I think that the inquiry is a good wake up call for us as Territorians to say, "Hey, what are we doing to help ourselves", and don't think taxation is the way. I think boosting the economy and getting jobs that way is the way to go.

MS CHESTER: Okay. We don't have any other questions for you, Gerry. So thank you appearing this afternoon.

MR WOOD: Thanks. Thank you.

MS CHESTER: Well, Gerry was our last formal participant for the hearings this afternoon. I am happy if anybody else has a burning desire to share their views with us and they didn't lob in a participation form with us. We're happy to hear from you. But I don't see anybody jumping off their seat, so I can assume that we can therefore close today's hearing and we'll resume tomorrow morning at 8 am. So thank you very much everybody.

MATTER ADJOURNED AT 4.40 PM UNTIL WEDNESDAY, 29 NOVEMBER 2017 AT 8 AM

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Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO HORIZONTAL FISCAL EQUALISATION

MR J COPPEL, Commissioner
MS K CHESTER, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT BROLGA ROOM, NOVOTEL CBD, 100 THE ESPLANADE, DARWIN, NORTHERN TERRITORY
ON WEDNESDAY, 29 NOVEMBER 2017 AT 8.00 AM

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RESUMED **[8.00 am]**

MR COPPEL: Good morning and welcome to the public hearing for the Productivity Commission Inquiry into Horizontal Fiscal Equalisation. My name is Jonathan Coppel, I'm one of the commissioners on the inquiry, and I'm joined by fellow commissioner and Deputy Chair of the Productivity Commission Karen Chester. I would like to begin by acknowledging the traditional custodians of the land on which we meet today, the Larrakia People. I would also like to pay my respects to elders past and present.

A little bit on the inquiry process and the conduct of the hearings today. This is the second day of two days of public hearings in Darwin and it is very well attended public hearings, we've had all told by the end of this morning I think 14 participants. And I think that's a record for the Productivity Commission on any inquiry for public hearings held in Darwin, so obviously a topic of great interest to Northern Territorians.

We've also held hearings in Perth, Melbourne and Adelaide for this inquiry and we will follow through with hearings on Friday this week in Hobart. We will then be working towards finalisation of the report which will be submitted to the Australian Government next year and participants and those who have registered with their interest in the inquiry will be alerted when the final report is released by the government, which may be up to 25 Parliamentary sitting days after the report has been submitted.

In terms of the conduct of the hearing, the purpose is to enable us to get feedback and allow public scrutiny of the Commission's work to tell us where you think we've got it right and where you think we've got it wrong, and where we may have had gaps that we haven't addressed that are relevant to the terms of the inquiry. We also draw on the public submissions that we've received, both pre draft and post draft, and I thank in advance many of the submissions that have been submitted by stakeholders in the Northern Territory post draft.

We do like to conduct the hearings in a relatively informal manner but I do remind participants that a full transcript is being taken and for this reason comments from the floor cannot be taken. However at the end of the participants speaking this morning we will have an opportunity for anyone who would like to make some brief comments before we close the hearings today.

A few words on how we conduct the hearings. Participants are invited to make a short opening statement. We'd like you to keep those brief, five to

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seven minutes, and this will allow us time to raise matters in submissions and on the points in your opening statement in greater detail. We don't require participants to take an oath but participants are required under the Productivity Commission Act to be truthful in their remarks.

The transcript of today's hearings and other hearings will be available from the Commission's website following the hearings. It takes usually just a couple of days. And also the participants' submissions to the inquiry are also available on the website. We have a number of media representatives here today and they have been briefed by PC staff on the ground rules so they'll be here for the opening statement and when the hearings start the media will - at least the TV media, will no longer be filming. Another requirement that I'm obliged to keep you informed about is the event of an evacuation under our Occupational Health and Safety Legislation. You are advised to leave the room, exit the hotel and follow the instructions of the fire wardens. We're on the ground floor so obviously don't take any lifts to elsewhere in the building.

Now that is the formalities and bit about the process of the inquiry. I would like to invite the first participant, the Treasurer of the Northern Territory, the Honourable Nicole Manison, to first give your name for the record and then if you would like to give a brief opening statement, thank you.

MS MANISON: Thank you. Nicole Manison, Treasurer of the Northern Territory. So good morning, Commissioner and Deputy Chair, and welcome to Darwin and the Northern Territory. I would also like to acknowledge we are on Larrakia Country and pay my respects to their elders past, present and emerging. I am joined today at the table by the Under Treasurer, Craig Graham, for the Northern Territory. And I would like to thank you again for travelling to the Territory to hear the views of the Northern Territory Government, business, industry, and community representatives, on the importance of maintaining HFE, horizontal fiscal equalisation, in its current form.

As you have read in the Northern Territory Government submission into the inquiry, we are, and we will always be, staunch defenders of the current HFE which provides each state and territory with the capacity to provide the same standard to services. HFE ensures equitable capacity for all governments to provide services to their constituents no matter where they live in Australia.

The Commission's draft recommendations to change the measure of HFE from equal to reasonable seems small enough but it would have far reaching and long term repercussions for every Territorian. If adopted, these changes could permanently reduce the standard of services and infrastructure in the Territory and Territorians would be worse off. This means worse

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roads, fewer teachers, fewer nurses, poorer quality infrastructure to support Territorians, fewer health services, fewer police on the beat. If adopted, these changes will simply make the rich states richer and the poorer jurisdictions like the Territory poorer.

The policy rationale underpinning the Commission's recommendations are not clear to the Territory. The Commission has made recommendations that look set to benefit one state, or the fiscally stronger states, without any evidence that this will deliver any net gains in terms of economic productivity or efficiency, or social wellbeing of all Australians. We believe the Commission's recommendation around equal to reasonable is at odds with equity and treating all Australians equally, which is the fundamental core of HFE and Australia's Federal system.

As the Territory has stated in its submissions, as have many other jurisdictions and contributors to this inquiry, HFE puts all states and territories on a level playing field in service delivery to Australians. The Commission's rationale that HFE has gone too far and that the level of redistribution has exceeded some unstated benchmarks goes against the fundamental purpose of HFE. HFE was never intended to be a budget balancing item for Western Australia, it is not meant to help states balance their budgets, it is a fiscal mechanism to achieve a social objective.

HFE has always been about access to services and equity of services. The current system of HFE has performed well and delivered fiscal equalisation outcomes as intended, particularly over the past 10 years, which has seen a divergence in states' economic circumstances. As you can see from the range of Territory participants at this hearing, the Territory stands united against any move away from full equalisation. All Territorians share our concerns about the impact of the Commission's draft recommendations will have on the Territory's economic future, and particularly the ability to reduce the gap on Indigenous disadvantage and to develop the north.

As I said at the outset, the recommendation to change the measure of HFE from equal to reasonable may seem small enough but would have far reaching long term repercussions for every Territorian. We believe partial equalisation would further entrench Indigenous disadvantage in the Territory and remove the ability of the Territory Government to provide services at standards comparable with other states. It would reduce the Territory's competitiveness and ability to support economic development and improve much needed infrastructure.

The Commission's recommendations would affect the Territory more than other jurisdictions because Commonwealth funding is a pivotal part of the Territory's finances. Total Commonwealth funding accounts for 70 per cent of the Territory's budget, and 50 per cent of that is GST, 20 per cent tied payments, compared to about 45 per cent for other jurisdictions. The funding

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requirement for the Territory is higher than most because it costs more to deliver the same level of critical government services in the Territory than in other jurisdictions. That's just a fact.

Thirty per cent of the Territory's population is Aboriginal. Of this population 80 per cent live in remote and very remote areas. The Territory population is spread across a vast geographic area, one sixth of Australia's land mass. The Territory's small population leads to a lack of economies to scale on service delivery with a higher per capita service delivery costs across all government services. The Territory's higher share of the GST revenue is a reflection of these unavoidable factors affecting the cost of necessary service delivery which should be at a basic expectation of Territory residents.

In the Territory the majority users of government services are Indigenous people. For example, while Indigenous Territorians make up 30 per cent of the Territory's population they represent about 70 per cent of the Territory's hospital separations and about 85 per cent of Public Housing tenants. As mentioned, 80 per cent of Indigenous Territorians live in the most remote and very remote areas and they are some of the most disadvantaged people in this country. They also have a very strong connection to their country, which is deeply important.

That's why even a small change on how we receive Commonwealth funding can have such a large impact in the Territory. For example, we've already seen through the 2017 update of the Commonwealth Grants Commission, or the CGC, led to a $2 billion downward revision of the estimated GST revenue to the Territory over forward years. This was largely due to a drop in our GST relativity which saw our share of the GST fall from 5.4 in '16/'17 to an expected share of 4.7 in '17/'18. Worryingly, it was the factors outside of the Northern Territory's control which led to a decline in this relativity.

In particular, a decline in the delivery costs of remote services in some other larger states led to a lower national average cost as calculated by the CGC. Because funding need is assessed against the national average the flow-on effect of this was a lower assessed funding need for the Territory. This is particularly concerning to me as services such as remote health and education are critical areas of disadvantage in the Territory. These are critical areas of need and the national effort in closing the gap on Indigenous disadvantage.

It is these issues that we will continually work with the CGC to refine. It is not, however, a reason to throw the principles that underpin HFE out the window. HFE in its current form is the best mechanism for achieving equity of access to services and for promoting national wellbeing and HFE does not impede states from pursuing economic growth, productivity, or tax reform. Because these draft recommendations made by the Commission will only

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widen the gap, exacerbate the extreme levels of disadvantage the Territory faces, and this will impede economic development of the north.

I understand the Commission has indicated at hearings in Adelaide that it was investigating ways to transition state's negatively affected by its proposals, it is not clear still what that could mean. The draft recommendations would leave the Territory permanently worse off. As I said, it would stand to widen the gap on Indigenous disadvantage, a point that is important not only to Territorians but to all Australians.

As the Commission itself has found, assessing indigeneity in the CGC processes is valid and important. The Commission's draft report discusses various methodological issues that have been raised by the states and correctly notes that the CGC will be considering these as part of its 2020 review. Consideration by the CGC is the appropriate process for dealing with these issues. A total overhaul of the form of HFE is not the appropriate way to deal with this.

The Territory is an emerging economy which has held self government for less than 40 years. At the time of self government the Territory inherited an undeveloped poorly maintained infrastructure stock with huge investment required to bring roads, schools, hospitals and social housing, to standards up to those expected in other states across Australia. For example, even today 75 per cent of our road network is unsealed. We are still trying to meet the infrastructure shortfall which as you know is not taken into account under the current form of HFE.

In order to have any impact on increasing the standard of infrastructure in the Territory the significant additional investment required in the Territory needs to be funded outside of HFE such as quarantined Commonwealth payments. Changing the current form of HFE would make this task even harder and will set the Territory back years in terms of both addressing our infrastructure gap and our gap of outcomes that we have there for our Indigenous population.

My final point to the Commission is to highlight the inconsistency between the recommendations to water down HFE and the Commonwealth and the Territory's priorities in these areas of Closing the Gap and developing the north. The north of Australia is home to the majority of Australia's Indigenous population. The north of Australia is rich in natural resources and is strategically located in the region but is challenged by infrastructure deficits compared to the densely populated eastern states.

Population concentration and industry investment targeted at the larger and southern states does not serve the nation well and comes at a cost. National productivity will be best served through greater regional economic development. To reach Australia's full potential we must reach Northern

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Australia and the Northern Territory's full potential economically, culturally, and socially. This task is made more difficult if the Commission's recommendations in their current forms are accepted by the Commonwealth Treasurer.

I hope these points are understood by the Commission as you go about your task of finalising the report for this inquiry. And I also hope that these points are well understood, certainly by the Federal Treasurer, before making decisions based on the Commission's recommendations and what they decide to do going forward. As I have stated in my covering letter in our submission to the Commission's draft report, it is in the interests of all Australians to close the gap on Indigenous disadvantage and to develop the north. Otherwise to do otherwise it would be a national shame.

I again want to thank you for travelling to Darwin to hear the views of Territorians on this important topic and for hearing them today. I really do appreciate it because as you can see this is an issue that's very important to the Northern Territory, so thank you.

MR COPPEL: Thank you. There's a lot to cover there and I thought I'd start by just focusing a little bit on the current system. You made the point that it's working well, it's working as intended, and I would like to get a sense from you as to how well it's actually achieving the objective that it sets itself, which is to provide the same average level of services for the same level of effort for the jurisdiction of the Northern Territory?

MS MANISON: Well, clearly what our concern was with the draft recommendations it was if we were to change the process of equalisation we would stand to lose more money through the GST distribution here in this country. We do know that we have some very large gaps in the Northern Territory around the areas of health, education, certainly when it comes into our justice system, and often we see the large deficits and disadvantage with our Indigenous population here in the Northern Territory. We do everything we can as a government to service that need and we are always very conscious that you need to have the capacity to go and respond where you see a priority for funding and where it is needed to improve those services and to be able to drive policies to make improvements for the Territorians.

This task will be made all the much harder if we have less capacity to do so with less money coming in to the Northern Territory. So we absolutely endeavour to improve service delivery for Territorians, we acknowledge there is a very large gap in disadvantage when it comes to particularly our Indigenous Territorians but this task will be made all the harder if we had less funding coming in.

MR COPPEL: The reason I asked the question is that in yesterday's public hearings there was a lot of focus on the actual approach that the CGC takes to

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assessing remoteness and with the specific factors that are particularly acute for the Northern Territory, and I think you touched on some of those.

MS MANISON: Yes.

MR COPPEL: We've also heard that a lot of the part of the assessment on the revenue side starts on the basis of people per capita, and that proportion shifts from one jurisdiction to another. But there's a gap between the actual aspiration of the goal as set by the CGC and the realisation of that and I'm just trying to get a sense of the materiality of that for a jurisdiction like the Northern Territory.

MS MANISON: So we're continuing discussions with the Commonwealth. I think a great issue where we have that further exacerbates those gaps and the challenges of the service delivery is the fact that we do have the infrastructure deficits. And one issue that I've been working with with the Commonwealth, and I will be working with the boards and treasurers, is the fact that HFE doesn't address those gaps. That's not the intended purpose of HFE as we know. So HFE does not help us address those gaps and disadvantage.

I get very frustrated where we do see money coming in to the Northern Territory from the Commonwealth that is to assist in targeting some of those gaps and then that is used to assess the Territory share of the GST. For example, remote housing is now utilised and assessed against our distribution of the GST, and that is an area where we have huge deficits and huge infrastructure gaps. And then the flow- on effect to the social outcomes of poor housing affects our ability in our service delivery here in the Northern Territory because we know that the flow-on effects from poor housing is health, education issues, a bit more likely to end up in the justice system and so forth. That's just one example.

Another infrastructure gap where we've got, which would enhance productivity as a nation because we'd have better access for business development, economic development, as well as the social need to be able to travel around the Northern Territory, is roads. So another point of frustration I've had recently is where we got this wonderful funding in for the Northern Australian Roads and the Beef Roads, so we got around a bit over $200 million in one hand to fund those roads, which is great, you got and you seal more roads, but then on the other hand, and that's an area of disadvantage with 75 per cent of the road network unsealed, on the other hand that got assessed with our distribution of the GST and then we pretty much so lost 200 million on the other.

So, great, we got $200 million worth of extra sealed roads but then on the other hand we lost another $200 million to go service Northern Territorians in areas of need and disadvantage. So we're working through

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that issue of how we better target those areas of disadvantage to make sure that we're not given on one hand and losing on the other. But if we are to change HFE so the Northern Territory starts getting less money from the start then that's not helping us.

MR COPPEL: Well maybe I will come back to the points you made about the equity of the systems and that the changes would be a departure from the equity principle that's embodied in HFE. And we pointed out in the draft report that the equity concept is a concept between individuals and what the equality that underlies HFE is to provide a jurisdiction capacity with the same effort to provide government services but to meet the equity objective you need to be able to follow through on that in the delivery of those government services.

And it's been pointed out in some work, including by academics, that the high level of assessed expenditure for the Northern Territory particularly reflecting remoteness and the factors to a high Indigenous population has led to high expenditure assessment but the actual expenditures are not following through in those particular areas, are going into other areas of government spending. So the point has been made that achieving that equity goal requires more. And I would be interested in getting your reaction to that sort of work, it's not just an individual, that gap between the assessed expenditure and the actual expenditure on particular areas like dealing with remote communities.

MS MANISON: Yes. So I think it would be fair to say that to access a lot of those specialist services, for example, those hospital services, that Territorians in remote areas often have to come into town, into our main urban centres of Darwin, Katherine, Tennant Creek and Alice Springs. So when you look at some of the reports that even the Productivity Commission produces, whether that be the report on government services, the Indigenous Expenditure Report, you will see that here in the Northern Territory we do have 30 per cent of our population again being Indigenous and we know that around 50 per cent of government expenditure goes towards Indigenous Territorians.

There is a lot of reporting that goes against service delivery here. And I think it's fair to say also, though, that a lot of those critical services that people from remote communities and remote areas do access do end up coming in to some of the mainstream services such as RDH, the Alice Springs Hospital, as well. But there's a lot of reporting that goes against how that money flows through out to the bush and out to the remote communities. But I again come back to the point that we are starting from so far behind when it comes to infrastructure deficits, and they are critical to closing the gap on some of those social issues, that there is still a lot more work that needs to be done.

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But as a government we are very focused on making sure that we provide the services to people in remote areas that are needed but some of those infrastructure gaps are very wide and so the costs are very high, but nonetheless we continue to make every effort to do so. And I think our commitment to education, in particular to increasing education resources that we've been doing, but also our commitment to housing, has been very critical to our work that we're doing to try to close that gap.

MS CHESTER: And indeed when you look at the metrics of the CGC, "Prepare treasurer over six years", and I think that might have been the table that has been popped in front of you there by your own treasurer, on the whole you are spending your assessed expenses, it's just when you look through to some of the categories there's some where there's big overspends, like post secondary education, and you're punching above weight on housing, and partly that might reflect what you're talking about with the infrastructure deficit?

MS MANISON: Yes.

MS CHESTER: And that's become a priority.

MS MANISON: Yes.

MS CHESTER: But what's been sort of pointed out to us by some of the Indigenous groups that we've had submissions and heard from, and other academics that have done some work in the areas, the welfare one, which is quite an under spend compared to your assessed expenses. So it sort of comes back to this point of the equity objective, equality is kind of a bit of an aspiration for HFE but for it to be an equitable outcome you'd see it being flowing through to where those assessed expenses are seen as the greatest. So you can see that there's a bit of a tension there and partly it's because the way the GST is allocated, as you pointed out earlier, it's you have autonomy in terms of how it's spent. But then it might also bring into question whether or not you're really delivering on that equity objective.

MS MANISON: But again I come back to the point with the draft recommendations around equalisation and changing it, with what is proposed at the moment the Northern Territory would receive less GST coming in to the Northern Territory. It is going to make that job all the harder if we as a government have less capacity to go fund the areas of service delivery that we see are needed. And for us targeting service delivery to improve outcomes for Indigenous Territorians is very, very important to us and if we have less capacity to do that through less money, through the GST distribution, that just makes it all the harder.

MS CHESTER: And I think yesterday we got a sense that maybe how people understood in the NT, the participants that have been interested, what

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the impact of our report might be. Albeit they're draft recommendations, and we did note that we did quite a lot of work around any transition path given at the starting point, there's been a bit of a conflating between other changes that you mentioned that you've experienced in your relativities because of the CGC versus what we're doing and people were talking about very large numbers, which aren't really - could in no way, shape or form be attributed to our draft recommendations.

But it will be helpful, and maybe your own treasurer might be able to help us here, just unbundling what were the key drivers or the factors behind that quite significant reduction in the NT's relativity, how much of it was sort of population versus costs, versus, you know, the factors of the CGC, and to what extent they might be addressed as part of the methodology review?

MS MANISON: I will come back to, though, and I'm sorry to keep harping on on this, Deputy Chair, but with regards to the draft report of what you have got here, and in place at the moment in the draft report the Territory would stand, if you were to change the distribution as proposed in the draft recommendations, we would stand to lose funding. We're not going to end up better off there, we will lose funding coming into the Northern Territory, so that makes our job all the harder.

The work that we're doing with the CGC and the discussions that we've had with the CGC, and certainly I've raised it with the Commonwealth Treasurer as well, with regards to the last assessment because that was an unprecedented situation, we've never seen such a steep drop in the assessment, it's had a deep impact on our finances going forward. But effectively there was an element of population in there but really, for us, where we found some real difficulties was the fact around those assessment areas around roads, around remote health and remote education, that really impacted us in that assessment.

And, of course, as we've been discussing these areas, and as you would have heard yesterday from some of our peak Aboriginal organisations where we do have some very extreme disadvantage, but I will let - Mr Graham, do you have anything else to add to that?

MR GRAHAM: Yes, we can give you the detailed breakdown of the components of the reduction or the components that attributed to that reduction of relativity. And it is, you know, things like population, changes in Commonwealth funding. And also a significant contributor was changes in expenditure patterns and things like remote health, remote education in other jurisdictions. So, yes, as part of the methodology review we need to understand what's driving those expenditure patterns and whether that is, you know, whether it's a measurement issue or whether it's a policy issue, or what's actually driving that and - - -

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MS CHESTER: Just, because I'm conscious that we've got media and stuff here, so how much of it was kind of population and other government transfers coming your way versus those assessed costs?

MR GRAHAM: From memory, I think it was they were roughly equal, I think it was about 40 or 50 million. But I'd need to get that break down to you.

MS CHESTER: And taken collectively over your forward estimate period, what's the impact of that to the revenue that you would have otherwise got from GST, I'm just trying to - again, we've got some issues being conflated here and it's good to unbundle it a bit.

MR GRAHAM: Yes, it's at, you know, four, five hundred million dollars a year over the forward estimates.

MS MANISON: And in a place where our budget is $6.7 billion this year, like that is a huge amount of money. A huge amount of money, $500 million a year, and, you know, like I said, every cent counts here in the Northern Territory of being able to target that disadvantage. But again, I come back to the point where if we are to target that disadvantage and overcome some of those issues we only stand to enhance the productivity in the Northern Territory and overall for this country. Because really, our main game here that we want to focus on is economic development here in the Northern Territory, of developing the north.

Our Indigenous population are a very important part of that and making sure they're part of that journey too as well as it's just the right thing to ensure that they get a fair go as well and that we can target those areas where they are severely disadvantaged too. But ultimately if we get it right for all Territorians I think the whole country stands to benefit because ultimately we'll be able to drive more productivity here that will benefit everyone.

MR COPPEL: On the question of indigeneity and the HFE, it is an area which is the responsibility of state and territory jurisdictions but also it's an area which is the responsibility of the Commonwealth. So there are joint responsibilities or fuzzy responsibilities, and there are a lot of issues within the CGC process that make it extremely difficult to make those sorts of calculations that they do to take into account different costs of providing those services. And it has been suggested, and we sort of raised it in the report, we didn't take it very far, in the context of a broader Commonwealth Territory, State, financial relations to take indigeneity out of the HFE process and provide separate grants for addressing the services in those communities. And I would be interested in getting your views about this idea of removing from the HFE process indigeneity as a factor.

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MS MANISON: I would be interested in how practically you would make that happen, I think that would be quite challenging. But effectively I think you're suggesting there that you have services for Indigenous people and non Indigenous people, and I just think principally the Northern Territory should be funded for its needs and recognising the fact that we have a high Indigenous population. But I don't think separating that service delivery is going to be easy or nor the best thing for the Northern Territory.

MS CHESTER: It isn't separating the service delivery, so some have suggested, and it's very good sort of public sector economists like Ross Garnaut and Vince FitzGerald previously, taking indigeneity out of HFE, getting the lines of accountability between Commonwealth, state, territory, better understood, greater principles of accountability, and not allowing it to be - you having full autonomy on how the money is spent. We didn't recommend that, and indeed, we said that our inquiry - because of those broader issues of responsibilities and accountability we're looking at HFE and we can't resolve them.

So we didn't come to a landing of taking indigeneity out but we did say longer term, indeed, part of our five year productivity review recommendations as well, is Commonwealth, State, Territory Governments need to go back to looking at where we do have these areas of overlap and what can be done to make better accountability and then decide how much autonomy should be afforded states and territories in particular areas, and indigeneity I think has been called out more so because of, as you referred to before, we're not making progress in closing the gap.

MS MANISON: Well I take the word autonomy on board. And where I would be deeply worried would be seeing that we have more decisions made on service delivery made in Canberra for the Territory than by Territorians making decisions about where the service delivery should be. So I'd be deeply worried about any changes that meant that we saw an increase of decision making for what's best for Territorians made in Canberra as opposed to decisions for Territorians being made here locally by a place where ultimately we have a government, here in the Northern Territory Government, and we're accountable to our constituents.

And if our constituents are not satisfied with our decision making they ultimately tell us at the ballot box. I'd be very concerned to see any autonomy stripped out of the Northern Territory with regards to how we spend money and contribute it towards service delivery. Where I am however again willing and want to have more conversation with my counterparts in Canberra, is around infrastructure delivery because, again, it's decisions that the Territory needs to make about those, where those priorities are, and to engage with the Commonwealth on it.

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You know, that's where I'm willing to have more open discussions, but I would push back as hard as I could on anything that would see, you know, less autonomy for the Northern Territory where it comes to decision making, because we know from experience that when decisions are made in Canberra for Territorians it doesn't tend to deliver the best outcomes.

MS CHESTER: And indeed, that's not the direction where our findings in our draft recommendation are in that regard, it's to have greater accountability and to have more autonomy for states and territories in how that many is spent, place based. You can't really do it in the context of HFE. Indeed, we know from the good work of the CGC that no state or territory gets to their assessed expenses following the equalisation, you need a further overlay of EPC because of vertical fiscal imbalance.

So for us it's all wound up in the context of BFI reform of revenue raising powers for the states and territories, greater accountability for areas where you do want to have that autonomy. So that's kind of the direction that we thought longer term and thus we didn't feel that we could grapple with indigeneity in or out of HFE at the moment in the terms of our inquiry, so that's where we kind of wanted to get your thoughts.

MR GRAHAM: Yes, I mean, I think what you're talking about there goes beyond HFE, and it's not - they're not issues that are confined to indigeneity, they relate to federalism broadly, I think, you know, in areas, there are similar areas in health, education. But I guess the issue with indigeneity for the Northern Territory is because Aboriginal people represent such a large area of population they are also significant users of mainstream services. So how you deal with those sorts of issues by taking indigeneity out of HFE, I guess they're the sorts of issues you'd need to give a lot of thought to.

MS CHESTER: Yes, and that's where we came to as well, so we didn't. So what area of agreement - - -

MR COPPEL: Another area in the draft report there I think there is agreement, or some agreement, from the Northern Territory, relates to recommendations that improve transparency and accountability and understanding of the HFE system. And I note that you agree with the recommendation that the CGC should play a greater role in explaining the outcomes of their process to the broader public and how decisions are achieved, that's in the submission post draft. We had also recommended that the data that the CGC uses to make those calculations should be in the public domain. Now that's something that has a different effect on accountability and transparency, it's the sort of thing that sometimes academics will use to look at how assessed expenditures relate to actual expenditures. And that part of the recommendation you disagree with and I'm wondering why you would disagree with that sort of information being in the public domain?

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MS MANISON: Well, I think it's important that there certainly is transparency out there around data. I actually would be more than comfortable with more information sharing than less, so that's something I'm certainly more than happy to look at again. But today's world, people do expect transparency and they do expect to be able to understand how decisions are made, so I'm actually quite comfortable with it.

MR COPPEL: Okay, good.

MS CHESTER: So just going back to I think a lot of people have taken an understanding of HFE to be all about equality/equity, and I think we can agree that there's a bit of a distinction between the two. The way the CGC does it, so firstly history tells us quite a lot here, no State, Territory, or Commonwealth, Government has ever put in place the same standard as the objective of HFE. Indeed, it's not in the CGC Act, and indeed, even though the CGC have been doing it that way, equalising to the highest plus an overlay of EPC since 1981, they only articulated it about 14 years later.

Indeed, even in the context of this inquiry we had state and territory officials not themselves realising how the same standard has been implemented with equalising to the highest with an EPC overlay, and I know that's a bit of a heuristic device but it is kind of interesting that no government in Australia has ever put in place that in a piece of legislation or an agreement, it's just in the CGC documents. So a statutory agency has effectively made that the policy whereas if you look back historically it was not substantially below or not substantially different, and indeed, that's still in the CGC Act.

So to some extent equalisation has evolved but it has evolved at the behest of an agency as opposed to a government of any day. And I just say that in terms of context because then when you look at the way the CGC actually tries to implement HFE they do have as the paramount and primary objective of equalising fiscal capacity, and we agree with that in our draft report, it should be the primary principle. But it also has four subsidiary principles and one of those subsidiary principles, one that we were kind of focusing on in terms of what's the impact of HFE on the economy, was the one of policy and neutrality.

So it would be good to get your sense as to how well you think HFE today is currently doing that balancing act between equalisation of fiscal capacity and policy neutrality, because that's where you would want to see a bit of a modicum of trade off between effectively equity and efficiency, and indeed, in some of that trade off there could be an overlap between equity and efficiency if it is having an impact on economies and economic growth?

MS MANISON: One thing I will say is that our distribution of the GST does not stop us from pursuing economic growth and development. Or

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productivity increases here in the Northern Territory. In a small place like this where you do want to see your economy grow and you would like to see more development, the impacts on the GST are not a factor in that. We want to grow our economy. We want more jobs. So for us it's not something that I believe stops productivity. Ultimately if we do have more jobs and we grow our economy it's going to mean better outcomes for all Territorians and less reliance on the GST, and that's what we would like to see.

So I think what's very important out of this, and I just come back to the point you raised about the CGC and more transparency, I don't think other states would probably - and I just think given the amount of people that put their hand up to appear at these hearings, GST distribution, HFE is such a hot topic but in a place like the Northern Territory where it has such a huge impact on our budget and on our incomes and - outcomes here every day, my apologies, on our outcomes is what I meant to say, it's really important that people understand the processes around the CGC and that extra level of transparency.

But also I've really got to stress that we look for opportunities to develop and grow our economy. GST does not stop us from pursuing those avenues of growth and we make the decisions that we feel are in the best interests of the Territory. But what will make it harder to be able to pursue some of those opportunities will be if we ultimately have less capacity to do so and less money coming in through HFE.

MR GRAHAM: Just getting back to that policy neutrality issue, and, you know, your point that the CGC has had a fair bit of flexibility in how it interprets its goal, and that can be a good thing or a bad thing depending on your perspective, I assume what you're getting at is the impact of Western Australia more recently on distribution and, you know, this view that Western Australia's policy is - or, you know, Western Australia is having a significant policy effect on the distribution of GST through mining royalties. And the CGC is grappling with that as part of the current methodology review but I think the challenge for them will be to ensure that they come up with an assessment or, you know, treatment of policy neutrality which doesn't, I guess, diminish to a great extent that objective of fiscal equalisation.

MS CHESTER: Yes, and with the CGC it then kind of becomes ad hoc fixes or ad hoc changes to try to take the pressure of the system. So when we sort of stepped back and looked at it, and our objective here is not about WA fiscal management, we had a frank exposition of that in our draft report, our issue is because you have WA being such an outlie and so much of the redistribution at the moment is for such a large equalisation task because of the fiscal outlay, that trade off between policy neutrality and equity is kind of swamped, it's not going to happen.

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So there's two strings here, one is you can try to reduce the pressure and allow a little bit of that trade off to occur so states do have incentives to dare greatly on development and do have incentives to do tax reform, or you can go down the route of carving out elements of mining royalties. Now we heard yesterday from the NT Minerals Council, so that maybe one or two of your constituents that may not agree fully with the government's position, Treasurer, but who are very supportive of 50 per cent discount on mining royalties.

Now, we rejected that in our draft report because we think that's highly inequitable. And then you've got the CGC as part of their methodology review recommending that for any increase in royalty rates the potential for a state or territory jurisdiction to keep 50 per cent of that. So 50 per cent is not taken into account in looking and assessing fiscal capacity. So we've got these two tensions here, we've got there's ad hoc ways of doing it and taking some pressure off the system, or we were looking at it sort of a more holistic fix so it just doesn't deal with one symptom at a time. It would be good to get your views on that?

MR GRAHAM: Yes, well, I mean, again it comes back to the point of where do you think HFE works, or doesn't. And it could be an argument that, you know, Western Australia's relativity is actually a sign that HFE does work because of the unusual situation, you know, it's just gone through a once in a hundred years sort of mining boom and, you know, eventually the system will adjust to that over time just as it has adjusted to the existing mining boom. But I think having the CGC is a degree of judgment as to how it incorporates or reflects that change in its assessments. It's done through a consultative way. And having the CGC, which are the subject matter experts, form a view as to how that should be incorporated is in, you know, in our mind is not a bad thing, rather than having some decision imposed on them from outside of the system. I mean, working within the existing institutional arrangements is a reasonable way to deal with it.

MR COPPEL: So is it that aspect which is the critical difference, because if you look at a mining discount or equalisation to the average, for example, they both amount to less than full equalisation or partial equalisation?

MR GRAHAM: Yes.

MR COPPEL: So really the point of contention is the process that would lead to such a different outcome from the current practices?

MR GRAHAM: We, just for the record, we wouldn't support the discount to the mining assessment. As I said, we think that Western Australia's relativity is a symptom that the system actually works.

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MS CHESTER: So there's two discounts, less make sure we don't confuse them for the transcript, so there's what the Minerals Councils have called for, and we addressed that in our draft report and said, no, that's not the smart thing to do from equity perspective, but then there's the CGC recommendation. So if you were to rewind the clock and do a royalty rate increase pre WA boom it would be interesting to see, and maybe you've crunched these numbers, what the impact would have been on the NT's relativity of a change that you're happy to go through a process with the CGC and for them to do some of these ad hoc fixes. It would be interesting to ask and answer the question what impact would that have had on the NT relativities, and it could have actually been worse than what we're recommending?

MR GRAHAM: Yes, we haven't done that work. But it's work we would need to do as part of the next major review.

MS CHESTER: Yes. Just so we understand your submission, which is the great advantage of having the public hearings after we've got them and so thank you for getting it in to us in time. One other point in your post draft report submission to us was around the use of external benchmarks. Now we made a call that - one of our objectives was to try to get greater simplicity into the system. One way of doing that, and it's indeed something that Jonathan and I looked at in the context of natural disaster funding arrangements, was greater simplicity by using external benchmarks for costs. It would still be, of course, adjusted according to disabilities around remoteness and indigeneity but there was a comment that you said that that would violate state sovereignty and I'm not exactly sure how, I couldn't connect the dots, so if you could explain that to me that would be great?

MR GRAHAM: Yes. So I mean the equalising to a benchmark or an outcome or an output has been looked at before. But it introduces a significant element of complexity in terms of determining what that benchmark should be. And then, you know, does that impede state autonomy relative to the existing arrangements where, you know, it is input or capacity based?

MS CHESTER: But isn't that kind of the direction that fiscal policy for large areas of expenditure is going in? Like, for example, in health where we're looking at sort of efficient cost benchmarks to make sure that states and territories have the right incentives in place, albeit it's still adjusted for disabilities like remoteness and indigeneity?

MR GRAHAM: But that's on the tied funding side, the whole concept of GST is that it's untied.

MS CHESTER: No, but this is just working out assessed expenses. So instead of doing it on the average of what states do, it adds an extra incentive

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in terms of the average of what's kind of considered to be an efficient benchmark, similar to what we've been doing. I think Victoria led the way and other states and territories are doing it now around health expenditure.

MR GRAHAM: Do you mean for state budgeting purposes?

MS CHESTER: Well for actually doing the calculations within the CGC as to what assessed expenses would be.

MR GRAHAM: Okay. I wasn't - - -

MS CHESTER: And maybe we're at counter purposes here and it might have been something else.

MR GRAHAM: Yes.

MS CHESTER: But that's where we were heading with efficient benchmarks, so.

MR GRAHAM: Okay.

MS MANISON: So again on behalf of the Territory Government we really do thank you for coming up here and listening to ourselves, I think it's great we've got the Opposition here, we've also got our main industry groups, some people that are just absolutely key to delivering better outcomes for the Territory. I can't stress enough, with regards to our views on equalisation and those potential changes, as I said, I think the Territory is a place of just amazing opportunity for national economic growth, for productivity, and for contributing so much more to this country. But the task is made all the much harder if we have less capacity to deliver critical services to Territorians. So we thank you for listening to us today and for coming here to give everybody an opportunity to contribute to your final report to the Treasurer. So thank you.

MS CHESTER: Thank you, Treasurer and Under Treasurer, we do appreciate the states and territories that have dared greatly by allowing ministers to appear.

MS MANISON: Thank you, very much.

MR COPPEL: Thank you. Our next participant is Gary Higgins. Sir, welcome.

MR HIGGINS: Thank you.

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MR COPPEL: Make yourself comfortable. When you're ready if you can give your name, each of you give your name for the purpose of the transcript and then a brief opening statement.

MR HIGGINS: Yes. I'm Gary Higgins, and I'm the Leader of the Opposition up here. With me is Sean Conway, and he's one of my senior advisers in the financial area.

MR COPPEL: If I can just ask Sean if you can give your name so that the voice recognition picks it up?

MR CONWAY: Yes, sure. Sean Conway.

MR COPPEL: Thank you.

MR HIGGINS: If I can do an opening statement?

MR COPPEL: Sure, yes.

MR HIGGINS: Commissioners, often in life using big words to confuse or obscure the true intent of what is being proposed. What we're all talking about today with the Horizontal Fiscal Equalisation Inquiry is about the levels of service and the simple questions, are all Australians equal? Should it make a difference if you were born in Brisbane or Batchelor, Pine Creek, or Perth, Wollongong or Wadeye? Should you get better opportunities for health and education just because of where you were born or live? The NT Opposition says that location shouldn't matter when it comes to health, education and opportunity. Clearly and simply, there should be no change to the way GST revenue is redistributed back to states and territories. Any change to the way GST revenue is distributed will be the end of the Northern Territory as we know it.

Commissioners, I hope you enjoy your time in Darwin, the capital of the Northern Territory, the capital of North Australia, and the gateway to Asia. The NT Opposition asked you to be here and I thank you for being here this week to allow Territorians their say on horizontal fiscal equalisation.

Let me now outline why the NT is such a special and unique place. We know from the ABS Census 2016 that there are at least 58,248 Aboriginal and Torres Strait Islander people in the Northern Territory. This is nine per cent of the total Aboriginal and Torres Strait Islander population in the nation. Importantly, Census 2016 states that 25.5 per cent of the Northern Territory population identified as being of Aboriginal and Torres Strait Islander descent. However the percentage of Aboriginal and Torres Strait Islanders in the Northern Territory is higher given the significant undercount of Aboriginal people.

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The Northern Territory Government coordinates essential services to 72 remote Indigenous communities. There are about 500 homelands in the Northern Territory with a total of 2400 homes. Around 10,000 people live in homelands while others have a small family group. And this represents its own challenges, none less than the provision of food and water. The cost of fuel, freight and refrigeration, all add up. And by the time food reaches a remote community it's far more expensive and far less fresh than it would be in an urban region.

It's no surprise that some Aboriginal people in homelands turn to cheaper, poor quality foods lacking nutritional value. This has caused significant poor health outcomes in the long term. It's very important to note that the cost to access communities it's significant. The cost of providing access is also a very heavy burden on the NT Government. The Commission should be aware of the seasonality considerations regarding providing services to communities. There are communities in the Northern Territory where the NT Government isn't able to provide services continually for 52 weeks of the year so the figure that we attribute for the cost of providing services is not a true reflection of the need. In fact it could be argued that the average cost of provision of services should be increased, indeed, even doubled, to be a true reflection of costs and need.

In short, the NT Government can't get to many of these remote communities to provide services due to the weather, distance, or lack of reliable road, or air transport infrastructure, and this should be taken on board by the Productivity Commission and reflected in the next Commonwealth Grants Commission update report. Research conducted by the Menzies School of Health Research found that 80 per cent of the health gap between Indigenous and non Indigenous Australians is due to chronic disease.

In remote areas 90 per cent of Indigenous children have some form of ear infection. One in three Indigenous people living in remote communities run out of food and have no money to buy more. Aboriginal people have Hepatitis B infection rates three times higher than non Indigenous Australians. At present there is a 10 year gap in the average life expectancy between Indigenous and non Indigenous Australians.

If I can just speak to you about a few Aboriginal communities in my own electorate of Daly, Wadeye is located approximately 420 kilometres south west of Darwin, it's accessed along the Daly River Road, which is not sealed, from the Daly River crossing and can only be accessed during the dry season, May to October. And it's worth noting that the town of Wadeye is 200 kilometres from Daly River, so 200 kilometres of dirt road. Along that Port Keats Road from Daly River to Wadeye there are many communities and outstations. Many of these communities are tens of kilometres off the main dirt road. One of the most telling indicators from 2016 is that median total

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family income for Wadeye was $584 versus 2105 for the rest of the Northern Territory.

Remoteness and the vastness of the Territory makes everything much more difficult and expensive. And the point I would like to make about remoteness it is in relation to how it limits the availability of service. While there may be many Indigenous people in southern states in absolute terms, for example in New South Wales and Victoria, Indigenous people in New South Wales and Victoria are unlikely to be hundreds of kilometres from basic services. In the NT 80 per cent of Indigenous people live in remote areas. And this is approximately 40 per cent in Western Australia.

So the question for the people living at Wadeye is how do they get to the services? The town gets cut off during the wet season. The only way to get in and out is to fly. And to illustrate the difficulty, the cost of a flight on Murin Air in and out of Wadeye is $330 each way. No hospital, think of what this means for an expectant mother or her partner. And this is just one town. There are a number of commonalities between all Aboriginal towns and communities across the Northern Territory, they are geographically dispersed, isolated and subject to seasonal conditions, lack basic infrastructure and services, they have high comparative levels of socioeconomic disadvantage.

We know that just over half of all remote communities in the NT don't have a local health clinic. The scale of the task to address this infrastructure deficit and close the Indigenous disadvantage gap is immense. Census data shows that Wadeye has one of the fastest growing rates, growing population rates, in the country. In 2006 the population at Wadeye was 2207. In 2016 it was 2858, an increase of 651, or 29.5 per cent growth, over the decade. The NT with a population of approximately 244,000 represents just one per cent of the national population. And despite our large area, over 1.3 million square kilometres, we're sparsely populated.

The structure of the NT economy is markedly different to the national economy and the Territory is a relatively small open economy that is significantly influenced by major projects with abundant natural resources, a public sector, and a Defence presence. The Territory economy has grown considerably over the last decade. The total gross state product has grown from 16.9 billion in 2006/'7, to 23.6 billion on 2015/'16 with population increases during this period by approximately 31,000 to over 240,000. And all of this has been built on the bedrock of certainty provided by HFE and the attendant GST revenue streams.

The certainty provided by HFE has enabled the NT Government to look outwards to Asia to put in place pro business policy settings. Looking north for trade we can grow our economy and population. The unintended consequences of removing that certainty are unclear. Commissioners, for 16

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years I was a mango farmer at the Daly River Mango Farm. I saw first hand a phenomenon I called intentional ignorance. And this is the injustice of inaction and the injustice of indifference. A head in the sand approach will not allow us to close the gap. Change in the current system of GST funding is exactly opposite of what is required to achieve the Closing the Gap initiatives.

The United Nations has described Australia's lack of progress on Closing the Gap as woefully inadequate, saying the over incarceration rate of Indigenous people is a major human rights concern. Indigenous Australians don't live as long as other Australians, their children are more likely to die as infants and their health, education, employment outcomes, are worse than non Indigenous people. Australia has promised to close this gap on the health, education and employment. Let us remind, Commissioners, that Prime Minister Malcolm Turnbull's words in relation to the 2017 Closing the Gap Report: "It is clear that Closing the Gap is a national responsibility that belongs to every Australian."

Changing the objectives of the HFE from full equalisation to reasonable equalisation, or from funding to provide equal level of service to a reasonable level of service, will not assist in any way the goals of the Federal Government in the Closing the Gap initiatives. In fact I put it to the Commissioners what message does changing the goal posts send to regional Australians and Aboriginal Australians, either we are all Australian, all equal, or we are not.

Commissioners, in any business or economy there will be good times and there will surely be bad. There are swings and roundabouts. It is inappropriate and frankly wrong to base irrevocable change of a good system, HFE, on the current economic conditions of one state, Western Australia, just because at one point in time they mount a good political campaign. To put it another way, as Saul Eslake does in his submission on the draft report, the alternative approach as canvassed in chapter 8 are all different ways of determining who loses so that Western Australia can win.

The observed effect of HFE in practice over its nearly two decades of operation in its current form has been to entrench pro-cyclical fiscal policy. In simple terms, it puts fuel on the fire when an economy is growing and due to the backward looking nature of the assessment makes slower economies slower. However, the weakness inherent in the system rights itself in the long term. To rewrite the objectives of HFE is to rewrite the principals of Federation. This is unfair and short sighted. The Productivity Commission must consider how any change to the GST revenue distribution framework would impact on the delivery of the Defence White Paper, the White Paper on developing North Australia or

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the bipartisan commitment to Closing the Gap.

In the Northern Territory maintaining equal as opposed to reasonable services in the NT will help attract more people. For the NT to grow and achieve sustainable population growth will require a level of service provisions comparable to competing Australian jurisdictions. It's important to note that the NT, while having one of the largest social provision obligation challenges, has the smallest taxable base of any jurisdiction. Over 50 per cent of the Territory's land mass and 80 per cent of the coastal waters have been given over to traditional owners under the Aboriginal Land Rights Act. The NT Opposition always puts the Territory first.

This issue of changing the GST distribution is a major issue for the NT Opposition because GST revenue makes up over 50 per cent of the NT's annual income. With the NT receiving 4.6 dollars for every one dollar raised the NT has the most to lose from any change to the current system of HFE. To reiterate, it is the Territory's highest expenditure needs rather than the lack of its major revenue raising efforts which derives the Territory's highest need for GST revenue. The Northern Territory uses this GST to provide critical government services in the Territory such as health, education, police and roads.

Vast distances push up the costs of service delivery. The cost of attracting and retaining staff and constructing and maintaining the necessary infrastructure in remote areas is far more expensive than in urban areas, which contribute to higher service delivery costs. The Commonwealth Grants Commission in its 2017 Update Report calculated that the Northern Territory is having an assessed expenditure of $19,072 per capita. Commissioner, it's of the utmost importance that the Productivity Commission record that the NT Opposition have consulted widely, rejected any move away from the current distribution model of HFE.

Prima facie, many of the partial equalisation distribution approaches would entrench disadvantage. The NT Opposition believes that HFE is a requirement for the sustainability of self government over the medium term. HFE has served the Commonwealth, the states and the territories well for many decades and the case for change is yet to be demonstrated or proven. Ensuring the long run viability and sustainability of the NT is very dependent on the ability of the jurisdiction to attract and maintain population numbers.

Given that geostrategic importance of Darwin and the Northern Territory more generally, how would any such move from full to

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reasonable equalisation affect, if at all, the rollout of the Defence White Paper of 2016? In the context of a small developing jurisdiction with an annual income of approximately six to seven billion dollars such a massive reduction in income would severely impact the ability of the NT to deliver essential services and functions.

In conclusion, the NT Opposition rejects any move away from the current distribution model for HFE. Indeed, any change to the current method of distributing GST would mean the end of the Northern Territory as we know it. The NT Opposition note that while jurisdictions can go from being GST winners to losers, these differences are equalised in the long term. There are also alternative approaches that may be considered to relieve interstate tensions. Those seeking to move away from the current model have yet to demonstrate clear evidence of a more certain, efficient, effective, or equitable, model.

Commissioners, the draft report into HFE fails to meet the standard expectation of its inquiry reports in two crucial and fundamental ways; it makes recommendations to fundamentally alter the objectives of the HFE without any supporting evidence; and the recommendations are inconsistent with the objectives of achieving higher living standards for all members of the Australian community. Long term less GST will have a snowball effect on our economy, decrease Territorians health and well being, and ultimately cost Australians more down the track to address the long term effects of systemic underfunding.

On behalf of all Territorians I would like to thank you for the opportunity here today and look forward to reading the final report when it's delivered to the Treasurer in late January 2018. This issue will impact the life of every Territorian and will influence the quality of life for generations of Territorians to come. And whilst we're only one per cent of Australia's population we have the right to equal services that the 99 other per cent have and I urge you don't change the current funding methodology that's based on the premise of provision of an equal level of service to one based on a reasonable level of service. That would not be a reasonable outcome for Territorians. And I thank you for listening to that statement.

MR COPPEL: Thank you, Gary. Let me start, I think your position is very firmly keep the system as it is. I think you identified one area of weakness, which is the pro-cyclicality, and I'll come back to that later. You made the point that the system is fair in the sense that it doesn't discriminate on the level of services provided regardless of where you live. And one of the points that had been made in a number of submissions, it's not made in our report, we don't endorse it, is that the

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fairest distribution would be on an equal per capita basis. That doesn't distinguish where you live. It provides the same amount of GST revenue per capita. I'd be interested in how you would interpret that view of a fair distribution in view of the current practice?

MR HIGGINS: Look, I think the whole basis of Federation is that everyone should have equal access to a service irrespective of where they live. And the cost of providing those services to Territorians of course is a lot higher than providing it anywhere else in, you know, southern states. So I completely, you know, sort of reject it, that the thing is that, you know, that would mean if you're getting a dollar for every person we'd get $244,000. So how you could provide service to people that are on, you know, unemployment benefits at Wadeye, I just can't see you providing that service.

The uniqueness about the Territory is also that one of the overriding things that we have here is the Aboriginal land. And I spoke about that. And 50 per cent of the land in the Territory is Indigenous and 80 per cent of the coastline. And that is a unique requirement here in the Territory.

MR COPPEL: Where that view has been most often expressed is Western Australia, not by the government of Western Australia, in similar issues of remoteness, a relatively large state, Indigenous population, nothing like the Northern Territory, but it does illustrate that the notion of fairness is one which can span a vast range of potential GST distribution rules. But you think then that the system that we have delivers on that notion of fairness that you think is the appropriate one for the Australian Federation. I don't know if you were here in the room when we were questioning the previous participant, that we made a point about a number of mechanisms that are used by the CGC where they may not have the right information, or the full information, they use discounts and they have materiality thresholds.

And all of these can act to result in a part of a distribution on an equal per capita basis so it in itself is a step below sort of equalisation so that the jurisdictions can provide the same level of services for the same level of effort. I'm wondering what your assessment is of how well the current system then meets that goal of providing the same level of services and the same level of - the average level of services for the same level of effort? Or are there particular features of the Northern Territory where you think the process isn't delivering against its objectives?

MR HIGGINS: Well, I think when you mention Western Australia I think one of the big differences again comes down to the Aboriginal land. And I raise the point the Western Australian Government closed a lot of

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the Aboriginal communities and said we're just not going to fund them. That's not a choice that the Territory Government would have because we have the uniqueness of the Aboriginal land. And the thing is in providing a service to some of those remote areas where a lot of it is that Aboriginal land, it's not a choice of people being able to move closer to where the services are provided, so the cost of providing a service to a place like Wadeye will always remain there irrespective of, you know, what changes you might get in Western Australia. If that sort of answers it?

MR COPPEL: I think it does. You are very much a supporter of the current system. You mentioned one of the issues associated with the averaging of the relativities over years and you make the point in your submission that it can complicate fiscal management, I'm interested in getting your views on whether you see a way in which that issue could be addressed within the current framework or whether there's another solution to that problem that you've identified?

MR HIGGINS: Look, I think the Grants Commission, which I know is separate, and the sort of the levers that they use, there's 30 different indicators that they're using, I mean, you can manipulate those to achieve or address some of the disadvantage that, you know, exists here in the Territory. And, you know, the issue about if you look at people that claim to be of Aboriginal descent, there's a higher increase in those and that higher increase is more in the southern states. And as I said before, those people then are a lot closer to services. That dilutes the effect of, you know, trying to address the gap in the Closing the Gap. So from that point of view there's been a dilution of the Aboriginality side of it. But the thing that - - -

MR COPPEL: Well the way interpreted it, at least in your post draft submission, is that the system amplifies the pro-cyclicality of fiscal policy so then you get greater booms and bigger downturns, is that linked to what you're saying or is it the way in which the process is actually calculated that is contravening to that outcome?

MR HIGGINS: I think if I interpret it right, and just bear with me, is that you're talking about the process actually looking backwards, so we've actually got a cycle that the GST revenue that you're getting today is based on the last sort of four years, I think, from memory. Is that what you're implying?

MR COPPEL: Yes, that's right, three years plus then there are data lags, yes.

MR HIGGINS: Yes.

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MR COPPEL: So what, you're saying that's an issue for the Northern Territory and its project management and - - -

MR HIGGINS: I think it means - - -

MR COPPEL: What do you see as a solution to that?

MR HIGGINS: Look, I don't know what the solution is. I think the point I made was that it averages itself out over time. It becomes a complex issue for the Territory in that while our economy may run level, if I gave that as an example, you've got to be aware of what is happening in the other states, that where these are going up or down because they're up and down will actually have an impact on our GST in years to come. So you'd have to be keeping track of that.

MS CHESTER: Gary, I think we can all sort of agree that the primary or the paramount objective of HFE is around equity through giving - well, having the aspiration of having equal fiscal capacity across states and territory jurisdictions. The HFE also has some subsidiary principles that they try to balance with the objective of equity, and one of those, and indeed, much of the focus of the work that we were asked to do for this inquiry, is around the one called policy neutrality, so the incentives that state and territory jurisdictions face with respect to decisions around development activities or tax reform and taxing revenue bases in jurisdictions. How well do you see the CGC getting that trade-off between equity and policy neutrality at the moment?

MR HIGGINS: I sympathise with them, I know I had a lot to do with the Grants Commission about 15 years ago, prior to becoming a mango farmer, but the issue around different governments having different policies and the impact of that on their own revenue raising I think is significant. And I think the Grants Commission take a lot of that into account when they do their calculations. In other words I will quite often refer to it as revenue foregone, which is revenue that you've lost. It's probably the wrong term but the thing is if a state has got the ability to raise some of its own revenue it should be raising that revenue where it can. Is that sort of the answer that you're looking for, along those lines?

MS CHESTER: Well I think the CGC tries to do it but it does it sort of in a reactive ad hoc way, and indeed, their recent review suggests - has one proposed change which is to discount royalties from a rate increase for the mining royalties, which could have significant implications for GST relativities if WA were to change their royalty rates on, say, iron ore. So that's one way of dealing with it.

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The other way that we've looked at dealing at it is more holistically in terms of because you've got WA being such an outlie the equalisation task within the GST pool has become so large there's no wriggle room for the trade off between equity and policy neutrality, or efficiency. So do you have a view on what would be the best way of addressing that, an holistic approach or the CGC attempting to, I guess, alleviate pressure on the system through its methodology review and turning their formula on and off?

MR HIGGINS: Look, my personal view is for the CGC to be doing it. I think the overall - it's a lot easier, from my point of view, it would be a lot easier for the states to monitor what's happening as opposed to the overall formula being changed.

MS CHESTER: I take it from your submission and your comments this morning that what's driving your concerns would be what impact it would have fiscally on the Northern Territory Government. What's your understanding of what would be the fiscal impact of our draft recommendations on the Northern Territory Government?

MR HIGGINS: Look I haven't done the exact figures but I mean the issue of decreasing from sort of equal to average I think is going to have a dramatic impact, especially in the Indigenous area, and that's the area that I've got the greatest concern with. And I think there's other issues involved around the Indigenous area that aren't - and it's not an issue for you people at the moment but it is an issue for the Grants Commission, and that is that while we look at the costs of providing a lot of these services I made the point in here that a lot of those costs are not being picked up, or it's the lack of costs.

The point is when you try and service an area like Wadeye and Wudikapildiyerr, and Emu Point, and Peppi, and all of these, on that one road, the thing is that they're cut off for nearly six months of the year. And for probably half that time you can't even fly in because they haven't even got proper airstrips. So there's no cost associated to delivering a service there, so they're missing out. So they're not actually getting the basics as opposed to being told that, you know, you're entitled to equal, they're just not even getting that basic. And I know that is an issue for the Grants Commission but it is - I think to alter the formula at the moment would have an even greater impact on that into the future.

MS CHESTER: Okay, because you do sort of paint a picture of Armageddon based on our draft report but if you actually have a look at what the flow through would be, so the worst case scenario, so say if we

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went to equalisation to the average and we did it cold turkey overnight and no transition path, the relativity for the NT the next year would go from 4.66 to 4.55, which is no more than I think about 2.4 percentage points of your revenue base. So I'm not sure what fiscal impact you're envisaging for the story of Armageddon that you're presenting? We're happy for your colleague to speak as well if that's helpful.

MR HIGGINS: Yes. No. I think our concern was - the thing is that the base - my argument is that the basis for our Federation and the basis of HFE is that everyone is entitled to the same service irrespective of what the small percentage decrease might be. And the thing is that to add a small percentage decrease, even a 2 per cent decrease, on the provision of those services on top of the issues that we already have is simply compounding the problem and it's not addressing the problem. And it's not addressing Closing the Gap, it's not providing better services to these people, it's simply adding to it.

It might only be two per cent today but is it five per cent tomorrow and 10 per cent the next day? That is my fear, and that is that at the moment we're not progressing and we need to progress. And to cut the amount of money that's available, irrespective of how small, would have an impact into the future. It's a compounded impact out into the future. If you look at how the population of Wadeye has grown, you know, you decrease the amount of money that's available to those people there and the thing is that will have a compounding effect, not only is it a two per cent decrease but it's also then an impact on the increasing population there.

The thing is that these people are people that, when you look at dealing with Indigenous people, to go out and try and explain a lot of these things, English is a second language, if I go out there most of the time I have to have someone with me that can understand the language. If I know what they're talking about I can pick up what they're talking about but I cannot speak the language. And that is even more difficult. And the thing is that if we look at education and all of those things, any decrease will have a dramatic impact on them.

MS CHESTER: So just looking at it then from the perspective of fiscal capacity of NT, does the NT Opposition have views on reform to the way the NT Government raises its own revenues to help improve that fiscal capacity?

MR HIGGINS: Look I think the NT Government at the moment has a document out on tax reform. I've been very vocal in my, you know, objection to that document at the moment, and it's around the timing of

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the document. The thing is that you don't, you will never, ever increase or get out of an economic hole by imposing taxes on your constituents. The thing is when you're in a good time that is the time to look at your taxes and to increase them and build up a pool, it is not the time to do it when you're in a bad economic time.

MR COPPEL: Okay, I think that we've run out of time. We're on a pretty - - -

MR HIGGINS: Thank you very much, and we look forward to the report.

MR COPPEL: Thank you, Gary.

MS CHESTER: Yes, thank you.

MR COPPEL: Our next participant is the Northern Territory Government. Welcome all, I think you know the process so when you're comfortable if you can give your name and if you have a brief opening statement if I could ask you to keep it brief because we really are pressed for time.

MR GRAHAM: Yes. So just to reiterate the thanks that the Treasurer offered up, thanks for making the time available to come and hold these hearings in Darwin. This is obviously a very important inquiry for the Northern Territory. With me I have; Jodie Ryan, the CEO of the Department of the Chief Minister; Mr Rod Applegate, Deputy CEO of the Departments of Primary Industry and Resources; and Ken Davies, CEO of the Department for Families.

MR COPPEL: Thank you. If you could briefly each give your name so that the voice recognition picks up your voice for the transcript?

MR GRAHAM: Yes, I'll just make an opening statement, brief, and then open - - -

MR COPPEL: Okay, thank you.

MR GRAHAM: As the Treasurer indicated the Northern Territory is comparatively more reliant on Commonwealth funding than the other states. And that is largely due to our expenditure needs. The Commonwealth Grants Commission assesses us across all of its expenditure categories as requiring to spend about two and a half times the national average to achieve national level of services. So changes in the distribution of GST revenue, even relatively small changes, have a

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disproportionate impact on the Northern Territory. A 10 per cent reduction in the Northern Territory's relativity results in about a $1100 per capita reduction in GST revenue compared to about $85 per capita for Western Australia.

The most recent update of relativities saw a $1100 per capita reduction of the Territory's GST revenue, that compares that the next most affected state was New South Wales, which experienced a $35 per capita increase. And just your query earlier about the breakdown of the components of that reduction in relativity, I've got the numbers now. So the total change resulted in a $269 million reduction in GST revenue, based on MYEFO estimates. And $77 million of that was attributed to population growth and the impact on infrastructure needs, $53 million of that was community health, $44 million Commonwealth payments, $31 million schools and $28 million for roads. And that was largely due to changes in expenditure in other jurisdictions and the impact on national averages, so factors outside the Northern Territory's control.

So any change in the, I guess, distribution of GST and the current system of HFE represents fiscal risk for the Northern Territory, particularly any diminution of the current approach to applying HFE. And that would happen at a time of significant economic transition for the Northern Territory, and again, with associated impact on budget certainty and investment certainty. I guess from a treasury and service perspective of a fundamental concern we have is the proposition that reducing the amount of GST that is distributed away from the larger states towards the smaller states would result in national efficiency gains.

I guess with similar inquiries and reviews in the past have not found any compelling evidence to support that assertion. You know, at best there's been a view that any efficiency gains would be at the margin and I guess our view is that any marginal increase in national efficiency would be offset by reduced or diminished fiscal capacity of the smaller states to deliver services. So that would need to be factored into any assessment. And I understand the Commission's draft report makes recommendations around transition and how transitional arrangements would need to be implemented to ensure the smaller states are not disadvantaged.

So I guess we're just not sure how that would work in practice because any reduction in HFE or the amount of GST revenue that flows from the largest to the smallest states would mean that the Territory's relativity would be lower than what it would under the current system, and so therefore would be worse off by effect. But I guess so they're issues that we would also be focused on in any future submissions. So that was just my brief opening statement, I'm not sure if anyone else wanted to say

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anything, but otherwise we're open to questions and discussion.

MS RYAN: Yes. No, I'm just happy for questions.

MR DAVIES: Could I, Commissioners, my name is Ken Davies, the Chief Executive of Territory Families, so I just wanted to give you my context just to bring a bit of an on the ground check to the discussions around the Grants Commission processes and equalisation process that flows. I did want to say I've been in the Northern Territory for 40 years, in my experience of self government, and this is during 1978, there is an assumption there that when the Australian Government handed over the management of the Territory to the Territory Government of 1978 there was a standard basic level of services that were existing.

I started off as a young teacher in 1978 in a place called Papunya and at that time there were around 1000 people in that community. There was some housing there but a large number of those people were in camps and in locations around the town itself. The schooling system was working but was very resourced to a minimum level and the standard of services out there that you would expect in a normal regional centre just didn't exist to the same level. So the context there around infrastructure, housing, Aboriginal people at that stage - the ALRA applied of course, but the outstations moved and the distribution of population hadn't started in earnest in Central Australia at that point in time so people were aggregated into those big regional communities at that time.

The complex layer now and the complexity is that we have many, many people living in a vast number of remote locations that weren't in those places at that particular point in time. And in the context of the service delivery that I have to provide to families and to children, particularly in a statutory sense, it's a very, very complex service delivery matrix to deliver right across the Territory in very remote locations. So I just wanted to just put that on the table.

In the context of the Northern Territory and the Royal Commission that's flowed out of that the Commission has made it pretty clear that additional resources will be required to do that. So they're both for the Territory to consider and for the Commonwealth to consider but this is not an environment where you have existing services in the primary, secondary or tertiary area in a vast number of the communities in very remote locations. So that's all I just wanted to say just in prefacing the context.

MR COPPEL: Thank you, Ken.

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MR APPLEGATE: I might make an opening statement. Rod Applegate, I'm Deputy Chief Executive of Department of Primary Industries and Resources, primarily looking after the resources sector. There's been some commentary about the resources sector in the Northern Territory so I thought I'd like to put some statements on record. The mining sector as a whole including minerals and petroleum accounts for about 12 per cent of the Northern Territory's economy, and that's the largest sector after construction.

It's grown consistently in the last 20 years along with the growth of the Northern Territory economy. The value of mining and energy and resource manufacturing sector in the Northern Territory is last year was valued at $4.7 billion. Minerals with the total value of 3.63 billion were produced in the NT in '16/'17. And I guess the royalties that flow from that, I think from Territory's figures, around $192 million, representative of about 9.3 per cent of our Territory's own source revenue. I'd like to make the point that there's been some comparisons about the Northern Territory and our resource rich neighbours in Queensland and Western Australia. There are some distinctive differences between getting resources developed and out of the ground in the Northern Territory compared with Western Australia and Queensland.

WA and Queensland both have resources sectors that are underpinned by very large resources of bulk commodities, which is largely iron ore in the Pilbara and coal in the Bowen Basin. This allows the economy as a scale to develop high quality rail and port infrastructures to support such multiple high volume mining projects in a very small area. For example, Port Hedland I think it supports about one million tons per tide in iron ore. In comparison the Northern Territory has a diversity of resources such as precious metals, gold, base metals, copper, lead zinc, manganese, phosphate, lithium, uranium, rare earth, bauxite, vanadium.

Unfortunately these deposits are located in very diverse and isolated geographical settings and geological settings across the Northern Territory. That presents very large challenges in that it makes it more difficult to economically develop those resources, develop common user infrastructures, support them, and making it an inherently higher costing for those projects to come to fruition than has been endured by major producers of coal and iron ore in our adjacent states.

I would just like to put on record there are some severe challenges to attracting investment in the Northern Territory. Despite that, we do have nine operating mines. But in no particular order obviously the infrastructure issues across the Northern Territory present a significant barrier to the development of our resources. We have one spine road

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going north/south, we have one road going left and one road going right. We have a central gas pipeline and we have a central rail. And in anyone's book that's not a lot of infrastructure to support the development of isolated resources across one sixth of Australia's land mass.

The other issues besides infrastructure is that we do, I think unlike much of Western Australia, Queensland, and some of the other states, our landscape is largely covered. Meaning that we don't have a lot of outcropping and therefore it's a lot higher risk for junior explorers to actually pinpoint where they should be putting their investment dollar, given the amount of cover over where our rocks and geology actually lies. Obviously attracting capital investment in greenfield developments or explorations is fairly high risk and we've seen some aversion to investors putting their money into that sort of risky investment exploration ventures.

I guess the other issue is that we do have a different arrangement, tenure arrangements across the Northern Territory which further adds to the risk profile for investors and junior explorers. And I suppose there are some more other things in the regulatory space which are a little different but that also presents some challenges. Thank you.

MR COPPEL: Thank you. And we'll come back to some of those specific challenges but I'd like to begin by asking Craig the reduction in the CGC relativity that you've outlined and the factors, was that something that was forecast or predicted by the Department of Finance?

MR GRAHAM: We had predicted a reduction in our relativity for '17/'18 compared to the previous year, but not to the magnitude that we experienced. As you would appreciate forecasting and predicting relativities is not simple.

MR COPPEL: Yes.

MR GRAHAM: But, yes, just so based on what was happening in other jurisdictions we formed the view, and in terms of where we were at with the averaging of relativities, we did think that it was more than likely that our relativity would decline. What we didn't anticipate were those external effects on our relativity, they were completely unforeseen.

MR COPPEL: And that exercise that you do to get an idea of what those relativities will be, do you extend that out for the forward years?

MR GRAHAM: For this year we basically gave up trying to predict what was going to happen with our relativities across the forward years. It's just too difficult to be able to forecast with any degree of reliability

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what our relativity is going to look like into the medium term.

MR COPPEL: So is that linked to the fact that the NT is a very small jurisdiction and so much of it is dependent on what happens in the other jurisdictions?

MR GRAHAM: Yes. That's the main reason in that it's just too difficult for us to anticipate what effects changes in other jurisdictions are going to have on the Northern Territory, because we have very little influence on averages, or disability factors, you know, cost and usage, weights, are just factors that we can't really control or influence. Or have any degree of certainty over what effect they're going to have.

MS CHESTER: Because one of the things we'd like to do in this post draft report stage, because we will be looking at the transition path issues for our final report, we've got some projections that the WA Government has provided us, and their ideas around a transition path, we'd like to actually do our own work there and we'd like to work with you to - and other state and territory jurisdictions, to try to at least have a little more confidence around what some of those projected relativities might be so they sort of pass the reasonable test and can sort of inform our final report. So if you'd be happy to - - -

MR GRAHAM: Yes, for sure, we're happy to work with you on those.

MR COPPEL: And a related question is whether you've done any work sort of in your department looking at the impact of some of the proposals that we have in the draft report on the Northern Territory, the fiscal impact and other impacts, if you have if you can talk us through that?

MR GRAHAM: Look, we haven't done a lot of work. Most of the work is focussing on our submissions and preparing, I guess, our argument for responding to the Commission's issues in the draft report. But that is work that is going to need to be done and certainly once we've got a bit more certainty as to where the Commission's report is going to head, and the other complicating factor is we've got the CGC's 2020 Methodology Review going on in parallel with this process so we're also needing to dedicate resources to preparing submissions for that process as well. We only have a small team of people in our Treasury that actually work in this area.

MR COPPEL: So on that last point, earlier you mentioned that you were opposed to the CGC proposal for its 2020 review of discounting 50 per cent the increase of a change in the royalty - - -

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MR GRAHAM: Yes, so just to clarify. We opposed discounting in principle but are not opposed to the issue of policy neutrality and a mining revenue being dealt with through the CGC process.

MR COPPEL: So that specific idea of the CGC through the CGC process is something that you see has merit or not?

MR GRAHAM: Do you mean the process?

MR COPPEL: Well the process we've talked about, but the specific idea that the CGC has put on the table to address the issue of policy neutrality with respect of the mining royalty assessment because that's one of the areas that we've identified as a source of inefficiency.

MR GRAHAM: Yes.

MR COPPEL: And I will get on to the other soon, what's being - - -

MR GRAHAM: So no, we don't support that proposal in principal but at the end of the day it's going to - we're going to have to come down to what, you know, a pragmatic approach. And if working with the CGC on that issue and what the possible alternatives are means that we're going to be able to live within or maintain the current system are the sorts of considerations we're going to weigh up.

MS CHESTER: Do you agree that there is a policy neutrality issue that the CGC needs to grapple with?

MR GRAHAM: Yes. I mean, you can't go through the period we've just gone through without having some sort of response because, you know, as I said initially, you could argue that it is just demonstrating that HFE works, it's the dynamic system, it's designed to reflect changes in states' fiscal circumstances. And the changes that Western Australia has just been through are unprecedented. And the relativity falling to the level that it has essentially just reflects the gains they've experienced through global market cycles and commodity price cycles. But again, it's going to come down to a practical approach in terms of do we attempt to deal with that within the existing framework or move away from the existing framework all together, and for us, the former option is probably a palatable one.

MS CHESTER: Does your view around that depend on whether or not you see the circumstances in WA being such an extraordinary outlier being a blip from the mining boom or being here to stay for the foreseeable future?

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MR GRAHAM: I think that it has been driven by the mining boom, how long it takes to wash out is, you know, is an issue that you can take an opposing view about but I think it is cyclical and that eventually it will wash out of the system. It could take quite a bit of time.

MS CHESTER: Yes, because based on - I mean, we really tried to get a better understanding of that when we were over in the west from, you know, the Chamber of Commerce over there and from the WA Government, and the sense that we got is that the production levels now are going to stay at that level and it will just be price movements that will drive it.

MR GRAHAM: Yes.

MS CHESTER: So it looks like it is here to stay and that then kind of flows through to what policy solution might be needed if we're trying to deal with those policy neutrality issues.

MR GRAHAM: Yes. I mean, whether it's transitional or permanent the fact is that Western Australia's own source revenues have exceeded or have risen to the point where their assessed need for GST funding has dropped, fallen right away. Now whether that is a national efficiency issue, you know, whether that having Western Australia's relativity as low as it is, whether it's transitional or permanent, whether that is impeding national economic growth, is one that we're not so certain about.

MR COPPEL: I just want to continue on the policy neutrality with respect to royalty revenues, which you recognise is an issue in the jurisdiction of WA, do you see this as an issue that may be in the Northern Territory or emerging in the Northern Territory with some of the development, particularly of natural gas?

MR GRAHAM: It could. It could be an issue in the future. But again, yes, whether it's to the same extent that's been experienced in Western Australia is another matter. And to the extent even if it does, again, it is a feature of HFE, you know, that we would live with. I mean, we would be happy to reduce our reliance on Commonwealth funding, if we can generate more revenue from our own sources to meet our expenditure needs, that that is not an adverse outcome for the Northern Territory. In fact over time into the future we would prefer to see that. Having us an outlier with relativity at four and a half is not an ideal situation.

MS CHESTER: So does that kind of then lead us to when you even look at some of the work the CGC has done, even WA as the stronger state,

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equalising to that stronger state even they can't meet their assessed expenses, you still need an EPC overlay. And that sort of gets you to the issue of vertical fiscal imbalance. And I guess there's only so much we can do within the confines of HFE on its own.

MR GRAHAM: Yes.

MS CHESTER: Is that what you're getting to, Craig, in terms of down the track NT being able to better deal with these issues directly?

MR GRAHAM: Yes, I mean, there is only so much HFE can do and so some of those future development issues need to be dealt with through other forums. But in terms of, I guess, just at this stage of development providing the Territory with the capacity to fund services to its citizens and to fund infrastructure, you know, the current model we have, is we can't think of any alternative that works more effectively.

MR COPPEL: You've initiated in the Northern Territory a process of tax reform and you've put out a discussion paper, is that framed from a revenue neutrality perspective or are you also looking at additional capacity to increase your own sources of revenue?

MR GRAHAM: It is more about the fact that I can't recall a similar review of our tax system as a whole being done. Most of the changes to our tax system have just been incremental and ad hoc over time. This is more just an opportunity to sit back and take a look at our taxes, our own source tax system as a whole, whether we've got the mix right, whether our tax system is acting to impede growth and development is more the purpose of the exercise.

MR COPPEL: Are you looking at how different tax bases, changes to those tax bases, may impact on HFE distribution for the Northern Territory?

MR GRAHAM: It's more in terms of the economic effects that the tax system has. It's not so much around what the impact it would have on our GST share but, you know, we couldn't do that work without informing government on what the likely whole of government funding or revenue implications are going to be.

MR COPPEL: And in the discussion paper you've got a number of examples of how changes in tax bases or tax rates would impact on revenue, can you sort of talk us through some of the assumptions you make in terms of needing elasticity for that work, I think is relevant to some of the criticisms that have been made on our cameos in the draft

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report in relation to elasticity, so I would be interested in whether the work that you've done for that discussion paper builds in some form of assumptions relating to elasticity?

MR GRAHAM: No, it doesn't, because trying to, I guess, assess the impact of elasticity is fraught. I mean, the CGC itself no longer factors in elasticity effects in its revenue assessments simply because of difficulties associated with it. But, I mean, we'd be happy to look at those in more detail if you think, you know, there's more work we could do or more work you think we could assist with in terms of helping you with your - or informing your recommendations.

MS CHESTER: And is that because it's hard to do, which we know, because even the CGC wants to do it because they know in principle that it does exist and to be able to understand the impacts of for them to grapple well with policy neutrality they do need to deal with the elasticity. It is difficult, indeed, I think they've got some major consultancy piece of work under the way on the whole area. So is it because it's just too difficult or you don't think the elasticity effect is there?

MR GRAHAM: I think it's both. It's difficult and, yes, there's some questions as to whether those effects are material.

MS CHESTER: So with the numbers that you've done in terms of revenue impact have you looked at trying to build in some impact on GST relativities or put that in the too hard basket as well?

MR GRAHAM: Yes, we haven't done that work. It's really just we haven't really had, you know, the time or the opportunity to go into that level of analysis. As you know, the timeframe for the inquiry is quite compressed and so I guess the work we've done was really to show, demonstrate the interrelationships, more so than trying to precisely quantify those effects.

MS CHESTER: What's the next milestone for that piece of work, the discussion paper?

MR GRAHAM: Yes, so submissions are due by the end of February and then that will form budget proposals to go into next year's budget.

MR COPPEL: A question we've asked a number of jurisdictions is the dichotomy between the Commonwealth Grants Commission process and jurisdictions that have state based Grants Commissions and how they allocate resources to local government areas, which is typically at least a sizeable portion on an equal per capita basis, and I'm wondering whether

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you see any sort of inconsistency in that treatment or issues in relation to sort of equity within a jurisdiction in terms of providing services, if you want to comment on that?

MR GRAHAM: Look, I can't profess to be an expert in the distribution of local government, the local government FAGs. But in terms of distribution of funding within the Northern Territory, you know, we don't attempt to mirror the Commonwealth Grants Commission's sort of, you know, use or cost weights or anything like that, but we do have funding formulas which account for issues like remoteness and indigeneity, school funding formulas, formulas for funding allocation of police and health resources, so there is I guess attempts made to ensure that the factors that influence costs and demand of services within the Northern Territory are taken into account in the funding, allocation of funding and resources.

MS CHESTER: Just in terms of one of the key things, so I think there were sort of two areas where we need to do a lot more work, it's around how much of a case is made about what's the impact on real economies and economic growth of HFE, and we're going to do some further work there, but also around the transition part. And when you kind of sit back for a minute, so we only sort of articulated one principal in guiding the transition path and that was that the fiscally weaker states and territories would not be materially disadvantaged.

So there's different ways of looking at that in terms of what are the levers. So pacing and over what period, what relativity you might want to see WA get to before you - so the band is a bit narrower before you started to implement a transition path. And then also around the GST funding mechanism as well, what's the growth rate on that pool. So are there any other sort of principles or levers in a transition path that you can think of that could help us do that work?

MR GRAHAM: To be honest we're not really sure what was meant by, you know, that no smaller - or a less fiscally - stronger states would not be materially worse off. Because as I said if there's a reduction in our relativity compared to what it would have been under the existing system then by design you'd be worse off. But in terms of any sort of transition, I think you've identified the two main levers as is relativity and a pool, there's no other levers, so to speak, that leap to mind. I mean, we will think about it more but I guess they're the two obvious ones, phasing in that relativity through some averaging process seems to be the obvious one.

MS RYAN: Jodie Ryan, from the Department of Chief Minister. Just on that, any transition, saying that we're not going to be worse off, the CGC

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would still have to do the work under the current system to determine what that worse off is. If presumably if we transition a way to a lower relativity we would then be reliant on the good graces of the Commonwealth to fund us and historically that's something that you can't actually rely on UTE. So they could suddenly have a budget issue and just cut the smaller states additional top up transition funding by 10 per cent, to them it's not much but for a jurisdiction our size that's a substantial amount.

We have a large proportion of our budget is ongoing funding. So you can't suddenly decide to close a school one year and then open it the next if you get the funding from the Commonwealth. We have schools that are remote, we have health clinics, we have hospitals, we have police stations, the large majority of our budget is taken on ongoing service delivery to Territorians. So to be at the whim of a Commonwealth budget annually would severely harm our ability to plan, predict, and actually try and deliver the services we have to deliver.

So we'd be constantly at the whim - and you might think that a couple of hundred million isn't much, in the Territory's budget's context it's an incredible amount. So our total budget is six and a half billion at the moment. One or two hundred million is a substantial amount, it's five to 10 schools. It's a hospital and a couple of health clinics.

MS CHESTER: So one other thing would be some of the larger states effectively co-funding that transition path, which is something that we put rather robustly to the WA Government when we were over there. You can enjoy reading the transcripts. But it would be good to get your feedback on their thinking, not just the projections but how they're approaching the transition path because we'll be looking at a transition path and we do want to be able to consult with you on that. And in terms of materially disadvantaged, the sorts of issues you just talked about now, Jodie, in terms of impact, in terms of percentage, say, of revenue capacity of the NT, is the sort of thing that would be another guiding principle in terms of impact on fiscally weaker states. Because when you kind of just look at the headline metrics at the moment superficially you'd see we're taking you - if we were to do it cold turkey the next day, we take you from 4.66 to 4.55, and superficially that doesn't look huge.

MS RYAN: But in practical terms it is.

MS CHESTER: Exactly, so that's where we need to - - -

MR COPPEL: We're calculating the authentics of it, translates, do you think we'll need it in 2016/'17, 79 million for Northern Territory - - -

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MS CHESTER: Or equalising to the second highest, 33 million. So and we still have to come to a landing on, if we end up landing in that area, on what is a reasonable standard. And we do have a spectrum from when we've raised if you're equalising to the second highest, which indeed, through the period 2000 to 2010/'11, I think, the outcomes of the current system overlap with equalising to the second highest. And that's only when you go equalising to the average that there would still be some disparity, so.

MR GRAHAM: I guess we'd be keen to understand the relative impact as well, you know, 79 million for us is significantly more than say 79 million for a larger - - -

MS CHESTER: No, and that's before I mentioned the 2.4 percentage points of your revenue, because that to me makes more - is a more meaningful metric than - yes.

MR GRAHAM: Yes.

MR COPPEL: Thank you, very much.

MS CHESTER: Look, I think you guys have said it first in terms of having four very senior officials joining us, I don't think I've had a public hearing where we've had so many senior folk from one jurisdiction attend, so we do thank you very much.

MR COPPEL: Our next participant is Tom Ganley. Northern Territory Airports.

MS CHESTER: And the man who knows where to find good coffee.

MR COPPEL: Welcome, Tom. We ask you to give your name for the purpose of the transcript and if you have an opening statement to keep it brief and then we can ask you a few questions. Thank you.

MR GANLEY: Thank you, and good morning, Commissioners. My name is Tom Ganley and I represent Northern Territory Airports. Northern Territory Airports is the private operator of Darwin, Alice Springs, and Tennant Creek Airports. And Darwin Airport itself has some 1800 people employed on that airport and represents about 1.2 per cent of the NT GSP. So it is a significant or a major business in the Northern Territory. We ourselves employ about 90 people. And I suppose just talking about the fiscal equalisation and the impact, our earnings are about $79 million. So the number we are talking about is very real to us. So we

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are a major investor also in the Northern Territory and have invested some $500 million across the Territory since 1998 when we were privatised.

I suppose just to get to some concise points on the horizontal fiscal equalisation, I suppose we did have some concern about the draft findings in that we see the system as it is providing some stability to government here and I suppose any adverse consequences to state funding is of concern to our business, and indeed many businesses in the Northern Territory. And it has a detrimental impact on potential investment in the Northern Territory and also just our competitiveness in the Northern Territory. We are a unique jurisdiction, as many of the other presenters have spoken about, in terms of our isolation, our Indigenous population, and the remoteness of that Indigenous population across one sixth of Australia's land mass.

So certainly we need funding stability and certainty to encourage investment, and indeed, I suppose the White Papers that are currently looking and focusing on North Australia are really about encouraging investment in the north and diversifying the economy. I suppose we are very much a small taxation base so if the Northern Territory Government does potentially lose up to the $79 million in GST funding and need to source it from own source revenue I suppose they've got very few levers to pull and that does concern business in the Northern Territory, particularly ours.

There are about 2000 businesses in the Northern Territory that pay payroll tax and I suppose the payroll tax harmonisation with the threshold at $1.5 million has been good in terms of allowing competitiveness across the Territory. I think the discussion paper that the government has sent out, if we were to recover that amount from payroll tax it would mean increasing the rate, say, from 5.5 to somewhere in the order of nearly seven. So that would be a concern to our competitive nature, and indeed businesses operating in the Northern Territory and not going elsewhere.

I suppose we have seen even in the Commonwealth context, I think some of the speakers yesterday spoke about some of the Commonwealth agencies that are no longer here, it is a real threat that business does leave the Northern Territory. The Taxation Office, ASIC, and others, have left. And indeed, that spreads across to private business here as well. As an airport it's a bit hard for us to lift our assets so we do need to work in the environment that we are here. We do use building block pricing so any cost increase to our base we will need to recover from our customers.

Some of those customers are major airlines but in the Northern Territory we have some 60,000 general aviation movements at Darwin

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Airport. And those light aircraft are servicing remote communities. And particular at this time of the year as we come into the wet those light aircraft are used essentially like taxis because we have very limited road to infrastructure in the Territory to those places, but indeed, two to three metres of rain a year impacts the serviceability of those roads, if indeed they do exist.

So certainly at our Tennant Creek Airport and our Alice Springs and Darwin Airports we see aircraft being used in that capacity. But supplying medical needs, postal needs, you know, we have flying vets, we have just some of those most basic necessities communities need are serviced from those airports. And of course light aircraft are quite expensive to operate, you've got to single pilot covering three or four passengers there so we do certainly need a competitive base here. We have a limited manufacturing base in the Northern Territory so we need to encourage investment, and we need that competitive business environment.

Indeed, when we expanded the Darwin terminal some two years ago we had to bring much of the product in from interstate, there was nowhere in Darwin that can provide curved steel so we had to bring that infrastructure in from Western Australia. We're about to overlay the runway at Alice Springs Airport, a $17 million investment. We have to truck a bitumen plant into Alice Springs and then also truck all of the bitumen in to allow that to occur. So these are unique problems we have in the Northern Territory but I even feel, you know, more so for places like Alyangula Airport trying to get a bitumen plant over to Alyangula, I'm glad I'm not operating that airport.

So I suppose, you know, we're seeing we need further funding here to create an investment portfolio here for the Northern Territory to expand. And I suppose we're keen to see some stability in the funding arrangements for the Northern Territory. The current methodology should hopefully continue and I suppose, you know, we're concerned if we do go to some sort of partial equalisation that it will severely impact the Northern Territory. But I certainly note in your report that you have taken care of that fact as well in terms of saying that reducing payments to the poorer jurisdictions is certainly undesirable. So I suppose those are just my key points.

MR COPPEL: Thank you, Tom. Can I just ask you are Northern Territory Airports a privately run or a state owned enterprise?

MR GANLEY: So we're actually a privatised airport regime, so we were privatised in June 1998, so we're essentially owned by the mums and dads

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of the Northern Territory. We have some 70,000 superannuation investors getting a return from the airports and some of those shareholders are also across other airports across Australia. But Australian Super, and indeed the NT Government Super Scheme, are major investors in our airports in the Northern Territory.

MR COPPEL: When you say changes to the HFE system would affect the cost base of NT Airports, how does that happen, what's the mechanism that - - -

MR GANLEY: Well I suppose it's just taking it to the next level, that the NT Government would then seek to recover that money to continue to provide the essential public services we need by obtaining that shortfall from its own source revenue, it's got very few levers to pull. So payroll tax, if we're one of the 2000 entities, we'd go up to potentially at 6.9, I think if they increase motor vehicle registration, fees, you know, I think the discussion paper says they'd go up by something like 240 per cent. And, you know, that is a severe impact here in the Northern Territory, we're competing to get employees from interstate if our registration fees are uncompetitive.

Yes, Darwin and Alice Springs have some public transport systems. We're not blessed such as Melbourne with a brilliant tram system, bus system and train system. You know, in Papunya and Yuendumu and others, you know, there is no public transport system, it's a motor vehicle or a pair of thongs. You know, that's all you've got to access the communities so those blunt levers that we have, you know, increasing gambling taxes, we need infrastructure here at casinos and others to be world competitive or to attract international investors and not rely on the local population. So we need those taxes to be competitive and for that investment not to go elsewhere and interstate, or overseas.

MS CHESTER: So I guess, Tom, from your perspective you're viewing it through the lens of your shareholders which is investor confidence and impact on costs?

MR GANLEY: Yes.

MS CHESTER: To the airports that you run. And in that context the NT Government have looked at some tax reform options including around payroll tax. From your perspective for investor confidence what would you want to see in terms of tax reform by the NT Government?

MR GANLEY: I'm glad they're actually undertaking the review and, you know, it is good for that to occur. I suppose we're looking at all of

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the elements there, we do need some stability though in what we've got so I suppose there is some sovereign risk there. You know, we look at South Australia proposing a bank tax and what that did to their funding sources for the government with, you know, the major banks looking to withdraw and do other bits there. So, you know, any of those types of taxes need to be viewed with caution. Similarly looking at insurance, you know, potential levies on insurance, you know, we're above the 26th parallel here so our insurances have a premium on them because we do have wind and cyclone, water and other risks there.

So we need to compete - we need to look through the lens that the government has got there to ensure that we remain competitive against interstate jurisdictions. So any changes to our system needs to be viewed in the context of what others are doing so that we don't outprice ourselves and certainly that's been one of the beauties of payroll tax harmonisation, is that, you know, it did reduce red tape and create some harmony across the environment. So I suppose we need to look at them all in context against interstate jurisdictions.

MS CHESTER: Because I think the Business Council when it looks at state based tax reform would in terms of payroll tax look at broadening the base and lowering the rate, which I imagine would be an advantage in a commercial sense for the NT Airport. And I haven't read the full detail of the discussion paper, I think Jonathan is probably a little bit ahead of me on that. Is that something that has been contemplated by the NT Government?

MR GANLEY: It certainly is in the discussion paper they have sent out. I suppose they have done a scenario there potentially lowering the threshold to 600,000 from the 1.5 million. I think we have some 13,000 business in the Northern Territory so it would certainly increase the taxable base. I suppose the concern there is also that many of these businesses are mum and dad type businesses, some of them are in rural communities, so it is increasing that cost base to those jurisdictions as well. So, you know, there is negative impacts there.

I suppose it creates a vicious cycle, if we increase taxation we reduce our competitiveness, we potentially reduce our population base and then potentially we reduce GST revenues going forward. So we can see it commences a downward spiral which is of concern, but it certainly is an option that is being looked at and, you know, the Chamber of Commerce, I believe, are even in the paper today saying they have some concerns from their 1200 or so members if they did broaden the tax base to say that 600,000 threshold.

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MR COPPEL: In the charges that you apply to airlines, you noted you've got many services providing access to remote parts of the Territory, in setting your charges do you try and take into account the costs of those services or do you also try and provide sort of access to remote communities by providing less than the cost, charging less than the costs of providing those services, or do you get any grants from the NT Government to enable that to address some of those remoteness - - -

MR GANLEY: No, so we get no state or federal funding in that respect. And indeed, the NT is probably a unique jurisdiction in that it operates probably 70 to 80 airports of its own or on behalf of the many outreach communities. So it's probably got its own - well, indeed, it does have its own funding constraints there, it seeks Federal Government funding to try and seal some of those strips or maintain them or even have lighting at night so the medical services can attend. But certainly in terms of our pricing, we allocate the assets that those aircraft utilise so that they're not subsidising or having to contribute to assets at our airports.

We are a joint user airfield so we have significant assets there that a light aircraft would not need. So the secondary runway at Darwin is sufficient for them, they do not need the 60 metre wide runway we have at Darwin which enables the A380 and Galaxy and others to use it. So we try and keep the cost base to what is needed so that those prices are what they need to be. But certainly our $25 or so a ton for maximum takeoff weight of an aircraft is small in the equation if it's sort of $800 one way to fly to, say, Tennant Creek. It's just the operating costs of those aircraft, they're very old aircraft.

The general aviation for aircraft is, you know, some 20 to 30 years old so we're having to maintain in Australia a large and old fleet. And then you've got the costs of labour. And fuel is, you know, about 30 per cent of the operating costs of those aircraft again. In Alice Springs and Tennant Creek the fuel needs to be trucked there so we've got expenses there. And then in our communities the Northern Territory Government also has issues in terms of having to secure aircraft on communities. We have certain security requirements, some of those aircraft need to be flown back because we have petrol sniffing and other social issues at some of those communities that require additional infrastructure to be put in at those ports.

MR COPPEL: They are the questions that I have for you, so again thank you very much for participating in the public hearings. It's good to get a perspective also from some of the potential stakeholders that may be impacted by changes to the HFE system.

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MR GANLEY: Thank you both very much, and thank you for extending your visit to the Northern Territory.

MS CHESTER: Okay, thanks, Tom.

MR COPPEL: The next participant is Des Crowe from the Australian Hotels Association. Thank you, now can you provide your name for the transcript and a brief opening statement?

MR CROWE: Des Crowe from the Australian Hotels Association NT Branch. We have 160 members across the Territory. The nature of our organisation is that we have different divisions. We have an accommodation division, we have what we call wayside inns, which are the remote area of businesses that are on all the arterial roads throughout the regions of the Territory. We have licensed clubs, we have the hotels and taverns. And accommodation division and restaurants is probably doubled up there, but - and overall in the hospitality in the Territory there's about 16,000 employed in the Northern Territory, of roughly just under 10,000 of that would be equivalent to full time, full time employment. So this is just a brief introduction.

There was only a couple of things I sort of wanted to mention today and I've obviously had the benefit of listening to what went on yesterday and this morning so I've got a lot better idea of what your focussed on as such. But certainly workforce development as it relates particularly to some of the work that we've been doing, Indigenous tourism opportunities. And then just a bit of a feedback to you in relation to the consequences of the change in relativities from the previous years to the impact that that's had on a sector of our industry as an immediate result of taxes being increased. So they're the three areas that I particularly want to address.

You were talking yesterday about some positive stories so if I just tell one positive story overall would be what's gone on at Yulara in relation to the Indigenous Academy, the training there of Indigenous students, preparing them for the hospitality workforce. They've got specific targets where they're trying to attain up to 50 per cent of the workforce there, which I think is roughly about 1000 would be the workforce there. At one stage there they were up to about 300 Indigenous employees involved in that, so that sends a very good message in relation to, (1), the Indigenous workforce, and (2), for us, being able to work in the hospitality industry in the Territory where we obviously place a heavy reliance on labour shortages, obviously coming from interstate or coming from overseas.

You've been given the numbers in relation to locals that are

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potentially not participating in the workforce, particularly there is obviously a high number in terms of Indigenous communities that aren't participating in the workforce. So one of the interesting things about that Indigenous involvement there, and it also sort of reflects about what's been said yesterday and today, is that that involvement has come mainly from interstate Indigenous students. So they've benefited through other services being interstate in relation to what level they are up to in terms of numeracy, literacy and their ability to be able to move to a location, to a remote location, and work there.

There are fundamental differences between that cohort and so the cohort of any other Indigenous, potential Indigenous people, that could work in just our sector for example. So we've been, the AHA, has been doing some work on workforce development, and Tennant Creek has been an interesting area there. We would see that if you could replicate what's gone on in Yulara, even to a smaller degree in places like Tennant Creek, it would have dramatic consequences on improving economic activity for tourism generally and that the major drivers of that tourism would be probably either Indigenous owned businesses or certainly businesses where there is a fair involvement from the Indigenous workforce.

So from a positive point, so we're quite optimistic that over a period of time that will occur. You can see with the Northern Territory Government what their approach in relation to the Arts and Museums, trails, these townships like Tennant Creek, like Katherine, like Nhulunbuy, are going to get the benefit of some capital investment. But our concern will be at this point in time is making sure that they've got an appropriate Indigenous workforce which is what the tourists will want, that Indigenous experience. And so from future wise tourism will depend on how we're able to engage with the communities and how they participate in our workforce.

But I note your comment yesterday about inside the gate and outside the gate, a lot of the work obviously has been dealt with inside the gate but we notice in a place like Tennant Creek that those that are progressing past year 9 and coming off community to move to Tennant Creek they can have substantial pastoral care issues, et cetera, about whether or not they can withstand living within Tennant Creek to participate to go through the school system, which might offer them VET opportunities. We know from your data that you presented in other reports that Cert III qualifications for Indigenous are well down on average. And I would go further than that, Cert III Indigenous in the Northern Territory would be well down on the Indigenous averages.

They're the sort of impediments that come through because of

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whether it's housing, education and health. But on the brighter side we sort of see where they've had the opportunity where other Indigenous communities have had the opportunities, we've seen this great interest to participate in the workforce and a benefit for us effectively from the hospitality point of view about participating in the hospitality and tourism workforce. That's a comment I sort of wanted to make and the next part was in just in relation to the impact in terms of business.

So as I said, I was probably coming to vent a bit of anger towards you guys previously in relation to the way that things have happened with the drop in the GST pooling for the Territory. But as I've been here the last of couple days you've sort of given me a good lesson on how the Commonwealth Grants Commission works and I've had the opportunity to read some of that material and obviously it is of concern that our budget relies so heavily on it. But as a consequence of that that's certainly one of the kneejerk reactions from the Territory Government when it came out earlier in the year, was to increase gaming taxes, particularly in relation to electronic gaming machines, which would affect about 80 businesses in the Territory. So a very small business compared to what you might be used to in the eastern states.

But the immediate effect of increasing the tax rates as such was obviously to devalue of the businesses and also to put pressure in relation to how the loan is assessed. So our experience in relation to just the impact of the gambling taxes in relation to electronic gaming machines going up has been a bitter experience for quite a few operators who only a couple of years ago, this is a fairly immature market in the community gaming where effectively they were invited to participate and buy entitlements, roughly 12 or 13 million dollars worth of entitlements were purchased. And then that was obviously based off a previous tax rate but as a consequence of the change in the GST pool the change of the tax rates meant that that's dramatically affected their ability to actually repay some of the loans that were made in relation to purchasing the entitlements to participate in that area to start with.

Now, you know, in terms of devaluations, et cetera, you're talking potentially, you know, the ranges depends on what your reliance is in relation to that income but 10 to 30 per cent of the value of your business is effectively taken away overnight. So those consequences when you look at other, when you look at the Territory revenue issue, in terms of payroll tax, land tax, would be a significant issue based on the nature of nearly all of our businesses are leasehold businesses. And, you know, unless there's some prohibition about passing that land tax on then you can expect the owner of the land will pass it under the lease terms to the tenant. So land tax will effectively be passed on to the leasehold

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businesses.

Payroll tax, again, there would be, you know, some of the nature of our smaller businesses wouldn't be caught by the payroll tax at this point in time, obviously a drop of threshold would involve them to be caught. And they're all obviously involved. Motor vehicle. But it's also the general effect of the increased taxes about what that would do to consumer sentiment and consumer discretionary spend. The overall effect in relation to it is that it undermines some of the services that are provided. We also have with the economy at the moment from our accommodation tourism point of view. I think Yulara is obviously doing exceptionally well, bursting at the seams, but really can't expand, from a productivity point of view.

Alice Springs' return is getting a lot stronger but it went down considerably from what it was 25 years ago, but it's on a rebuild. The Greater Darwin region is one that suffered heavily as a result of the drop off of the top of tourism, and also the drop off in relation to the revenues being raised through accommodation. That's probably not going to change in the immediate future as such and the tourism, the rebuilding of the tourism industry up here is probably going to be a bit of a slow burn. And sort of the airlines are the critical factor in relation to that, the cost of airfares here is enormous, as you might have noticed if you look at your tickets, about what it costs to actually fly to Darwin and to fly to Alice from Darwin, fly to Katherine and Tennant Creek. I mean, they're all enormous costs which are impediments for certainly for tourists as such.

I know you've only given me a couple of minutes but the only other thing, I will just make some comment. I would have concerns about a reduction in the GST pooling where effectively the autonomy was taken, you know, where there might be an opportunity to quarantine moneys, and that was given - that was done by the Commonwealth. The dealing with the Commonwealth has been quite difficult in certain areas here in the Territory over the last 20 years. Employment services has been a major one where we've lost a lot of the flexibilities as a result of the privatisation of those employment services as such, and then the outcomes and deliverables that are sought from Canberra are different to the outcomes and deliverables required in the Territory and the flexibility that's needed.

We've seen as a result of all that a loss of involvement with community as a result of the Commonwealth being involved and, you know, changing those programs. Now they were obviously CS were involved but you can see the way that they deal with things is to reduce the number of the people on the ground and outsource things. And then those that are left are left with some tied funding, which they don't have

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the flexibility to actually do the job properly or to change and have a different approach, which is what's needed in some of our - you know, for example, Tennant Creek or Katherine might need a slightly different approach to how what you might need in Darwin. Or certainly a different approach to what might be required in terms of Melbourne.

We've also sort of seen in relation to things like immigration, et cetera, about the application of strict black and white approach of a federal scheme that hasn't quite worked for us in terms of things like the 457 visas and interestingly the development of the Designated Area Migration Agreement, which has been managed by the Northern Territory Government but still controlled by the Department of Immigration. It's something that's been quite successful because the local knowledge and understanding of what actually happens on the ground has been very important.

So I always get concerned – well, I support the Northern Territory Government about them losing autonomy and those sort of things and when you look at the big ticks under the big ticket items obviously, you know, people tend to focus on the education and - education and health obviously are the major ones, et cetera, but in terms of employment services and training for workforce development, you know, from the Territory, we need to be able to increase participation in workforce at a Territory level. And that is going to be our major solution because I don't believe politically we're going to get much help in relation to overseas migration.

Your report, you know, gives a quick summary in relation to the impediments in relation to - well not the impediments but the reasons why people don't migrate from their own state as such. So it was actually quite interesting to read that part of your report when we consider about population, and our major thing is we don't have enough skilled people here to do the jobs that are on offer as such. Short term we need to seek migration. Interstate migration is pretty poor. We have to then rely on overseas migration as such. But the end result would be higher workforce participation from locals.

MR COPPEL: Great, thank you. If I can summarise, is the key point you were making that a change in the GST distribution would lead to implications for other tax bases that would then have consequences, flow-on consequences, for the businesses that you represent?

MR CROWE: Certainly, and just, you know, a snapshot would be - the one thing I didn't mention is that the proposed investment that was coming as a result of that and certainly for those businesses that were

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involved in purchasing gaming entitlements, hasn't been achieved as a consequence of the new tax rate. Because some of them has commenced it but when they'd realised that their return on investment has been greatly reduced, a combination of their ability to source finance and then just general planning on any return on investment, it's just they can't proceed with it.

So where you start, and you've got to get a balance in terms of what revenue you can get out of businesses, but where you go too far you won't get private investment. And the private investment, you know, like, so we're talking about associated construction. So the smaller tradies around the place aren't getting those constructions. So I don't know what the multiplier is these days, about two and a half, in relation to generally in relation to where some construction businesses would go and where that would flow through to the community.

So those decisions aren't being made and my concern would be whether it's our sector or another sector where we're basically talking about small business, where you suddenly increase - or, sorry, reduce profitability as a consequence of increasing the taxation, or the revenue collect, then you can stymie investment. And you also start pressuring whether or not they can sustain their business. And that's got to flow on to the workforce because if you can't - you know, the services need to go, and there might be entertainment options, it might be as simple as we're not going to get a muso in tonight in relation to we can't afford to be paying for these.

So then our live music industry starts getting reduced in the Territory. So you have all these indirect consequences as a result of decisions that need to be made and so going back to some very core things of just trying to provide food and accommodation and beverages.

MR COPPEL: You may have heard earlier when the Northern Territory Government was at the table the discussion on tax reform in the Northern Territory and we were asking about what they considered to be the impact of, for example, the change in payroll tax on the number of people employed. And they were essentially for that exercise saying that there's zero impact, that's what we call an elasticity in economics. Listening to you, you would suggest that certainly there is an impact and the way you characterise it would be those impacts on the level of activity, level of employment, could be quite substantial even from quite small changes in tax rates?

MR CROWE: Yes, because of the other boot, and I mean it's the accumulative effect of what's gone on as such, so, yes. And to be honest,

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we haven't gone through sort of like in relation to examining the land tax but obviously the land tax scenario, you know, there's that transitional arrangement potentially where they go into land tax and they reduce the conveyance rate, well that doesn't help us, you know, we've already acquired the businesses as such and then we're going to get the land in terms of a leasehold. And those costs, you know, are being passed on.

I mean, you heard the airports talk about their costs, well what would they do? Well they're effectively the landlord, they're going to pass it on to their tenants so it's no different, you know? And when you look at it, you know, and I think the problem we had in relation to dealing with Treasury, Treasury looked at basic figures and then made a decision in relation to a tax rate. Well, they didn't actually consult with us and then they didn't actually understand how that might affect how our loan ratio, your loan valuation ratios, would be impacted. And what margin of businesses would be impacted as a consequence of those tax rates.

They didn't do any economic modelling in relation to it, they sort of tend to say well that's a big picture, big amount there, and that's a big amount there, let's work that out. And we obviously we are meeting with Treasury to provide them with the further information to give them that actually that economic modelling about how it impacts businesses because when you're talking about Territory we're not talking a huge number of businesses. So it doesn't actually take that long to sit down and work out what impact it's going to have.

I think you learn a lot from - the accommodation one is, you know, another important one in relation to payroll tax, et cetera. They're in a situation at the moment where we hadn't seen a huge reinvestment in capital or, you know, refurbs that are probably required to maintain the standards that all the tourism bodies would be asking for because there's some great uncertainty because of our economy at the moment. There's also to a certain degree there's an unknown about in terms of disruption in relation to as INPEX comes off line here in Darwin here in particular the number of units that are vacated which then compete in the same market as the accommodation for tourists.

So owners and managers of the accommodation are uncertain as to, you know, like they're seeing things reduce and they're obviously seeing their revenue reduce, and so they're not in a position to reinvest. So again, things like payroll come along or land taxes, et cetera, come along, that affects all their bottom line. And they then also compare it to interstate or internationally how they are trading. And you know, the high costs of freight, et cetera, the air fares, et cetera, make it very, very difficult to compare from like Darwin and I feel sorry for some of the

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managers that take over accommodation places here that are in the chains because they're on a hiding to nothing on comparisons to other parts of Australia and as well as internationally. We're at a disadvantage in terms of what the cost is to actually provide the type of accommodation that they're used to providing uniformly across the chain.

MS CHESTER: Des, I'm conscious of time, I've just got one super quick question for you. It goes back to the point that you made about the increase in the gambling or the gaming revenue on gaming machines, what was the revenue raised from that change, what sort of - - -

MR CROWE: Well that's where we're still trying to get some figures out of Treasury as to the effect of that because we've only got figures prior to the revenue coming in, but it was within the hotel sector, it's my understanding it's somewhere five, six million as such and then probably put in on an annual - it's an annual increase, and the revenue, I think roughly the revenue from hotels is roughly about - so turnover, is about 30 million.

MS CHESTER: Yes. Now the only reason I ask is that the way the CGC deals with one issue of policy neutrality around gambling revenues is to actually take it out of the equation. So it's off the table, it's not taken into account when they work out the relativities. So to some extent by dealing with the policy neutrality issue that way it actually creates an incentive for states then to tax that base more because it doesn't impact their relativities in a negative sense.

MR CROWE: We've now got the highest tax rate in the country in relation to the EGMs as such. And there are other gambling access that they would have but the difference there is a lot of them are tied up into agreements, long term agreements, whereas those of you that aren't tied up to an agreement are subject to, you know, potentially a decision that can - with no notice, well a couple of months' notice, which isn't the sort of conversation that you want to have with banks. And probably the only other thing I can mention in relation to that from a productivity point of view, it means that the multinationals are in the best positions to be able to come in and buy up on some of these businesses because of the nature of they don't need to go and source lending.

So in terms of their ability to those larger corporations, they've got the ability to have their own self funded. And in the Territory it becomes quite obvious their ability to do that. And that would be of a concern, as those tax revenues go up and the profit drops down a few of our businesses are going to be certainly under the pump. We know a few of them that are already boots up. But it does open the door for those that

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don't have to worry about lenders or banks, their ability to come in. And that's probably a consequence of raising the tax rates.

MR COPPEL: I'm going to have to draw it to a close because we've got only about 15 minutes left and we've got one other participant and potentially those at the end that may want to speak. So again, thank you very much for participating in the hearings and giving your views on the possible implications of changes.

MR CROWE: Thank you very much for attending, coming to Darwin, I appreciate it because it was very informative, and from a transparency point of view I think it's been great.

MR COPPEL: Thank you. Our final participant is David Malone. We are pressed for time, so if you can keep your opening statement very brief and then we'll only have a couple of minutes to actually ask you questions.

MR MALONE: All right, I will keep it very brief. Dave Malone from Master Builders NT. Our industry looks at things in a very, very simple way and we look at the fact that the only sustainable way to actually reduce relativities for the Northern Territory in the long run is to grow this economy. That anything else just creates a vicious cycle of decline and, you know, governments will cut back on both infrastructure and services as a result. The alternative is try and grow this economy as quickly as we can. And you know, it's sometimes lost in terms of context, and Ken Davies talked about this today, the fact of the matter is that we only started this journey for the Northern Territory in many ways, you know, some 40-odd years ago in terms of trying to build a sustainable economy over one sixth of Australia's land mass.

We think that infrastructure is the key. That in actual fact even in 2017 there's an enormous deficit in terms of infrastructure in the Northern Territory. Today if you look at the Northern Territory Government's budget perhaps 25 per cent of the total budget is being spent on infrastructure right now. And it's infrastructure in terms of putting bridges across rivers just so people can get close to all weather access. In many ways all weather access is still a luxury good in the Northern Territory where people get that for short periods of the dry season and that adds to the cost for business to do business and it certainly adds to the cost for government to deliver services to the community.

So we would argue that when you're looking at relativities for the Northern Territory you need to take into account this context that unlike some other states which have 200 years plus at some cost infrastructure

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that's gone in and that business community investors are able to leverage that, service providers are able to leverage that. The Northern Territory has been given the challenge of trying to deliver those services post 1978. I've been generally speaking, the Northern Territory has done a great job so far. There's always questions about where priorities might go, but the number one challenge for the Northern Territory going forward is to put infrastructure in place that allows the private sector to invest to grow the size of this economy so that we actually get to the point where we're closer to parity with the other states in Australia. How is that?

MR COPPEL: Thank you, excellent. I have one question which does relate to infrastructure, and among the Commonwealth payments to state and territory jurisdiction, it's obviously the distribution of the GST pool, there are also special grants, including for infrastructure, and I'm wondering what perspective you have on how those grants may interact with the distribution of the GST pool and go some way to tackling some of the issues that you just mentioned in your opening statement?

MR MALONE: I get the point. I look around the country and I see the Federal Government talking about a new airport for New South Wales, or new freeways. The fact of the matter is the Federal Government is making contributions in every state and territory to infrastructure. When we see large cities get to the point where there's diseconomies the government continues to invest to try and break down those diseconomies. When you look at the Northern Territory the reality is the Commonwealth makes a substantial contribution to the NT, there is no doubt about it whatsoever, but the deficit is significantly larger than that.

It is also the major beneficiary of almost all the economic development work that the Northern Territory Government is doing. If we look at the LNG plant being built across Darwin Harbour, that's a $9 billion plant there and part of a $40 billion project. The company tax of 30 per cent will go to the Federal Government. The 40 per cent for the PRRT, the tax on the resource, will go to the Federal Government. The remainder will be held by the company. The Northern Territory Government gets to get payroll tax from a highly capital intensive facility. But it has to provide the services that made that project go forward.

Now, I know that's exactly the same for all the other states but the Commonwealth is a major beneficiary of the work that's being done by the Northern Territory in trying to grow the economy over this time. It is only reasonable that it makes a contribution. The other thing is it does have special responsibilities considering the fact that it was actually responsible for this jurisdiction through to 1978. That was an easy one.

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MR COPPEL: We'll keep it very brief and thank you for participating.

MR MALONE: Thank you.

MR COPPEL: So we've completed the people that have registered to participate. Now is an opportunity, and I can see in the front row, for any brief comments that you want to make either on what you've heard this morning or other observations that you'd like to make. So if you could come to the table and like others give your name for the record?

MS CHESTER: And you said two minutes.

MR GOSLING: Yes.

MS CHESTER: Really? I've got the debaters' bell ready.

MR GOSLING: Can you give me a wrap up at one? Just give me a - - -

MS CHESTER: Yes, you're on.

MR GOSLING: Thanks very much. Luke Gosling, the Federal Member for Solomon. I don't want to go over a lot of the ground. I have a prepared statement that I can email in. But a lot of the points have been covered this morning. It's great that the NT Government and the Opposition Leader were able to speak as well as the NT Government bureaucrats to flesh those out. And Karen, I know you've got plenty of previous experience in the Indigenous area. There is a lot of extreme disadvantage, if I can just stress that point.

So you've got a child in a NT community that can't hear because of persistent ear infection so they get kicked out of school eventually and they end up in the justice system. And the Royal Commission recently just showed us how much of an effect down the track a lack of investment in those primary care services can have later on because we lose kids out of the system. So I just wanted to stress that point. And the fact that the NT Government, and the members of industry that have been here I'm sure would agree, that I seem to get the feeling from your comments that you think there's not enough incentive for the government and for industry to get some economic development happening, that they need a bit more incentive.

But the incentive is in the disadvantage and the challenges that are there for the Northern Territory Government and for industry to do well and to prosper. So I think you needn't worry too much about that. I just get a bit of a concern about this false economy where if you penalise

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smaller not as strong economies that's not going to lead to the growth that we need to make sure that Territorians have access to the same services as people throughout Australia. But I really thank you for coming, really thank you for coming up to Darwin. Can I just also quickly in my minute remaining reflect on the fact that you mentioned the CGC sometimes doing its work but doesn't have the full or right information.

Can I just flag the fact that the Australian Bureau of Statistics Office here in Darwin has been cut from 34 down to 15? I'm still getting my head around the way the estimated population number works in relation to how the CGC does its thing but having less ability to count Territorians is a problem. We've also seen significant cuts to the Australian Electoral Commission Office. And again, because of those distances, because of the difficulties we have in providing services there's the lowest enrolment in the country here as well. So I just point to the disadvantage the Territory has when the Commonwealth cuts jobs in the public service it leads to less services to Territorians. Thank you very much for coming up and I hope you make your plane.

MR COPPEL: Great, excellent, thank you.

MS CHESTER: Thank you.

MR COPPEL: Are there any other people in the room who would like to make a brief statement before we wrap up proceedings? I don't see any so I will formally close the public hearings in Darwin and the Commission will reconvene on Friday morning this week in Hobart, which will be the final public hearing. Once again, thank you all for your participation.

MS CHESTER: Thank you.

MATTER ADJOURNED AT 10.54 AM UNTIL
FRIDAY, 1 DECEMBER 2017

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Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO HORIZONTAL FISCAL EQUALISATION

MR J COPPEL, Commissioner
MS K CHESTER, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT CHURCHILL ROOM, SALAMANCA INN, 10 GLADSTONE STREET, HOBART, TASMANIA
ON FRIDAY, 1 DECEMBER 2017 AT 10.27 AM

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RESUMED **[10.27 am]**

MS CHESTER: Good morning, everyone. We'll get underway. We've got our first participants here, so we'll have a little five-minute efficiency dividend. Good morning and welcome to the seventh day of our public hearings for the Productivity Commission's Inquiry into Horizontal Fiscal Equalisation. I'm Karen Chester, the deputy chair of the Commission and one of the Commissioners on this inquiry. I'm joined by my fellow Commissioner, Jonathan Coppel.

I'd just like to begin and open our hearings by acknowledging the traditional custodians of the land on which we meet today, the Mouheneenner people. I'd like to pay my respects to elders past and present.

Now, this is the final day of public hearings for this inquiry. In the past couple of weeks, Jonathan, I and the team have cantered around Australia to Perth, Melbourne, Adelaide and Darwin, and we saved Hobart as lucky last. During that process we've heard from some 50 participants over seven days. This actually follows, as many of you would be aware, much consultation that we've already had today. We've had meetings with many participants, we've travelled to every State and Territory jurisdiction before our draft report meeting with State and Territory officials, academics and other interested parties. We've just cracked the centenary of submissions. So we've had 44 post-draft report submissions, which takes us to a nice 100.

Now, after these hearings we'll be working towards completing a final report which will be submitted to the Australian Government next year. Participants in those – that have been registered for hearings will be advised when the final report is released. Once we give a report to Government, under our Act they have 25 Parliamentary sitting days after completion to table it.

The purpose of today's hearings and all of our hearings is really just to facilitate public scrutiny of our work, get feedback on the draft report, what we got right, what we got wrong and what we missed altogether. We like to conduct the hearings in a reasonably informal manner, but because we have a transcript being recorded we can't take or entertain comments from the floor. But at the end of today's proceedings if there's somebody here who has not registered and has a burning desire to be heard on these issues, if we've got time, we'll allow you to make some brief comments.

Now, participants are invited to make short opening remarks and we like to keep those up to five minutes. That's really just so we've got enough

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time to discuss matters that you've raised with us and that we'd like to get a better understanding of. Participants aren't required to take an oath; we just ask that you be truthful. You are welcome and, indeed, we like it when people do comment on the submissions and evidence we've received from other participants, especially from those in Western Australia, we found that we've had some feedback on.

The transcript will be available from the Commission's website following the hearings. Participant submissions to the inquiry, as everyone should be aware, are also available on the website. For any media representatives that are attending today – and I don't think we have any, which is – one. I hope you've been given the rules of play and engagement and you'll follow those religiously. Most importantly note though that we will not have any video or audio recording as soon as I finish these opening remarks. But given there's no camera crews, we've all avoided that one.

Now, there is some piece of legislation that means I'm meant to say the following words. In the unlikely event of an emergency that requires the evacuation of this building, I'm just going to say follow common sense and don't take the lifts. With no further ado, I'd like to invite our first participants to join us from the Tasmanian Council of Social Services.

If you just take your time, make yourself comfortable, grab a glass of water. Then when you are comfortable, if you'd just like to each state your name and the organisation that you represent just for the purposes of voice recognition for the transcript. Then if you'd like to make some brief opening remarks.

MS GOODES: Kym Goodes, CEO of the Tasmanian Council of Social Service.

MR DALLA-FONTANA: I'm Isaac Dalla-Fontana, I'm a graduate policy officer for Tasmanian Council of Social Service.

MS GOODES: We've prepared some slides, I think, to, I guess, value-add to the written submission that has come through. Just for context, the Tasmanian Council of Social Service is the peak body for the community services sector in Tasmania. We also represent low-income, disadvantaged Tasmanians; so we wear both hats. Our expertise that we bring today is not necessarily in the detail of tax transfer systems or even the Grants Commission, but rather, the human side of what happens when taxes are sent through to states and how our service system in Tasmania needs to be able to respond to the needs of our population; in particular, as a state with the most disadvantaged population in the country, what we would like to talk through, I guess, in terms of that impact.

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As you will see in the first slide, Tasmania is, sadly, a place of quite entrenched disadvantage. It's also the consistent beneficiary of the Commonwealth–to–state and state–to–state fiscal transfers. This is not the question. What we need to ask is whether the people of Tasmania can receive the standard of services expected and owed to all Australian citizens without the extent of these transfers. So the strong view of TasCOSS is that no, Tasmania's population experiences a degree of disadvantage across many decades and across economic cycles that needs the system as it is to stay in place.

As indicated by the first graph, the economic fortunes of Australia's states and territories have diverged further over the past three decades. So through this time Tasmania's status as Australia's poorest and most disadvantaged state has remained unchanged. Slide 2 shows that our labour market has historically and consistently been soft compared to the other states and unemployment generally the highest in the federation.

Slide 3 shows that in recent times our unemployment rate has fallen relative to other states. Our under-utilisation rate remains high. In fact, under-employment is now probably Tasmania's biggest challenge, a problem potentially greater than unemployment itself. There is simply more people looking for more hours of work than there are jobs. It also appears that, as supported by slide 4, this trend of economic returns increasingly going to large cities might be affecting Tasmania. There's not much that we can do about that as a state. Hobart as our capital city has a population of 220,000 people.

Slide 5 shows us that part of the reason for our persistent disadvantage is our consistently low educational outcomes. Tasmania has the lowest attainment of Year 12 certificate rate of any other Australian state or territory besides the Northern Territory. This is also true across the population as a whole. Tasmania is the least likely to have finished year 12, according to the most recent Census data.

Slides 6 and 7 show a small ray of hope, I guess, for want of a better way of putting it, a bit of a bright spot in the figures. That is, that our numbers of graduation at tertiary level are stronger in relative terms in recent years. However, the level of attainment in the younger population remains stagnated. That's a real concern to us, I guess, in terms of our future demographic profile, which we'll talk a little bit about.

In slide 8 we can see that it seems that many of our young people with tertiary qualifications are heading elsewhere for work. Slides 8 and 9 are probably the most, I guess, startling slides in terms of our migration of young people what we would call off–island, versus the intake of older

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Australians into Tasmania. So what we can see from that demographic migration data is that we lose our young people between the ages of 15 and 29. While some trickle back, in the main that part of our population leaves our island due to lack of employment opportunities and, in the main, they don't come back.

We would say that other states in Australia clearly benefit from the flow-out of our young population and in return for its young people, Tasmania has long received interstate migration of arrivals of people past or at retirement age. This has a huge burden on our system all on its own. So in the middle of the last century Tasmania's population was the youngest Australian territory in the country and we are now the oldest. That has a substantial impact on the services that we need to provide.

The effects of these flows mean that there is a large bite in our age profiling in the 20 to 39 age range right at the point where most states in Australia have a population bulge. This bite will accelerate Tasmania's impending population decline because it's the cohort that starts families and raises children. Tasmania's poor demographic will increase the demand for government services relative to other states and sharply reduce our ability by the state government to fund these services through its own revenue such as payroll tax and, perhaps more importantly, through taxes that are fuelled by population growth such as land taxes and stamp duties.

So even today the need for services are not being met by our current Tasmanian population and, sadly, our population suffers as a result of that. Tasmanians are more likely to die prematurely and they are more likely to die of avoidable causes than [people in] any other state or territory besides the Northern Territory, even when we take into account our age profile. The Tasmanian Government has limited policy levers to prevent the outflow of our young people and as large cities are increasingly magnets for people and capital, this trend will likely continue.

The Tasmanian Government and the Tasmanian people are especially vulnerable to changes in the equalisation process. Forty-one per cent of Tasmania's total budget revenue comes from GST payments, the most of any state, other than the Northern Territory. So this is more than five times the proportion of WA and approaching double for New South Wales and Victoria amounts.

TasCOSS believes – and it is obvious – that every one of the trends that we have discussed so far would be more severe if the Tasmanian Government lost a substantial proportion of its HFE payments and could no longer provide a standard of service equivalent to other Australian states and support the many jobs in Tasmania that are now created and in time

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exist as part of that service system, both in health, education and across the community services sector.

The 2012 GST distribution review specifically recommended against incremental changes to the HFE, finding that half-measures were untenable and the only alternative way was the wholesale rewriting of Australia's intergovernmental relations. TasCOSS believes that nothing has changed enough in the respective capacities and needs of this state to come to any other conclusion other than that of the previous review. In Tasmania's unique context as Australia's smallest and poorest state or territory, the human cost of movement away from the full HFE would be devastating. Beyond its immediate human cost, it would hasten the vicious cycles of our demographic decline as it would spur faster emigration of our skilled young people, drain our working-age population and make it increasingly unfeasible for the state to fund services for the population that remained.

Given that we live in communities, not economies, we urge the Commission to give full consideration to the human cost of any reduction in the degree of a HFE.

MS CHESTER: Thank you very much, Kym, for those opening remarks. We might just kick off with – I guess, as you said in your opening remarks, you are bringing the human side to this equation. Indeed, the way HFE works is to try to equalise the fiscal capacity of the state. So when we look at the overriding principle being one of equity, there's kind of then – equity, for me, is about the individual, the human side and what flows through to them, whereas the way HFE does it is about giving a state or a territory government an equalisation of fiscal capacity. You kind of then look through to well, what actually trickles through to the individuals.

I'm not sure to what extent, and I didn't anticipate – we didn't expect you to be across the detail of how it works. Indeed, we sort of think that there's only probably 30 people in Australia that know how it works. Some of them reside in Tasmania. But when you actually look through to the expenses side of HFE – so what the CGC does is they assess the expenses by saying, "This is what Tasmania would need," and then they adjust those expenses for disabilities; so remoteness factors, Indigeneity, all those sorts of things. When you look at what's assessed for Tasmania and then what the Tasmanian Government actually spends the GST moneys on, there is a bit of a mismatch. Are you aware of that?

MS GOODES: Yes and no. There's certainly a desire from TasCOSS and in all of our advocacy work with our state government to see greater levels of transparency, I guess, in terms of where that money that's flowing into our state, through the Grants Commission, is directly attributed to what we

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would consider to be appropriate policy and service outcomes. So while we're, as a small organisation, not able to draw it down to a potential level of detail, we certainly – in our State Budget advocacy work, our submissions to the state, are keen to see a greater level of transparency and a deeper understanding of where that income into our state is directly impacting, what we know from our (indistinct) data, from our demographic profile of need, how we – ensuring that that money is being spent in the way that it is intended to be spent.

MS CHESTER: That's why I raise it with you, because listening to your opening remarks and reading your post-draft report submission, you are very much looking at how that equalisation process works through to the equity, which is the individual. When you kind of then look at the numbers CGC does prepare for us, over the last six years, Tasmania actually against its assessed expenses is 7 percentage points under. That's fine and understandable. Some states are above and some are below because it's untied moneys. They can spend it on what they like.

But then when you look through to the categories where they are underspending around sort of welfare and services to communities – so services to communities is only 34.8 per cent of what they should be – what they're assessed as needing to spend for that fiscal capacity. Welfare is 87 per cent, housing 82 per cent, post-secondary education 83 per cent. So you can see that there's – when you talk about it from an equity perspective, it's kind of useful to then look through to see well, these are the assessed expenses, but what's the actual outcome and what other priorities have crowded out those assessed needs?

MS GOODES: That's right. We would say – and it's relevant, as it is almost daily in terms of media coverage but also the focus through parliamentary processes, inquiries, our hospital system is a major challenge for us as a state. In terms of the government's allocation across its budget, we would be arguing strongly that we won't, in fact, stem the tide in terms of the chronic – proportion of chronic illness in our population, for example, which means that our hospital system is disproportionate in its funding needs to areas like housing, welfare. We have limited investment, we would argue, in preventative health measures.

So in terms of turning the tide around and looking at how in 50 years' time we could be having a different conversation, we would absolutely agree that there needs to be a greater accountability and a greater transparency around where both previous and current state governments are putting their focus in terms of those funds. Where it is in untied grants, we would argue strongly that if we cannot address our educational outcomes as a priority in this state we will continue to stay in the state of disadvantage that we're in.

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I know Saul Eslake is presenting later on this morning. Saul, I'm sure, will talk about the fact that we spend more on education in Tasmania for students per head of population than any other state or territory and we still get the worst outcomes. TasCOSS argues strongly and consistently that we need to look at different ways of working if we are to get different outcomes for our population. I think what you're highlighting in terms of some discrepancies, I guess in funds in – versus expenditure, we would argue is one of the first places we need to go with that.

MS CHESTER: That's only even then – not even looking at the effectiveness of that system, which is, I think, what you're coming to and what Saul will focus on. Indeed, our recent five-year productivity review had a whole section of it dedicated to better educational outcomes, particularly for our young Australians. Indeed, some of the areas we went into there, we were informed by earlier discussions we had with senior officials at Tasmanian Department of Premier and Cabinet early on, very much around that mismatch that you've got between educational outcomes and economic participation.

MS GOODES: That's right. I guess the other Productivity Commission report that we are strongly focused on at the moment is around regional Australia and regional economies. We will be putting a strong case to the government and both major parties, basically, leading into the election that in terms of the GST revenue into Tasmania, we need to reset the infrastructure to greater take into account human capital, social capital, not just economic capital which is predominantly where government tends to focus. We think that we need to look at a different model of investment into Tasmanian communities that understands that there is a range of capitals that actually make up a resilient state or a resilient community. At the moment we haven't got that balance right.

MS CHESTER: I guess there is this broader picture in policy speak that the Commission look at and HFE is kind of one small component part of it. I'm not suggesting, given the numbers, that it's an insignificant component part for the Tasmanian budget. But it would be good to – because you have sort of painted a little bit of a picture of Armageddon from our draft report, what do you understand to be the likely fiscal impact and – even if our draft recommendations were adopted by government and implemented tomorrow, what do you understand to be the fiscal impact and how that might flow through to service standards?

MS GOODES: I think it would be on two fronts. Obviously in terms of the general services delivered by the government itself and particularly in health and education, we would see the biggest hit if we were to take a single dollar out of either of those systems at the moment. That's not to

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argue that the dollars going into those systems don't need to be used more efficiently and effectively and potentially revisit what we would probably describe as – not necessarily the most contemporary policy approaches in some instances.

But the flow-on effect out into the community across a range of other parts of our service system – so like many other states and territories, our government has outsourced, to predominantly the community sector, but in some cases [the] for-profit [sector]. A large proportion of human services didn't agree. That is being delivered in a model that we would already argue is so lame that it can't be maintained into the long term to withdraw funds in any element of that, whether that's in housing and homelessness or services all the way through to just the range of emergency services that are delivered. But all our disability services, our family intervention services, many of the counselling and support and financial services that are outsourced by government to the sector would be dramatically reduced should the revenue reduce.

MS CHESTER: I guess, so you did have a bit of an understanding of what the fiscal impact might be – so this would be like an overnight implementation, which is not what we're recommending. Indeed, we're looking at a very – we want to have a very well-phased transition path because we do understand the impact particularly on the fiscally weaker states, that even if you were to implement either equalising to the average or equalising to the second highest state overnight – and I look at it as maybe a percentage of revenue because that's – those order of magnitudes make more sense to me than just dollars. It would be 1.3 per cent to 2.8 per cent of Tasmania's current revenue. So that's not really a material number. It's not an immaterial number but it's not a material number.

When I look at that and then I look at assessed versus actual expenses, it's not clear to me that it would really impact the standard of services for those assessed expenses. But I guess coming back to the point of the transition path, and that's an area where we've tried to sort of consult with the fiscally weaker states, the principle that we set out in our draft report was to say that we wouldn't want to see the fiscally weaker states materially disadvantaged by this change, particularly given our starting point with quite large relativities at the moment. So in terms of how we then look at transitioning over a longer period of time and pacing it gradually such that even a non-gradual phase – immediate phase-in would be 1.3 per cent to 2.8 per cent – what do you think would be not materially disadvantaging the state if we were to try to implement that principle?

MS GOODES: Well, I assume that principle assumes that the state will be able to make up that revenue through other means. My observation and our

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understanding is that that would be very challenging for our state, in part because of the figures we're presenting in terms of the declining number of young people who are in that sort of age bracket where we could maintain what we would consider to be the critical mass of population we would need. But equally, in terms of the State Government's capacity to address what are such entrenched levels of disadvantage, we strongly argue that no matter how staged the transition of that was, how would we take into account where the State Government would be picking up any loss.

MS CHESTER: Does TasCOSS have any sort of views – you touched on earlier in your opening remarks about sort of efficient – tax reform and efficient optimal taxing of the Tasmanian revenue bases. Do you have views on that, where you'd like to see taxation policy - - -

MS GOODES: To be honest, at a limited level, because generally the work that Councils of Social Service do at a national level is really looking more at what we're meant to be looking at federally. We would argue as COSSs collectively – and we have in a number of instances – that we actually need to have this conversation at a federal level before we can have it at a state level.

MS CHESTER: And that's where we kind of get to in the draft report as well where we flagged that – and it's kind of interesting. The CGC did some analysis post our draft report which shows that even with WA, with its current mining royalties, being the fiscally strongest state, even when you equalise them as the highest, they themselves can't meet their assessed expenses. So the key issue here is really not HFE, it's really vertical fiscal imbalance which is driving it.

MS GOODES: That's right, yes, and which is sort of our national conversation that we partner with ACOSS. I know that ACOSS present regularly on this at a range of different hearings. We would argue that we currently need to have a complete overhaul of our tax system to also understand in some of the data we've presented today the changing nature of work, the need to maintain a strong safety net in a country that is seeing a decline in fulltime employment and wages stagnating. We don't currently have a system, we think, that is looking into the future and has the vision of how we are going to move, not just this part of our tax system but our whole system, to better cater for the needs of the country where we're moving in the next 50, hundred years. At a state level we don't have and haven't done any sort of detailed - - -

MS CHESTER: No, that's fine.

MR COPPEL: I just wanted to pick up on a point you made about the

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regions within Tasmania. Tasmania is a bit unique in that local governments actually provide quite a lot of community services to their community and the system we have in Australia at the federal level among the states and territories is, in part, reproduced for funding for local governments. That's based on a system which is quite different from the federal level. It's not equalising to the strongest state. It has quite a significant proportion based on the per capita basis. I'm wondering – there seems to be a disconnect – if you had any comment on that.

MS GOODES: Yes. My observation is that our local government system in Tasmania is quite different to other parts of the country. I know for a fact in Victoria local government delivers direct services in disability, aged care, and is quite a prominent service provider. That doesn't happen in Tasmania. Our councils vary from some councils employing community staff who work on the ground in communities, but not in direct service delivery, more in that community development space. We do have 29 councils, which is a lot of councils for a small state, and we have limited consistency, I guess, in terms of who delivers what.

So we'll get a large council in the north with limited community development input, [and a] council in the south like Hobart City Council with a strong team in that space. Again, it is one of those variables in Tasmania that it makes it challenging for us. We don't have consistency of what that looks like, I guess, across our state. What we do have though is pockets across Tasmania that in our more rural and regional areas – the east coast – often people look at our west coast and our declining employment. But actually the average household income on the east coast of Tasmania is around about $300 less than any other parts of our state. So we have major variances in terms of the need. People move to those communities because they're generally cheaper to live in, but equally, they are the areas least serviced in terms of health or even – getting a critical mass of students to make a school at its most viable level.

It is in part – while we look like a small state, actually geographically we're one of the most dispersed populations in the country and our capacity at the three layers of government to service the needs based on our demographic profile is pretty challenging.

MR COPPEL: I just have one final question. You hold the strong view that the current system should be maintained. Do you have any views on within that current system changes that could be made to improve how HFE works?

MS GOODES: I think it comes back to the point that we were just touching on with Karen's question around being very direct and transparent and

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accountable. So we would argue that we still have deficit areas of investment by state government. That's been the case not just currently but for quite a long period of time. We would argue strongly that the more accountable and transparent through that Grants Commission process that those funds are, the more capacity we have to make sure that we're targeting the right areas and that we've got the balance right between what we would call the tertiary end of our need in the system, at a particularly – health level, versus the preventative and primary areas that may mean that in 50 years' time we can turn around some of those areas of disadvantage that are currently really weighing the state down and holding us back.

MR COPPEL: In terms of specifics to get that improved transparency and accountability, you mentioned in your opening remarks work within the State Budget. Are there other measures that would support improved transparency?

MS GOODES: It's one of those areas where I'm always hesitant to say – we need to sit down and really understand what that would look like. I guess there's some concern at the moment, for example, with the legislation that's just been tabled around the national housing – of local housing partnership. So the NAHA [National Affordable Housing Agreement] is suddenly going to tie the states to a whole range of areas that may not be directly related to social housing or homelessness. So I'm always a bit wary to make comment in that regard without saying that I think potentially where we could add some value at the moment in terms of this review is potentially understanding at a deeper level what needs to be addressed – is there, ah, particular areas of service delivery. For example, affordable housing is a major issue in Tasmania and particularly in Hobart, as it is in many other parts of Australia. I don't think there's a simple answer to that question, I guess, is what I'm saying because what we often see is the unintended consequence if we don't drill that down and understand what is the problem we're trying to address, and looking at it in terms of a contemporary policy environment what would we want to do differently for that to happen.

MS CHESTER: We know from our own work on ROGS, reporting on government services, that there's a lot of very detailed work required there.

MS GOODES: That's right.

MS CHESTER: In terms of what might be relevant for our report though is – and this might sound like a Dorothy Dixer but it's not meant to be one. We've actually asked for the cover to be open completely on the information, data that the states and territories give the Grants Commission, their worksheets, how they do their calculations. The reason we do that is

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because we've got a lot of academics that would like to roll up their sleeves and do some really good work. You might be familiar with Neil Warren from UNSW, his work in this area.

MS GOODES: Yes, I am.

MS CHESTER: We've got state and territory governments, some saying yes, some, including the Tasmanian Government, saying no, that it would lead to a misunderstanding of the system to allow access to that data. So it'd be good to get your thoughts on that.

MS GOODES: Again, I can't comment on what our Treasury does in terms of crunching those numbers and how they come up with the rationale that they do. What I will say though is – and I've said this recently in the NAHA example – the community services sector receives large grants from state government and our sector has to report on outcomes. We have to be able to provide very detailed modelling around the unit pricing models that we use to cost our services. So I do find some irony when we have governments who require that of those that they fund, but they don't want to be able to respond in an equal way when they receive funding, whether that's from the Commonwealth or anywhere else. I think there is a principled approach to ensuring that outputs, outcomes and impact is able to be transparent from a state government perspective as much as we are, as a sector, required to be very transparent in terms of grant funding we receive.

MS CHESTER: We don't have any other questions, Kym. Thanks very much for participating in our inquiry today.

MS GOODES: Thank you.

MS CHESTER: I'd like to call the next participant to our inquiry, the Tasmanian Government and the Tasmanian Treasurer. Welcome and please come and join us. Good morning, Treasurer. Good to see you again.

MR GUTWEIN: Likewise.

MS CHESTER: Nice to do it in Hobart this time.

MR COPPEL: Jonathan Coppel.
MS CHESTER: Good to see you, Tony. Hello Anton, good to see you again. Please take a seat, make yourself comfortable, gentlemen.

MR GUTWEIN: Now, do you have a copy of the presentation I was planning to run through or not?

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MS CHESTER: No.

MR GUTWEIN: You don't.

MS CHESTER: We look forward to it, as long as it doesn't go longer than five minutes, Treasurer.

MR GUTWEIN: I will get through it at a canter.

MS CHESTER: Excellent. Thank you very much. And your colleague in the Northern Territory as well. Just from a logistical perspective, can you just state name, rank and title just for the purposes of voice recognition for our colleague here. Then if you'd like to make some opening remarks with your presentation for us, that'd be great. Thank you.

MR GUTWEIN: Peter Gutwein, Treasurer of Tasmania.

MR FERRALL: Tony Ferrall, Secretary of Department of Treasury and Finance.

MR VOSS: Anton Voss, Deputy Secretary of Department of Treasury and Finance.

MR GUTWEIN: Karen, thank you very much. Firstly, could I just thank the Commission for coming to Tasmania. I'm pleased that you're here and that you've got an opportunity to hear firsthand from others in regards to their view on your draft report. I want to briefly discuss the intent of HFE, including the importance of HFE. I then want to talk about the scope of the Productivity Commission's inquiry on HFE, including the influence of Western Australia's current budgetary circumstances, and then discuss the key findings and recommendations from the draft report, including the strong state premium concept as well.

If I can move to the second slide, the aim of HFE is to equalise the capacity of state governments to provide services of a similar standard across the country. It reflects a belief that Australians, wherever they live, should have access to similar standards of service. It's a strong egalitarian principle that's been reflected in the CGC's approach in one form or another since its inception in 1933. Australians do not want to see a nation with regional disparities that exist in some other federations that protect state autonomy and enable for provisions of services to state communities reflecting specific and varied priorities to those communities. Any move away from full horizontal fiscal equalisation would reduce the level of equity between the states and territories.

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The third slide, what does HFE mean for Tasmania? In 2017-18 our total revenue was expected to be approximately $5.9 billion. The state's largest source of revenue is GST, estimated to be $2.4 billion or approximately 41 per cent. The effect of HFE is that it will deliver 18 per cent of Tasmania's total revenue. We receive 1.1 billion more than our population share and this 1.1 billion reflects the fact that per capita cost to provide an average level of services to Tasmanians is higher than the national average and that our revenue raising capacity is lower than the national average.

Putting this into perspective, HFE distributions represent 64 per cent of Tasmania's health expenditure, 71 per cent of education expenditure, or 100 per cent of housing, social security and welfare, public order and safety in 2017-18 terms. The Commonwealth Treasurer issued terms of reference to the Productivity Commission on 5 May. I note that he did that without any consultation with the states or territories. In our view, this was largely driven by lobbying from Western Australia, given the problems that Western Australia have with their budget position.

The Commission was asked to determine whether the current HFE system impacted adversely on the Australian community, economy and state and territory governments in terms of economic activity, national productivity and incentives for state revenue and expenditure reforms. The Commission was then asked to determine whether there were preferable alternatives, if any, to the current HFE system, what improvements could be achieved.

Tasmania considers that the clear implication of the first issue is that the Commission had to initially demonstrate that the impact of the current system of HFE has been detrimental before it could address the second and propose preferable alternatives. Tasmania further considers that if the Commission was able to demonstrate that HFE was detrimental, it would then need to clearly demonstrate that any alternatives to the current system of HFE were materially better over the longer or shorter term.

I might just touch on the Western Australian impact. The 2011-12 Budget speech by Christian Porter I think is very informative. The recent debate about the integrity of the current HFE system being generated by the decline in WA's share, I think when considered in the context of what Mr Porter said in respect of his 2011-12 Budget, in his Budget speech, where quite clearly he understood that there would be an impact and he set his Budget settings on the basis that there would be a floor, erroneously assumed on his behalf at that time. That has largely led to some of the difficulties that they face.

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Now, the other point that should be made in respect of WA is that through the period they benefited by about $7 billion in additional GST from 2010-11 to 2013-14 because of the mining revenue assessment, due to the lagged approach that's taken with the assessment. I want to be clear, the fact that they find themselves now in difficult financial circumstances is not the fault of HFE or the GST distribution methodology. The lagged GST assessment, the decline in WA's share were predictable and were well-known by the Western Australian Government. The changes to GST methodology that Mr Porter forecast in that speech didn't eventuate; and for sound reasons didn't eventuate.

But what happened – Western Australia kept on spending. They chose to increase their current expenditure by historically very large rates in public sector wages and salaries and services and spending on infrastructure. Much of this increased expenditure has become structurally embedded, such that it's difficult for them to unwind. Consequently, WA now faces major challenges in respect of restraining its expenditure.

I just want to make the point that their current expenditure growth rates from 2006-07 through to 2015-16, based on actual expenditure data, was 7.3 per cent annum; significantly higher. They were 2.4 per cent forecast in their recent budget, but 5.6 per cent if you take the average across the 06-07 through to 2020-21. They had significantly high rates of expenditure growth.

Turn to the next slide, their total revenue. The point that I want to make here is that even though that their share has fallen to around 0.3 of an equal per capita share as a result of the increase in mining royalties, when taking into consideration all other income and revenues, [WA] has remained at above per capita total revenue compared to the national average. I want to make the point that in the period 2010-11 through to 2020-21 that the average per capita received in revenue in WA's case is $10,658 per head; in the Tasmanian context it's $10,372 per head. So even taking into account the rise and fall in respect of the GST, the total revenue on average received by Western Australians compared to Tasmanians is still high; is still high under the current system.

We would argue that HFE is working as it should. The chart that I have there, that illustrates that – the decline in WA's relativity as its own source revenue grew rapidly from the mid-2000s until 2013-14. But as you can see from the chart, the forecasts and projections indicate that their relativity will come back. Now, this is a zero sum game. At the end of the day, this will result in other states' relativities experiencing a corresponding decline and subsequent narrowing of the current divergence. We believe that this demonstrates that the current system is working well.

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Tasmania is of the opinion that the Commission in its draft report has not proven that HFE has a negative national impact, has not sufficiently underpinned its major recommendations with evidence-heavy arguments and has placed too much emphasis on ameliorating the current budget position of WA. I'll take you through the next slide just in terms of some of the outcomes and evidence that was provided in the report.

The draft report found that HFE was unlikely to impact on efficient delivery of state services, economic growth and productivity or movement of labour and capital. It is difficult to prove that it impacted on potential policy reform. No evidence was produced that it impacted on efficient infrastructure development. There was no direct evidence provided that it impacted on state taxation reform, the development of revenue bases and tax rates, state policies to facilitate, restrict or tax the development of resources or state policy choices relating to resource extraction.

Notwithstanding the conclusion that there is no direct evidence that GST effects have played into specific policy decisions in the past, the Commission has presented two hypothetical reform cameos in an attempt to show how GST can be affected by changes in state policy. You're arguing that HFE is a potential disincentive, is, therefore, a barrier to efficient tax reform. We consider that those two tax reform cameos present an overly simplistic view of the impacts of tax reform on GST payments, which fail to take into account issues such as transitional and implementation issues, the complexity of implementing tax reforms and impacts on individual taxpayers.

To just move to the two main options that have been presented, I just want to point out that in respect of those two alternatives for less than full equalisation, equalising to the average of all states or equalising to the second strongest state, in both cases there's a large redistribution through to the strongest state. Our treasury modelling shows that New South Wales benefits from 2018-19 onwards and Western Australia from 17-18 onwards when equalising to the average of all states. Western Australia benefits from 17-18 onwards when equalising to the second strongest state.

Either alternative to the current system would leave Tasmania substantially worse off, resulting in the loss of millions of dollars of funding required for essential services. In these two example cases, $640 million in round numbers in the first instance and around 170 million in the second over the period. I want to just touch on the partial equalisation, to the average fiscal capacity. The context, if GST distribution was based on an equalisation to the average fiscal capacity of all the states, the $168 million loss in 2017-18 terms would mean that 1800 nurses or 1900 teachers would be unfunded, or all of Tasmania's police officers unfunded. That's 48 per

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cent of our nurses, 41 per cent of our teachers or a hundred per cent of our police officers if it were applied to either of those employment cohorts.

Distribution based on equalising to the second strongest state, for a $77 million loss in 2017-18 terms would result in approximately 800 nurses, 850 teachers and 700 police officers being unfunded. The strong state premium, I just want to make the point that the Commonwealth Grants Commission in its submission to your draft report expressed concern of the potential implications of the alternative options and the suggestion it would create a different playing field for the advantaged state which would attract what it refers to as a strong state premium. It's considered this would have a number of consequences that would exacerbate the fiscal strength of those other states that are treated differently to the stronger state.

In concluding, our state has serious concerns about the draft report. The majority of states and territories accord with our position, as do respected independent bodies, including the CGC. It appears that the only support has been received from the beneficiaries of the recommendations, which for obvious reasons doesn't surprise us. We do not believe that the Commission has proved that HFE has a negative national economic impact and we don't believe that the major recommendations have been underpinned with detailed evidence. With that, I'll draw my opening remarks to a close and do my best to answer any questions that you have.

MS CHESTER: Thank you very much for those opening remarks, Treasurer, and thank you for cantering through them at a productive pace. We might start with WA because, unsurprisingly, that was a lot of the focus of your opening remarks. I guess and in part some media reportings have mischaracterised our report as our recommendations being in some way prompted by WA's fiscal position and its budget management. A lot of the material that you went through, Treasurer, and, indeed, in your pre-draft report submission and your post-draft report submission resonates with us in terms of how we – our exposition of the WA Budget management position, the quotes from the Budget speeches, their ability to forecast their relativities. Do you have an issue with how we've presented the WA Budget management in our draft report? Because we thought it was a pretty sort of frank and fearless exposition. Indeed, it's difficult then to connect the dots to our draft recommendations, which I'll come back to in a moment.

MR GUTWEIN: Well, I would argue that if we're both in accord in respect to WA's financial mismanagement, that at the end of the day you should draw the inquiry to a close and allow the system to sort it out for them. To be frank, I'd argued – and since being Treasurer over the four years that I've been Treasurer – with the previous WA Treasurer, Mr Mike Nahan – and I'll argue with the current Treasurer, Ben Wyatt, in respect of

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this. The simple fact of the matter is that WA received $7 billion more in GST that it should have because of the lag. It set its budget forecasts on erroneous conclusions that they drew themselves. It's in a position now where it receives less GST.

But the point that I want to make there is that in terms of total revenue, they will receive on a per-capita basis over the period from 2010-11 to 2020-21, on average, $10,650 or thereabouts in terms of revenue per capita compared to Tasmania which is 10,300. Even with the impact of the lower relativity, they will do better in revenue terms than what this state will.

MS CHESTER: Let's go to why WA does matter to our inquiry and how it does relate to our terms of reference and the impact HFE may have on the real economy. With WA being an outlier – and, indeed, when we – post-draft report we wanted to get a better idea as to whether or not we thought that WA being the outlier was here to stay.

MR FERRALL: (Indistinct).

MS CHESTER: Being fiscally stronger than all the other states.

MR FERRALL: Effectively, I think you're indicating that WA is an outlier and they're an outlier in terms of their budget management; there's no doubt about that. But in terms of HFE, they're not an outlier.

MS CHESTER: No, I'm not suggesting they're an outlier in terms of HFE. I'm suggesting that their fiscal strength, their fiscal position has made them an outlier, consistent with the Treasurer's metrics in terms of how much fiscally stronger they are. That's how we use the term "outlier" in our report. The reason that that matters is (1) is it a blip or is it here to stay? Our understanding from feedback from the miners, from Chamber of Commerce in WA is that it is likely to be here for the foreseeable future. Why does that matter? It matters only in a sense of it means the redistribution, the equalisation task within HFE is greater than it's ever been historically and that's here to stay for a while.

That kind of just brings me back to the key area that we wanted to discuss with you today is that I think we can all agree – and, indeed, some of our recommendations the Tasmanian Government does agree with – is that equity is the primary goal of HFE. But the CGC themselves have some subsidiary principles that they try to balance with. One that we're grappling with is the focus of our concern about the impact HFE may be having on the real economy, when the equalisation task is so great, is the one of policy neutrality.

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So we'd like to get your views on how well the CGC is grappling with this trade-off between the equity principle and the one of policy neutrality. I think the way we've focussed on policy neutrality, indeed the CGC does, is the impact it may have on states' decisions with respect to development activity, especially controversial development activity, and then also with respect to any significant tax reform changes. So how well do you think the CGC can do that task at the moment and how well are they doing it, Treasurer?

MR GUTWEIN: Firstly, let me just come back to the, WA and whether it's different or not. WA's own budget papers indicate that their relativities would rise. Now, the simple fact of the matter is that the Secretary of Treasury was making the point - - -

MS CHESTER: But they don't go back to historical trends.

MR GUTWEIN: Unless you want to argue that - - -

MS CHESTER: No, I'm just trying to get the context right.

MR GUTWEIN: The context is that as Australians the resources of this country shouldn't be delineated by lines drawn on a map. That's the concept of the fiscal equalisation. In terms of WA, will they receive over a longer period of time a lower relativity? Probably. But so they should. At the end of the day, as I've demonstrated, in terms of the period out to 2020-21, the average per capita revenue that they will receive in Western Australia is higher than what we will receive here. To be clear - - -

MS CHESTER: Can we just bring it back though to the implications of that, not in terms of WA's fiscal position and budget management, but the implications that might have for the trade-offs. Under the current arrangements how do you feel the CGC is faring at getting that balancing act right between the equity principle and policy neutrality, because they've got their own methodology review underway and they're trying to grapple with it already? So they're grappling with the same issue that we're grappling with.

MR GUTWEIN: My personal view – and I'll allow Treasury officials to make their points as well – I believe that the system is working very well at the moment. Again, you can't divorce this conversation and this inquiry from the fact that WA put themselves into the position that they are in. That is a statement of fact. That can't be divorced. Now, if WA had been better budget managers and if they had spent some of that revenue that they received as a result of the lag more appropriately or they had not spent that

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revenue, which is probably more appropriate, that they had ensured that they strengthened their financial position rather than continuing to spend, I don't think we'd be having this conversation. My view is that the system works very well. I'll allow the Secretary of Treasury - - -

MS CHESTER: Just on that, what matters from our perspective is how large the equalisation task is within the GST core because that has implications for the trade-off between the equity principle and the policy neutrality principle. So this is quite separate to WA's budget management. I think we can agree to agree on that because it was in our report.

MR FERRALL: Why are you saying the level of distribution within the pool effectively impacts on your view of policy neutrality in this case? I don't quite understand what you're trying to get at. I mean, effectively the large redistribution is just showing that HFE is working. It's not a - - -

MS CHESTER: It is working from an equity perspective. But because the equalisation task has become so great, which means - - -

MR FERRALL: What do you mean by that? I'm struggling with that when you say "it's become so great".

MS CHESTER: So it's gone from about – it's now about 70 per cent of the pool is now redistribution across and between the states. So because you have one large outlier – I don't have the metrics in front of me, but I think we've gone from about, in a net sense, the churn is about – it was 7 or 9 per cent and now it's up around 13 per cent. So that means more is moving away from EPC. Now, we reject any suggestion – we did have a lot of submissions that suggested we go to EPC, being the view that EPC, equal per capita, meant that you had a completely neutral system. There wouldn't be perverse incentives or disincentives for some of these policy neutrality issues.

Indeed, we've had one participant suggest let's just lock the rates that we've got today. It wasn't in WA. Thus, they don't change over time. Thus, you'd have a completely neutral system. I think it was – might have even been Vince Fitzgerald in South Australia. So that's why it kind of matters and that's what really prompted our focus on how is it coping at the moment with getting that trade-off right? Because if you equalising to the highest and you've got the highest as such an outlier, doesn't seem to be much wriggle room. You'd be aware of the CGC's recent report where their way of dealing with that trade-off is to have a draft recommendation to allow, say WA – so wherever a state effectively sets the average as WA does for iron ore – but if they increase their royalty rate then they get to keep 50 per cent of the revenue. So that's the way the CGC is trying to grapple with it.

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We're trying to grapple with it a little more holistically. That's why I asked the question – and it's a genuine question – how do you think the system is grappling with that trade-off at the moment and what are your views on how the CGC is trying to deal with it? Because that of itself would have implications to Tasmania's relativities going forward.

MR FERRALL: CGC continually refines its methodology and it has to grapple with those sorts of issues and it's got a proposition now which we are looking at and where CGC is seeking feedback, I think, by February next year. We'll be looking at it from that point of view, from a Tasmanian point of view in terms of the impact and whether we think it's appropriate to make that adjustment within the current CGC methodology.

MR COPPEL: Can I bring you to that specific example of policy non-neutrality, which is the iron ore assessment? We've got 97 per cent of iron ore sitting in WA taking the average – the average policy is going to be led by what happens in WA. That's why there's a recognised issue of policy non-neutrality in the CGC. Do you accept that as a specific area of policy neutrality with the current system that we have?

MR GUTWEIN: Before the Secretary Treasury answers that, can I just say again, that is not a good outcome for Tasmania and, again, that doesn't recognise the fact that Australians, wherever they are, the resources of this country shouldn't be delineated by lines on a map and those more fortunate than the rest of the country by virtue of where they live geographically. As a government, we will resist any change that would see any detrimental impact on the state. Now, I know that we're working through that issue that the CGC has put forward.

But, again, I come back to the root cause of why we're having this discussion. One state didn't manage its budget appropriately and has put itself into a difficult position. That state will still receive on a per-capita basis more revenue than what this state will, yet we're sitting here having an argument about how we can actually provide that state with more money. We don't accept that that state should be provided with an uplift. Now, Mr Ferrall wants to add something further.

MR FERRALL: As I said, I think that the process the CGC is going through is consistent with how it's adjusted for – or attempted to adjust for policy neutrality over a number of years. So the outcome of that will be a range of adjustments potentially. There'll be debate and argument and discussion across the states as to whether the adjustment should or shouldn't occur. I think that's quite different to the propositions or cameos that you've put forward in the report. I'm comfortable that the CGC will work through that issue of policy neutrality quite appropriately and reasonably.

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We may not agree with the outcome. We may have different views. But it is able for a position of policy neutrality.

MS CHESTER: So it would be good to know what you think the impact might be on Tasmania. Even if you were to sort of rewind the clock and look at what would have happened if WA had increased the royalty at the beginning of the mining – royalty rates at the beginning of the mining boom and retained 50 per cent of the rate increase royalties. To some extent, in our draft report we rejected for the very reasons that you've outlined, Treasure, why we didn't think on all mining royalties there should be a 50 per cent discount because of how fortuitous you are to have what's under the ground within which these state/territories lines are drawn.

But there are these issues of policy neutrality that the CGC is going to be grappling with. It's a statutory agency and it's going to make those, effectively policy calls themselves. Yes, they do consult with states and territories, but they're going to have to make some big ones going forward because if the WA outlier is here to stay – they're coming more to the fore is what I'd like to suggest.

MR FERRALL: Mining booms aren't unique. They just haven't occurred in the last few years. These things have occurred in the past and, again, the CGC has worked through those and so have all of the states and territories. I mean, you keep sort of throwing that WA is an outlier. I think I'd totally reject that it is an outlier in that sense. I mean, these things have occurred in the past; they've been dealt with appropriately through the CGC process.

MS CHESTER: And that's part of the evidence-gathering that we're doing at the moment. We always put out a draft report but we don't have a full evidence base. That's why we have a draft report, that's why we have public hearings and we have post-draft submissions and further consultation. But the evidence that we've gathered so far would suggest that the production levels are set at that very high level now. They are here for the foreseeable future, given the iron ore that's under the ground, the contracts that are in place, and it might just move around a bit according to price volatility, commodity prices. So from that perspective, you would envisage the CGC is going to have to grapple with these policy neutrality issues themselves.

MR VOSS: Well, they are grappling with these. As Tony said, we're going through a process. The fundamental primary objective they have – you talk about the policy neutrality principle. You've got a range of supporting principles, but HFE is the overriding primary objective. Tasmania will be arguing along – we're obviously still considering the proposal they've put up. But the issue with going down the policy neutrality suggestion that you've done and the draft one that's put up with the CGC is ultimately it comes back to the HFE question and you meet up with permanently

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entrenching – WA in this case – or the high fiscal capacity of the other states. That is, as you say, something the CGC has got to consider as they go through that process. You talked about realigning the clock. Well, as the Treasurer said earlier, they sort of got $7 billion over four years through that lag process. They would have got even more money through that.

MS CHESTER: Well, I was only making that comment in terms of understanding what the impacts were because CGC is going to be grappling with these issues going forward. Even our tax reform cameos – and we're doing a bunch more of them on the good, bad and the ugly as more evidence base to help inform where we might land in our final report. The CGC themselves are now - - -

MR FERRALL: Why are the cameos evidence based – I mean, they're clearly not evidence based because the Commission hasn't been able to find evidence to support the cameos.

MS CHESTER: Well, we have had some further evidence and you'll see those in the transcript hearings from WA and other states and territories. And that's part of our process at the moment is to garner further evidence. So where we're looking for what incentives might face a state or territory with a system that we kind of think is struggling because of the equalisation task being so great, we will always do modelling to get a better understanding as part of our evidence basis to what those incentives and disincentives might be.

The CGC themselves are starting to focus on this as well. Indeed – and you might have more insights than we do about this, but they're now looking at what policy neutrality issues they are facing on the way states undertake their tax policy and tax reform with the consultancy that they're doing on elasticities because they don't feel that they've got that right at the moment. It is very difficult. Indeed, we grappled with it in our cameos as well. So what I'm suggesting is that the policy neutrality issues are going to be needed to be dealt with and the CGC is kind of heading in that direction and that's really what motivated our draft recommendations.

So that's why we want to get a sense of where you sit in terms of do you see this policy neutrality issues as being material, the ones that CGC is grappling with at the moment, and how comfortable are you or what are your views on the pros and cons of the way the CGC is proposing to deal with them?

MR VOSS: I think part of the evidence to date is that – I mean, in the past WA has raised iron ore royalties and I think in the most recent budget they found something in regard to gold royalties as well, despite the fact it would

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impact on their GST. I think Tony's point around the evidence is there are so many factors to consider, as you'd appreciate, with regard to tax policy. It's not as straightforward as just the impact on the GST (indistinct).

MR COPPEL: And we wouldn't deny that. The point of the cameo is really to try and tease out what can't be teased out in the actual information that we have. There's no counterfactual but it's to illustrate that principle and we would agree that it's sort of at a lower level than if there were actual. But it does illustrate a point and it illustrates the point for the large states. We're not saying it would be something that would influence Tasmania given the size of Tasmania in the overall economy.

MR FERRALL: I think the cameos as presented, at best, illustrate that under certain circumstances something is theoretically possible. Going to Anton's point, it's sort of an nth order issue when you start looking at tax reform or other reforms. So simply because something is theoretically possible under certain circumstances doesn't mean that it's supportive or evidence that that is driving a particular behaviour.

MR GUTWEIN: The concern I've got with the cameos as well is now that you've stood them up I'm certain that WA and potentially some of the other stronger states may do their very best to back-fill it to ensure that the argument does stand. But the simple fact – and, again, I come back to this. The outcome of this inquiry, the Commonwealth Grants Commission process as well, we need to be very, very careful that what doesn't occur is we don't entrench the relative disadvantage that the smaller states have. Tasmania wants to be in a position where it is more self-reliant and we want to grow our own revenue base. Now, I've said publicly I wish that we had some of the challenges that WA have had in the past.

MS CHESTER: It's interesting you raise that, Treasurer, because even with WA being the fiscally strongest state – when you look at the recent – the CGC gave us a very helpful submission post-draft report where they showed that even WA – so once we equalise to the highest WA can't even meet their assessed expenses. So kind of the real driving factor there is vertical fiscal imbalance. So what position states and territories still have to - - -

MR GUTWEIN: Well, we'd like as much money from the Commonwealth as we can possibly get.

MS CHESTER: Well, do you want it through revenue raising powers, Treasurer, or do you want it through - - -

MR GUTWEIN: Again, there was discussion over the last couple of years

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in regards to the White Paper, which, unfortunately, that discussion was curtailed and never went further. I'm not going to set tax policy here today in regards to the state. But obviously we want to be in a position where we do have a strong efficient and growing tax base. Obviously those discussions will continue. But the concern that I've got is that for a state as Tasmania, which has had a relative disadvantage to the rest of the Commonwealth – we've had to overcome the tyranny of distance and we have around 1 per cent of the footprint of this country.

I would hope that the outcome of this isn't that you make recommendations that would entrench that disadvantage and make it more difficult. This is one of the things I wanted to get to, as I'm sure you will at some stage. But the conversation in regards to transition paths, we won't look at any transition path because at the end of the day all that is is a transition to a point where Tasmania will receive less revenue than other states.

MS CHESTER: So it is kind of important though to see it in that broader context of longer term Commonwealth/state relations, because there's only so much you can expect HFE to do in and of itself in terms of - - -

MR GUTWEIN: True, but I come back to the point, if we're talking about Commonwealth/state relations, it shouldn't be driven by the fact that one state was the catalyst because it couldn't manage its own budget position.

MS CHESTER: Well, terms of references come to our desks in many way, shapes and forms, Treasurer.

MR GUTWEIN: I'm sure they do.

MS CHESTER: At the end of the day, it's more important what we do with them. Coming back to the issue that does matter the most from Tasmania's perspective, and that is the equity principle within HFE. The way that HFE – and, indeed, we touched on this earlier with TasCOSS, our first participant at this morning's hearings. The way HFE does it is gives you guys the fiscal capacity to meet your assessed expenses. But GST money's untied, you have autonomy in terms of how you spend it. So when you're trying to look at it from an equity lens we've had participants, academics, different groups representing disadvantaged members of the Australian communities, indigenous groups, look through to what actually happens when you get your GST moneys and then what actually is spent on those assisted – so what's the outcome. When you look at it for Tasmania there is a material difference across some areas that are of concern to those stakeholder groups.

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At the moment for Tassie over the last sort of six years your 7 percentage points – and don't get me wrong, we know that there's state autonomy and it's your decisions and you're making those trade-offs in your own Cabinet room. But when we're looking at it through the equity lens you're 7 percentage point short of spending what you are assessed as needing to spend in those areas of services to communities, welfare, housing, post-secondary education. Then when you look through – so schools education is the one that you actually meet the target and just go slightly above it. All the others way under; services to communities is 34.8. I guess what sort of - - -

MR FERRALL: So you didn't look at the revenue side? I mean, what you're using - - -

MS CHESTER: Revenue is relevant to fiscal capacity.

MR FERRALL: You're actually misusing what the HFE does in that example. The calculation isn't to indicate what a state should or has to spend in those categories. I mean, it's certainly a matter for the states to make choices. But in presenting that as you just have then, you ignored the other side, of it, which is the revenue side, where the state has a below average in terms of revenue.

MS CHESTER: That's why you do get that money to get you up to your assessed expenses.

MR FERRALL: No, but if you looked at our assessed revenue raising capacity, we raise below our assessed capacity.

MR VOSS: You made an example before with regard to WA can't budget because they're not getting enough. On the basis of your criteria, we are, Tasmania over the past three years on average is in exactly the same boat; we are raising less in total assessed revenue than what our assessed expenditure is.

MS CHESTER: Don't worry, we had the same discussion with WA and the Northern Territory.

MR VOSS: I'm not saying it's necessarily bad. I think you're misusing - - -

MS CHESTER: No, so I'm trying to understand when - - -

MR VOSS: Sorry. It's a theoretical construct base which they use to help them distribute GST. As you said, Australia has autonomy, they have

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untied funding. But it's not like the Treasurer and Tony going to budget committee and sit down and see, "What did the CGC say?" and that's how much we spend or don't spend. It's just not how it works. Some of the detail in regard to things like services to communities or (indistinct) the other side on other revenue there's a policy choice about revenue. The government has made a range of choices in regard to how much they raise and then you've got to set that off, as you'd understand, with the expenditure side. It's just very unhelpful in many ways around saying that, "Hey, the CGC said you should be spending X amount on housing or health," or whatever and then indicating that's what the government should be doing, because that's - - -

MR FERRALL: Because the CGC doesn't actually say that. If you read their report that's not what they're saying.

MS CHESTER: We understand all of that and we understand autonomy and trade-offs in Cabinet. But in the same instance we have a slide pack from the Treasurer that says what are the implications of our draft recommendations. It's translated to some of these areas.

MR GUTWEIN: I think, quite clearly, the slide pack that I provided does indicate that if the outcome of this is that you take further revenue off us, then there will be those sorts of implications; as simple as that. But, again, and with the greatest of respect, the Productivity Commission doesn't make recommendations in regards to what states should spend on health or education or other services. The Commonwealth Grants Commission doesn't. HFE provides the states with a level of revenue and at the end of the day, then priorities and choices are made. I don't believe that utilising that example – and it's been utilised by others in public before, both under this government and past governments. I don't think it stands up.

MS CHESTER: Stands up in what sense?

MR GUTWEIN: Well, I don't think the point that you're attempting to make is that, based on the Commonwealth Grants Commission view of the world in regards to the revenues that you receive that you should be spending at or more in respect of those particular areas that you've raised. I think they are policy choices for governments to be taken with the full context and understanding of what's occurring in a state at that particular time.

MS CHESTER: That's right, and that's why it's untied money.

MR GUTWEIN: Absolutely.

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MS CHESTER: We don't have a problem with that in our report, Treasurer.

MR GUTWEIN: Good.

MS CHESTER: But it was more - - -

MR FERRALL: I'm trying to understand if you accept that, I don't quite understand the point you're trying to make. If you accept that it's a construct for another purpose and then you're trying to utilise it - - -

MR VOSS: Similar to pay equity, which is based on a notional average level of services. You mentioned education before.

MS CHESTER: Sorry, can I just respond to the first point? This is like debating, which means it's a good public hearing. No, the reason I raise it is because you're making decisions in Cabinet for the best interests of Tasmanians to not spend the assessed expenses in the way that the CGC assessed your needs in deciding what your fiscal capacity should be. You're obviously making a decision to spend it on something else. I guess is there any trade-off then with that equity principle being carried through? That's the whole reason for this question.

MR FERRALL: No, but you don't make a choice in the manner you've presented to spend it somewhere else. I mean, you make a choice by – or the governments make a choice to spend the revenue they have in particular ways because it's their judgment that that is the best or most appropriate way for expending the funds for the benefit of the community. How the Grants Commission has measured or assessed the distribution of the untied funds is totally irrelevant to the policy choices that a government makes. That's the point I'm making. You're trying to conflate the two of them. One is for a very particular purpose.

MS CHESTER: It's very helpful what you just said.

MR VOSS: I think the other really important thing on the benchmark that you're using is a notional average service delivery. You mentioned education before. You were saying Tasmania seems to spend the right amount on an equity basis. As is known in Tasmania, there are a range of areas where our education performance has been low over a long period of time. The government has undertaken a whole range of reforms to try and lift that education outcomes because we've had a range of very poor education outcomes which feed into a range of issues with health, with productivity in the state, with wages, a whole range of issues. In this case this government makes a rational choice on an equity basis to spend more

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money on education than other areas. The benchmark you're using on an assessed expenditure level to determine equity is based on a notional service level average across the country but which is not what they're – Tony's point that sort of the premise you're basing it on in an equity sense – we just don't think that's valid.

MS CHESTER: That's helpful, gentlemen. Turning then to the fiscal impact, if we set aside a transition path for the moment, if we were to move tomorrow to one of our – and we only flagged that there's a whole range of different ways that you could equalise to less than the highest state. The two that we focused on, for providing some transparency around what the implications of that might be, in an immediate sense to states and territories, was equalising to the average and equalising to the second highest. In your post-draft report submission, indeed, in our report we have what the immediate fiscal impact that might be on Tasmania if we were to do it cold turkey overnight for the next year. But when you kind of step back and look at that as a percentage of your state revenues it's 1.3 to 2.8 per cent.

MR GUTWEIN: So the point being that - - -

MS CHESTER: So then if we're looking – we're interested and thinking of a transition path. I know you don't want to contemplate one, Treasurer. But if we are trying to implement the principle which we flagged in our draft report of wanting to ensure that a transition path ensured that the fiscally weaker states were not materially disadvantaged, where does the 1.3, 2.8 per cent sort of sit, in your view, of what's materially disadvantaged or are there other principles we should be following?

MR GUTWEIN: I'm sure the Productivity Commission has had this presented to it before. With the transition part what you're talking about is the boiling frog. That's what you're talking about. That's exactly what you're proposing is that with the transition path we won't lose all of the money upfront, but we will get to a point at some stage where we will – and we will have that embedded moving forward.

The concern that I've got is that in a country that's got a strong egalitarian history, culture and ethos, that if you put in place a transition path to actually take this to a point where – that you believe we can manage our revenues down over that particular period of time and our expenditures and it's a longer period to allow us to get used to it – what you will simply do is entrench the relative disadvantage and the difference between ourselves and the larger states. That's simply not fair. That's simply not reasonable. That's why from the point of view of the state we don't want to discuss and we will fight a transition path on any terms, because it simply entrenches that relative disadvantage. It just takes a little longer to do it.

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MS CHESTER: Let's leave the transition path and maybe there's a couple of other areas we did want to touch on with you, if we may. The first one was in the post-draft report submission you had some concerns about our suggestion that the CGC would issue draft rulings to a state or territory jurisdiction who wanted to better understand if they were to embark on a major economic development activity that might have significant costs that they would have to expend in an infrastructure sense or if they were looking at doing a major tax reform what might be the implications or how it would be assessed or treated by the CGC. We thought that was a helpful recommendation in terms of taking uncertainty or policy chill out of the equation, which we've received some earlier submissions and commentary on from other parties. But you didn't quite see it that way?

MR FERRALL: Look, I guess our concern would be that things move and change significantly over time. To ask the CGC to give rulings sort of, I guess, a la the ATO, wouldn't necessarily take into account the particular circumstances of issues at future points in time. So I'm not sure it would actually give the certainty that you're intending to try and find by creating those draft rulings. I think to the extent some of them are more principles than rulings, it might work. But if they are principles, not rulings, then they still won't give that level of certainty. So it's really a question of what might happen over time, how things change and the specificity of those rulings.

MS CHESTER: We did see them being akin to an ATO ruling where – and having in a previous life worked on tax policy stuff at Commonwealth level – it has those caveats that I think you're talking about, Tony, where you've got your concerns. That is, that there are changes in how the ATO over time will interpret the law. There are changes in their regs. There are changes in the law. A draft ruling, as we understand it, doesn't exclude you from any of those developments. Indeed, so the CGC methodology review would still occur. So it is a point in time, but it's for them to get a sense if all the other parts of the playing field stay about the same, how are you going to assess it?

MR FERRALL: I mean, I suppose the other point I'd make is that there's generally no particular surprise for states in terms of how the CGC assesses particular matters. Certainly from a Tasmanian point of view, when we're looking at particular issues we can be pretty certain how the CGC may deal with a particular transaction that the state might be involved with in terms of receiving funds from the Commonwealth for capital or other matters. So I think there's a good understanding of that. Going to the next step in terms of the ruling is to give certainty, I think you must be talking about other matters which are very particular, which is why I say that I think it would be difficult, potentially, for CGC to make those rulings on a very particular matter and then for them to be applied as a ruling more broadly.

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MS CHESTER: I'm very conscious of time and we've probably nearly overstayed our welcome with you, Treasurer. But I think the other area where we would like to get some help and assistance from you is you very helpfully provided some headline numbers from some projections and modellings that your officials have done. We'd very much appreciate if you'd be able to share those numbers with us, with our – at officials level because we've got projections from WA and a transition path from them. We want to do our own work. But at least the one thing we would like to sort of try to get some semblance of agreement, even with the confidence band, is under current arrangements what projections of relativities, at least for the forward estimates, might be. So if we can ask for your assistance in doing that.

MR GUTWEIN: We're quite happy to share that and work with you. As I think we've indicated to you, we have our own CGC model. But it is heavily driven by the inputs of estimates from other states in terms of their own revenues. So we don't try and project other states' own source revenue. So we take that effectively from the other states' projections.

MS CHESTER: That'd be great if we could work together. I'd much appreciate it. One more from Jonathan.

MR COPPEL: One question, which particularly relates to an area where I think Tasmania is in, at least, partial agreement with the draft report, which is the recommendation that the CGC take on a greater role in explaining how the decisions have been made and the outcomes that have dropped out of that process. So that's for improved understanding of the HFE and what it's aiming to do.

A second element of that was greater transparency in the information that the CGC uses to reach that outcome so that it's at a much more detailed level. It's not the sort of information that would inform the person in the street, but it's the sort of information that is used by academics, for example, the sort of work that looks at accountability issues in terms of assessed expenditure's actual outlays, but sits within the realm of looking at HFE. It's that aspect that I think you took exception to in your post-draft response. I'm wondering if you could elaborate a little bit more on your reasons why you see that aspect of improved transparency as being not a productive one.

MR FERRALL: I don't think we've said that aspect of it isn't productive. I think you've got to link that to the first part of your comment, which is about the CGC taking a role in terms of developing a better and proper understanding of effectively what it does. There's been a range of commentary similar to what you put forward earlier around the assessments in the different categories and whether a state should or shouldn't expend

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at that point. If you read the CGC's own guidelines and their own reports, they don't make anything like that sort of assertion and so there's a gap between what the CGC is doing and a clear understanding of what they're doing, and even what some academics are picking up and saying, "Well, this must mean states should spend at a certain level and if you're not, you're doing something wrong."

I think the role of the CGC can be enhanced in terms of improving that understanding and so that, I guess, less informed commentators don't make the mistake of trying to utilise the CGC methodology and information inappropriately.

MR COPPEL: Is that possible? I mean, when you have information sort of user beware - - -

MR FERRALL: Look, I don't think it's just pure user beware. I think there's always an onus on people who release information, governments that release information, to ensure that there's a clear understanding of what the information is. If you just put it out, effectively it's just data; it's not information.

MR VOSS: Or at least trying to correct misconceptions that might arise.

MS CHESTER: And that's why we've said necessarily running in parallel to the CGC playing more of an educative role so they feel they could take to task, if they wanted to, associate professors from the UNSW. But from our perspective, indeed, we thought most state and territory governments, the Australian Government, were heading in the direction of open data to allow it to be utilised by other parties and for better understanding.

MR VOSS: To be fair to them, as you know, there is a lot of – there's still a lot of stuff there on – if you want to get into it. I think what Tony is talking about is sort of the man in the street and the misinformation that's sometimes espoused by people who don't want to get all the detail because it's all right for us economists to get into that sort of stuff, but generally they don't. I think that's the balancing act that we're struggling - - -

MS CHESTER: That's okay, we wouldn't want to rely on what people said about our reports in the media to get an understanding of what was in our reports. Anyway, thank you very much. You've all been very generous with your time today and we do appreciate that it's been able to be such a frank exchange of views and ideas as we pursue the holy grail of finalising our report. Good to come to Hobart, Treasurer.

MR GUTWEIN: Good to see you again, Karen.

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MS CHESTER: So I'd like to invite our next participants up to join us. The Tasmanian Opposition Labor Leader to join us, thank you, and Shadow Treasurer. Good morning, welcome, thank you for coming. Good to meet you. Thank you very much for joining us this morning. Once you've had a chance just to make yourselves comfortable, if you wouldn't mind just each stating name, rank and title for the purposes of our voice recognition, although if they confused yours that'd be problematic. And if you'd like to make some brief opening remarks. We'd like to keep those to up to five minutes, if that's at all possible.

MS WHITE: That's fine. Thank you. I'm Rebecca White, leader of the Tasmanian Labor Party.

MR BACON: Scott Bacon, Shadow Treasurer.

MS WHITE: Firstly, I'd just like to thank you very much for coming to Hobart and providing an opportunity for a hearing to be had. It is an issue that Tasmanians feel particularly passionate about, as you've just witnessed from some of our presentations. At the outset I'd just make the statement that the Labor Party in Tasmania does not support the change to HFE as consistent with our presentations and submissions that we've made to you. We're not making that argument because we don't think there should be economic reform, it's just that there hasn't been any evidence presented in work that's been provided to date that demonstrates change to HFE is in federation's best interests and certainly not in Tasmania's best interests.

Tasmania has a track record of good economic and tax reform. I know that's been presented to you by the Government in their submission. In our submission we did as well. I'll just note some of those things. So we have undertaken reforms in the electricity sector, reforms to water pricing, governance arrangements relating to the commercial activities of government businesses, deregulating shop trading hours in 2002, taxi industry reforms in 2003. Together with Victoria, Tasmania was the first state to meet its targets to abolish inefficient state taxes as part of the 1999 Intergovernmental Agreement on Federal/State Financial Relations. We were also one of the first states to develop harmonised payroll tax arrangements.

Just recently the Labor Party has announced a policy to introduce points of consumption tax for gaming products to assist to fund some of the government activities here in this state. So we do continue to be supportive of tax reform and national tax reform specifically. It is disappointing that any tax review recommendations weren't ever pursued. But one of our concerns about the current Productivity Commission inquiry is that it is occurring in the absence of a wider debate about tax reform for the nation.

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Arguments over HFE have become a distraction, really, for any real effort to make state taxes more efficient, more harmonious or more competitive. Perversely, any change to the GST that would negatively impact Tasmania, as proposed by the draft report, would actually increase the state's reliance on inefficient taxes like payroll tax, stamp duty and land tax, and act as a disincentive for tax reform at a state level.

In addition to the loss of about $1 billion in revenue that's been forecast through the modelling that's been done by the report provided, it would devastate our ability to deliver essential services, health and education. We already as a state face challenges delivering those core essential services. We have very disparate population, an ageing demographic. We are commonly told we're older and sicker and poorer than other states across the country. That does mean that we have a particularly heavy reliance on public services like health and education.

A loss in GST, our ability to deliver on our obligation to support our people would be diminished. So we don't want to see that happen. We don't want Tasmanians become second-class citizens. I think, as the Treasurer eloquently put as well, we are an egalitarian society, Australia, and we pride ourselves on that and we don't want to move away from a model that currently supports all of our citizens to access the same (indistinct) and level of services no matter where they live in Australia.

It's good to see here in Tasmania at least all sides of politics coming together and we share the same view on this; that we don't want to see change to HFE that would disadvantage Tasmania or leave us worse off. And confusions about the model and perceptions around CGC are not well-founded as a basis for change. The argument that you've made around misunderstanding, for how it works, does not provide strong evidence for there to be then a change in the distribution model. The arguments made by Western Australia do not propose that this be the solution to their problems. There are other ways to deal with their particular issue at this point in time that does not disadvantage the rest of the country, particularly Tasmania.

I do note that in the submissions you've received the South Australian Government, the Victorian Government, the governments of the ACT and the Northern Territory and various business and community groups in those states, as well as community groups here in Tasmania, have all raised concerns about the recommendations of the draft report. Our final message to you, Commissioners, would be that we'd certainly welcome a debate about national tax reform, but please don't abandon the system that has served our federation well for decades.

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MS CHESTER: Thank you very much for those opening remarks and thank you also for the post-draft report submission that we've received from you. We might just kick off first with what I guess we can all agree on, indeed – that within HFE, that the primary policy objective of HFE is about equity and providing states with similar fiscal capacities. The way that that's evolved over time by the CGC, instead of it being able to provide a standard of service that was not substantially lower or similar, has now become one to the same standard. Indeed, looking back through the history it's quite revealing that that was never decided by any Cabinet or any government legislation, state, territory or Commonwealth. It was actually decided by the CGC, a statutory agency.

But the CGC also in deciding what HFE should be, that it's now to the same standard, did also identify some subsidiary principles that they tried to get the balancing act right with equity. The one, and, indeed, sort of the primary one that we've focused on in terms of what could be the potential economic impact of HFE as it's currently practised on the Australian economy is around policy neutrality. So it would be good to get your views on, to what extent you feel the current system can handle that trade-off between equity and policy neutrality.

MS WHITE: Can you give me an example of policy neutrality so I can better understand that concept?

MS CHESTER: Yes, sure. The two key streams are really around where one particular state might set the average, so WA with iron ore, Queensland with coal. They might face perverse incentives about what they do with that development activity or how they might tax it because of the way the HFE system works. So there's ground development activity. Then the other stream is around tax policy and tax decisions. So these are areas where the CGC is sort of grappling with this trade-off. Indeed, their most recent methodology review second report, I think it is, has some recommendations as to how to deal with it, including discounting by 50 per cent any royalties that a state or territory may raise from an increase in the royalty rate for a royalty base, a revenue base for which they effectively set the average. So again, iron ore for WA or coal for Queensland. It would be good to get your sense of how the system is grappling with that trade-off at the moment.

MS WHITE: My understanding is that the 2012 review found that there wasn't a disincentive for states to pursue policy decisions that worked to the benefit of their state but to the disadvantage, I guess, of federation in their distribution.

MS CHESTER: I think you're referring to the Brumby, Carter and Greiner

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review. They identified in principle or theoretically that those disincentives exist, but they struggled to find an evidence base. We've had states and territories suggest to us that there is a reverse evidence base, to the extent that some states and territories may not dare greatly and do development activities that might be controversial and they're effectively cross-subsidised by the other states that do those development activities through the HFE. With respect to the tax reform stuff, we did run some cameos just to get an idea of what the counterfactual would be, given we don't have a counterfactual.

MR BACON: We think fundamentally any of the scenarios that have been put forward that make Tasmania worse off in terms of GST payments would make it more difficult for Tasmania to reform their budget or to put forward any meaningful economic reform. I think we've shown, even from opposition, that we're willing to talk about tax reform. Rebecca mentioned the point of consumption tax for online gaming. I mean, there's no doubt that's going to become a national tax. We've seen the government here in Tasmania over the last four years effectively say there'd be no changes really to taxation. They've now put forward a policy for the next election to say they won't introduce any new taxes or increase any taxes. But we've shown a willingness to introduce a tax that we don't think will have a significant effect on any Tasmanians, but would raise additional revenue that we could put into government services.

MS CHESTER: How much revenue would that gaming tax you're talking about - - -

MR BACON: We've got modelling that, based on the South Australian experience, it would raise some upwards of $3 million a year. We've committed from opposition to introduce that tax. We're more than willing to have a conversation about tax reform, as Rebecca said, particularly at a national level. We think it really needs to be driven by the Federal Government if we are going to see any meaningful reform. But fundamentally, if Tasmania has got less GST we find it hard to believe that it would be an incentive for us to undertake major tax reform or rely less heavily on inefficient taxes. We just think that any of the scenarios that have been put forward would make it more difficult, not provide an incentive to do those things.

MS CHESTER: Setting aside just Commonwealth, state and vertical fiscal and balancing tax issues – we will come back to that – do you have a view – does the Labor Party have a view as to whether or not Tasmania is getting best bang for buck out of its revenue bases at the moment in terms of ultimately taxing those revenue bases and raising as much revenue as possible but without discouraging economic activity?

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MS WHITE: Well, it's a hard one to be able to provide you with a comprehensive answer from Opposition, to be honest, without the resources of Treasury. But there are a number of inefficient taxes that have been identified but they're not new taxes; they're existing taxes. However, to reform them would require a fundamental change to the way that we tax a lot of those things that are economic drivers of the state. There's a lot of challenges to overcome, I suppose, before you would tax some of those things.

MS CHESTER: From your perspective, tax reform at a state level needs to really be part and parcel of a broader Commonwealth slate...

MS WHITE: Well, Tasmania was one of the states that got rid a lot of the inefficient taxes when the GST was introduced. But there are very few taxes or revenue raising abilities that we have compared to other jurisdictions, where they've maintained continued use of some of those taxes. For us, we don't have many options necessarily; we've only got a few limited options to raise revenue as a state. That's why we are so dependent on the GST and why any change to it would be so devastating for us.

MS CHESTER: We'll come back to fiscal impacts in a moment. But in terms of if we were to look at them, in that, down the track with the broader lens of changes to vertical fiscal imbalance – because I'm not sure if you were here earlier but we talked about even – WA, as an outlier in a fiscally stronger state at the moment, even they at their fiscal capacity can't meet their assessed expenses, which is a function of vertical fiscal imbalance or they're not doing the right thing by their own tax bases at the moment. So what would you see as being any change in taxing powers Commonwealth/state to facilitate Tasmania having a better fiscal capacity and being able to sort of look at doing some home-grown tax reform?

MR BACON: We certainly would be keen to participate in those discussions. But we think that the inquiry at the moment in terms of distribution of the GST shouldn't be held in isolation of a broader national discussion around tax reform. It's really difficult for Tasmania as such a small state really to push ahead without any leadership at a federal level. We think that at the moment while that conversation is not going on, there shouldn't be any change, in particular, to the way that the GST is distributed.

MS CHESTER: We sort of say in our draft report that, "Look, there's only so much we can do in the confines of HFE in and of itself." That to do any more sort of holistic reform to Commonwealth–state federal financial

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relations would require issues like vertical fiscal imbalance to be considered. So we do sort of acknowledge that. I guess what I was interested in was, what do you see that that might look like to allow you to sort of be able to contemplate having a greater fiscal capacity for Tasmania and to be able to sort of embrace any state-based tax reform.

MR BACON: We'd say almost you'd need to look at that, if not in conjunction, then before you look at any change of distribution to the GST. We think it's almost – you've got things around the wrong way effectively, that there should be that national conversation rather than just talking about the GST and only putting forward scenarios where Tasmania will be worse off. It gives us less incentive. All it does is unite effectively everyone in Tasmania at a political level against any changes rather than getting people talking about what is possible on the other end. From our point of view, the situation where it is at the moment, we agree – we heard some of the comments that the Treasurer made. But effectively there's nowhere in Tasmania that can support any change at the moment and there's no way you can even get people to have a conversation about changes to state taxation or to vertical fiscal imbalance until you effectively take this off the table.

MS WHITE: I know you're very limited by the terms of reference that you were provided and obviously you've got to make your inquiries based around the terms of reference. But I think that's the biggest problem for us, as the Shadow Treasurer has outlined, is that the terms of reference are very narrow in scope and it does limit the ability for us as a nation to have a conversation about all the other things we do need to be talking about.

MS CHESTER: I think our biggest constraint is something called the zero sum game, but anyway.

MR COPPEL: Rebecca, you mentioned in your opening statement that there are other ways of dealing with the problems with HFE today. Can you explain to us then what you see as those problems and the solutions that represent other ways?

MS WHITE: The reason why we're all in this room and the reason you are touring the country is because Western Australia is crying poor because they're not receiving GST that they think they're entitled to. They, because of the lag effect, benefited from GST and the mining boom at the same time. Whilst from a period of about 2011 it was forecast their GST would decline, they've clearly failed to plan for that and now they find themselves in a situation they are. Can't also hide away from the fact that there's politics at play here where there are seats in Western Australia that the Liberal Government wants to win. So they're playing to that audience too.

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There are ways to deal with Western Australia's problem in isolation without dismantling HFE. The Labor Party at a federal level has identified additional money that could be provided for infrastructure to assist that state government to deal with some of its fiscal challenges and obligations to its people. They are decisions that can be made at a policy level by Canberra politicians that deal with the current problem Western Australia has, without impacting and disadvantaging other states and smaller states like Tasmania.

My recommendation would be that – my hope would be that your report back to government demonstrates that there's an unwillingness across Australia, not just from small states like Tasmania but from some of the larger states like Victoria too, to dismantle HFE and that in order for the government to deal with the political problem it sees in Western Australia it needs to find another way.

MS CHESTER: The problem with that is that that's not our motivation. Our motivation is actually how well the system is getting that trade-off between equity and policy neutrality. So a top-up from the Commonwealth effectively just increases the effective relativity that WA gets. It doesn't change the incentive issues and the policy neutrality issues that is the focus of our inquiry.

MS WHITE: You can't deny that that's what's precipitated the inquiry and it's an issue – a problem Western Australia will soon find resolved anyway because it will swing back the other way and they will receive more GST under the existing HFE model. So they will soon start to benefit more because of the existing model that supports the rest of us.

MR COPPEL: In our terms of reference we were asked to examine what impact HFE has on state/territory budget management, which everyone is pointing to the example of WA. Our conclusion was that HFE is a sideshow to that. The experience of WA is management. What we've identified, I guess, as a specific area which does relate to WA is the subsidiary principle of policy neutrality which does come into conflict with how HFE works in the case of the mining royalty assessment for iron ore where the average is dictated by one state, given the nature of where the resource lies.

That's an issue that's been identified also as an issue with the CGC review of its methodology. It's proposed for discussion a discount on the marginal increase in revenue from an increase in the royalty rate as one way of minimising or muting that impact. It too boils down to less than full equalisation or partial equalisation. Do you see policy non-neutrality in that specific example as a problem? Do you have any views on the proposal that's been put by the CGC to at least go some way to addressing that issue?

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MS WHITE: That would be for the mining royalty discount?

MR COPPEL: Well, it relates most pertinently to mining royalties, but that's framed in a slightly broader way.

MS WHITE: My understanding is that if – say we be specific about a mining royalty discount. But even in that scenario Tasmania would be left worst off to the tune of about $42 million in just one year. So even under that scenario Tasmania loses because of policy decisions that are being made in Western Australia. So I do still have problems with that, obviously. I'm not sure if you've got anything.

MR BACON: I can only agree effectively.

MS CHESTER: Sorry, $42 million, that's a straight discount, whereas the CGC is just looking at – just so you're not mischaracterised when the transcripts are read by others, that that's for – and that's something that we recommended against in our draft report. We didn't agree with having a broad mining royalties discount because we think that that breaches the equity principle of HFE. The CGC themselves will make a decision and they've got a draft on the table which says if WA or any state or territory that effectively sets the average increases the royalty rate they get to keep 50 per cent of what they raise from that increase. So that in and of itself would have implications because it's revenue that then is not assessed as part of the HFE.

MS WHITE: No, and not available to redistribute to smaller states like Tasmania. Have they done modelling around what that could look like?

MR COPPEL: It would be in the CGC documents.

MS WHITE: I don't feel I could make a comment on that without seeing the detail.

MS CHESTER: But that's kind of what we're grappling with. The CGC within their own sort of way of viewing HFE will make decisions as they go in terms of how they will grapple with policy neutrality. We've come up with recommendations that probably deals a little more holistically. But I think the policy neutrality issues are here to stay.

MS WHITE: Yes. For things like mining extraction though when you are part of a federation, those mineral resources belong to the whole nation. It's fortunate for Western Australians that they are obviously in Western Australia and they can benefit as a jurisdiction from that. But the reason

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we're part of a federation is that we do share our resources and what can be extracted from the ground and we share in the benefits from that too. So I would have trouble – and Australia, not just Tasmania, if one state was able to benefit more from the fact that they sit on a mineral deposit and don't share that equitably, if there were changes that disadvantages other Australians because they don't live there.

MS CHESTER: So that's kind of why we landed on not supporting – what a lot of people, including the Minerals Council, put to us was to just discount mining royalties across the board. The flipside though is if you are state or territory government and you're looking at doing a development activity and particularly one that might be controversial, you're going to wear the political pain but you're not going to get all the revenue gain. We still need to have the overriding principle of equity but we need to be conscious that that in and of itself could deprive the development activity, which then all states and territories would stand to benefit from the royalties that would come from it. These are the sorts of policy neutrality issues that we're kind of grappling with, not WA budget management.

MS WHITE: I mean, you're right, it's a national issue.

MS CHESTER: So it's how that might impact on the real economy is kind of the heart of our report. They're all the questions that we had for you.

MS WHITE: Thank you.

MS CHESTER: Is there anything else that you wanted to say before we hear from our next participant who is a national treasure in Tasmania, Saul Eslake?

MR BACON: We fundamentally don't think that the case has been made for any change to the current system. We see the issue in WA as a one-off outcome to assist them. It has stood the country in good stead for a long period of time. So we just don't think the case has been made for any change.

MS CHESTER: Thank you very much for appearing today.

MR BACON: Thanks for coming down.

MS WHITE: Yes, thank you for coming to Hobart.

MS CHESTER: I've already hinted at who our next participant is. I'd like to welcome Saul Eslake to join us. Just make yourself comfortable, Saul. Saul, thank you very much for joining us. Just for the purposes of the

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transcript recording, if you can just state your name and who, if anything, you represent. Then if you'd like to make some brief opening remarks. I'm conscious of time. If you could keep them to up to five minutes. And cognisant that we've read everything you've provided and said in the public record. So it'd be good if you could sort of focus on anything that's new.

MR ESLAKE: Thank you. My name is Saul Eslake. I'm an independent economist. I'm also a vice-chancellor's fellow with the University of Tasmania and a non-executive director of Hydro Tasmania, but I'm here in a personal capacity and not representing any of those or any other organisations. Thank you for the opportunity to be here and to comment on the draft report. As you said, you've seen my submission and other things that I've said. So I guess I kind of summarise it by saying I'm not here to say that the system of horizontal fiscal equalisation is perfect or that it shouldn't be changed in any way.

But what I would say is that, in my view, the draft report has not persuaded me, at least, of some of the conclusions that it's stated. In particular, it hasn't persuaded me that the system is broken. It hasn't persuaded me that full equalisation is not an objective which should continue to be pursued. It hasn't persuaded me that there is, in any material sense, perverse incentives that discourage state governments from pursuing worthwhile economic or taxation reforms, or foregoing worthwhile economic development opportunities.

The report seems to accept the fact that, a vast majority of Western Australians regard the outcomes it's been delivering in recent years as unfair, as sufficient evidence to back away from the objective of full equalisation. It hasn't established any principled reason as to why something less than full equalisation ought to be pursued and all of the options that it has presented thus far are essentially different ways of deciding who should get less so that Western Australia can get more.

In my view, notwithstanding the difficulties that Western Australia is currently experiencing, they are, nonetheless, by many relevant measures the wealthiest people in Australia as a group. Almost all of the Commission's recommendations, in effect, require cash to be transferred from the governments of states and territories which are poorer than Western Australia to the government of Western Australia so that, as the Grants Commission has put in its submission to you, Western Australia can enjoy a kind of fiscal premium relative to the rest of Australia.

I said at the beginning that it's not my position that the system is perfect or doesn't need change. But what I would have thought would have been more consistent with the terms of reference that you have is to ask whether

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there is anything about the way in which the Grants Commission goes about achieving full equalisation that has detrimental effects on economic activity, productivity or any of the other things that are considered worthwhile. If it's established that they do, for example, in the analysis which you provide about the different treatment of changes in tax rates from changes in the basis of taxation, which was a point I hadn't previously considered, if you've established that full equalisation could be pursued in simpler, more transparent, more predictable ways or pursued in a way that would tangibly enhance economic efficiency, then the recommendations that might flow from that are far more likely to be acceptable, irrespective of their impact on what each state and territory receives.

MS CHESTER: Thank you, Saul. That was incredibly efficient, Saul. Thank you very much. Just at the outset and just so we don't perpetrate any mischaracterisation of our report and very conscious that some people will read what's in the media and interviews that people have and can sometimes misconstrue what's in our report, our report explicitly says the system is not broken but we feel it's struggling a little bit with where the equalisation task has gotten to. We say that equity has to remain the primary objective as it is currently. We say what's happened in WA has eroded confidence, but we attribute that more to the lack of accountability and the lack of understanding of the current CGC model, thus, our very frank exposition of WA's budget management. Indeed, we drew on some of your previous work on that, Saul.

Just so people don't read articles and mischaracterise our report – indeed, I met with one other silver-haired gentleman who's an economist that I greatly admire recently and he'd only read that article and said, "What the heck are you doing?" Then when we talked this person through what we'd actually done in our draft report his view changed. Anyway, I just want to make sure that the mischaracterisation couldn't be attributed back to you, Saul, so I thought that was important to be read in the context of what your opening remarks were.

I guess coming back to the key issue here is how well is the HFE system currently performing? What impact might it have on the real economy, which was kind of the guts of what we were asked to do? You yourself say, I think in everything we've read, that you've told us, your opening remarks, that the system is not perfect. It does need some fixes. What do you think are the current flaws of the system and what are the fixes that are required?

MR ESLAKE: Let me answer that, first of all, by saying that the fact that the system is currently producing outcomes which have no historical precedent is not in and of itself evidence that the system is, I think the words that are used in the report even, under strain.

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MS CHESTER: We'll come back to that because that is a key issue. But just in terms of what you think are the problems and what you think the fixes are.

MR ESLAKE: I think the problems are partly, as the report has diagnosed, that the system is poorly understood. Very few people outside state treasuries and part of the federal treasury and the Grants Commission itself understand how it works. It relies to a very great extent on judgments by the Grants Commission which are hard for outsiders to replicate. The outcomes can be variable from year to year, which make the management of state and territory budgets harder than it would otherwise be, although I'd also note in saying that comment that, for example, volatility in stamp duty revenues in particular can have a similar impact and in some cases a bigger impact on state budgets than changes in GST relativities from year to year. So that of itself is not necessarily an argument against it.

Finally, and your report has been influential in my own thinking about this, there are some anomalies in the way the Grants Commission arrives at its findings regarding fiscal capacity and the use of fiscal capacity from the different ways in which the Commission treats, on the one hand, changes in tax rates and, on the other, changes in the base of state taxation, which, although you didn't provide, because I don't think there is any, evidence that that's been a serious obstacle to state governments making those sorts of decisions in the past, it, nonetheless, could quite easily result in – may have resulted in states either being treated unfairly from some kind of objective standpoint or not pursuing desirable reforms such as the one you canvass of replacing stamp duty with land tax, of which I've been a very long-standing advocate.

I don't think that the possible impact on GST revenue is a reason why no state government has done that up to this point. But it obviously would be a consideration. I'm also an advocate of in Tasmania lowering the rate of payroll tax and applying it to all businesses; broadening the base, lowering the rate. And I infer from the analysis that's in your discussion of the stamp duty land tax, that that might also have problematic implications for Tasmania's GST share. So those kind of things, which you would approach not by saying, "Let's step back from full equalisation and see what happens," but rather, "Let's look at the way in which the Grants Commission actually goes about achieving full equalisation and see what happens."

I think that's an approach that would be much more consistent with your overriding objectives of seeing whether the system has any adverse consequences for productivity, economic efficiency, economic growth and

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so on than saying that the trade-off between equity, on the one hand, and efficiency, on the other, ought to be shifted in the direction of efficiency, which is, in effect, what you're saying by recommending something less than full equalisation.

MS CHESTER: If you look at some of our options in terms of what might be a way of equalising to less than the higher state, it's because that equalisation task becomes so large and, as you'd appreciate as an economist, that as you move away from EPC you do start mucking around with incentives that states might face. And we reject moving to EPC because that completely abrogates the equity objective.

MR ESLAKE: And I would even question whether EPC should be used as a benchmark. I know it's an easy benchmark to use. But given that grants have never been carved up among states and territories on an EPC basis, given that state governments themselves don't distribute money within their jurisdictions on an EPC basis, but rather, on the basis of some perception of need - - -

MS CHESTER: I think they do with local councils though.

MR ESLAKE: No, they - - -

MS CHESTER: Some state and territory jurisdictions do, so their version of HFE for their local council is very close to EPC.

MR ESLAKE: My understanding is that with local governments they distribute 70 per cent on an EPC basis and 30 per cent on an equalisation, on an HFE basis, and they all have state grants commissions in order to recommend that. Even with that money they don't distribute it on a pure EPC basis. But accepting that it is, as you say – I mean, the federal government tax transfer system doesn't distribute money among the population on an equal per-capita basis. We accept that some people are going to be significant net contributors to the system and some people are going to be net withdrawers from the overall tax transfer system.

While there may be some adverse consequences for efficiency arising from the fact that 3 per cent of taxpayers pay 30 per cent of personal income tax, nobody seriously argues that that should be used as a reason as to why that same 3 per cent of taxpayers should pay say 20 per cent of personal income tax.

MS CHESTER: I think we can agree that we do not see EPC as an equity benchmark for looking at HFE. But for some it could be seen as an efficiency benchmark. But the whole ballgame here is really, equity is the

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primary objective. Policy neutrality or efficiency is a subsidiary objective. How do we get the trade-off right within the system without eroding to too great an extent the equity objective? How do you think the CGC is going at the moment, Saul, in terms of getting that trade-off right between policy neutrality and equity?

MR ESLAKE: Well, what I say is that the existing system of HFE, combined with the spatial effects of the federal tax transfer system, have created a situation where the degree of inequality across Australia is substantially less than the degree of inequality you can observe in other federations. Now, a large part of that is because of the way the federal tax transfer system works. But, as your report, like many others beforehand, acknowledge, Australia goes further in the pursuit of HFE than almost any other federation.

I'd argue that we do that because we can, and the reason we can is because our federation is characterised by much more vertical fiscal imbalance than almost any other federation and it's the vertical fiscal imbalance which, in effect, determines how much is available for HFE. So I think it is something to be proud of rather than something to regard as prima facie grounds for questioning the system, that there is less inequality across Australia regionally than there is in many other federations. While the system has been delivering those outcomes under more challenging circumstances in recent years than previously, Australia, nonetheless, has achieved better overall economic growth than many other countries and has increased its per-capita standard of living relative to most other federations.

So I'd argue that it's hard to point to any significant efficiency or economic cost that Australia as a whole has suffered because we have pursued HFE to a greater extent than other federations.

MS CHESTER: HFE today now has a much greater equalisation task within the GST core because we do have an outlier.

MR ESLAKE: Yes.

MS CHESTER: So that means we're further away from EPC. You do agree though that EPC is kind of like an efficiency benchmark but not an equity benchmark. So you don't see that there's any policy neutrality issues at play at the moment across the Australian economy with development activities or tax?

MR ESLAKE: I think you make a case that there could be in terms of the different treatment of rates of taxation versus the base of taxation. What you, like others who've investigated this before, have been unable to come

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up with is any evidence that what might be true in theory has actually occurred in practice. I struggle to believe that any state has foregone economic development opportunities or worthwhile reforms purely or predominantly because of concerns as to what that would mean for their share of GST revenues. I have seen even here in Tasmania, for example - - -

MS CHESTER: And we don't say that in the report, Saul, either, just so it's not mischaracterised.

MR ESLAKE: No, but others have said it to you.

MS CHESTER: But if those disincentives are material and decisions are always made at a margin, how can you expect a state or territory government to dare greatly with a controversial development activity or dare greatly with a tax reform of the kind that you and I and Jonathan would like to see if they are perversely penalised by the GST relativities?

MR ESLAKE: Because there's neither evidence, nor can I recall in the Tasmanian context or, for that matter even, given I lived there for 30 years, in the Victorian context a government ever saying that although we recognise this particular proposal is something that would be good for the state that would create jobs, that would generate revenue, that might generate export income, we're not going to go ahead with it because it will have some impact on our share of GST revenues. I mean, this state government here, for example, was at potentially some – not the present state government, previous state governments have been advocates of some quite controversial development proposals. I'm thinking here about the pulp mill, for example, or, on a smaller scale mines on the fringes of national parks and wilderness areas, which - - -

MS CHESTER: And we say in our report the smaller states that disincentive effect is so muted because they are smaller states. It doesn't really influence the GST relativity. So it's really the larger states.

MR ESLAKE: So let me turn that around the other way. With the possible exception of attitudes to uranium mining, which in Western Australia come and go, depending on who the state government is, I'm not aware that any Western Australian government has held back from developing any of that state's resources for fear of an adverse impact on its share of the GST. I'm not aware that the Northern Territory has, where perhaps the incentive effect might be even greater, held back from supporting, encouraging the development of natural resources in the territory because of a fear that it might have some adverse impact on the very large proportion of the share they get of the GST.

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MS CHESTER: I think we can all agree it's difficult to have evidence of a counterfactual and thus, like good economists, we try to then model through cameos or other means what the incentive effects are that they face.

MR COPPEL: If I come back to the question that Karen raised, do you see EPC as an efficiency benchmark?

MR ESLAKE: It's a simple one to use, but whether – I'm not persuaded that equal per capita necessarily represents efficiency. It represents simplicity, but does it represent efficiency in the economic as opposed to the accounting or commercial sense of that term? I'm not sure that you can make a persuasive case one way or the other. It's simple, but I think that's all it is.

MR COPPEL: Isn't it founded on the basis that the outcome can't be influenced by your own decision, it's a per capita – like a head tax.

MR ESLAKE: In that case, for example, would you say universal basic income is the efficiency benchmark for a social security system or a tax system or a poll tax is an efficiency benchmark?

MS CHESTER: We're looking at it from the perspective of policy neutrality, Saul, from policy neutrality from the state and territories' perspective. There's two suggestions we've had about the efficiency benchmark. One is you just set the current relativities in concrete and you never change them, because then whatever a state does cannot affect it. But we know that that completely abrogates the equity objective. The other efficiency benchmark is EPC and how far you stray from that gives you a suggestion of what the trade-off might be. We do not recommend going to EPC for the very reasons that it does undermine the equity objective.

MR ESLAKE: I think all I can say is that it is something that you might use to establish a boundary but that's all.

MR COPPEL: Earlier you said that maybe there are alternatives to equal per capita. Do you have something specific in mind as that benchmark?

MR ESLAKE: You could, for example, have the revenue as a percentage of gross state product would be another possible boundary definition.

MR COPPEL: This is an area where previous reviews, including by the CGC, have looked at sort of broader indicators as a way of getting simplicity and policy neutrality even. But it's always been concluded that it leads to unequal outcomes or outcomes that stray too far away from where we are at the present or where analysis was undertaken. But we've asked

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in the draft report for – we've encouraged the CGC to continue examining whether there are those sort of broad indicator that could be used as a benchmark. I'm a bit doubtful, given the past work, how fruitful that will be. But we're not giving up yet, so to speak.

MR ESLAKE: I haven't explored what this would mean for either outcomes for individual states and territories or for the system as a whole. But it may be, for example, that you could simplify the assessment of revenue disabilities or capacities by focusing on three or four heads of revenue and doing everything else as a proportion of gross state product. So you might explicitly look at payroll tax, stamp duties, land tax and mineral royalties, and all other revenue you just looked at in terms of gross state product as an indicator of revenue raising capacity.

On the expenditure side, you could perhaps look at education, health, public transport and maybe law and order as sort of key areas of state responsibility and do something similar to what the Grants Commission does at the moment and then simplify the treatment of everything else. As I say, I haven't attempted to work out what doing something like that might mean in practice and what consequences it would have for state shares. But if you started out from an objective of making the system simpler, easier to understand and, from one perspective, carrying greater accountability, that might be a way of going. You still have full equalisation as the policy goal, but the way in which you get there may, in the end, mean a different distribution of revenue from what you currently have.

I mean, what constitutes full equalisation is, to some extent, in the eye of the beholder, if I can put it that way. It is what drops out of the myriad of calculations that the Grants Commission does at a micro level. Over time, over the history of the Grants Commission, those calculations have got into finer detail and become more complicated and thus more opaque to anyone who is outside the system who can't really replicate what they do. For example, as I think I've said in some of the things, it surprises me in some ways, given that on broad economic indicators Victoria is now a relatively poor state in terms of per-capita gross product, per-capita household income, that it isn't what the Western Australians would call a recipient state, that it's still a donor state.

How you get to that income is, I suppose, mainly on the expenditure side of the way the Grants Commission goes about its process. But I guess the point I'm trying to make is that a more fruitful attempt to manage the trade-offs between equity and efficiency in the HFE system might come from thinking about how the Commission achieve full equalisation as opposed to questioning whether full equalisation ought to be the objective.

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MS CHESTER: Just coming back to this issue of grappling with the trade-off between equity and efficiency, which I think we can all agree there is a trade-off, the CGC is doing that in parallel at the moment with its own methodology review, Saul, that you'd be more than familiar with. One of the potential changes that they're thinking about is, in terms of the royalty rate issue, would be to allow a state that sets the average – WA on iron ore – to keep 50 per cent of the revenue streams from any increase in the royalty rate. So that, to me, is sort of kind of like a way of trying to deal with that policy neutrality issue. It would be good to get your thoughts on that.

MR ESLAKE: My instinctive reaction to that is that that's just a different way of giving WA more money. I mean, the reality is that the tax base which Western Australia has, if it's properly defined, is not something over which the Western Australian Government has any great influence. As I think I said in a different context, they didn't put the minerals there. They don't put the capital up to develop them and neither, for that matter, do most individual Western Australians. Most of the capital that's developed their resources has come either from interstate or from overseas. The prices that are paid for those resources are determined on international markets, not by any conscious policy choices by the Western Australia Government.

So if through no particular circumstances of their doing they have the capacity to raise far more revenue from the rest of the country – raise far more revenue from exploitation of their mineral resources than any other part of the country, it's not obvious to me why any part of that should be excluded from the determination of fiscal capacity, which is what applying a discount in effect amounts to. I don't want to misquote you here, but I think your report rejected the idea of applying either discounts to particular types of revenue a la the Canadian approach or putting floors under a state's GST shares, which is equivalent of putting a cap on everyone else's. I think I would apply the same framework to thinking about the suggestion that they get a discount for any revenue that comes from an increase in the rate of tax they apply to mining royalty – rate of tax – mining royalty rate they apply.

MS CHESTER: We didn't comment on the CGC one because their report came out contemporaneously with our draft report. So you haven't mischaracterised us on those other issues. But I guess the CGC do see it as a policy neutrality issue similar to, I think, the coal, sea and gas. They're treating it like gambling and taking it out so you get rid of what some might claim to be a perverse cross-subsidy from those states that are daring greatly and doing coals and gas and those states that aren't being effectively cross-subsidised.

MR ESLAKE: Yes, although my impression – and this is an issue that's

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come up in Tasmania, of course. But my impression is that the decisions that state governments have made about coal and gas have got nothing to do with either the revenue they would get from them or whatever impact that might have on their GST shares.

MS CHESTER: Which raises the issue about whether or not it even breached the materiality threshold and therefore come into play, which is kind of interesting in and of itself. But you can see where we're going here. But the CGC is starting to grapple with these policy neutrality issues as they see them, but dealing with them in kind of like an ad hoc piecemeal way.

MR ESLAKE: I suppose my response to that would be, as I've suggested in a different context, that maybe the issue that is really critical here is the difference in the approach the Grants Commission takes to changes in tax rates from the approach that they take to changes in the tax base.

MR COPPEL: The CGC uses discounts quite frequently as part of the decisions they make in undertaking their calculations and they'll do that when they are not fully confident that their assessment is a reliable one. So in a sense it's an extension, what they're proposing, to the current practices. You've made the point that any discount is, by definition, going to be a departure from full equalisation. But if you take that strictly any change from what we have at the moment will be a departure. If I listen to you, you would rule out our – based on that immediate fact that any change is going to lead to a different distribution. We're in the zero sum game; some win, some lose.

MR ESLAKE: Yes, it's obviously anything you do is a zero sum game and we all understand that. But what I'm saying, I think, is that full equalisation is, in effect – what is full equalisation? What dollar distribution of revenues is consistent with full equalisation? Well, the answer to that is whatever the Grants Commission says it is. The Grants Commission has changed its formulas, what it includes, what it excludes, what it discounts, what it doesn't over a period of time. But the result that they present has always been characterised as full equalisation.

What I'm saying to you is that there may well be different ways of achieving the goal of full equalisation, that come out with a different dollar distribution of revenues from that which comes from the present system, but are arrived at through processes that have different effects on incentives, if there are any, that may be simpler and easier to understand and explain, that may be more easily replicated by outsiders to the process, to – approximated by outsiders to the process and perhaps more predictable by state treasuries who have to live with the consequences; and you could still describe those as full equalisation.

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So I guess the most important point I'm trying to make is not that there should be no change to the system at all, not that it's perfect, but that the pursuit of what would be accepted by the public at large and participants in the process as full equalisation, even though it resulted in a different dollar distribution of numbers, could perhaps be achieved by a different process from the one that is used at the moment.

MR COPPEL: Are you making a distinction between the process and the methodology - - -

MR ESLAKE: I'm using process and methodology interchangeably.

MS CHESTER: It's an important point that you make there, Saul, by saying what is full equalisation is what spits out of what the CGC does. Indeed, when we started this inquiry we thought history was going to be important, that history might reveal – and you've read the report fairly closely. We do run through the evolution of how the CGC has equalised and how it's been described as becoming full equalisation, but requiring fiscal capacity to be able to provide the services of the same standard. Did we get that evolution right? Because I'm still struggling to understand, the current CGC Act doesn't require them to equalise to the same standard. There's been no decision by a government or a Cabinet to provide a fiscal capacity to get them to the same standard. It's just something the CGC just decided to do.

MR ESLAKE: I mean, what my understanding is, that the CGC seeks, as they say, to recommend a distribution of revenues that allows each state by equal effort to provide its citizens with a similar standard of public services.

MS CHESTER: No, it's the same standard.

MR ESLAKE: Same standard. Yes, my apologies, same standard.

MS CHESTER: It used to be similar but they changed it.

MR ESLAKE: Was that in the mid-1980s?

MS CHESTER: Well, they started doing it back in '81 but they didn't actually say that's how they were doing it in a public record until about 14 years later. If WA hadn't have happened, that penny wouldn't have dropped with me. I always assumed that they were equalising to an average. But when you realise they're equalising to the highest we don't sort of go back through the history and realise it's just something they decided to do.

MR ESLAKE: If you go back further into the history, as you demonstrate,

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of course, states could choose whether they wanted to be part of the process or not by being claimant states or withdrawing from claimancy. Sometimes withdrawing from claimancy was held up as proof of superior economic management.

MS CHESTER: But that's a decision by a state or territory government.

MR ESLAKE: Yes.

MS CHESTER: I guess what I'm trying to draw out here is to make sure we did get that history right, given you know this history better than we do. That it is quite bizarre that a statutory agency just decided in a policy sense how we were going to do it. It's different from what's in their Act and it's different from how it was done historically.

MR ESLAKE: And in the same way, as you'll know, that around the early 1980s the basis for comparison changed from the standard states, as it used to be called – Victoria and New South Wales – to the average of all states. Again, that was a decision that I think was, in essence, made by the Grants Commission rather than by the federal parliament or anyone else.

MS CHESTER: Does that kind of then make sense from a governance perspective? These are big policy decisions and we now realise the cost of that policy decision as it's played out with a fiscal outlier like WA. It's made the equalisation task much greater than it would otherwise be.

MR ESLAKE: Well, let me unpick that a bit. I'm not sure what the cost of full equalisation is or whether it's significant. The fact that Western Australia has become an outlier in terms of what the system produces is a direct result of the fact that Western Australia is an outlier in terms of how wealthy it is.

MS CHESTER: I'm not disagreeing with you on that. But in terms of it – we're struggling with policy neutrality and efficiency and the equalisation task is much greater within the GST pool. Assuming we have an evidence base that we can further establish that suggests that there could be real cost to the economy of that occurring – do you see where my logic is going?

MR ESLAKE: I mean, if the evidence base was so strong that there are efficiency costs, surely you would be able to point to something.

MS CHESTER: Well, that's why we have draft reports and public hearings and post-draft report submissions.

MR ESLAKE: I think you're the, as I understand it, third inquiry that's

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looked at this because your predecessor, the Industry Commission, did one in 1993 and Messrs Brumby, Carter and Greiner did one in 2012.

MS CHESTER: And the previous two were slightly more constrained than we are, but anyway.

MR ESLAKE: But they weren't able to come up with any evidence. With due respect to Messrs Brumby and Greiner, given everything they had said about the system with their former hats on, you would have thought that if there was any evidence that supported the arguments that they used to put as premiers of their respective states, they would have found it and put it in their report.

MS CHESTER: Well, they didn't have the cameos. I'm very conscious of time and I'm meant to be chairing this, which means I'm doing a very bad job.

MR COPPEL: Can I just pick up the last point that you made? You've made that point that there's insufficient evidence to justify changes to the system. The other point that you make is that the changes that are proposed in the draft report don't address particular problems. Which of the two – do you give equal weight to those or which of the two do you think you hold with a strong conviction?

MR ESLAKE: I would put a stronger weight on seeking to find ways of achieving full equalisation, whatever you define that to be, in ways that are simpler, more transparent, easier to understand and more predictable. Because, as I say, I go back to the point that full equalisation is what the Grants Commission says it is and otherwise it's sort of a bit hard to define what it actually is. I mean, you can say there's that principle that each state by equal effort can, in theory, provide the same standard of public services or similar standard of public services as the average of all states. No one really knows what that means in practice. It's very hard to define beyond – yes, conceptually you know what it means, but in practice what does that mean about how big classrooms should be in one state compared with another or how long is an acceptable waiting list for acute hospital care in one state compared with another. No one attempts to define that.

So we sort of accept that full equalisation is what the Grants Commission says it is and the response of states who feel aggrieved by that is to say that we should pursue something less than full equalisation. New South Wales and Victoria have always argued for equal per capita. Western Australia used not to do that when they were a recipient and now they've argued either for equal per capita or floor or a discount for mining but they want to step away from the objective of full equalisation.

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The point of view that I'm putting to you, from a sense of someone who's always interested in economic reforms that will produce benefits for the country as a whole, is not to question the objective of full equalisation but to question how we get to that objective and what it might actually mean.

MS CHESTER: One more quick question because you're a bit of a state budget guru, what do you consider would be the kind of variants that the Tassie Government would typically have around some of its key revenue measures? How much bouncing around do they have in their forecasts and what can they sort of wear without it sort of impacting standard of services that the budget can deliver on, Saul?

MR ESLAKE: Well, I'd calculate it, as you know, that an equal per capita distribution would force Tasmania either to double its state taxation revenue or - - -

MS CHESTER: Stepping away from HFE for a moment, just in the normal course of the state government doing its budget management, they don't always get their forecasts right around their revenue basis. What sort of variants do they currently have with their forecasting abilities around their revenue basis? I know that's up or down.

MR ESLAKE: That's not a calculation I've done. But my impression is that the own-source revenue side of Tasmania's budget has been less volatile than that of many other states because the economy has been less volatile. In particular, stamp duty revenue will have been lower on average but much less volatile than the states that have had pronounced housing and property market cycles. Likewise, employment has been pretty flat here compared with the growth that has occurred in other states. Land tax revenue never shows much volatility because it's the most predictable form of state revenue. The other area of volatility in revenue for the Tasmanian Government is in the revenue it gets from its GBEs because the electricity industry, which is the largest component of those, is very volatile, particularly given that sort of hydrology of Hydro Tasmania.

But, of course, from Tasmania's point of view with something like 60 per cent of its revenue coming from Canberra year by year movements in the GST revenue share are probably the bigger source of uncertainty from year to year in constructing the state budget. I don't know whether you've spoken to the Tasmanian Treasury yet or not. That's a question they'd be much better placed to answer than me.

MS CHESTER: I just wanted to get a sense because even if we were to sort of cold turkey to one of our proposals, the impact, when you look at it

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in terms of as a percentage of state revenues is 1.3 to 2.8 per cent. I'm just trying to get a sense of order of magnitude as to what they would have to deal with in a normal budget management perspective and whether that would - - -

MR ESLAKE: I put a table estimating that in my submission to you. I took the dollar numbers from, I think, four of the options you canvassed and said what was that as a percentage of revenue. Equalisation to the second stronger state was, I think, about one and a half percent of revenue for every state, except WA, which got a lot even out of that. I mean, Tasmania could live with, could accommodate, changes to the GST sharing formula to the cost of 77 million. That wouldn't break the state; they could cover that. It might be more problematic for the Northern Territory, for example. That's not to say I think Tasmania would regard it as an acceptable outcome or one that they would desire – and it's not for me to speak on behalf of the Tasmanian Government anyway. But it wouldn't break the state. The consequences of that will be far less serious than an equal per capita distribution which, again, I accept is not what you recommended but is often used as the benchmark.

MS CHESTER: No, it's just a lot of people are portraying that we're recommending as kind of Armageddon.

MR ESLAKE: It isn't. I mean, the other option which wasn't in your report but was in the CGC submission on your draft report was, in effect, going back to the claimant state arrangements whereby you equalise among the four smaller states and territories and leave the big four states out of it.

MS CHESTER: Yes, that was an interesting post-draft report submission, not commenting on policy was their opening statement. I think we've run way over, but it's been very helpful, Saul. We appreciate you being very frank with us and being generous with your time and helping us with this inquiry. So thank you for appearing.

MR ESLAKE: Thank you for listening.

MS CHESTER: Folks, I know we're running late, but we do need to take just a five-minute break for those of us that haven't been able to enter or exit the room for the last few hours. So we're going to take a five-minute break. We'll resume at 10 minutes past 1. Thank you.

ADJOURNED **[1.07 pm]**

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RESUMED **[1.12 pm]**

MS CHESTER: We're going to resume our public hearing here in Hobart before it starts bucketing rain. I'd like to welcome our next participants from the Launceston Chamber of Commerce. I've been to Launceston many times. Thank you for travelling down here for our public hearings in Hobart today. If each of you could just state your name and organisation just for the purposes of voice recognition for the transcript, that'd be appreciated. Then if you'd like to make some brief opening remarks.

MS HEALY: Janine Healy, treasurer of the Launceston Chamber of Commerce and former president.

MR GROSE: Neil Grose, executive officer at Launceston Chamber of Commerce.

MS BAIN: Donna Bain, voluntary director of Launceston Chamber of Commerce, former president.

MS CHESTER: If you'd like to make some opening remarks.

MR GROSE: Yes, thank you very much and thanks for holding the hearing in Hobart. We do appreciate it. It wasn't initially on the schedule. So we do appreciate that and we do appreciate the chance to contribute. It probably won't be to the depth of my predecessor. I guess therein lies what we want to talk about, is the practical implications of any adjustment to GST, particularly downwards. Tasmania, for better or for worse, does rely on that strong and reliable and predictable GST flow from Canberra. We've seen in the past, particularly in the previous state government, when GST revenue dropped, not by proportion but by dollar amount, it had a significant and ongoing impact on the Tasmanian community and the business community. We saw lots of cuts in health. We saw lots of cuts in community. That has an impact, an undeniable impact, on business confidence. Tasmania is a state which really does rely heavily on business confidence. We are certainly in an upswing at the moment with business confidence and in great part some of that is driven by some vision and investment by state government. Some of it is federal government. But a lot of that is always in partnership with the state government.

Now, our concern is that if there is a significant and radical drop in GST revenue, then that ability of the state government to contribute to that growth wanes. I can give you a very brief example. It's a small one. In the northeast of Tasmania, a depressed little town called Derby, was an old mining town. It basically had 30 people living in it and about 50 dogs. But

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it was recognised as a world-class venue potential, for mountain biking. With investment by state government and partnered by the federal government and local government, we now have a world-class mountain biking venue there which brings 30,000 visitors a year to Derby. But more important than that, it's created between 40 and 50 ongoing and permanent jobs. So that investment by government has transformed that very marginal regional economy.

There are many, many other ways that we rely upon the state government to contribute to our economic growth, probably more than any other state. As a chamber of commerce, we'd probably be the last organisation that would say that government cannot improve its financial performance in terms of expenditure and revenue. Revenue is one of those issues, for a Tasmanian government in particular, where we are limited. Our hole in the ground is a lot smaller than Western Australia's or anyone else, as is our capacity to exploit that. The change in the Tasmanian economy is moving away from that primary industry based economy, apart from agriculture. But certainly in terms of mining and, to a certain degree, forestry, our reliance is now on a new economy.

It's worth pointing out that Tasmania has the fastest internet speed, available in Launceston and Hobart, of anywhere else in Australia. We've got 65 per cent of our community is connected directly to fibre. We have so much potential and it's already showing in that growth in technology and professional services, which is all intellect based. There's no scope for the Tasmanian economy, I hope, to tax that. However, when it comes to mining and forestry in particular, it's a declining opportunity for the state government.

In the northeast in the '90s when the forestry industry was at its peak there was a million tonnes of forest products coming out of the northeast, all which was subject to royalty. Even though the forestry industry has bounced back, that's still only at about 300,000 tonnes. It will never ever get back to that scope. So there's not that capacity for the state government to say, "You know what, we've just lost a whole bunch of GST revenue, let's see what we can increase in royalty." There just isn't that scope.

I guess the changing nature of that economy is reflected in the membership base of the Chamber of Commerce. We're Australia's oldest chamber and we can plot the changes in the economy and the business make-up right back to 1849. Our membership base now is probably 40 per cent in that professional services, whether that's accountants, marketing, change people, that intellect base. If you went back 50 years ago it would have been in a manufacturing base. If you went back a hundred years ago it would have been in a mining base. So we see that change.

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Now, mining and manufacturing and that primary production is a source of revenue for government. Where we are at the moment there's not that scope.

MS CHESTER: Thank you very much for those opening remarks. It is good that we get a perspective from chambers like yourself in terms of how the economy in Tasmania is evolving. Indeed, my first inquiry when I joined the Commission four years ago was on the Tasmanian freight and shipping. So I spent a bit of time up the north. I guess my initial question is a little bit about – and we all do acknowledge that the fiscally weaker states are very much more reliant on the GST revenues as they're distributed through the HFE mechanism. Does the chamber have views on how the Tasmanian Government actually spends those GST moneys that they get?

MR GROSE: I think certainly over the last four years we would see that the government has been very wise in the way they spend that money. They've looked to projects of infrastructure rather than just spending it for the sake of spending it. Their long-term legacy projects, Derby is probably one example, there are a range of others. There's assistance to technology. There's manufacturing hubs. There's the expansion of the university. That is a key one. That goes across all three corners of the state. Launceston at the moment is the beneficiary of a city deal which is bringing $260 million investment to Launceston; $60 million of that is state government investment.

So we would say that the state government has been incredibly wise in that, but also they've used that revenue to repair our health system and our emergency services system. We've seen a rebuilding of the health system. On the broad brush, there's more nurses, there's more doctors, there's more hospital beds, but also has improved the structure of that. We also see that with the police force. So we've seen more police on the beat, which makes everyone happy, but also in the other emergency services field, which people don't often see until they're in trouble, which is the fire service, State Emergency Service and other volunteer organisations.

MS CHESTER: Because I guess people sort of equate the HFE with the principle of equalising fiscal capacities with an equity outcome, and with an equity outcome is where are those dollars spent? That doesn't determine whether that's still an equitable outcome; it depends on how well they're spent and whether they're the right priorities. But when we kind of look then as to – and, as you'd know, the states and territories have autonomy with how that – it's not tied funding. But the CGC goes through this incredibly complex and elaborate process to determine what Tasmania's assessed needs are across areas like schools education, post-secondary

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education, health, housing, welfare, services to communities, roads and transport.

Then you get the GST money. Then when I look at what Tassie actually spends – and these are CGC numbers over the past six years – they're actually 7 percentage points below what they're assessed in terms of their expenditure in those areas. That may mean that they're just doing it more efficiently or they're getting better outcomes. But in the areas that you've identified as the priorities – post-secondary education, health, services to communities – they're way under the numbers that the CGC assesses as your needs once they've taken into account disabilities like remoteness, aged population, all the rest of it.

So I'm just – we have people saying any change, even if it results in a 1.3 per cent change to our GST as a percentage of our revenue, will result in these incredibly inequitable outcomes. But then when I kind of look at how it's working at the moment it doesn't transfer through to how the CGC assesses what those needs are in terms of where the money is then spent. I'm not suggesting that that in and of itself suggests inequity because, again, it depends on value for money, priorities and all the rest of it. But is that - - -

MR GROSE: Yes, I guess it's probably a far more complicated question than my small brain can cope with. In terms of the GST revenue, it provides certainty for ongoing things which need a level of stability such as education. We need to know that we've got enough teachers to staff our schools. We need to know that we've got enough nurses. The CGC process is about infrastructure building, so the main road on the Midland Highway is that Grants Commission type thing and other iterations of that. There's a whole range of projects going on around the state or about to start around the state which bolster that up.

But that ongoing revenue stream, the GST side of things, that is the fundamental underpinning of how government services provide. They can't rely on a grant to run a school system because you need that consistency.

MS CHESTER: Indeed, we recommended not making any changes to the way they do the averaging over sort of the three-year history and then a two-year data lag. So there is greater predictability for the states to manage their budgets knowing what those relativities might be over time. But I guess we're kind of looking at well, if we in our final report do recommend any changes, one of our issues would be developing an appropriate transition path and being guided – and we only identified one principle. There's probably other principles as to how you sort of manage transition path to implement a change.

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One of the principles that we articulated was that a state and territory jurisdiction that's fiscally weak like Tasmania would not be materially disadvantaged.

MR GROSE: In a transition – and all business copes with transition. You cope with revenue going down, you cope with shrinking business and you cope with expanding business and how you manage that. In a government sense, a transition – and I heard the Treasurer earlier saying he was utterly and utterly opposed to a transition period. In practical terms, we support that. We don't see there should be a transition. But a transition has to be a managed and staged – the worst decisions that governments ever make are when they're in distress. We saw those decisions made when GST revenue dropped four, five, six years ago, when all those decisions were made to impact on the health system and close wards and do that.

The ongoing impact of that we will still suffer from for 20 years hence. I know that wasn't a horizontal fiscal equalisation issue. That was just simply we didn't have enough dollars. But it's still the same impact. It's still dollars into the economy. Any transition has to be strategic. So if there is to be a transition – and we would argue that there isn't – the lead time to that has to be enough so that government can not only make the right decisions but take the community along with those decisions, because the last thing you need is for government in Tasmania to become unstable because of decisions made outside of Tasmania.

One of our foibles is the Hare-Clark system, which means that, by and large, we have an inherently unstable political system where we often end up with a hung parliament. From a business point of view, things tend to slow down. We don't like to see that. If, for example, the precursor to going back into that situation was a funding arrangement contrived outside of our control, that would be a bad outcome in terms of strategic planning for Tasmania but also in actual practical outcomes on the ground.

It wouldn't be fair to Tasmania or Tasmanians to say that GST revenue is going to drop in two years' time. I don't believe that's enough time for such a diverse economy and an economy that relies heavily on government investment and government support. It needs to be much, much longer. I mean, there's the old rule of thirds in Tasmania. There's a third are dependent on the government, a third work for the government, a third are in private industry, but probably two-thirds of that private industry depends upon government for their private industry. The impact of reducing structurally Tasmania's access to GST funds has impacts far deeper than many would realise.

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MS CHESTER: If you were here earlier you would perhaps heard me say what percentage of Tasmania's revenue – if we were to cold turkey and do it overnight, it would be a 1.3 percentage point or 2.8 percentage point reduction in revenues.

MR GROSE: And that would have a massive impact on Tasmania; there's no doubt about that. I mean, 2.8 per cent doesn't sound like a lot, but in terms of a dollar amount it's a huge amount. That is a ward in a hospital. It is a mental health program for youth. It is do we reinvest in a technology hub? Do we support community into breaking out of being a community like Derby, which were utterly dependent upon social security; now they're a strong, vibrant private enterprise community which is standing on their own two feet. Do we do not that? It will cause so much dislocation within the Tasmanian economy that the shrinkage in the economy will be far greater than the 2.8 per cent you would get from GST. It would compound.

MR COPPEL: I just want to come back to a point you make in your submission about the criteria that you use for what would represent an appropriate distribution of the GST. You've got factors in there like predictable, fair, transparent, accountable and reasonable.

MR GROSE: Yes.

MR COPPEL: Can you give us your assessment of how you see the current distribution process measuring up to those criteria?

MR GROSE: Well, we can only compare the situation now with the situation we've always been used to. So it is our status quo. Our cloth has been cut to that. In terms of Tasmania as a whole, we'd always like to see more money. But from a business point of view, we'd like to see that more strategic. But in terms of the balance, the way it's done, we can always argue whether there should be more spent on school, more spent on medicine, more spent on a whole range of things. But by and large, the current government has done a very good job in distributing that for the betterment of Tasmania and Tasmania's economy, but more importantly, its community. To have a strong business community you need a strong community to start with.

MR COPPEL: Just getting back to one of those criteria was reasonable. What do you mean specifically there?

MR GROSE: Well, reasonable always depends on who's being reasonable. Reasonable, from our point of view, is that the balance is probably right. So we wouldn't want to see that balance changed. I mean, business would always like to see more infrastructure that businesses can

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leverage off to grow. But the balance is right. We have a unique community in Tasmania – we've got all the broad brush things. We've got a small population, we're an island state. That stretch of water is our advantage but it's also our massive disadvantage.

We've got the nation's most regionalised population and also the nation's oldest population. I mean, part of that is because we're a beautiful place to live but it's also because we're a cheap place to live too. And we've got the highest rate of disability in the nation and we've probably got Australia's second or third worst health outcomes. You have to balance that against what else you're trying to do with that money.

MS BAIN: I think to pick up some of the earlier remarks we made today, I think our opportunities to strengthen the transparency and accountability of the system, a system which is so important to not only the integrity of the nation's finances but integrity of the state's finances, ought to be better understood for a range of reasons. One, it makes those decision-makers more accountable and allows the stakeholders in the system, e.g. Launceston Chamber of Commerce, to actually understand how governments make decisions and how those decisions play out in communities, because in small, reasonably diverse communities like Tasmania, as Neil has said, the impact can be disproportionate.

It looks and feels perhaps larger than it would be in a state of, a population of 6 million, where a decision almost literally disappears in the noise. A decision like that here in Tasmania has an extraordinary impact. So issues tied up with social licence become very critical for business decision-making because everybody here will have a view about how that plays out in their community. So I think there are opportunities for government and the Grants Commission to spend much more time explaining what it is they do and how they do it and that comment earlier around the information which is fed from this jurisdiction into that decision-making process and back, we need to understand how that works, because if we are to influence what that looks like today and how we think that plays out in the future we're going to do that on an informed basis.

So we are all grappling with the fact that this is a very strange black box into which a whole bunch of stuff goes and then magically something appears at some stage and we wonder where it comes from. That has an impact on our capacity to have a think about what that might look medium and long term, because the last thing, as Neil just said, we want is to make decisions which are reactionary and short term, because otherwise you actually end up spending more money trying to fix that stuff, in fact, if you don't get it right the first time. Sometimes you spend more time and effort trying to do that than if you'd actually done it properly in the first place. So

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I think this process does trigger the need to do that in a much more transparent and accountable way.

MR COPPEL: In our draft report one of our recommendations where I think there's more or less universal agreement is that the CGC take on a larger role in explaining what they're trying to do and how the decisions they reached have been reached.

MS BAIN: Because as Mr Eslake said, those decisions and that conversation you had around the policy framework, which the Commission seems to have stumbled into, is that an informed policy decision? To what extent have the people in this room and elsewhere in this community had a say in how that conversation is played out, because it plays out in the detail of the money that comes back to this state. So it's very important for us to understand how that works and to have a very strong opportunity to have a say in that policy framework.

MR COPPEL: How would you get there? Do you have any specific ideas on how you would create that dynamic?

MS BAIN: Well, Tasmania has a fairly strong community engagement strategy. We have mechanisms in which we can engage our local communities. Having people like you down here starts that conversation. We prepare information which people can readily understand and you engage with the local community about who they are, what they do and what their expectations are of that process. And that dialogue continues. I think in that conversation, as Ms Goodes said earlier this morning, you do have conversations around the inclusion principles which guide this state.

As other speakers will probably talk about, the clean and green philosophy which underpins part of this state. It gives this state an opportunity to say, "Actually, this is how we want to run our jurisdiction. These are the principles under which we as a state want to operate." It's around giving business a fair go, we'll be clean and green when we do that. We'll be inclusive. We engage the community and allows us to do that.

At the moment we're doing that in bits and pieces. But I think this is an opportunity we need, to have this say at this level, not just at the state or local level where those decisions are played out. That takes some time. You need to allow enough time to do that and to be respectful of processes and that needs to be (indistinct) because stuff will fall out of that which none of us have anticipated. That's the fun bit, to be honest, because you learn stuff about how communities react.

MR COPPEL: Thank you.

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MS CHESTER: That's all of our questions. Apart from me saying I'm looking forward to coming back to Launceston next year because I discovered another great business up there, the pinot noir shop; they have an annual event. Thank you and safe travels. I'd like to call our final participant in our hearings in Hobart today from the Tasmanian Chamber of Commerce and Industry, Mr Michael Bailey to join us. Welcome.

MR BAILEY: Thank you for coming.

MS CHESTER: Well, we put the offer on the table, you get four participants, we will come. You topped us by two.

MR BAILEY: That's good, you've done well. Look, it's kind of depressing being last because you hear what other people say and realise that there's not much left on your list that you can actually talk about.

MS CHESTER: That's okay, we're running late, but we're keen to hear if there's anything further you want to share with us.

MR BAILEY: Really, I think just to extend of - - -

MS CHESTER: Sorry, before we do, if you could just say your name and organisation for voice recognition, otherwise he's going to throw paper planes at me.

MR BAILEY: Fair enough too. Michael Bailey, the CEO of the Tasmanian Chamber of Commerce and Industry. Certainly from the Tasmanian Chamber of Commerce and Industry's perspective, the HFE system is one that holds the federation together. It's a system that has over 30 years of, I suppose, precedent that's established it. Clearly as business lobbies we always argue that the government can spend money in better ways than they do. We always argue for efficiencies and for different ways of doing things. I've got to say that this government is working hard in that space but also is looking at different ways of attacking some systemic problems in our state; issues of health and education are prime ones.

Previous speakers have spoken about our health issues, our education issues, which are among the worst in the country. In fact, I think on many of those measures we are the worst. So we need to do things differently in our state. We also have different issues such as freight – which impact the way we can actually hit export markets and even hit mainland markets – which are quite unique to our state in many instances.

We feel as a state that this whole argument has just come about because of Western Australia's mismanagement of their once-in-history opportunity

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to take advantage of a mining boom. That played out very clearly in the media here with comments about us being a mendicant state, for example. What's frustrating for us is that at this point in time our state is really on the path to a much more sustainable economic future. Our indicators are looking good, exports are growing, employment is growing and we're looking at education and health in different ways.

For us, it seems a particularly unhelpful time to be talking about a review of how GST is actually managed across the country. As a chamber of commerce, we'd argue that if we need to look at tax, let's look at tax, let's look at a GST increase, for example, rather than fiddling with the system to try and appease the larger states who seem to be miffed that the smaller states have had a better run because of our (indistinct) economic times.

From our point of view, this seems to be almost a frustrating diversion from getting on with improving our state. As a community, we're all very focused on doing that.

MS CHESTER: Thank you very much for those opening remarks, Michael. Maybe we'll start off where you left off, which is around tax reform. That's what I was trying to get my notes – so just setting aside, apart from the GST rate increase, which I'll make very clear for the transcript was suggested by you and not by me, just looking first at state-based taxes. From the chamber's perspective, are there reforms that you would see from an investor confidence, business perspective?

MR BAILEY: Yes, there are and we've argued for those pretty strongly. There are only really a couple of taxes that we can look at. We understand in our state we can't take a tax away without replacing it with something else. Ideally I'd love to wish away payroll tax, for example, which I think in any state is a crazy tax, particularly in a state like ours where we're trying to grow employment. We've argued for things such as looking at a reduction in payroll tax or at least passing it to all businesses, albeit at a much smaller rate. At the moment it's capped - - -

MS CHESTER: So broadening base, lowering rate.

MR BAILEY: Indeed, which may be fairer, or looking at broadening land tax to include all land holders, rather than just business owners and shack owners, as a way of compensating for reductions in payroll tax. Again, we'll continue to argue for those. But fundamentally, government and governments before that have all agreed that these things need to be looked at. In fact, there was a tri-partisan committee formed to look at taxation in Tasmania that just became increasingly difficult. It becomes politically

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very hard. The previous speakers from the Launceston chamber put it very well, that we do have a third of our market unemployed or on some sort of benefit, a third of our market who are employed by government in some form and a third of our market who are in business, which makes political change actually really difficult because the first two-thirds quite often can be very resistant to change.

So our government needs to move carefully, without kind of stirring up the hornet's nest of doom, to effect such changes. So again, we'll continue to argue for that. We'll continue to argue too for reviews of our state and local government public services and how we could do those differently and better. But they're kind of hedging around the edges. At the end of the day, our state is incredibly dependent on the distribution of GST. Again, I suppose fiddling with the way that that's actually determined, which, again, appears to be an effort of the bigger states to try and claw some money back to them, is very unhelpful for us.

MS CHESTER: You survived. Thank you very much for appearing. And we have covered a lot of ground with - - -

MR BAILEY: We have, and, again, I was sitting here listening and thinking we can tick that, we can tick that, we can tick that. But, again, I'll leave you my card and if you ever need any contact that would be absolutely fantastic.

MS CHESTER: We come down to Tassie quite often with many of our inquiries. So it's always good to have contacts with respective chambers. Thank you. On that note and before I do close our hearings here in Hobart, it would be remiss of me not to double-check that there's nobody else who's sneaked in who has a burning desire to share a view with us. If they'd like to, I'm happy to ask them to come up and join us. If not, I'm equally happy to call our Hobart hearings to a close, which is the end of all of our public hearings on HFE. Thank you one and all. We'll close the hearings.

ADJOURNED INDEFINITELY [1.39 pm]

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Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO HORIZONTAL FISCAL EQUALISATION

MR J COPPEL, Commissioner
MS K CHESTER, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT ROYAL ON THE PARK HOTEL, BRISBANE, QUEENSLAND
ON MONDAY, 5 FEBRUARY 2018 AT 9.00 AM

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MR COPPEL: Welcome to today's Public Hearing for the Productivity Commission Inquiry into Horizontal Fiscal Equalisation. My name is Jonathan Coppel. I'm one of the Commissioners on the inquiry and I'm joined by my fellow Commissioner and Deputy Chair of the Commission, Karen Chester.

I'd like to begin by acknowledging the traditional custodians of the land on which we meet, the Turrubul people. I would also like to pay my respects to elders past and present.

So this is the final public hearing for this inquiry and it follows public hearings we held in November and December last year in Adelaide, Melbourne, Darwin and Hobart. This particular hearing was requested by the Queensland government as our earlier round of public hearings coincided with the state election.

In terms of the report, we are working to complete the final report which is to be submitted to the Australian government by May '15. Participants and those who have registered their interest in the inquiry will be advised when the final report is released by the government, which may be up to 25 parliamentary sitting days after its completion.

Now, for today the purpose of these hearings is to facilitate public scrutiny of the Commission's work and to get feedback on the draft report. We do like to conduct the hearings in a reasonably informal manner but I do remind participants that the full transcript is being taken and for this reason comments from the floor cannot be taken. But at the end of the day I will give an opportunity for those who wish to make a brief presentation to do so.

Participants are invited to make short opening remarks of no more than five minutes. We have got a lot of people scheduled for today so we are going to be strict in terms of the overall amount of time allocated. So going beyond five minutes will leave less time for Q&A on your submissions.

Participants are not required to take an oath but are required under the Productivity Commission Act to be truthful in their remarks and participants are welcome to comment on issues raised in other submissions. Now, the transcript that I mentioned earlier will be available from the Commission's website following the hearings and participants' submissions to this inquiry are also available on the website.

Now, if there are any media in the room this morning, we do have some general rules that apply and if there is media in the room, if they could see Brad in the back to see what those rules are? Most importantly though, note

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that no video or audio recording of participants is allowed past this point without our permission.

Finally, to comply with the requirements of the Commonwealth Occupational Health and Safety Legislation, you're advised that in the unlikely event of an emergency requiring the evacuation of this building, to follow the instructions of hotel staff and not use the lifts.

So with those formalities out of the way, I'd like to invite our first participants from Griffith University who are at the table. For the purposes of the transcript, if you could each give your name and then a brief introductory set of remarks, hopefully no more than five minutes? Thank you.

PROF WANNA: I'm Professor John Wanna from ANU and Griffith University.

MS SPENCER: Nancy Spencer from Griffith University, Policy and Innovation Hub.

DR CHAI: Andreas Chai from the Economics Discipline at Griffith University.

PROF WANNA: Well, thank you for the opportunity of making a submission and talking to it today. I think our main gist of our submission is that the agenda really ought to be a bit broader and a bit wider lens, that there is a huge opportunity here for the Productivity Commission to do something for all Australians, and that is start a process, a long process, of reforming fiscal federalism.

We often take the view that we should really - I think the states are not incentivised to make a lot of necessary reforms and this is one opportunity where we can throw the ball back in their court to actually encourage them and give them incentives to look for efficiencies in service delivery and possibly reward them; look to deliver better services and to undertake tax reform. As you say in one of your cameos, states doing tax reform, for example moving from a stamp duty basis to a more generalised land tax, can actually disadvantage them under current formulas.

I think we have been discussing fiscal reform for many years, probably since 1904, I think it was, when the first challenge on the Braddon clause came. But recently we've had a lot of enthusiasm about the white paper and about the COAG process and to some extent the Commonwealth has gone to water on that and the Commonwealth has been abrogating its

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responsibilities and walking away from some of the agendas it put out, which we think were very good agendas.

If the consequence of this report is very minor recommendations which is to change the definition slightly of HFE or encourage the Grants Commission to go more public in espousing the merits and benefits, then I think Australians will be disappointed in the lost opportunity.

In terms of the specifics, it is a long-term issue, fiscal federalism. It won't be solved by one thing and I think the danger of this report is you call out one thing, the relationship between the GST and HFE, and try and tweak a little reform which really is connected to many other parts of the system. And I think while it's not in your terms of reference to reform the whole system, you can point to directions that COAG and the Council of Governments, Financial Council of Government, should be moving towards.

If we take some of your assertions – and we think two or three times you assert that HFE is very well accepted and very strong and very popular – I don't see a great deal of evidence for that. I would say, if you look back 117 years, it is a hugely contentious topic and has been the source of intense politics at various times, particularly in the '30s, particularly in the '80s and particularly, of course, GST.

So I don't see any evidence that it is very well established and I think it depends what questions you ask. If you ask general Australians, "Would you prefer all Australians to have similar education and hospital status?" They will probably say yes. If you ask them, "If one state has a Rolls Royce service provision should that be equalised across Australia?" Probably say no. If you ask them, "Would you like your tax transferred to other jurisdictions?" I think most Australians would say no.

Quite frankly, most Australians have never heard of HFE. It's not a concept that they're particularly focused on. It's also increasing as a proportion of the GST. It's now getting close to 13 per cent so as that figure increases as part of the GST take it will get more contentious, not less contentious.

I think timely HFE, which I understand for political reasons in 1990, 2000 was a smart move to get a broader tax through. But having said that, having now framed it as being the only element of HFE, I think that is really counterproductive. That's the zero sum game and that's at least a lot of stupid politicking where states just simply go cap in hand to the Commonwealth whenever there's an issue they want to spend more money on.

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I think we've got to turn that around and I think there's many ways we can turn that around or start to turn that around. One way, for example, is to recommend that we not think of GST as the sole source of horizontal fiscal equalisation. We might want to go to - and you allude to that in part. We might want to go to a return to FAGS where income tax, lump sums, are given to states to equalise.

We may want to think, for example, about whether the Commonwealth should totally fund the education and hospitals, could be delivered by the state, that we fund it and that has been put to both the Hawke and Rudd governments. It's not - and I think Abbott once contemplated it. That would largely obviate any need for fiscal equalisation if the Commonwealth were paying for those massive services. But most of the other - the industry parts of government are not subject to that horizontal equalisation need necessarily.

I think there is a lot of fictions around equalisation. For example, the Grants Commission calculates it on fiscal capacity. I don't see any logical reason why they should focus on revenues. They should just focus on the costs of delivering services. They should also then encourage and in some cases impose funding conditions on the states to equalise, if that's what they're funding.

At the moment we say, "Here's your dollop of money," and the states are quite happy with that. They get largely an untied amount of money. If we're serious about equalising services then we should say, "States, you've got to equalise your services. You've got to improve your education."

For a long time in Queensland we have no, effectively, grade 1 of school. Everybody else had that extra year and it was only when a windfall came to the Beattie government that they put that area back in. For many years we made submissions about road funding and that was spent on the roads we made the submissions about. So actually to get states to equalise the services, if that's the intention, ought to be something we should think.

It should be based on the cost of delivery and that will vary. It will be more expensive to deliver something in Sydney than it will possibly in Tasmania. And you'll hear from Queensland about remote regional Indigenous has been another factor as well.

Timing is a problem, and although it's gone down from a five year loop to a three year loop, it's still a problem. And there's a statement in your report that says, "These are cyclical effects and the whole purpose of

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equalisation is not to address cyclical." Well, it ought to be. It ought to be. I mean, that is a problem for state governments.

If they are facing severe cyclical conditions - and remember, the revenues part of a budget is the hardest part to estimate and it's most fickle and subject to economic growth. Expenditures are much more easily calculated. Then it's a volatility that all governments will face but it's very, very serious for the ones that have an economic boom and bust model.

The stable economies are fine. The ones that have huge changes in their economic capacity, particularly with mining, are going to be subject to this (indistinct). It's not a massive structural problem because it will right itself over time. We all know that. But it is a problem at that point in time.

If we talk about Commonwealth redressing things through FAGS with lump sum funding you've got a comment in there that this may mean that the states would be subject to the fiscal position of the Commonwealth. That is true, but everybody is because the Commonwealth could address that like Chile does with a contingency front.

Rather like with the Future Fund, it could put money into a contingency fund which could be used to balance out all the time. There was some suggestion that the Commonwealth was trying that around 1908, 1909, 1910 when it set up special reserves and these special reserves could equalise all the time so we've got a five year period.

Our main point though I think is that we should start to think about the states having a guaranteed share of revenue. I think some of the arguments above DFI are very abstract but it is an issue about holding governments to account. We're probably not going to separate rules and responsibilities between the Commonwealth and state and territories. We're probably going to go into an area of more hybrid, more shared delivery systems where the Commonwealth takes more and more responsibility for funding.

I think giving the states - or pushing the Commonwealth to consider a guaranteed revenue may be over a 10 year frame which could be adjusted, you know, within that time. But giving them some certainty would really help their budgetary position and their calculations. I don't think the changes for most states, in terms of HFE changes through the GST, massively destabilises their budget position. I think most can calculate and accept that. Thank you.

MR COPPEL: Thank you, John, and thank you also for the submission that you've looked at Productivity Commission. Both the submission and your introductory remarks raised many, many issues so we won't be able to

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get into all of them. But I did want to make the point at the outset that our terms - and I think you made the same point, that our terms of reference was really focused on HFE.

PROF WANNA: Constraint, yes.

MR COPPEL: But we do, in the draft report, make some reference to the broader picture of Commonwealth-state financial relations and how some of the options would really be dependent on a wider scope. So I think we have some similarity there but - - -

PROF WANNA: You do talk about those broader metrics, you know, like state productivity, state gross product. Can I ask why you're not more enamoured with those kinds of things rather than the more detailed calculation on the tax and expenditure side?

MR COPPEL: Sure. So as you'll see in the draft report, we did look at some of those very broad indicators and how they them compared with the current system and you get a very, very different outcome. You're even getting into a situation where some of the jurisdictions would be paying back to the Commonwealth out of their revenue. And that reflects a wide range of factors, including the cost of delivery of services or the fact that some jurisdictions have a large number of government employees which are exempt from payroll tax, the ACT in particular, but Northern Territory as well. It is an area where maybe the use of not necessarily sort of a single indicator but a set of indicators - - -

PROF WANNA: Small circle.

MR COPPEL: - - - where we think there's some prospect there and that again is something in the draft report. But maybe if I begin by starting off on this sort of bigger Commonwealth, state, federal relations issue? You gave some areas which you thought were important but I'd like to get your views, in the context of HFE, which areas of broader Commonwealth-state fiscal relations do you see as important to look at in the context of HFE?

PROF WANNA: I think we should look at how far Australians want - as we say in our submission, the second part, the degree to which Australians want public goods and in particular that would be infrastructure services. And I think we should also look at the degree to which Australians want redistributive policies. And I think we can do that not through accepting that just governments define this by sweetheart deals between themselves, but with more an evidence base, more, you know, statistical base from polling. And I think Australians would be able to give answers to those questions, properly put.

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In terms of areas of equalisation, I mean, I think there's - there are real problems in Australia in terms of, you know, population structure and in terms of the regional and remoteness which we have to live with. And those things need to be addressed but I think it would be better addressed sometimes by states themselves being held to account if they had their own guaranteed revenue base.

I think there's too much of the senseless politics of states and territories going down to COAG, agreeing to anything to get a bucket of money off the table and then going back and doing precisely what they like or varying it considerably within that scope. I think that that, you know, short-changes and I think it is almost a cancer in the system. It's - and one we can't get out of. If you're going to hear from the Treasurer this afternoon and those arguments will - potentially those arguments will largely be put.

So I think making the states more accountable and incentivising them to do things better is crying out for what we need to do. And it may be a generational thing, but let's start moving towards it. Let's start to take the steps. Let's start to put the agendas down. Let's start to get some discussion.

As I said in the submission and in the introductory remarks, the white paper is a good place to start. Paper 5, the white paper, has some excellent analysis but it doesn't have a lot of solutions, but it has a good analysis. And the COAG statement on how Commonwealth and state should work together to improve services is another good start.

I think COAG will be crucial to this process but at the moment with the zero sum game it's very hard to get a consensus agreement. I think if we change the rules of that game then we might get states and territories saying, "We have shared interests in this."

MR COPPEL: So one of the points you made about getting a better sense of the preferences of states and territories is to do polling.

PROF WANNA: Survey them, yes.

MR COPPEL: Survey them. How - - -

PROF WANNA: And their stakeholders as well.

MR COPPEL: Can you just run me through how that would work? Would it be a regular exercise and how would you then use that information to

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make, you know, judgements between equity, efficiency, simplicity of the system?

DR CHAI: Can I take this one?

PROF WANNA: Sure.

DR CHAI: Yes, so willingness to pay measures have been used throughout the world in large-scale decision-making for - think about compensation and accidents and disasters about how much people should get compensated. Willingness to pay measures, there's an accepted science around those. You don't ask people directly about how much people - government services they need but you ask - you give them choices and options but there are implicit trade-offs between things like equity and the level of government services they need. These willingness to pay approaches have stood up in the court of law about the science behind them. They're very well developed. They've been around for 20 or 30 years.

Something where we get a general understanding of the level of benefit that we're delivering across the different states and territories would be really useful, generally because there's a good argument by Tiebout in 1956 that there could be a bit of a self-selection process going on that people in different states and territories may have different preferences. And as a result equalisation process may be quite distortionary, might not be optimal for welfare.

So generally having a consultative process would be good because it would inform the public about what's going on and how these decisions are made. And at the same time we could base the decision and the allegations on more feedback about what the preferences are.

As we note in the submission, it's not just their preferences for public goods. It's their redistributive preferences. That's fairly new but it is still an idea about even if people have the same demand for public services across the country, which is not necessarily the case, but even if they did they may have different preferences about how willing they are to redistribute to get that type of equality.

MR COPPEL: But isn't this essentially the argument for why the revenue distributed from the GST isn't tied to the actual calculations of the assessed need, individual expenditure areas? It is precisely to allow the states the discretion to determine how they allocate those resources across the different services that governments provide. In your opening remarks you

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suggested that health and education could go to the Commonwealth level in - - -

PROF WANNA: For funding, for funding.

MR COPPEL: For funding. That would leave very little for states in terms of their roles and responsibilities because education and health infrastructure are essentially the vast bulk of the responsibilities of states. So I'm sort of interested in sort of pursuing a little bit further. I mean, is that part of your reasoning? Do you think that ultimate fix for some of the issues that have been identified with the relations is more of a unitary system of government?

PROF WANNA: Well, there's two things. One, as you know, in our public policy lots of lobbyists, lots of pressure groups in our society just simply think government is, you know, like a poker machine. You just press a button and money will come out. But you never put the other side which goes (indistinct) which is, where is the money coming from? What kind of revenue stream are they hoping to tie that from?

Now, we could think more, for example, about hypothecated taxes. We could run our health system with a much more hypothecated thing where money came in, actuarially assessed and then going out. I don't think the states would have less responsibility. I think the states could increase their areas of responsibility and improve their services.

Just because the Commonwealth funds it, the states - for example, if the Commonwealth were to fund education and health, the Commonwealth could make performance payments like they did with the competition policy in the '90s. They could make performance payments contingent on improvements and that would help the states, give them a real incentive to stop and think.

Instead of, "The Commonwealth is a big bag of money and we've just got to - like pushing a balloon, you've just got to keep pushing it in various spots." It would start to get them to think, "We've got to rationalise our services. We've got to start to deliver more effective education." You know, "We're falling down that piece of chart and why is that?"

DR CHAI: Yes, that's right.

PROF WANNA: There's no incentive for the states to improve.

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DR CHAI: I think effectively - I don't think Australians really care which part of the government delivers which part of the service, as long as their assumption about what service is there - - -

PROF WANNA: It's seamless.

DR CHAI: - - - but that's the important thing. And so the policy neutrality, that probably needs to be thought about when it comes to HFE because it's effectively what John's arguing, is that we need to have outcome based measures - - -

MR COPPEL: So that we can bring it back to HFE, because let me start it off by the broad landscape there, what in your view would be the objective of HFE and how would you then define that objective in terms of the way in which you would implement HFE under your view of the world of HFE?

PROF WANNA: Well, you might think it comes out of the unitary system but if you look at New Zealand, New Zealand have about 10 key deliverables which are usually complex, multiagency, over periods of time. They're to do with life expectancy, health indicators. They're published. They're updated, I think, every quarter and those are indicators that all the agencies and to some extent the non-government sector are working towards. And the government is held to account and they're very honest in those things. So many of them are improving but some of them have deteriorated slightly and then there's a big effort to try and improve them.

I think if we were to identify, probably through a COAG process, a number of main indicators of standard of living in Australia, wellbeing, and then said, "These will be joint responsibilities. It doesn't matter how the funding mechanism (indistinct) but these will be joint responsibilities and we will ensure that all Australians - almost like there's a constitutional right - get access to these kinds of things." And I think that would be a way forward.

Some states have thought about this individually but what the Commonwealth does is it hands over (indistinct) which is a zero sum game which is counterproductive and you're probably not going to survive going forward. And then it bribes the states with special payments and national partnership payments to do X and Y on top of that. Now, that system could be a bit unpacked to make it more rational and to line up the incentives more so that we're not in a kind of patron mendicant situation all the time.

MS CHESTER: Just coming back to the point earlier on that you raised, John, about accountability and I think a careful read of our draft report would suggest that the Princess and the Pea problem here with HFE is really

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accountability. Indeed, it was quite interesting reading the Commonwealth Grants Commission's submission to us post our draft report where they took our version of their (indistinct) of equalising to the highest state and showed that even if you equalise to the highest state today, even WA can't meet its assessed expenses until you've got that final overlay of the EPC based distribution, GST. And why? Because of VFI.

PROF WANNA: Yes.

MS CHESTER: So in our report we look at the accountability issue in two ways. One is from taxing powers, and you'd look at reforming that through addressing VFI in a longer-term sense. But the other one is accountability for spending. So who's effective - having a clear line of responsibility for health or education. And agree with the point you made. We're very much in a hybrid world at the moment and wrestling that barnacle off the ship is probably going to be near impossible, which means we're then in a world of, "How far can we really deliver accountability in broader Commonwealth-state financial relations if we've only got the VFI levy to deal with?" Which I think is where you're heading. Is that going to be enough in the absence of a reform or clear accountability around funding and spending responsibilities?

PROF WANNA: I think we're going to see going forward much more joint management of issues, much more - rather than siloed, and I don't mean siloed between agencies but between governments. Much more interaction between governments. We're starting to see it in some of the case management examples that are happening around Australia but I think we'll see far more.

I mean, you know, look at universities. Universities have both Commonwealth appointments on them and state appointments on them and that's to kind of give a governing flavour to what's going on in that sector. I think we're going to see more of that coming into other sectors. I mean, there will be areas which will be entirely state based. A lot of the land based stuff and such and law and order base will be largely in the state sector. But I think many of the important and expensive components of our federation are going to be joint services and jointly managed and I'm including not only education and health but infrastructure as well and possibly issues around national security.

MS CHESTER: So if we agree that that's where things are heading I guess the question is, is that a good thing or a bad thing? If we're trying to get some semblance of accountability within a fiscal federation is it just having accountability on revenue-raising powers or do we also need to have accountability on spending responsibilities? So I think we can all agree that

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that's the direction we're heading in. How much accountability can we then get?

PROF WANNA: Well, the Commonwealth is always going to have far more accountability for revenue-raising unless it actually seeds some component of direct taxation to the states. A formulaic guaranteed revenue share would be better where the Commonwealth still took responsibility for it overall because the Commonwealth has got a macroeconomic function as well as a budgetary function.

MS CHESTER: So you wouldn't see a situation - - -

PROF WANNA: But states should be held much more to account for their service delivery because they're in the business of doing that. I mean, if you look at the Commonwealth there's only about five agencies that deliver really a great deal of services. The rest are all policy or regulatory. The ones, you know, like taxation, immigration and the like, Centrelink, you know, they're delivering things but that's a relatively - and it's a big component in terms of employees of the Commonwealth but it's a relatively confined area. The states are, you know, three quarters - 80 per cent of our public service is in the states. They're the ones largely delivering all the services that most people get.

MS CHESTER: So if we looked at doing a modicum of reform within HFE to try to elevate - get a better trade-off between efficiency and equity which is kind of what we're trying to do here, if it was then tied to some form of reform of revenue-raising responsibilities going forward would you see that being a path worth pursuing?

PROF WANNA: I'd see that as a plus and I would also see that improved performance as a plus. So we can incentivise them to deliver better.

MS CHESTER: With the VFI component of it, and I may have misunderstood what you said before, are you talking about just guaranteeing the states a percentage of a Commonwealth revenue, which is what we're effectively doing with the GST, or is it actually saying to them, similar to like Commission of Audit and other reports, "Here's part of the income tax pie. You can now increase it or decrease it going forward. So it's now a revenue that you have control over and you're therefore accountable for it."

PROF WANNA: That's been tried, to my knowledge, twice and never been taken up by any state. In fact, I think never won an election on the basis of double taxation when - it was the Fraser government first allowed the states to have a self-declared component. I think it would still be better

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for the Commonwealth as a - in terms of the efficiency of collection, it would be better for the Commonwealth to be the main taxing entity in Australia. They have the capacity not to erode the tax base, where there's always a risk in a competitive environment where states compete against each other will erode the tax base. And we've seen that, for example, in a lot of payroll taxation which is still a big factor for states, but we've also seen it largely eroded in areas of work supply.

So I think the preferred model would be to give the states a percentage so if the income taxes went up and was, you know, $450 billion, if it went up to, say, $500 billion and there was a large increase in tax the states would share because it's largely from their population that is contributing that taxation. It's not the Commonwealth's at one level. The Commonwealth sees the administration of taxation in - well, the 42.(?)10.31.30

But it's the people's money and, you know, as the white paper says, you know, one of the things that ought to be addressed is that relationship. It is VFI at the moment and the Commonwealth fiddles that with block grants that are untied and then the various ones that are tied and it came to that under section 96.

MR COPPEL: There are more questions that we could ask you but we have run out of time.

PROF WANNA: Sure, thank you.

MR COPPEL: We do note that you've brought those up in your submission to this inquiry so once again thank you very much for your participation today and in the inquiry.

PROF WANNA: Thank you.

MS CHESTER: Thank you.

PROF WANNA: There is one just final point.

MR COPPEL: Sure.

PROF WANNA: One of the other professors of economics put a paragraph in there saying one of the problems with using the GST for fiscal equalisation is that this is a regressive tax and you're using it to redress inequalities. And he thought it would be better to have those inequalities addressed by direct taxation so it's a progressive tax funding the redistribution effort rather than the regressive tax doing the job.

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MR COPPEL: Yes. I mean, there's a distinction between the inequalities on individuals - - -

PROF WANNA: That's right.

MR COPPEL: - - - and HFE which is looking at the inequality of the capacity of the states.

PROF WANNA: Yes, I mean, at one level every dollar going to the Commonwealth is part of the Commonwealth - you know, the budget allocative process but it would make better sense to have taxes that had a specific purpose in mind and use them for that specific purpose.

MR COPPEL: Good, thank you.

MS CHESTER: Thank you.

PROF WANNA: Thank you.

MR COPPEL: Our next participant or participants are from the Queensland Chamber of Commerce and Industry. Make yourself comfortable and likewise, when you are, for the purpose of the transcript give your name and a short opening statement. And again thank you also for your submission - or your submissions and also for the earlier meeting we had. It seems like a long time ago last year. So over to you, thank you.

MR TAIT: Good morning. My name is Stephen Tait. I'm the CEO of the Chamber of Commerce Industry Queensland.

MR GOSAREVSKI: Steven Gosarevski. I'm an economist at the Chamber.

MS WHITTLE: Kate Whittle, General Manager of Advocacy position.

MR COPPEL: Welcome.

MR TAIT: We welcome the opportunity to appear this morning before the Productivity Commission. As you know, we represent the views of over 400,000 Queensland businesses on local, state and federal issues that matter to them. As part of a federated model we have a close working relationship with Australian Chamber of Commerce and Industry and we appear jointly on behalf of both. We advocate on policies that are in the best interests of business, especially in Queensland, the Queensland economy but more importantly the Queensland community.

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We commend your Productivity Commission's draft report. We overall agree with the objectives and the conclusions that were arrived at. Nevertheless, as noted in our respective submissions to the inquiry to date, we are here today to make representations opposing any substantial changes to the existing HFE system for distributing GST to Australia's states and territories.

It is our strong belief that a reduction in GST revenues for Queensland would undoubtedly impact on the capacity of the Queensland government to deliver services to the citizens of Queensland. And in the context of our vast and decentralised state, any changes to the current distribution model would force the hand of the Queensland government to raise taxes on business, thereby undermining the strength and competitiveness of the Queensland economy, which would have a direct impact on those one in two jobs that are employed by small business in Queensland.

Under the alternative approaches to HFE, was in the draft report, Queensland stands to lose anywhere between $729 million to $1.6 billion if the changes were applied to the 2017-18 GST distribution. We have publicly expressed this concern about Queensland's budgetary position on an ongoing basis, in particular rising debt levels, and removing such a substantial amount from the budget would have to be met through an increase in taxes or through cuts to government spending, and both options are unpalatable.

Our members have told us that electricity costs are one of the biggest issues holding back their businesses from growing. This reduction in funds would mean that the Queensland government would continue to use government-owned corporations for their dividends and currently the Queensland government is covering the cost of solar and water scheme to the cost of over $770 million a year. A loss of GST funding could result in this cost shifting back to our members and businesses or public infrastructure investment is at a decade long low in Queensland.

In the southeast Queensland region congestion is becoming a major issue and impost on business, while the region's water supply, telecoms and transport infrastructure is lacking. Infrastructure investment is one of the easiest categories to cut when a government seeks to fund quick savings through spending reductions.

This impact would further slow the growth in employment and economic outcomes, particularly in the regions. The Back to Work Jobs Program is a $305 million fund to incentivise employers to hire out jobseekers. This has been a popular program among our members in the

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business community, with over 10,000 workers hired under this program. We have grave concerns that this program could be scaled back or removed.

Equally important, we believe that this could jeopardise a number of key welfare and business programs which are relevant to regional communities. The state government currently relies on a number of inefficient taxes such as payroll tax and stamp duties, and these taxes would be an obvious target for the government to recoup any lost GST funding.

Thereby with reference to the recommendation 2.1 as contained in the draft report, the Chamber rejects that there must be a substantial departure from the (indistinct) efficiency. We recommend that the Commission retreats from their reasonable rather than full equalisation and explore alternative mechanisms for greater revenue raising capacity by the states and territories.

This could take the form of broader structural reform of the federal taxation system, thereby leaving room for the state and federal governments to remove inefficient taxes such as payroll tax and stamp duty, while allowed to continue to deliver the service to their respective populations.

The decision to move to partial equalisation would be highly detrimental to Queensland, we believe. We believe only proper equalisation of the revenue sources of states and territories is key to maintaining equity in the system and compensating those states and territories for factors beyond their control. The Australian economy faces a number of impending challenges due to technology change, an ageing population and increased mobility of investment. Queensland businesses consider the national tax system, which has remained relatively unchanged since the 1950s, to be outdated and a brake on the economic growth.

We believe that the federal government has other policy and fiscal levers which they can pull to mean equity in the GST system while improving fiscal position for all states and territories without resorting to billion dollar cuts to the Queensland budget. CCIQ suggests that the Productivity Commission make recommendations to government that encompass holistic tax reform of Australia's tax system. But as acknowledged this morning, whilst this may be out of your scope, it's an important factor to discuss.

We believe that GST could be and should be redistributed and broadened. Raising the GST and removing the exemptions to health, education and food could generate an additional $10 billion in revenue, increasing the size of the GST draw would result in a greater share of distribution to the states, allocated on an equally per capita basis. By

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creating more efficient broad based taxes, inefficient state-based taxes such as payroll tax can eventually be abolished and this would remove the need for fundamental change in the current HFE system. In fact, this recommendation was made in Australia's Future Tax System, commonly known as the Henry Review.

Obviously any full scale review of the tax system would be welcome to participate in that discussion at a federal level. But in closing we would like to thank you for allowing us to participate today and on behalf of the over 400,000 small businesses (indistinct) in response to the draft. Thank you very much.

MR COPPEL: Thank you, Stephen. Again there are many areas that you have touched on that we may not be able to delve into today, but I would like to begin again with the broader picture. And you've made the point that there are other levers that could be pulled to improve Commonwealth-state financial relations. You've mentioned tax reform. Do you have other policy areas in mind that fall under that category of "other levers to pull"?

MR GOSAREVSKI: Well, the Henry tax review still has 130-odd recommendations that still haven't been implemented. You know, I think the literature out there has a lot of options that we need to address and, as your report suggests, that there's so many trade-offs amongst the system here.

Where one of the things that - you know, some of the taxes that we've considered and looking at are things like, you know, a congestion tax or value capture. And, you know, for the Brisbane cross river rail project, that has been, you know, a mooted e-tax that the government could implement. But as your cameo has demonstrated, there's these trade-offs going on now where you raise a congestion tax, Queensland's GST share actually starts to fall.

So the cameos that you produced was actually quite enlightening to see how the interactions of all these different taxes and levers work. And so I guess it's a bit too big for us to come up with the solution here but, you know, we do appreciate the forensic effort that you've done. And I think, yes, studies like this would help us come to a better conclusion as to different levers that could be pulled.

MR COPPEL: So those cameos were designed to sort of analyse and assess the impact that HFE has on incentives for major reforms, so efficiency or distortions in the system. And it's an area where past reviews haven't been able to find tangible evidence that there's a disincentive and

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that's one of the reasons why we've looked at cameos, because when it is an area of major reform in a large state those disincentives in principle can be quite sizeable.

So I think a better example is the cameo that looks at a switch between stamp duty and land tax. It particularly had consequences for Victoria and New South Wales if acting unilaterally. And that is part of the reasoning behind a change in the definition of HFE. HFE has multiple objectives. Equitable distribution is one of those but also to avoid distortions or inefficiencies.

The way the system is designed at the moment is that it gives effectively total weight to the equitable distribution of the GST pool and that leaves very little scope to give some weight to the efficiency concerns with HFE. So I'm interested in how you interpret equity and what is equitable for HFE? And more specifically, when there is, you know, major reform undertaken by a state do you see sort of a role for HFE to provide some sort of reward for that effort?

MR TAIT: I think with any tax and the word "accountability" is being used a lot this morning. But if we're actually thinking as a state of what the future of Queensland needs to be and what it can do as a driver for the whole of Australia so that everybody can benefit from it, I think we have to take a longer term view of what incentives and environment we can create through an overhaul of the current tax reform to make sure that we are actually investing in the right infrastructure, the right technologies, the right economic drivers for the whole of Australia.

I think the accountability around that should be looked at. I think whether (indistinct) provide better services or better outcomes should and could be tied to that reform. But ultimately accountability is based on a democratic model with an election. Whether Queenslanders will actually decide whether or not they will get a benefit or a reduction in service from any government would be the same at the ballot box.

MR COPPEL: What about the notion of fairness and reward for effort? Major reform effort can lead to a large proportion of the additional revenue, not necessarily from tax reform, being redistributed among the other states. And there's always risks involved in major reform effort so the notion of some reward for that effort, which by definition would be a departure from full equalisation. Do you have any thoughts on that as a notion that should be embodied in the HFE system?

MS WHITTLE: Be keen to see the propositions for the structure of that and we've seen incentivisation policies from the federal government such

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as the recycling program. It largely remains political if you have got governments of different persuasions (indistinct). I do think that there's - it's like having a policy discussion (indistinct) for managerial reform. We'd be keen to provide more feedback on that if that's something you're looking to incorporate in your final report.

But overall I think the substance of our appearance today is, you know, Queensland stands to lose a substantial amount of GST if some of what was included in your report was adopted by the government. And our representations are that we have a broader look at the system.

MR COPPEL: One specific mechanism that's been proposed by the Commonwealth Grants Commission, which is akin to providing some reward for effort, is to allow states to retain 50 per cent of the additional revenue from a tax rate change. I'm interested in what your views are on that particular proposal.

MS WHITTLE: Stephen?

MR GOSAREVSKI: So which sort of taxes were they proposing?

MR TAIT: It was the income tax.

MR COPPEL: So it could be any state based taxes, unsourced revenue taxes.

MR GOSAREVSKI: Okay. It's interesting because - - -

MR COPPEL: Could be a royalty.

MR GOSAREVSKI: Yes, I was going to say, like, you know, you can't really raise royalties because, yes, you get the mining royalty offside and that you know - - -

MS CHESTER: I think that was the key example they gave. So think of a state which may be setting the average, so WA iron ore, for example. Having that incentive when they face such a tough lobby group to increase royalty rates when there's an assumption that maybe iron ore is being undertaxed at the moment with royalties. So where those disincentives are at play - it wasn't kind of fully - from memory, Jonathon, it wasn't really fully articulated in that paper of the CGCs exactly.

MR COPPEL: No, but I think the impetus has come from these particular examples in the mining sector which is also an important sector in the Queensland economy.

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MR TAIT: In Queensland.

MR GOSAREVSKI: Yes, it's a tough challenge. Like, yes, the way all these state averages interact and play out, if you could increase - in Western Australia if they could double the mining royalties they'd essentially bridge the VFI gap, wouldn't they? Because yes, it's about $3,000 per capita they get in royalty revenue and possibly more - - -

MR TAIT: I think if we're looking at all of the levers, especially in the VFI, I think it's something that we do have to look at. I think there's got to be all elements of whether or not we look at (indistinct) share income tax, whether or not we actually look at untied or tied payments. I think these levers exist but I think they need to be explored through the lens of individual states, not just what they currently do but projected revenues as well.

I think that's a really important part because whilst projection can be subjective to some extent and open to macro factors, the fact of the matter is you can - I mean, hope is not a strategy. You can have your strategy which applies to an incentive if you want a state or an area to actually grow. Whether you put that tax incentive to help them do it instead of it being (indistinct) tax. So I think it needs to be done in conjunction with the likes of COAC(?).

MS CHESTER: So can I take from - your primary concern is more an immediate one in terms of reforming HFE in the current context with the zero sum game would result in the short to medium term in - depending on what transition path you were to follow, what compensation mechanisms might be in place - Queensland getting less of the GST than they would otherwise have gotten.

But the Chamber doesn't have any problem with some of the arguments in our report about getting a better balance between equity and efficiency in how HFE and what incentives that might have for particularly state based tax reform? Is that - just trying to make sure I fully understand.

MS WHITTLE: Yes, absolutely.

MS CHESTER: Yes, so if that kind of then takes us to the position of the zero sum game maybe there's two angles we could pursue. The first one is, Stephen, coming back to your point about reforms that the chamber would support like a broadening of the base of the GST, do you see that playing a role in Commonwealth, state, federal financial reforms and fixing up HFE?

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MR TAIT: Yes, I do. It's absolutely critical.

MS CHESTER: How would you see it playing that role?

MR TAIT: I think if we can actually implement a broader GST conversation, whilst it may be politically difficult in some respects, I think it is critical. But how that plays out is actually for discussion with the public as well as the government. Broadening out, whether it's on health, whether it's on education, whether it's on the food component. That will grow significantly the GST pool but I'm aware that that would have an impact on other areas of society that perhaps would be impacted as a result of it. But I think we need to have a - we'd have a sensible and reasonable conversation about how that could be implemented.

MS CHESTER: Okay, so some sort of link-in being HFE reform funding mechanism through GST base, noting that it's quite difficult to do, given - - -

MR TAIT: Yes.

MS CHESTER: - - - other inequitable flow-on effects that that might result in. I guess the other angle though then is about - from a budget management perspective for the state government and people sort of throw around the big numbers, i.e. what would happen overnight if we did a cold turkey implementation of any change to HFE. That's where they get - even if you were to take those big numbers and assume outrageously that we do a cold turkey implementation - which we don't, we're looking at transition paths - that would only result in an impact on the Queensland state government's revenues at under 3 per cent.

So I'm just trying to work out what impact then that you feel that that would have from a budget management perspective with a state government that's already dealing with variability in its own source revenues around 7 per cent year to year? Just trying to work out how this becomes an Armageddon for the Chamber.

MR TAIT: I think it's said in our opening remarks. Our organisation is an apolitical organisation. It's entirely focused on supporting its members. The accountability of a government and how it allocates its taxes is something that we strongly advocate on on their behalf. I understand the Treasurer's speaking this afternoon. I'm sure she can give you a greater indication of that Armageddon on small business.

But to us we would rather GST stayed - HFE stayed exactly as it is and that would be our view on it. As opposed to what could be the Armageddon

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impact, we believe that given our examples this morning (indistinct) think it would have a significant impact. So in the short-term that's our position.

MS CHESTER: So if we're trying to then connect the dots, because I guess your concerns are you think it will have an impact and that would flow through to areas that you're concerned about like infrastructure and the like. One of the things with HFE is it's untied. So even though the CGC goes through this very elaborate process and very formulaic process of assessing what expenses should be, the money then comes to a state and the state can still decide how it spends it.

So you're going through and look at the numbers of what a state's assessed expenses are for something like transport and then what the state actually then chooses to spend on transport. There's not a lot of - it's not 100 to 100 or 1 to 1. So any changes that could happen in HFE, maybe 2 to 3 percentage points, doesn't automatically flow through to what those assessed - whether assessed expenses are still met. Sorry, I've probably explained that in a very articulate way.

MS WHITTLE: No.

MS CHESTER: So say today, 84.2 cents in the dollar is what the state government spends on transport against its assessed expenses, so any changes that we would be proposing would probably still mean the state government's not actually spending what its assessed expenses are on transport. So I'm just trying to understand how you think no change to the system would still deliver you the assessed expenses as determined by the CGC.

MR TAIT: Is that on the current expenditure or the future expenditure?

MS CHESTER: No, it's current.

MR TAIT: Current. I think our biggest concern is what the future would look like if we change because our impact of a future change to the HFE could impact on our need for greater investment in infrastructure, not currently what it is. We have a - - -

MS CHESTER: So if we look future then, at the moment Queensland is a net recipient, not a donor state. Queensland rotates between the two depending on typically big natural disasters clustered together, a couple of other factors around some of your state revenue bases. Longer term, if Queensland were to be a donor state moving away from full and comprehensive equalisation would actually benefit the state in a revenue sense.

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MS WHITTLE: I mean, our submission at this time simply reflects our short to medium term view on (indistinct). Ultimately, as we said - I take your point, Commissioner, that there's some economic arguments that are suggesting a short-term Armageddon. There are transitionary process and your report provides for those more sophisticated outcomes. But ultimately our view at this stage is, because we are in the position that we are and receiving funds that we're receiving, we couldn't contemplate a change to that in the short to medium term.

MS CHESTER: So no change at all?

MS WHITTLE: Well, no. I think some - - -

MS CHESTER: So maybe the better way to ask the question would be, if we were to look at it from a transition path perspective, so if we were to agree to agree that there could be some efficiency benefits from a change to the HFE system. There could be benefits longer term for Queensland and Queensland businesses. From a transition path then what do you think would be a reasonable principle to guide what a state would be able to bear in terms of any changes to the GST amount that it receives such that it's something that the state could digest?

MS WHITTLE: Yes, absolutely. I think that will take place anyway, a reasonable transition, and we'd be keen to participate in that discussion. I think we're talking about policy levers, incentivisation programs at the federal level. We're very open to that as well, especially those that consider (indistinct) inefficient state-based taxes. So as kind of we move forward with this conversation there's lots of different angles that we'd be keen to look at. But confining it to the HFE scenario, I think in the immediate term - Stephen, did you have any other comments here?

MR COPPEL: I mean, you did, Stephen, make the point about some of the distortions associated with major tax reform that are linked to HFE. How would you go about addressing those without making changes to the HFE? Are there other - do you have other ways in which you think those impacts could be minimised without making changes to HFE?

MR GOSAREVSKI: I think it would have to be Commonwealth led in some way, ensuring that, you know, states don't act unilaterally as well so that, you know, it - I think, yes, there's multiple elements. Like you said, simplicity as well. If there was, you know, the - the assessments were made on some broader indicators, then I think the policy neutrality issues could be bypassed. Yes, however I think within this complex box there's so many

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trade-offs going and interacting within each other that, yes, I can't give you a firm answer as to how it would play out.

MR COPPEL: But do you see the use of - or at least the investigation of broad indicators as an area presumably to be led by the CGC as a fruitful area for - look at further? It's been looked at many times in the past.

MR TAIT: Yes, I think it's worthwhile exploring all these new levers. We could look to actually help smooth that transition, if indeed there was one.

MR GOSAREVSKI: I think, yes, it - I think as we had in that initial discussion we had just - one of the biggest problems is that people don't understand the system and, you know, averaging the states across a range of different tax bases and - it's difficult, having the - a common person to grasp what exactly is going on underneath the system and, yes, trying to work out where these trade-offs are occurring. I think moving to a more simplified assessment process, I think we could deliver some dividends.

MS CHESTER: I just had one final quick question. Hopefully it's one that's more bread and butter for the Chamber. What's on your sort of Christmas list for the state government in terms of state based tax reform that you'd like to see?

MR TAIT: Payroll tax.

MS CHESTER: So economists and Chambers sometimes have different definitions of what payroll tax reform looks like.

MS WHITTLE: Yes.

MS CHESTER: What's your version of payroll tax reform?

MR TAIT: Apart from the abolition initially, we're keen to see how we can actually raise that threshold over a period of time.

MS CHESTER: Okay, so not broadening the base and lowering the rate? All right. Okay, we can agree to disagree on that one.

MS WHITTLE: Yes.

MR TAIT: Absolutely, Commissioner. Thank you.

MS WHITTLE: Any further questions?

MR COPPEL: No. Thank you very much.

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MR TAIT: Thank you very much.

MS CHESTER: Thank you very much.

MR COPPEL: Our next participant is the Queensland Council of Social Services - participants. So there are still some clean cups there. Help yourselves to water. Also make yourselves comfortable and again for the purpose of the transcript if you could each give your name and affiliation and a brief opening statement? Thank you.

MR HENLEY: Sure. Mark Henley, Chief Executive Officer, Queensland Council of Social Service.

MS BUTCHER: I'm Megan Butcher, Policy Lead for Queensland Council of Social Service.

MR HENLEY: Thank you very much for the opportunity to present at the public hearing. I'd also like to acknowledge the traditional custodians of the land that we're meeting on and pay respects to their elders past and present and the important needs and opportunities that we should be providing their current and future leaders, as they have so much to offer this country.

From just a quick background on QCOSS, we have a vision of a Queensland free of poverty and disadvantage. We look at that by, "How do we actually build social and economic wellbeing for every individual and every community and across this state?" And we also work closely with our counterparts, the Councils of Social Service, on a national basis, and the state and territories, to bring together our resources.

We have approximately 550 member organisations and they range from the very large global community service organisations to the very small and discrete. Could be based in particular communities across this state in rural or remote Queensland or they could be very much an issue based organisation, whether that be mental health, homelessness, domestic and family violence. They are quite broad but they all play a very important role across the community.

I think a few things to start by is that we believe equalisation is critical for the right investment to maximise social and economic wellbeing. The federal government is responsible to provide the financial capacity to deliver services regardless of where people live, and that being to the same standard for every person across the country.

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Adequate funding for essential services like health, education, transport, housing, is foundational to create social and economic wellbeing in strong and thriving communities. Full equalisation ensures the GST revenue is redistributed to states and territories to provide the financial capacity to deliver those services to the same standard.

I also believe full equalisation is the fairest way to redistribute GST revenue. The federal government is responsible to every person across the country for comparable levels of taxation and fair redistribution of GST revenue, regardless of where people live. The HFE formula accounts for differences between states and territories in both revenue and spending issues that are outside the control of government policy.

I also believe that recent HFE reviews resolve the issues of this inquiry. Recent HFE reviews include the 2012 GST review by former Premiers Brumby and Greiner, the Grants Commission's 2015 review, and the 2017 position paper. Each of these found no evidence that HFE acts as a disincentive to efficiency policy reforms.

Each of these reviews also recommended retaining the current HFE objective of full equalisation. We also believe that it has been clear that the Productivity Commission has not made the case for a need to change HFE. Current problems with the GST shortfall to Western Australia are temporary and avoidable through better planning. Disincentives to reform are theoretical only, and not having ever happened in practice.

The Productivity Commission alternative approaches to HFE lack evidence. The Productivity Commission itself has made the case against most alternative approaches, including equal per capita and special exemptions for mining. The recommended alternative is a spectrum of equalisation which does not achieve full equalisation, and the Queensland government submission highlights the fact that this alternative would result in significant windfalls to Western Australia and losses to all other states.

What we do recommend is a wider review of federalism. QCOSS supports the Productivity Commission and Queensland government's call for a wider review of federal-state financial relations and federalism in general. However, such a review does not need to consider changing what is already working well like the HFE.

Despite the dysfunctional blame shifting between federal and state governments, HFE is a success story and, as the Grants Commission states, the achievement of HFE among the states and territories is a strength of the Australian Federation. A current example of the dysfunctional nature of

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federalism is the federal government's proposed withdrawal of the National Partnership on Remote Housing.

Like the HFE, making such changes goes against the federal government's own published review. Once we have settled federal financial equalisation we can then encourage the Queensland government to introduce regional equalisation of services within Queensland.

MR COPPEL: Thank you. Let me just make a point in response to your comment that the draft report put forward a number of alternative benchmarks for HFE and distribution of GST without consideration of the evidence. The draft report deliberately put out a number of options without giving a specific recommendation so as to get feedback from inquiry participants and stakeholders on those options. It is also an area where the merits and the demerits of these approaches are being investigated in much greater depth for the final report. So it was, in a sense, a - it was a deliberate way in which we gout get participant input on those options. So I think you've given your views on alternatives to full equalisation, but I may come back to that.

I wanted to also start, as with Griffith University, with the broader Commonwealth state financial relations. It's a feature of many of the submissions from Queensland that many agree that this is an area that needs to be reformed and that HFE should be looked at in this broader picture. Now, if Commonwealth state financial relations were to be reassessed I'd be interested in your views on where HFE would fit within that broader picture or a reformed HFE within that broader picture.

MR HENLEY: I think from a QCOSS perspective the HFE or the financial - looking at just the financial side is a narrower approach than what we would be asking. I think it's important that from federal and state governments we actually look at what the vision is for this country and what our expectations are around what people should have access to.

Those conversations came up in the earlier discussions about we would be very strongly arguing that every person in this country, regardless of where they live, should have access to housing, the right type of education, the right health supports and health outcomes, that there is every opportunity for economic participation and that we build strong and functioning communities across this state.

Then you can actually decide about what is the revenue that would be required to invest to make sure that that is in place. I think that we lack an argument or a conversation in this country, and at a state level as we've recently put in as our state election platform, about what's a clear vision

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and what does success look like at a state level but also at a local community level? Then we can have conversations about what does it cost to actually make sure that the governments play the correct role and getting clarity between what will the federal government be responsible for, what will the state governments be responsible for, what will local government? But also, more importantly, what will the community itself be responsible for?

So I think it's the wrong argument or conversation to have until we actually have clarity about our understanding and I think the NDIS is a classic example. There was a decision that we should better support people with a disability. The community was overall supportive of that and a decision was made. And then the budget was put there to support that, so at least that was done in the right way about getting the right policy platform. We often have conversations and the budget is driving strategy, not strategy driving budgets. I'm not sure if that helps with your answer but I think we've got to come back to what conversation we need to start and what our expectations are for what a good life is for people.

MR COPPEL: I think it gives a sense of how you define the agenda but it's sort of like, as you say, a starting point and our terms of reference are focused on HFE and the system of HFE. But it does recognise that there are interactions and I wanted to tease out a little bit more the implications of those interactions with the HFE which is sort of our area of focus.

MR HENLEY: Can I just add, I think it makes it very difficult to have that conversation until you've had the foundational conversations.

MR COPPEL: Sure.

MR HENLEY: So often the conversations don't start where you actually need to have them and when there are reviews, public hearings, inquiries, we get the wrong foundations.

MR COPPEL: I wanted to get your views on sort of HFE, if you'd like, within the state jurisdictions. So as you know, each state government has an equivalent of the Commonwealth Grants Commission which is responsible for making an allocation of funds for local government. It aims but falls far short of equalisation as the Commonwealth government commission aims to achieve. I'm wondering if you have views on within state horizontal fiscal equalisation and whether there are any lessons that can be drawn from that for horizontal fiscal equalisation from the perspective of the Commonwealth and the state governments?

MR HENLEY: We've no doubt - so you're referring to how does it roll out in Queensland as far as - yes.

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MR COPPEL: Yes.

MR HENLEY: We've got no doubt that there can be improvements made in relation to that throughout the state. We know - and it's very, very clear that there are less services available to people in rural remote Queensland and that that needs to be improved significantly, and that's across many areas of the community.

MR COPPEL: Do you think that's realistic, that - well, you know, significantly improved, by that do you have in mind moving in the same direction as what the CGC aims to achieve? So we're talking about in terms of an ability for local government to provide the same level of services across all local governments within Queensland.

MS BUTCHER: So also, I mean, as the mechanism for achieving an objective, so HFE is a mechanism for achieving an objective which is the same capacity to deliver services no matter where people live. So that's one of the fundamental, I guess, objectives. So I guess one of our perspectives is we're not sure how effective it is in achieving that. But fundamentally we believe in that objective and we believe in full equalisation as a way of achieving that. So our position is we have a good system at the moment. What we may need to focus on though is that benchmark, is understanding that objective better. And we also think that getting it right at the kind of federal, state level provides a pathway for the states getting it right at the state, local government level.

MR HENLEY: So we've had conversations as an organisation about the fact that we believe that provides the foundation at the national level for us to then - as the final dot point was, that we can actually then start to have that conversation at a state level. We haven't talked about the detail of what that might look like but we would welcome that conversation with the state government.

MS BUTCHER: I think some of our concern is around losing sight of that objective, of that human-centric objective, and losing sight of that through this kind of economic efficiency kind of, I guess, arguments and commentary which I think risk that ultimate objective which as an organisation, QCOSS, obviously that's the foundation for what we think HFE is meant to achieve.

MR COPPEL: So the point that came up in the remarks from Griffith University earlier this morning about the actual expenditure in particular areas of government, state government responsibility and the assessed level of expenditure to be akin to providing the same level of services across

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jurisdictions, and in the - so this is the difference between assessed expenses and actual spending by the Queensland government. There are issues with how you interpret those two quantum, but if you look at the case of the Queensland government, the areas of welfare and services to communities fall well below the assessed level of expenditure to provide the same level of services as calculated by the CGC. In the case of services to communities it's about three quarters, 73 per cent, and for welfare it's 84 per cent. I'm wondering if you have any comments on what that means or the implications of that and how HFE works?

MS BUTCHER: I guess again HFE is a mechanism to give capacity to achieve those kind of outcomes. I mean, our role as an organisation is to put pressure on the Queensland government to kind of make sure that that actually happens in practice. But I don't really see that that is an objective or part of the HFE kind of story. It's something that comes as the nature of federalism but not even about states; our independent governments, and they make decisions based on what they believe is best for their government, their state, their people.

MR HENLEY: A comment in relation to that, and it is off the HFE topic to an extent but it does come down to federalism. And the comment, I'm fairly sure, made by Griffith University earlier about place management I think was their term, or we talk about place based approaches or community led. There are much more efficient ways in which government can invest. Government structures don't support communities and particularly if you are vulnerable for any reason they are very siloed approaches and programs that are developed. If you're a person who experiences disadvantage or vulnerability trying to navigate what supports and services are out there it is incredibly complex.

Can it be improved? Absolutely, it can be, and that's some of the work that we're doing and we welcome the fact that the state government is coming on board and agreeing the fact that there are better ways to do it, and that is doing it at the local level and bringing services together. So yes, things can be improved. But what we would argue strongly is if you've got a strong basis for something that's working and it's based on equity, don't change it until you change the things that really need to fundamentally change, the way in which governments go about their work.

MS CHESTER: I think it is fair to say that a lot of the debate in this area tends to sort of focus on inputs and outputs and not outcomes so it's hard to sort of follow through and work out what's good and what's not so good. An area - and that's true in the whole efficiency debate as well. I mean, why does efficiency matter? It's only kind of a means to an end. For us, where we looked at it in our report, it was if we weren't getting the trade-off

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right between equity and efficiency and HFE and that was holding back a state from developing activities or getting a better revenue base.

Thus the Henry Tax Reform identified that to some extent a lot of the states have what would be called in the business community a lazy balance sheet with respect to how much bang for buck they're getting for their community out of their revenue bases, which again is a means to an end, to fund public expenditures. But I guess I wasn't going to raise this but it was one area of our report that we really struggled with and it was actually prompted, Mark, by something that you said in your opening remarks and that is the whole area of indigeneity. So yes, we've been given this narrow terms of reference.

Some people had recommended to us in the confines of HFE that the indigeneity factor with respect to Indigenous as a percentage of population and the remoteness factor should be taken out of HFE. It's just distorting the system and because the states have full autonomy with how they expend these monies there's a disconnect between what the assessed expenses are that might be related to Indigenous disadvantage and what's actually being spend and some examples were given for the NT.

Where we kind of landed in our draft report was to say it's that much bigger picture. It's about the overall responsibility between Commonwealth and state for addressing Indigenous disadvantage. And just taking it out of HFE in the absence of that broader reform just kind of didn't make sense to us so we left that untouched. We said, "Leave it in there," but the government, as part of broader federal financial reform, should look at areas of responsibility and accountability around addressing Indigenous disadvantage. I kind of thought we didn't get a lot of people comment on that part of our report but I thought it might be one that you'd have some useful insights to share with us. And sorry, that was a very long way of saying - - -

MR HENLEY: That's all right.

MS CHESTER: - - - where we landed in our draft report on indigeneity, did you agree or disagree? We'd love to hear your thoughts.

MR HENLEY: I don't know the detail about where you landed in your report, sorry. But what I will say about indigeneity is that there are fundamental flaws in the way in which a lot of investment happens in Indigenous communities and things that happen to those communities rather than those communities given an opportunity to better meet their own needs and determine their own futures. If you look to the Queensland Productivity Commission Review that was - their final report went to the

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state government, I think, just on literally Christmas eve. There's a very good - well, there's a report that makes some very good recommendations in relation to the approaches that should be taken.

Regardless about how some of the supports may be provided by way of funding, it is actually about the way in which things happen or the how. When communities or people experience racism day in, day out and it doesn't matter how good the supports and services may be, they're always going to be disadvantaged because of what happens to them. So I think that it's more about the how rather than about what you do, or maybe it's about what you do rather than the how, too. I think that these are fundamental conversations that need to happen with Indigenous people about what will best provide better outcomes for them. It's not just about the dollars.

MS CHESTER: No. But in terms of getting to the right "how", do you think this issue of accountability about responsibilities for the policy and the outcomes on the ground for Indigenous disadvantage, that that's a factor at play?

MR HENLEY: Absolutely.

MS CHESTER: Which is where we sort of cast it in our report, was you've got to look at those bigger picture before you can address it in isolation through HFE.

MR HENLEY: I think in general terms it's either good policy that's needed that's relevant to those communities or for those people and it's also about the implementation. NDIS is a classic example of a wonderful policy that could better support people with a disability and we see some wonderful outcomes. And we see some appalling outcomes for other people because of the implementation that gets rolled out. So I'm not sure if I'm answering your question exactly but I think that there is a fundamental question about how communities are engaged and being part of the solutions because it's very clear governments don't have all the answers. And to their credit, the state government's acknowledging that but they need to engage in this and do what they do better.

MS BUTCHER: I think by specifically including it as well as a factor in HFE consideration is basically calling on state governments to make it a focus as well of their policies and practices. So just by merely including it specifically as a consideration, even though it's about capacity of governments to deliver, it's basically saying, "Well, you know, you should be doing something in this space." So there's no direct accountability but I think it's building an expectation that governments will deliver specifically for Indigenous communities.

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MR HENLEY: I mean, we can't look at that in isolation of the state government. There are federal government policies that are very perverse in relation to Indigenous communities at the moment, whether that's welfare, whether that's the Community Development Program or other issues around housing. So there has to be a joined up approach about what this looks like.

MR COPPEL: One of the areas that - one of the points that's been made in our consultations for this inquiry is the view that HFE isn't fair. And if you listen to the arguments that are often made when that point is raised is that it's not fair from the perspective of the distribution of the GST pool of revenue. It's a sense that states that made major initiatives in terms of substantial reforms only see a small part of the rewards from that effort return to the state because the HFE system acts to equalise the capacities across the jurisdictions.

So in a sense there's a sense of fairness - an element of fairness representing sort of an element of reward for major reform and that is an argument - then becomes an argument for at least preserving a certain amount of that payoff to the jurisdiction that enacted the reform. I'm interested in your views on that line of reasoning, this notion of reward for effort, some reward for effort.

MR HENLEY: So if you look to the mining boom some five or six years ago, the classic situation would be said in communities such as Mackay which were absolutely booming on the back of that. You could look to having a different - imposing different revenue-generating, government having different revenue-generating options for Mackay. If you looked to Mackay now in the last couple of years would you impose a totally different approach?

While you could actually say that some states may offer more by way of contribution to revenue, there's no doubt that communities within the state are in exactly the same position. I think fundamentally we have to come back to we're part of the one country and that every part contributes to the whole. We wouldn't want to bring that down to each person in the particular community and that's why we're looking at having some revenue base from taxation that is consistently applied to everybody based on what a community - whether that's the individual or a corporate - can actually raise by way of revenue.

Different people have different skills and experiences and bring different things to a community. So I struggle with the concept that there

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should be anything other than equity across how each of the states contribute, as I would for community by community across the state.

MR COPPEL: Well, one point I didn't mention that is also mentioned is that in making these major initiatives there are risks involved and to the extent that the risks materialise, the consequences for that state are different from a situation where the risks may not materialise. So they're exposed to the downside but not to the upside so there's an element of uncertainty and that can be a deterrent to reform. So again a richer set of reasons for why that reward for effort notion is advocated.

MS BUTCHER: But wouldn't that - I mean, from types of reform there's not just, obviously, the revenue gain. There are other gains and I mean, usually the decision to undertake broad taxation reform would be based on a number of considerations of which HFE may or may not be one of those kind of driving forces. But I would suspect it would be more about the fundamental overarching objective of the reform and the broader far-reaching impacts to the state. So I don't know that there's been any particular cases where a state has chosen not to do something based, you know, primarily on HFE or if this is just more of, I guess, a possibility or, you know, something that could happen or we think might happen.

MS CHESTER: Yes, well, it's unsurprising that, I guess, the state's been a little bit shy on the evidence base here about to what extent would - there are implications of undertaking - or daring greatly in undertaking state based tax reform in terms of the implications it might have for what they get from the GST distribution. But the cameos - and so because they were shy on coming forward with any evidence as to what extent that might be a factor in their consideration of their cabinets, and we do note completely that there are a lot of other political economy factors that are taken into account and also the impacts on, you know, economic growth and jobs from doing good tax reform which is kind of why we did the cameos because we were grappling to understand what the evidence base may be.

But the cameos do show you the kind of factual - if a state were to unilaterally dare greatly and undertake one of those reforms, that there is quite a material disincentive for them doing so. So we're not saying that that's going to be the single tipping point but it is a large factor. I guess at the end of the day to what extent would a government take that into account is one question.

But if you connect the dots then to - and I think it's coming back to the point you made earlier, Mike. You're looking through the lens of, "First let's decide what we want to be able to spend on Australians to make sure that we have an equitable society." But at the end of the day there's still

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going to be a budget envelope to pay for that. I guess we were concerned that if there were material disincentives for those reforms occurring you're already going to permanently constrain that budget envelope. Did that kind of make sense or was that just a - - -

MR HENLEY: It does. It does, but the community has a certain expectation. The community can make very good decisions about what they want to support when they're informed. People aren't well informed about what government strategies are overall, about what the vision is for this country, or for any particular community when we look at that. There is opportunity - and the NDIS is a classic example about having different expectations for people. And that was led by people with disability and community organisations who were providing services for people with disability and, of course, then the broader corporate sector got on board and supported it.

Government follows good policy and there is an opportunity for government to actually lead on some of these conversations about what a good vision is for a country and I think that that's their responsibility. That's what they're elected to do and do what the community's expectations are, not their expectations. So I think that as an organisation we think that there's a better conversation that can be had rather than a jobs conversation. That's the government's mantra, jobs and growth. It's very narrow.

I think coming back also to the previous question about, you know, responsibilities and different states experience different issues or challenges, Queensland has its fair share of disasters, whether that's cyclones, droughts, et cetera. It would be everybody's expectation that governments have a responsibility to support those communities. So there has to be this clear understand about - come back to, "Who is going to perform that role at those times?" The three levels of government step in and probably also add to a very - another level of dysfunctional support when you're people on the ground looking for supports, and some people still struggling on the back of the 2011 floods.

The intent is there but the systems don't support people well. So there are better ways to do things and it's just not a revenue conversation. I think that's why we keep coming back. Don't change something if it's not broken. Let's fix the things that need to be fixed which is federalism, roles and responsibilities, three levels of government. What role does the community play? Let's get some of these foundational conversations right first.

MS CHESTER: Just a final question then, and going back to maybe what we heard from Griffith University earlier today where we do have a trend

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towards the hybrid model of different levels of government being involved in every stream of expenditure. I won't profess to be an expert on NDIS. My colleagues back at the Commission have done a lot of better work in that area. But one of the clear areas in developing the architecture for that was having very clear lines of responsibility amongst government and having accountability.

So given in every other area we've got this trend towards the hybrid model of both Commonwealth, state being involved in major areas of expenditure so you don't have that accountability to the community about really who's spending what in these areas, is that for you one of the sort of more architectural stumbling blocks that you're thinking that needs to be addressed before - - -

MR HENLEY: There is a lack of accountability as far as - let's take it to that outcomes conversation rather than inputs and outputs. There is a lack of accountability about what the outcomes look like for people. The better that we can get into that space to really understand what good community outcomes look like - we can look to the Scandinavian countries about what good education looks like, what good housing looks like.

It doesn't - it's more about the - there's an often said conversation about, "It's all about culture rather than about structure." And if we can get the culture right about having the right values as a community, having the right expectations about what a good community looks like, it's more important to have that rather than the structures. The structures should flow after that if everyone has clear line of sight about what they're actually trying to achieve. That's not clear in the current environment across the government and across community. And I think corporate sector is confused, not that I want to speak for them.

MR COPPEL: Okay, thank you very much, Mark and Megan, and, again, thank you for your submission on the draft report.

MR HENLEY: Pleasure.

MS BUTCHER: Thank you.

MS CHESTER: Thank you.

MR COPPEL: So we're going to take a short break now and we'll reconvene at 11 o'clock with the Queensland Council of Unions. Is it Ros and Michael and John? You're all here.

MS McLENNAN: Just John and I.

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MR COPPEL: Right, okay. So we'll reconvene just before 11 o'clock so that we stay on schedule. Yes, thank you. For those that are interested, there's tea and coffee just outside the room.

ADJOURNED **[10.36 am]**

RESUMED **[10.58 am]**

MR COPPEL: Okay, we'll reconvene with the Queensland Council of Unions. Welcome. Thank you for your submission or submissions and if you could each, for the transcript, give your name and affiliation and then a brief set of opening remarks and then we'll get into Q&A. Thank you.

MS McLENNAN: Thank you. My name is Ros McLennan. I'm the General Secretary of the Queensland Council of Unions.

MR MARTIN: Good morning. My name is John Martin. I'm the Policy and Research Officer at the Queensland Council of Unions.

MR SPRECKLEY: My name is John Spreckley. I'm the Industrial Coordinator of United Voice, Queensland. We're affiliated union of the Queensland Council of Unions as well.

MR COPPEL: Thank you.

MS McLENNAN: Well, good morning and thank you for the opportunity to have a conversation about this draft report. The Queensland Council of Unions is Queensland's peak union body. We represent the majority of Queensland unions which in turn are operating across a broad range of industries and occupational groupings. The number of employees who are members of Queensland Council of Unions affiliated unions is in the order of 250,000.

The QCU did make a written submission, as did United Voice, based on the interests of employees in Queensland. Queensland workers have had substantial experience with what can go wrong when funding is cut to essential services in our decentralised state. That written submission was provided by the QCU and UV to the Productivity Commission so my address will be short.

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The QCU is opposed to any changes to the existing distribution of GST revenue that would leave Queenslanders worse off. Our submission goes to a range of factors associated with our state that makes the proper funding for public services and infrastructure essential. And finally, our submission traverses our recent experiences in Queensland when public services have been cut, purportedly because of a budget emergency.

As stated in our submission, there's a chorus of support for the existing system which raises questions in one's mind about why the inquiry is necessary and what motivated it in the first place. Recommendation 2.1 in the Productivity Commission's draft report appears to be contemplating a reduction in standards from full to reasonable equalisation. And the QCU supports the Queensland government's rejection of this notion and does so in the context of rising inequality in Australia. The element of policy neutrality has been rightly identified by the Productivity Commission's report as an essential aspect of the HFE. The QCU is a firm defender of policy neutrality, considering our recent experiences here in Queensland where Queensland has steadfastly opposed further privatisation and sale of state owned assets.

It has been suggested that perverse incentives may exist for state and territory governments to be making decisions based on the impact those decisions will have on their respective share of GST revenue. Queensland is an extremely decentralised state. 48.3 per cent of the population resides in the greater Brisbane area, which is the second smallest percentage of any jurisdiction next to Tasmania. Decentralisation brings with it an array of challenges, particularly for the delivery of public services such as health, education and transport.

On one scenario, estimates of the potential loss to Queensland from changes to the existing arrangements are in the order of $1.5 billion which, in terms of service delivery, equates to the fulltime equivalent of more than 13,300 nurses or one third of the state's state school teachers.

Similar grim predictions could be made for other services provided by the Queensland government including child safety and transport. The absence of alternative employment prospects will mean that job losses in regional areas will have a worse impact than those in metro ones. It's not just the service delivery that suffers from cuts to funding but also employment.

Our Queensland Council of Unions submission uses Townsville as an example of how susceptible regional centres are to rising unemployment arising from funding cuts and economic downturn. Personally I have a strong connection with North Queensland. I grew up in a small cane

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farming town called Ingham, halfway between Townsville and Cairns. I served for six years as a regional organiser with my union - the Independent Education Union based in Townsville - by helping workers build power in their workplaces and communities in the area from Cairns to Mount Isa, down to Sarina just south of Mackay and including Palmyra. So I'm acutely aware both through my childhood and my early years of work about the experiences of people in those communities.

Our submission also makes specific reference to the political environment in Queensland around asset sales. The opposition of Queenslanders to asset sales closely relates to the previous discussion about policy neutrality, but also provides for a political reality. As we stated in our submission, the significance of maintaining assets in state ownership in Queensland can't be overstated. We've got successive governments, both my Labor Government and the Newman LNP Government to attest to how emphatic Queenslanders are about keeping public assets in public hands.

Also in terms of the climate of this state, the reality of climate change is that natural disasters are increasing and Queensland does face significant financial losses from these more frequent events. We included in our submission the fact that the recent Cyclone Debbie cost the state's economy $2 billion and took $1.5 billion from the state's treasury in the year ahead and previous to that it was Cyclone Yasi, so you know, on recent estimates, once every six years we've got an effect of that proportion on our economy and budget as a result of natural disasters. We reiterate that it would be absolutely catastrophic if state revenue that's been placed under significant strain from those natural disasters in the last decade were further damaged by any reduction in federal funding.

Our submission also goes into some detail about the way in which the Newman government used a supposed budget emergency to justify savage cuts to frontline services and employment and this experience remains in the forefront of the mind of the Queenslanders who bore the brunt of those cuts. The Newman government also used that manufactured budget emergency to justify repressive cuts to workers' employment lines. These concerns are not imagined, as they've been lived through recently by workers who don't want to see a repeat of the slash and burn agenda, justified however thinly by budget cuts.

Our submission also touches upon the recent discussion about low wage growth in Australia and goes on to assert that the suppression of workers' rights, as experienced in Queensland, contributed to the low wages growth and in conclusion, the union movement supports the existing arrangements. Queenslanders, particularly those in regional areas, rely heavily on public services. Not only would there be a substantial drain on

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the provision of essential services, but employment outcomes in the region would again be (indistinct) quality. Moreover, the union movement harbours very real fears of budgetary constraints being used in order to justify further attacks on working people and their rights and we're happy to take any questions.

MR COPPEL: Good, thank you, Ros. I wanted to touch on some of the issues which our terms of reference ask the commission to examine. One is the equitable distribution of the GST; another is looking at the efficiency effects of HFE and the way in which the GST pool is distributed. Now it's a question that I raised earlier about equity and fairness, where some of the stakeholders in this inquiry have made the point that fairness also involves an element of providing reward for effort. That may be the context of a major tax reform, where our cameos have illustrated in some circumstances that that can lead to a larger redistribution rather than a proportional increase in the state's economic benefits from that reform effort.

This has been - particularly those that are critical of the HFE system - what lies behind statements that the system isn't fair. It also seems to lie behind statements that suggest that the system isn't working, that it doesn't have the integrity to win the acceptance by all jurisdictions. So I'm interested in getting your ideas on this notion of fairness, including an element of reward for effort or a reward for undertaking risk, and whether you see that HFE system can reflect a degree of reward for effort in the way in which is distributes the GST pool.

MS McLENNAN: I think the first point I'd make in answer to your question is the view that the current HFE has achieved its objectives without having a net negative effect on productivity and economic growth. It is shared by a range of stakeholders, in addition to the Queensland government and ourselves. It is shared by the Australian Chamber of Commerce and Industry, the Chamber of Commerce and Industry Queensland, Victorian government and the Victorian Trades Hall Council, and that's referenced in the Queensland Teacher's Union submission.

The other point I'd make is that Queensland is diverse and a decentralised state, including aspects like indigenous population, geographic difference, extreme weather and those with a disadvantage will always be hardest hit and certainly if more can be done with more, but more can't be done with less and then I guess the options that are canvassed to consult on and explore within the draft report do - those options do envisage a lessening of the monies that would be available to Queensland, either cutting it by $1.5 billion which, as we said in our submission, would be just catastrophic. So I think that most probably monies need to be allocated to the foundation.

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MR COPPEL: You may be familiar with draft report, having looked at various cameos that try and understand better the implications of how the GST may affect the distribution on individual states and they showed that, particularly for one state moving to quite substantial tax reform on its own, that there could be significant disincentives to contemplate such a reform. That's not to say that there are other considerations. We accept that there are other considerations in any reform decision, but it's the sort of thing that, to the extent that there is such a disincentive, you would then expect that then not to be something that you would observe in practice.

That's a departure from some of the earlier reviews on the HFE system, so there's a demonstration that there can be a substantial inefficiency in the HFE system linked to that system. How do you - I mean, do you - my question I guess is in two parts. One is do you accept that analysis and (b) if you do, then how would you address that in the current regime where primacy is given, total primacy is given to the equitable distribution of the GST with no weight for some of these other effects that may come to pass because of the HFE system?

MS McLENNAN: Well we support - obviously we support policy neutrality and I guess in the same vein, we're concerned when there's been instances of that being undermined. Like in the instance where, you know, former Treasurer Joe Hockey encouraged Queensland to engage in asset recycling and wanted to get more funding from the feds for the services that the government would wish to provide to Queenslanders. So those kind of tactics I think are a concern and it's a reason why HFE I think is the best system that we have on offer at the moment and there are dangers in changing the way that's implemented from full to reasonable equalisation; dangerous in terms of the disastrous and negative impact on Queensland's ability to provide high quality and accessible public services to Queenslanders wherever they may live.

MR MARTIN: Yes, I guess the question presupposes some level of inefficiency that we may not necessarily agree with and I guess by nature we're going to err on the side of equity, you know, given who we represent and the policy positions that we advocate, that we will err on the side of equity over efficiency or so-called efficiency. I guess other unions that will be making submissions today can also talk about it, but whether or not the concept of efficiency in a public sector setting is necessarily what you're after and by that I mean there's different means of measuring efficiency.

In particular, I'm thinking of class sizes, when I look to the Teacher's Union, who are nodding in agreement. One version of efficiency would be to increase the number of students in a class, thereby reducing the overall

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cost. That's well-known to have an adverse outcome for education. Similarly, you know, the patient to staff ratios in the nursing areas. So I'm not sure that we would assume or accept the assumption of inefficiency to start with.

I did note in the discussion around, you know, the perverse incentives that are said that might exist. In all of my dealings with government, I've never heard it said - I've heard "no" on numerous occasions, as you could expect, but I've never heard it because no, that may have an impact on our GST revenue. You know, like on what we get from HFE. That's not in my experience a primary consideration as to the way in which governments make decisions, so I'm not entirely sure that there is a problem to be fixed and if the current system is providing for equity, then we would congratulate or be supportive of that system.

MR COPPEL: I notice in your submission that you are supportive of the Queensland government's submission to the inquiry and in their submission they say that the Commonwealth Grants Commission aims for equalising to the same capacity, but in practice because of data deficiencies, the magnitudes of effects - a whole range of reasons - what the outcome is is a similar level of services; similar being something different from the same. Do you also agree with that conclusion in the Queensland government's submission to this inquiry?

MS McLENNAN: We have said in our written submission that we support the Queensland government's submission to this inquiry. However, we think that, you know, if full equalisation delivers that level of service to Queenslanders wherever they live, then that's certainly going to be undermined and not enhanced by any envisaged option to move to a reasonable equalisation level. We'd also agree with the Queensland government's submission that any, you know, findings and recommendations may best be referred to COAG for discussion there as well.

It's foundationally, I think - you know, fair minded that Australians are entitled to high quality and accessible public services wherever they might live; particularly a sharp point in Queensland given the decentralised nature of the state, but I think foundationally it's a point of principle.

MR COPPEL: Well one of the other points that they make in their submission is that, given the way in which the system centres around distribution of a GST pool of tax revenue, any change by definition is going to have an effect; a positive effect on some states and a negative effect on other states and in that environment, you're not going to see any movement

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away from the current system unless there's some degree of acceptance of some impacts that may affect the budgetary situation of a state or a territory.

That's a view I think that Queensland has expressed that is different from other state jurisdictions, but what it's saying is that there needs to be an element of give and take within reason. Listening to your remarks, you seem to be of the view that any change that involves a departure from the current distribution outcomes would be seen as something not to support, even if it had other - even if it represented improvements to the overall HFE system. Am I mischaracterising you? If not, how do you respond?

MR MARTIN: I think in answering your question, our submission was far more focused and narrow than that of the state government. We don't have any first-hand knowledge of the CGC - that's the state government audit, so we're probably confined to those elements that would be about HFE and its potential impact on Queensland, particularly when you see the possibility of $1.5 billion, you know, as a potential loss, whether that be over time or immediately, but that was more our concern and our concern, having regard to the recent experiences that Queensland workers have undertaken or have felt.

MS McLENNAN: The catastrophe of the scope of that potential loss of monies, you know, to Queensland, what that would mean for people throughout the state in terms of the reduction in public services that would be required if the monies coming into Queensland fell by $1.5 billion. Like, just catastrophic. You know, the Queensland Teachers' Union in their submission pointed to the fact that that equals a loss of one third of the current state school teachers.

In the nurses' union submission the Queensland Nurses and Midwives Union said that that amount of money would equate to a loss of 13,376 nurses and so it's not just the loss of services to Queensland workers and their families all throughout the state, but it's also the impact of those job losses in the regional communities and the metro areas, but particularly in regional communities where there aren't a lot of other employment options. We used in our submission Townsville as an example of how not only were there savage job cuts as a result of the contrived budget emergency and subsequent sackings undertaken by Campbell Newman's recent state government, but there was also the closure of Queensland Nickel.

At the same time that happened, the abattoir in Townville had 580 odd workers and they stood down for the longest end of season shut down ever because of a combination of climate factors and live exports. Like, when that happens, the economic impact on families certainly is there because there's not other job options that they can take up, but also the economic

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impact on the town; you know, just small businesses suffer, the place suffers and this is what we're worried about, you know. They're looking at - - -

MS CHESTER: Well, maybe if we focus on it, because we totally appreciate the lens that you bring to our inquiry is more of an immediate lens in terms of if there were to be a policy change, what impact would that have on the state budget? So one of the reasons that we've been also afforded some additional time to work on this inquiry was to think through some transition paths.

I guess in that context, the numbers that you mentioned earlier, Ros, are kind of like - they sound like big numbers and they are big numbers, but it's important to see them in the context of overall revenues for the state government, so I think the numbers that you were quoting were, from our report, if you were to do a cold turkey immediate implementation of equalising to the average, that is what the fiscal impact would be on the state government.

Now, in our draft report we said that we would never contemplate nor recommend a cold turkey implementation, so if we were to look at it from a transition path perspective - and I'm sure that the council's obviously involved in making submissions to the Queensland government and you're very familiar with their budget processes, so if you were to look at it from a transition path perspective, what sort of percentage of revenue - if there is a one-off policy change - can a Queensland government digest or manage sustainably without it resulting in the sort of job losses that you're talking about?

MS McLENNAN: Look, I think with respect a slower path to less is still not palatable. Like, you know, as I mentioned earlier, the government can do more for working Queenslanders with more money, but they can't do more for working Queenslanders with less, so even if you're not envisaging a cold turkey option of that $1.5 billion cut, any cut would be unpalatable and catastrophic, no matter if it's a slow burn or a quick burn.

MS CHESTER: Okay, well let's come to longer term in a moment, because there's two streams to the longer term, but if we just focus on the near term transition path, so say in the context of working with the Queensland government and doing a budget submission to them, if they were contemplating even - I think the cold turkey represents I think between two or three percentage points of their current revenue. We already know that their own-source revenue bounces around every year from 7 to 8 per cent.

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If they were looking at managing that over, say, a four year period - so it's not 2 to 3 per cent in one year; it's spread over that four years - what would you suggest to the Queensland government in terms of spending priorities, because I know when we hear these stories when we've been to other states and territories we hear it in terms of headline job losses for teachers and nurses and ambulance drivers and all the rest of it. Are there other areas of spending that you would see as being less priority from the council's perspective?

MS McLENNAN: Well, in terms of priority areas, the Queensland government has just won at the end of last year a majority government on the basis of campaigning for increasing the rebuild and restoration of frontline jobs and services, spending money on infrastructure projects especially in regional areas to create employment and growth, all while protecting workers' rights and keeping public assets in public hands. So how they can deliver on that mandate that the Queensland public have given them with less money as a result of any option to decrease the amount provided, I fail to see how that's possible.

MR MARTIN: If I could just jump in there, perhaps the Chamber of Commerce, their pessimistic view would have been - was this morning, was that that would lead to an increase in other taxation at a state level and our pessimistic view is that it would lead to a cut to services and employment, but equally that would be an alternative way of recouping any lost revenue that occurred from a reduction in GST revenue for Queensland, would be to increase other means of state revenue, which I would anticipate - and I would have no mandate to say that at this point in time, but I would anticipate that would be one of the possibilities that the union movement would advocate, rather than cuts to services and employment.

MS CHESTER: So that's a great segue to the medium to longer term and it's been suggested to us during the public hearings, including this morning from Griffith University and the Chamber of Commerce, that we've kind of been asked to look at HFE in isolation. That said, we did dare greatly and make some - I think they were broader findings with respect to it. There's only so much heavy lifting you can do with HFE; you need to also look at the broader context of federal financial relations.

So longer term, if you would look at it through the lens of - I think the Chamber of Commerce suggested broadening the base of GST as a funding mechanism and I know Griffith University suggested in the context of addressing thereby vertical fiscal imbalance, so actually giving the states a percentage of personal income tax. So thus we move away from a zero sum game and state has a different revenue base to play with.

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So with HFE reform work considered in the context of the broader federal financial relations - and this is what's been put to us; this is not something that we've recommended or anticipated, apart from you can't do too much to HFE alone; you need to look at broader federal financial relations and addressing VFI in the medium to longer term. If it were cast in that context, does that change the way that you would view HFE? Thus it's not sort of the current small and zero sum game equation, which means - - -

MR SPRECKLY: The issue of currently, in a very simplistic way, the federal government is accruing more revenue than it requires to fund its services it's directly responsible for and the state governments have less access to generate the revenue for the services they need, so some money has to come from the federal level to the state policy level, so from our point of view and if I give an example of some of the areas where our members work - such as in health services, paramedic services, as just one example - the demand on those services is actually increasing every year just through the nature of the client base of patient acuity and so forth and ageing population and the population density and all those things.

So if there were to be any changes to the existing funding that's derived from GST, just reason that the money will have to come from somewhere else. It's not going to be possible to trim or cut or slow the rate of keeping up with the services required for those areas of the population. Now that's just a snapshot, but I'm sure that it's similar across other types of areas where the states are required to fund the services, so it's really - - -

MR COPPEL: And if that were to happen, if states were to increase their own sources of tax revenue, is that something - you said you would support that alternative, but is that - - -

MR MARTIN: No, what I said - I didn't say that anyone would necessarily support it. What I said is the Chamber of Commerce earlier today suggested that that would be a possibility. I said that that may be something that would be an alternative for a state government to look at and I would assume, without having any authority to say so, but I would assume that our policy position would be more likely for an increase in revenue rather than a cut to services. But I might also add, broadening the GST, I would anticipate the concern there - particularly for lower income earners - is the regressive nature of the GST, so yes, that would be another means to obtain revenue, but it might not be particularly palatable to lower income earners.

MS CHESTER: That's why we were very careful to make it clear that that was suggested to us by others, not something that we had contemplated in our draft report.

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MS McLENNAN: However, we would be enthused in terms of increasing tax revenue by, you know, more activity in terms of making sure the very rich pay their fair share of tax, major corporations.

MS CHESTER: Yes.

MR MARTIN: Or not cutting taxes might also be a method by which revenue could be maintained.

MS CHESTER: Yes. Well, it's interesting because part of it is kind of like the VFI problem, which is kind of outside our scope of reference, so that kind of needs to be sorted. The other issue that Jonathan was focusing on earlier is we know that from the Henry tax review there were a lot of areas that were identified where states could actually be - by reforming their tax bases, would have actually greater revenue sources than they currently do, daring greatly with a move away from stamp duty to a broad-base land tax, which also has implications for equity.

Where we're struggling is with the current HFE system there is, we've discovered through the cameo analysis - which is new and novel analysis - that there is a very material disincentive for the large states on the eastern coast to contemplate doing that, if they were to look through to what implications that would have for their GST distribution. So there's a couple of ways of looking at the revenue side of the equation and just through the HFE narrow inquiry, we've looked at that one. I guess we hear from many that states don't take into account the implications for their GST distribution of a policy change. I think from our seven months on this inquiry to date, I think we've seen enough evidence to know that states are very mindful of any policy change that would impact their GST distributions.

So I think the cameos do really stand on their own merit as an example of what's referred to as efficiency, but then can flow through to revenue-raising capacities of a state, which is ultimately the budget envelope for delivering the frontline services that you're here to champion. Sorry, I'm just trying to help connect the dots to - people hear economists use, you know, dorky words like "efficiency" and everybody just thinks efficiency means more for less. It's actually about growing the pie of the revenue base at the state level.

MS McLENNAN: Well, presumably without bumping into the policy neutrality that has to be foundational to it as well.

MS CHESTER: Yes, exactly.

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MR MARTIN: I guess we've gone to some lengths to describe our experience with being with this new inefficiency recently and that may have been the definition that you're looking at, but that certainly wasn't the one that was adopted by the Newman government.

MS CHESTER: It's a means to many ends, I agree. Does the Queensland government currently have an efficiency dividend in its year to year budget management? Is there an efficiency dividend required of the state agencies? Do we know what it is?

MR MARTIN: I was about to suggest that perhaps a more direct line of evidence would be to ask the QDE.

MS CHESTER: We will, thank you.

MR COPPEL: We will. And just one further point on raising own sources of revenue, one of the arguments that's consistently been put to us as a consequence of anything less than full equalisation or equalising to the same level of standards is that you would then create different fiscal capacity across jurisdictions and that would enable a jurisdiction to, for example, offer lower taxes to draw in business. The competition between jurisdictions.

We saw something similar to that many years ago with death duties in Queensland; removing them as a way of attracting people to Queensland. And that's seen as a risk from moving away from full equalisation, so my question is, when you consider that one of the implications would be to raise revenue, how do you see that risk of task competition? Is it real or is it something that is there in principle, but likely to be small?

MS McLENNAN: I think it is probably a risk, that there are dangers, as we've expressed, you know, verbally and in our written submission, of changing from full to reasonable equalisation. We worry that - we believe that Australians, regardless of where they live, deserve high quality and accessible public services and we can see the risk that that won't be delivered from a worker lens, which is obviously the experience that we're being to the conversation, from a worker lens.

Workers also want to feel that they've got sufficient resources and funding to deliver high quality public services to people in the areas where they work, both in industry and geography and cognisant of, you know, particular areas like indigeneity that you raised with the previous group making submissions. So for those reasons I think it's better to veer away from an option where there might be inherent risk in whether it does or

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doesn't deliver and stick with the current way of organising HFE that is full rather than reasonable equalisation.

MR MARTIN: Of course, the potential would be for a race to the bottom. You know, that would be the concern if the states competed with one another on levels of taxation and then, you know, it would inevitably be a race to the bottom which would lead to a shortfall in funding and go back to where we started with our submission I guess.

MR COPPEL: Good. Thank you very much; we'll leave it at that. Our next participant is the Queensland Teachers Union presented by Kevin Bates. Make yourself comfortable.

MR BATES: Thank you very much.

MR COPPEL: When you are, if you could for the transcript give your name and affiliation and a brief opening statement?

MR BATES: Thank you very much. My name is Kevin Bates and I'm the President of the Queensland Teachers' Union.

MR NGUYEN: Giau Nguyen, Queensland Teachers' Union Industrial and Research Officer.

MR BATES: Thank you and good morning.

MR COPPEL: Thank you.

MR BATES: The Queensland Teachers' Union employees represent more than 45,000 teachers and principals in state schools and TAFE in Queensland. The QTU has been the industrial and professional voice of teachers and principals in this state for more than 128 years. I understand that members have received - been provided with a copy of our submissions, so I don't intend to go to the detail of that, but there are a few comments that I would like to make. We don't propose any amendments to our written submission at this time and since providing our submission, we've had the opportunity to consider the submissions of the Queensland Council of Unions and we take this opportunity to endorse those submissions and the evidence that's been provided here this morning in terms of the thrust of that information.

Over the last 30 years I've been a teacher, curriculum head of the department and union officer working in state schools throughout Queensland. I was elected in my current position as President of the Queensland Teachers' Union in 2012 and re-elected in 2015 and 2018. In

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addition to this position, I am the President of the Australian Education Union Queensland Branch, a member of the Executive Committee of both the Australian Education Union and the Queensland Council of Unions. I represent the QTU on diverse forums on education within Queensland, nationally and internationally.

In addressing the specific terms of this inquiry, the QTU's evidence is founded on our collective expertise in education and public policy issues and our coverage of most teachers and principals engaged in public education, whether in the prep year - also called the foundation year in the national context - primary schools, secondary schools or TAFE. There are currently around 48,000 registered teachers working in Queensland state schools.

In Queensland more than 1,200 state schools cater for more than 550,000 students and there are another 200,000 students in almost 50 TAFE campuses. The Queensland state education system provides a high quality public service across the length and breadth of our state. Indeed there are schools throughout Queensland that operate in locations when there are no other services or facilities.

Provision of education services in Queensland consumes more than 24 per cent of the state budget. Our education system is growing rapidly and certain circumstances such as the progress of the introduction of the prep year around a decade ago will see abnormally large growth in student enrolments, necessitating a considerable boost in education spending across the remainder of the current decade and beyond. This expanded education spending will entail increases in both recurrent and capital investment. The Queensland education system will need to expand by between 3,000 and 5,000 additional teachers by 2030 to cater for the expected growth in student enrolments.

I note from media reports today that Treasury modelling in Queensland on a worst case scenario would see Queensland required to shed as many as 5,000 teachers. Based on experiences during the denial of two Queensland schools of 519 growth-based teaching positions under the Newman Liberal-National government in 2012 to 2015, the combined impacts of enrolment growth and forced workforce reduction would be catastrophic.

Another consideration arises because, coupled with this projection of a larger call on the state budget due to enrolment growth, Queensland has traditionally under-spent on education when compared with other Australian states. Queensland students experience significant disadvantage, cumulatively determined by factors such as remoteness, school size, socioeconomic status, Aboriginal and Torres Strait Islander

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heritage, diverse cultural and language backgrounds and a high instance of disability. The "No Mind Left Behind" report by the McKell Institute from October 2016 provides a comprehensive analysis of the disadvantage of young people and places Queensland third in the nation, behind the Northern Territory and Tasmania for the proportion of young people who live in educationally disadvantaged electorates.

Despite the inferior nature of the Turnbull government's new school funding model when compared with the real Gonski needs-based funding model, Queensland will still be compelled by legislation to significantly increase state expenditure on education over the next decade. In short, any changes to the distribution of GST revenue that would reduce Queensland's share will have a disproportionately large impact on essential public services provided by the state government. Such changes are therefore opposed by the QTU.

Alternately, responsibility for funding public services should continue to be allocated based on due recognition of revenue raising capacity. To be clear, neither does the QTU support any moves by the federal government to adopt greater control over or indeed take control of essential public services such as health and education. In closing, we thank the commission for the opportunity to make this submission and I look forward to answering any questions you may have.

MR COPPEL: Thank you. To start, one of the questions that we've put to previous participants in today's hearing is this notion of reward for effort. There's an element of fairness in part of the equity of the HFE system. I was wondering if you could share any thoughts that you have on this notion. It particularly relates to sort of quite significant reforms where there could be a tangible reward or risks involved. I'd be interested in whether you think that notion has a role to play within the HFE system or a bigger role to play.

MR BATES: Our concern about the notion of reward for effort is that it's usually couched in terms of a return that does not necessarily generate positive economic outcomes for all individuals within the community. Our concern goes to the fact that we have a significant need to lift the tail, as it were, in an education sense, ensure that all people have access to high quality services. One of the things that falls short in terms of reward for effort is often an understanding or an expectation around the notion of equality, that that equality somehow means treating everyone equal. Our view is that there are times when there should in fact be differentiated outcomes in order to ensure that those who have the greatest disadvantage can reach the expected level of opportunity.

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There is then the issue about the difference between opportunity and reward. For us, there's a significant issue about policy settings that are determined by the notion of rewarding particular alternate policy settings, you know, the federal government might deem to be appropriate and in particularly in the context of what has been in recent years fairly significant swings based on partisan issues between the intent and effect of those policy settings. So from our - I guess our considered opinion would be that reward for effort has in its most neutral sense potential, but unfortunately it's coloured by the partisan impact of policy settings that can create, in our experience, quite significant negative consequences, particularly for the most disadvantaged members of our community.

MR COPPEL: So the way we're thinking about this is in terms of sort of a reward for effort, not among individuals but specific jurisdictions and then it's up to that jurisdiction to determine how they then allocate those beneficial responses from either reforms or other policy measures. So it's not - we're not talking about the individual, but it does sort of bring me to another analogy that is often put in terms of consultations that we've had for this inquiry that relates to the way in which state grants commissions provide a level of capacity among local governments to provide local government services and there the pool is much smaller so there's nothing like the full equalisation that you have with the GST pool, but it does draw out some of the analogies of what would be potential consequences from something which is less than full equalisation and it is a quite substantial departure and the way in which the system works is not too different from having a relativity flaw.

I put to you as a question: is that a fair analogy to make when looking at the broader HFE system and if it is, sort of what implications do you draw from that for the broader HFE system?

MR BATES: One of the fundamental issues is obviously that the rapid expansion of need in public services has outstripped the capacity for governments to pay. It seems reasonably clear that there is a significant unmet need. So the context here - and I guess this is where we would depart slightly from our colleagues in the Council of Unions - we have for a long time held the view that states can do more to raise additional revenue to support the delivery of public services.

That's not without political cost; we absolutely understand that decisions are made based on the reality of how those policy decisions will impact on the ability of the government to continue to be the government. So we have to accept that reality but that doesn't, in our view, prevent us from saying that there are opportunity costs that come with decisions about policy in relation to revenue raising.

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So in the same context, whether or not the analogy of the State Grants Commission, you know, in a smaller scale distributing on the basis of the capacity of the state as an analogy of the broader system is problematic insomuch as it seems to us that there are inherent difficulties in the nature of the federation and I think that goes well beyond the conversation that we're having here, but I do note in the draft report that it is a consideration in terms of the role of HFE in attempting to address, you know, the VFI and some of the other consequences of the nature of the federation.

Indeed, it couches it in the terms of, you know, the role of a comprehensive national government would be to ensure that there is a capacity to deliver services, quality public services, wherever they might be in a country and that, you know, the role of those lower levels of government would be seen quite differently obviously in that context. So I don't think we can divorce - sadly, we cannot divorce ourselves from the reality of history and where we find ourselves in the terms of the federation, so I know there's been a conversation and I've been a part of it myself over the past decade in terms of rethinking the federation.

You might have noted from my brief comments that we don't support the moves that were put on the table at the time in terms of redistributing the responsibilities of the states and the federal government in terms of the current constitutional divide, but by the same token, you know, we do acknowledge that there are limitations to the capacity of our economic system to deliver on the basis of some of those realities that have been generated by the nature of the federation. So from our perspective it's about doing what we can through policy settings to mitigate against the most negative consequences and we would like in an ideal world obviously to eliminate those negative consequences to ensure that there is enough money in every community to deliver the public services that people deserve.

The choices that governments make are about prioritising and they prioritise their budgets and they prioritise their revenue raising based on a range of competing factors and so in that context I guess my concern would be that - not necessarily about the scale or about other reasons for the analogy not being effective, but rather there is a broader and overriding issue that relates to the very nature of the federation that impacts on those issues.

MR COPPEL: One of the specific proposals that's actually being put on the table, to give some notion of reward for effort - I'm putting words into the CGC's mouth here - is the idea of providing a discount on increases in revenues. Now I'm interested in getting your view on - so that would represent less than full equalisation. There are many other things that the

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CGC does that actually makes that aspiration - the outcome different from the aspiration, but on that specific idea that's being put on the table by the CGC of a discount of marginal revenues, do you have any views on that and what it would achieve?

MR BATES: I would just I guess urge some caution. I mean, we may be getting a little bit out of my scope of expertise. I have a view, but it's not one that I would urge you to rely on as categorical in terms of, you know, where I come from in my expertise. My view goes to the issue of the fact that there is I think a level of concern regarding the political realities that each jurisdiction has to contend with and so by that I mean that we cannot assume, as is often the case in a perfect market sense, that people are fully informed when they make decisions, that they do so with the appropriate motivation and best interests.

There is a whole range of competing factors that impact on decision-making and my concern is that there is often a disconnect between the theoretical underpinnings of the sort of circumstances that you describe and the reality that's faced by those that are making decisions in a public policy context. So it's particularly important to understand I guess that, you know, coming out of three years of an LNP government between 2012 and 2015 there are a certain set of policy principles in Queensland that are so intolerable to the community that they are political poison and so as a context, that has to be taken into consideration in terms of any decisions that the Queensland government makes.

Is that of concern to the Commonwealth Grants Commission or to the federal government? Probably not. But it's a reality that can't be denied in our particular context and I am sure that in terms of Western Australia currently dealing with the aftermath of the Barnett years and so on, that each of the states and territories would perceive there to be those unique state-based characteristics that drive their particular motivations in a public policy sense.

So my concern I guess goes to the fact that there has to be some overarching set of principles that we're trying to establish and where we're at at the moment in terms of HFE being about equalisation is crucial in terms of attempting to get to the point. I note your comments before about similar but not the same levels of services; again, a recognition I think of reality as opposed to purist policy settings. That's still a worthy goal in terms of understanding that those services will by their nature be different in certain communities because of the nature of disadvantage, isolation and other considerations that impact on their delivery.

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So there is a real issue in attempting to divorce the conversation from the broader reality that's faced in individual jurisdictions, but fundamentally has to come back to what are the agreed principles that the federation as a whole accepts and is willing to go forward with and it's only through some confidence in those areas - and I go back to your reward for effort comments. You know, there does seem to me to be a strong potential for a race to the bottom, where we set up a circumstance of competition between states and territories to try and enhance their revenue base from the federal government through some sort of perceived reward for doing things differently or better that doesn't necessarily result in better outcomes for the populace. So there has to be a balance of those things.

MR COPPEL: When you talk about agreed principles for the HFE, community acceptance of those principles, if you look back over the history of HFE in the last couple of decades, that's very much been a role - well, that's very much been guided by how the CGC has established its frameworks for the way in which is reports to the government. It has set the standard of the same level of - equalising fiscal capacity to provide the same level of services. It's not something that's been necessarily agreed with within a broader process. Do you think there is a case then to initiate a forum in which the principles and the goal of HFE is discussed and agreed, which may be different from the current objective that the CGC uses for the purposes of its reports?

MR BATES: My response is couched in the terms of my experience in the education sector and what's been happening nationally over quite a number of years, but it's flavoured by a bit of disappointment with the conversations that have occurred resulting in what appear on the surface to be laudable goals and appropriate motivations but fail in terms of their implementation, which is so often the case in a public sense.

So I am concerned that even with the concept of a forum, that - and COAG and others exist already that might provide an appropriate opportunity for, you know, beating out a policy position that could be carried forward, but the reality here is that the federation in this particular sense operates on goodwill and there is a very large concern about the fact that, despite agreements, there's always an opportunity for the states to vary or misinterpret or reinterpret what those particular agreements might mean in terms of implementation.

So I guess at a level I've just argued against my point, but that's the reality that we have to be conscious of. We should set goals and until there is that motivation, perhaps a pure motivation around ensuring that all Australians enjoy a quality standard of public services and enjoy the benefits of what our citizens in metropolitan communities, for example,

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enjoy, then if we can agree on something like that and we start working towards that as the goal, then there is a greater capacity to deliver for all Australians as a consequence.

MS CHESTER: A couple of quick questions, if I may. Before I forget, the efficiency dividend, you're our man who knows the answer to this one?

MR BATES: Yes, indeed. Well, specifically in the context of education I'm acutely aware of it. In my job I'm responsible for analysing the budget and Mr Nguyen on my right here helps to write the budget submission. Last year was around about $24 million was the efficiency dividend for the Education Department in Queensland. When you consider it's a part of the $11.8 billion budget, it was a very small efficiency dividend.

It was much larger under the previous LNP government and I think - I hesitate to use the word "token", but there's an element of ensuring that there was at least some consideration contained within the budget papers and with a budget of that size, of around about $11.8 billion in state education, that that sort of efficiency dividend is reasonably easy to achieve, but it's there nonetheless, rather than having been taken out completely, so there may well be - there are other efficiency dividends for other departments. I'm not aware of the exact numbers of - - -

MS CHESTER: That's okay. We can ask colleagues from the Queensland Treasury this afternoon, but I was just trying to work out whether there was like a global efficiency dividend across all portfolios, but it sounds from what you're saying, Kevin, that's not the case.

MR BATES: My understanding is it's set on a department by department basis.

MS CHESTER: Okay. I guess just while we're on that point of different portfolios or different areas of expenses, so as you know at the moment the way the GST monies are distributed to the states it's this mechanism of building up assessed expenses and looking at assessed revenues to come up with fiscal capacity, but largely it's about making sure that all states can meet the same level of their assessed expenses. The money is given to states on a fully autonomous basis, but when you look through to how the monies are spent you can get a little bit of an idea as to what the state's spending priorities are, give or take if a state's a little bit more efficient than the CGC's expecting them to be, but an under-spend may not be the end of the world.

How do you sort of view that through the lens of what might be the impact of any change to HFE, even given the order of magnitude that we're

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looking at, if in the areas that you're interested - in education, so in both of those areas, for schools and post-schools, what the state government spends is less than the assessed expenses?

MR BATES: That's an ongoing concern for us and a matter that we continue to pursue with the state government. The reality however is that, as you say, it's about priority setting within the state budget. We would expect that issues such as the one I raised about the new school funding model that the Turnbull government introduced, that have now legislated set expectations around expenditure, will change that. We don't think that was the best way to go about it, but nonetheless it will change state spending priorities.

The fundamental impact of that however is that there will be reductions in expenditure and other things in order to compensate because there is a fixed pool that's available, without increasing state debt. So there is a very real issue here about if we go down that path and legislate in a whole range of areas - that is, the federal government attempting to dictate to states in a range of areas like health, like education; big budget items, that they must spend a certain amount - we begin to get to the point of what's the point of having a state government in the first place?

So my concern I guess goes to the notion of the autonomous spending is absolutely relevant. It is and should be up to state governments to determine and there are those of us who will continue to fight the good fight to ensure that our particular area of public policy gets the funding that it deserves. I don't support therefore that notion of legislation at the federal level determining how much money should be allocated to a particular area.

But having said that, we're again in this issue I guess of trying to deal with HFE and I acknowledge that you talked about the notion that there needs to be a bigger conversation; it can't just be about HFE in isolation, but rather needs to perhaps be looking at financial circumstances of a much broader base and the way in which, you know, the intergovernmental financial relations can actually be better targeted towards building the resource base of the states to deliver the services that they are responsible for, because at the end of the day, by the nature of the federation, the federal government has or at least should have accepted that the states have responsibility for delivering education and health and given that they don't have the capacity to raise revenue to the extent that is required to deliver those services, there has to be a contribution from the federal government.

Those things appear to me to be the givens. It's then the details of that that are much less certain and do tend to fluctuate on a fairly significant

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basis in terms of a whole range of global impacts, national impacts and state impacts.

MS CHESTER: Okay, so from your perspective then if the HFE is cast in the context of broader federal financial reforms, looking at both VFI, so taxing abilities of the states, but also more importantly I think you've touched on and emphasised whereas others haven't this morning getting the funding responsibilities right, so there is that sort of cut-through to accountability.

MR BATES: Yes. I think importantly, however, our goal obviously, just to be really clear, is ultimately we need to see more money and better services, so I mean however that might be achieved, our view is that's the goal. So if the goal is reduce revenue raising and reduce services, then that to us is unacceptable. So in the context of more revenue, more services, then that's a good outcome and there could be a conversation in that broader sense around how monies are distributed, but it needs to be premised with that.

MS CHESTER: Okay. Part of the challenge that we have at the moment is our starting point. Indeed, if you were to rewind the clock any time over the last 15 years, some of the large states have actually been in favour of moving away from the current equalisation benchmark and standard of full equalisation to the highest state.

Historically Queensland's kind of been a net recipient sometimes and a net donor at other times, so if we were to fast forward the clock ten years and you know, touch wood we have a period of time with less natural disasters, which is what tends to tip you between being a net recipient versus a net donor, it could actually be in Queensland's longer term net benefit to move towards this change, if you're just purely looking at it through the lens of how much of the GST bucket you get. If that were the case, does that change - because I mean we totally understand the focus from the unions has been on immediate transition: what's the impact on the budget?

MR BATES: I mean there is a fundamental principle that operates under a much more "what would we do" and that is, you know, to each according to their needs and from each according to their abilities. So I think, you know, there is a story to be told in what you've described in terms of that transition at times between donor and recipient. But fundamentally it's about capacity, so rather than there being an imposed figure at an imposed level, that rather as circumstances have changed there's been a capacity for the system to respond and to create a circumstance where that doesn't have the sort of impact that we would be concerned about, you know, in the Queensland context of that imposed difference in terms of the level of

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contribution. So if you understand the subtle difference in what I'm saying - - -

MRS CHESTER: Yes. No, I do.

MR BATES: So there is a difference between having a policy setting that allows for that sort of differentiation based on specific circumstances, as opposed to the creation of a policy regime that proposes an outcome that might have a lack of flexibility on that count.

MR COPPEL: Thank you very much.

MR BATES: A pleasure.

MR COPPEL: Our next participant is Sean Butler, representing Senator Peter Georgiou. So welcome, make yourself comfortable. When you are, if you could give for the transcript your name and affiliation and then a brief opening statement? We note that we have received a submission from you, so you may want to talk to some of those points; you may want to take them as given.

MR BUTLER: Good morning. My name's Sean Butler. I'm from Western Australia and I'm representing Senator Peter Georgiou. We've made a submission to this inquiry before; he's sent me across to, I suppose, explain our state's position or his position. The lack of structural reform of the GST is the single most important issue facing Western Australia at present. This is not about putting one state against the other or an "us or them" argument. It's about fairness, economic efficiency, what's best for the nation as a whole and encouraging the other states to develop their own resources.

Western Australia only receives 34 cents for every dollar of GST it collects. Other states get between 89 cents and $1.81. The lowest any other state's share has ever dropped to is 84 cents for Victoria in 1994. The Productivity Commission Draft Report released in October last year concluded that the current system is under significant strain as Western Australia's share of the GST has fallen to an extreme low; extreme to the extent that Western Australians get just $878 per capita, compared with an average of $2,553. South Australians get $3,671, Tasmanians get $4,601 - five times as much - and the people of the Northern Territory get $11,000.

Under proposals from this commission, the current system whereby GST money is redistributed to elevate every state to the level of the strongest state should be dumped as to either an average level or the strongest state level would be the benchmark. Under the average formula

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proposed, Western Australia stands to gain an extra $3.2 billion a year. Under the second strongest state level, WA would gain an extra potentially $3.6 billion a year, so there's a lot at stake here.

Other states have argued this is unfair, but the proposals would still leave Western Australia subsidising the other states. It needs to be understood that if several other states had a small percentage cut in their subsidies from Western Australia it would translate into a significant gain for Western Australia compared to the very low share that Western Australia gets now. This is an argument about the fairness and good economic policy. Again, it's not about us versus them. WA is not looking for subsidies, just fairness.

It's ironic that Western Australia, which has had progressive economic policies and contributes to 35 per cent of Australia's exports - more than any other state - is now being punished for its success. Our share of the GST collective has fallen from 95 cents in the dollar in 2007 to just 34 cents in 2017. Our state government, whether Liberal or Labor, are now under financial strain to the extent that they have lost its AAA credit rating and have had to cut back on core services and go into debt. Meanwhile New South Wales, which received almost three times our per capita distribution, is in surplus so much that they can afford to bulldoze their 18 year old Sydney Olympic Stadium and rebuild it. What an extravagance.

The current HFE system, which operates in an extreme fashion, is not adopted to this extent anywhere else in the world. It embodies the socialist ideal of redistribution of wealth to the extent of trying to make everyone equal. Nothing kills human enterprise faster than that. I've just got some figures on the share of Australia's export incomes. It's from the Australian Department of Foreign Affairs and Trade. Western Australia provides 35.2 per cent of Australia's export income and yet our share of the GST is between a quarter and a fifth less than other states. Tasmania, which provides 1.2 per cent of Australia's export income, receives five times the distribution.

We just want to make the point that Western Australia is more than pulling its weight but is being unfairly, we believe, acted against. Give Western Australia a fair share of what we earn; the result will be greater investment and greater development of the nation as a whole. We would all be better off.

What others say: last year's CommSec states that the states report showed WA to be the lowest of all states. This is an unbelievable situation, considering the state is by far the leader in export earnings. New South Wales was top spot; Tasmania fourth. Western Australia rated below the

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national average on all eight indicators and trailed the nation in terms of economic growth and construction work. Meanwhile there is a construction boom in the eastern states, powered largely by the flow of funds and the huge grants from Western Australia. This is simply not sustainable, economically or politically.

The Chamber of Minerals and Energy claim that the big iron ore miners pay $19 per tonne in taxes and royalties. $19 per tonne. $12.65 goes for federal company taxes. $5 of that is effectively redistributed away from Western Australia under the current GST formula. Just $1.23 of that $19 stays in Western Australia. Under current arrangement, a state that encourages mining and development - let's say Western Australia - will find the benefits of any additional royalty revenue short-lived. After a few short years, the gain in royalty income is effectively distributed away to other states, so WA is effectively no better off after funding the cost of investment and infrastructure for these projects, as well as having the associated labour shortages and cost pressures as a result of these investments.

It's been reported over the years that the resource development from Western Australia has had to build an extra infrastructure equivalent to that of the entire state of Tasmania. The state government has had to fund extra roads, freeways, ports, hospitals and schools as a result of the economic growth due to the development of our resources. Both Labor and Liberal state governments are in positions where it's impossible to balance the state budget with billions of dollars being diverted out of the state. The state government of Western Australia is now in a position where it has to cut back on core services, even though the state as a whole provides the largest portion of Australia's export income.

No matter how you look at it, the system is unfair and it is not in the nation's best interests to keep it going as it is. Under the current system, states do not need to strengthen their own natural resource industries because they know they can sit back and wait for the GST distribution to bring them up to the leading state's capacity every year. If New South Wales and Victoria developed their onshore gas resources they could create billion dollar industries and inject a million dollars into their own government state revenues. Imagine if states like Queensland were allowed to build dams and irrigate inland areas or further develop their natural resources such as those in the Galilee Basin. How much extra revenue would be generated?

Under the current unfair system we have effectively removed the incentive for states to develop their resource industries and the nation as a whole suffers. There needs to be bipartisan support for change. BHP has said that the current system - to allow WA to keep a greater share - has said

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that changing the current system to allow WA to keep a greater share will generate - would benefit jobs and further investment in resource industries in regional communities. The head of BHP, Mike Henry, has been quoted as saying reform would not only be good for WA, it would be in the nation's interest.

Research by the Federal Parliamentary Library shows the annual carve up of GST has not only hit WA's state budget but has also hit our jobs market. Since 2001 Western Australia has lost a staggering $41.5 billion to other states and territories when compared to if the GST was distributed on a per capita basis. According to the library, about 35 per cent of that or $15.5 billion would have been spent on job-creating infrastructure. This could have generated 32,000 full-time jobs. What a wasted opportunity.

While Western Australia has been building one of the world's showpiece mining industries the benefits of it have been redistributed to those states who have not done as much hard work. Victoria has been rapidly shutting down its mining industry and has been the biggest beneficiary, reaping an extra $18 billion. The Western Australian Chamber of Commerce has argued that Australia's GST should be one that encourages every state to develop their own economy and pursue tax reforms that stimulate growth and increase the size of GST, benefitting every Australian. Every state should be encouraged to stand on its own two feet and if changes are not made, the national economy could suffer as a result.

The Institute of Public Affairs in a research paper released in November 2017 stated that there is no justifiable rationale for jurisdictional equalisation: "Equalisation negatively distorts incentives in several ways. It reduces the incentive for mobile factors of production such as labour and capital to move to higher productivity locations and thereby imposing efficiency costs on the national economy. It incentivises state governments to avoid important economic policy reforms and can - and encourage net recipient states to develop a dependency on the Commonwealth government. If the WA government has its finances strangled any further, the state won't be able to provide the infrastructure and services for the next boom; the whole country will suffer as a result. Is that what we want?"

In relation to one of the other submissions to this inquiry, Saul Eslake made a submission. He's a very well respected economist, but his views differ from the findings of many other economists. He states in relation to proposals to equalising cuts to the second strongest state or average: "It is difficult to think of any valid reason why some states should be thus advantaged, especially considering that its superior fiscal capacity is largely the result of luck. That is, having been endowed with uniquely rich

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resources, the value of which have been greatly enhanced by increased demand for those resources from the world's most populous nation, being China, rather than that of consequences of policy decisions made by the state as a whole."

This statement is an insult to all Western Australians. Western Australia's superior fiscal capacity is not the result of luck; it's the result of forward thinking by successive state governments, premiers - including Charles Court, Geoff Gallop, Colin Barnett - and entrepreneurial businesspeople like Lang Hancock, Andrew Forrest and Gina Rinehart, to name a few. Other states have huge untapped natural resources, which for political reasons are not being developed. If other states want to lock up their resources and have less productive policies that's their choice, but they should not then come begging for help from Australia's most progressive state.

Other economists: independent international academic studies from some of the world's top universities, indicate that revenue transfer systems like the current GST system are not in the nation's best interest. I quote a paper from the London School of Economics and Political Science and Stanford University, "The fiscal interest approach: the design of tax and transfer systems" and here are some extracts: "Effect on promoting growth and development: transfers to sub national governments such as state governments are typically set by a formula that comprises a series of weights for different criteria including economic and demographic characters such as income and population", much like the Australian current HFE system.

"However the attempt to correct horizontal imbalances by allocating more transfers to poorer regions often means that these transfer systems exhibit poor responses to locations that foster local economic growth and sometimes can even produce completely adverse incentives." In other words, they achieve what they're not meant to achieve; go in reverse.

MR COPPEL: Can I just interrupt, because I know we've got a limited amount of time and we would like to ask some questions, if you could wrap up the - - -

MR BUTLER: Yes, yes. Okay. I'll sum up then. So basically the other economists were saying the same sort of thing. I was going to go on and say what our politicians are doing, so politically - it is a hard one politically because obviously if we get more, they get less, but our argument is about growing the pie, making more money for everybody. I'll just sum up the last paragraph I've got, the last little bit.

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The Western Australian economy is suffering as a result of the current system. Billions of dollars have been siphoned out of the state and the state government now has to cut back on core services, including hospitals and schools. Western Australians are justifiably outraged by the current system. There are articles in the media almost daily about it and the general mood is that we are being ripped off and that neither of the two major parties cares. If changes are not made, this will lead to further economic stress and greater voter dissatisfaction. New parties are being formed to take up the issue and voters will go to alternatives who offer genuine change.

As a nation, we should abandon the system that rewards less productive states and their governments for placing low priority on economic development and development of their national resources. The current distribution system is broken and it's in our nation's best interest to fix it, not just for the good of Western Australia but for the long-term good of all Australia.

MR COPPEL: Okay, thank you. Let me begin, because you mentioned several times that HFE is about fairness.

MR BUTLER: Yes.

MR COPPEL: You've mentioned that in your submission as well and that this lack of fairness is sort of compromising, undermining, public confidence in HFE. But can you elaborate a little bit more on what you have in mind in terms of fairness, what is fairness and - - -

MR BUTLER: Yes. I've listened to some of the other submissions and it's not about us and them. We're not trying to - I don't think anyone's saying that we want to penalise other states. But I think you asked a question of one of the others about reward for effort. We want to create - I think to make the country a better place, if we make the pie bigger it's better for everybody. So at the moment we've got a certain pie. Western Australia is generating a fair bit of it and it's being siphoned off. If we can make the pie bigger, there's more money for everybody because at the end of the day, schools, hospital services, it all gets down to money. So if other state governments are encouraged to develop their resources, to develop their industries, the pie is bigger.

So I think that in the long-term is much fairer than having the eastern states relying upon a resource boom from Western Australia. What happens if the resource boom ends? You'll be dependent on us generating this huge amount of money. What happens if one day it dries up? Shouldn't we be developing other industries and other resources in other states? Wouldn't that be in the long-term better for all of Australia? So in the answer to

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fairness, I think - looking long-term, I think if you want fairness you've got to look at alternatives.

MR COPPEL: I mean, South Australia is a state that's got - what is it, natural - all the states have some to different degrees, natural resources. Queensland is also very well endowed with natural resources. It's been put to us that there's nothing in the HFE system that is itself stopping indeed very active promotion of natural resources in jurisdictions other than WA, except WA is very fortunate; they've got a lot of them.

MR BUTLER: Well that might have been put to you, but the fact is if the other states had severe budgetary constraints like Western Australia has got, the state governments there might be more incentivised for things to happen. I mean, there's only a certain pot of money and if you're short of money you've got to cut back services, so Western Australia has had some progressive governments, both Labor and Liberal, in the past and we are reaping the benefit of that, but the fact that our economy is so - you've got to ask why is the Western Australian economy so successful?

It's not just its - you know, the government has got a deficit problem, but that's because the money is being siphoned off. But if other governments were under budgetary constraints too, if they had less money, they might be more inclined to - I think you've got to incentivise the governments to both develop their resources and to be fiscally responsible.

MR COPPEL: So can I ask you then what you would then have in mind as - what do you see as the objective of HFE? Do you see a role for HFE?

MR BUTLER: Yes, I see a role. Look, I think - I don't think anyone wants to see an Australia that's divided with the rich and poor and you know, disadvantaged, so I don't think anyone wants that. But I think that the extent of the redistribution, it is higher than - according to what I've read - than in any other country in the world, the way it's being redistributed. You've proposed several models, either on the second most or the average. I think that would potentially be fair. The bottom line is it needs to be changed.

The problem is politically it's a hard stop because you're going to be screamed at, you know, if you do change it, but I think the bigger argument is what's best for Australia. We don't - I mean, talk about schools being cut back. You know, we're cutting back schools in Western Australia. This is on the paper coming over on the plane. Schools being shut down. You know, we're going to be another $348 million worse off this year. There has to be some sort of change, whether it's - I mean, I would think one of

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the two options you put up, the average or the second best, but they're fairly significant changes.

MR COPPEL: And that's been again put to us this morning that the impact of those options, including equalisation to the average, Queensland can be in the order of one and a half billion. Do you have - if it were cold turkey - and one of the areas that we're looking at for the final report is questions of implementation and transition - do you have any views on how changes to the HFE system could be implemented in a way that minimises those impacts or provides a buy-in to change?

MR BUTLER: I'm not an economist; I'm just going on what I've read and what a lot of people have told me. Obviously if it was cold turkey that could create some problems, so maybe it's something that's phased in. But you know, the bottom line is, as terrible as it would be if other states lost some money, Western Australia's economy is suffering. Maybe there's a phase-in period that - I don't know, but you know, ultimately I think it's in the nation's interest over the next few years to change the system; maybe not overnight, but maybe it's phased in somehow.

MR COPPEL: One of the points you've made that's particularly affecting WA at the moment is the low relativity and part of that is linked to the fact that the way the calculations are made, there's a lag involved. There has to be some form of lag involved. And so during the boom years you argued WA was receiving more than what it would have been than if you calculated it on a year by year basis and it's just re-equilibrating. That's something that every jurisdiction that knows how the system works can take that into account in its budget planning. But you're using that as an argument against the system itself.

MR BUTLER: Partly.

MR COPPEL: Do you think - I mean, why was it not possible to be able to at least anticipate that those lags would unwind themselves and that would be a negative consequence for GST?

MR BUTLER: We're talking of lags down from, what, 80 something cents to 30 something cents to the dollar over a few years, so we're talking about significant drops. They're very significant drops. And we're talking about significant mining downturn. I mean, Western Australia was a very big peak and it was a significant downturn. We're in the ironic position now where as a result of what's happened people are actually leaving Western Australia. The economy over there is almost in recession, whereas it's booming over here. I come from Perth and it's Sleepy Hollow at the

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moment. Over here there's cranes everywhere and I think all this money is coming from Western Australia.

Obviously there's a lag, but I think there's a whole lot of issues that have to be addressed, but the size of the drop, I don't think anyone could have anticipated it and I mean, what can a state government do? A state government can't just - we can't just shut down schools and hospitals. We're in the situation we've had to go into debt to keep things going.

MR COPPEL: Well, the lack represents about $7 billion, the sort of $7 billion more that was paid. That was one aspect of it. The other is that it was predicted. Western Australian Treasury actually did a pretty good job of predicting what its relativity would be. That still leaves the per capita level of revenue for WA much higher than it is - - -

MR BUTLER: Even if it was predicted, what is a state government to do in a state that's growing its economy? There are people coming into the state during the mining boom. People have knocked various state governments and said why did Colin Barnett build a new hospital? You know, but what's the government to do? Imagine if he hadn't built the new hospital. So he could have cut back years ago and we wouldn't have our new hospital, we wouldn't have our freeway extended.

In fact, if he had done that, there's a counterproductive argument that if we'd cut back years ago we now wouldn't have the infrastructure and you now wouldn't have the resources flowing into the states, so it's a little bit of a catch-22. If you want a state to grow, it needs the money to develop the infrastructure. When people are coming into the state - we had at one stage 1,000 people coming into the state a week.

MS CHESTER: So Sean, you've obviously been a close reader of our draft report.

MR BUTLER: Yes, yes.

MS CHESTER: There's a very frank exposition of state budget management by the Western Australian government and the role that that plays in the WA government's current budget position. Is there anything in that fact base that you disagree with?

MR BUTLER: Look, there's arguments that the Western Australian budget hasn't been properly managed, but I'm looking at the bigger picture. I'm looking at the bigger picture of a sudden drop off - - -

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MS CHESTER: Sorry, can we just go back to the question, because a lot of what you're talking about is the current WA government's fiscal situation, which is contributed to by two factors: one, the current relativity, but the overriding factor is actually the starting point for the budget, which is a function of previous budget management, so we'd kind of like to focus on evidence, so is there any additional evidence or anything that you think that we've gotten wrong in that exposition of the WA - - -

MR BUTLER: No, not of the actual - - -

MS CHESTER: Okay. All right. So I guess the other issue that I had that I just wanted to get a better handle on is your use of the term "subsidy". We use the term "subsidy" quite a lot as dorky economists in terms of how industry assistance occurs through tariffs and taxes and grants and the like. I'm just trying to work out - and we also suffer from people use it in quite a pejorative way, so we're very careful when we use it that we use it when it should apply. I'm a little unclear as to why an agreement was struck between state and territory governments to divide the GST bucket up on the basis of HFE and the way the CGC does the formulas, how following that system now results in a subsidy? Can you just talk us through the logic of that?

MR BUTLER: Well, maybe the word "subsidy" is a bit flippant. I'm talking the talk of the street in Western Australia, so obviously there was an agreement made. I suppose one question I'd have to ask is, what if it had gone the other way and one of the other states was subsidising Western Australia to the extent that they had to cut back on services? We just feel as a - the people in - there's a general feeling in Western Australia, no matter what side of politics you're on, that the system is unfair. So "subsidy" is probably the wrong word. It was agreed on years ago, that's right, but I don't think anyone would have foreseen the outcome.

MS CHESTER: Well, I think we showed that the WA government actually did a pretty good job of forecasting where the relativities were going to go, but I do understand what you're saying, that if people don't understand what HFE is and how the system is meant to work, then any departure from equal per capita distribution, if you don't understand what HFE is and how it's meant to work, could look unfair, which is I guess what we're struggling with, is we've got a system that was agreed between state and territories was to distribute it on this basis. There's an objective behind that basis. And now - - -

MR BUTLER: This is maybe irrelevant. When John Howard brought the GST and it was advertised as a fairer and better system, I think at that point it was almost dollar for dollar; it was very even. And you know, Western

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Australians voted that and thought, well, that's fair enough. But if John Howard had gone to that election and said we're bringing in a GST system and Western Australia will get 30 cents in the dollar, no one in Western Australia would have voted for it. So I know what you're saying, but at the same time it doesn't - the counter argument, whether you talk about fairness or not, I'm talking about trying to grow the pie for all of Australia. I think that's probably more where we're coming from.

MS CHESTER: So WA today is still the fiscally strongest state in Australia - - -

MR BUTLER: Yes, on export services.

MS CHESTER: Well, overall, as assessed by the CGC as the fiscally strongest state and - - -

MR BUTLER: Then how come its economy is in almost a recession compared to the other states?

MS CHESTER: So it's in terms of fiscal - well I think there's an important distinction to be made between a mining investment boom and a mining boom and indeed, this is one of the issues that we've discussed at length when we went over to Perth and with people like the WA Chamber of Commerce and Industry. How long is that fiscally strongest position going to remain in place and it looks like it is for the foreseeable future that WA will continue to be the fiscally strongest state, because albeit the investment has now come off, but the iron ore is coming out of the ground and the royalties are being earned off that ore base. So if HFE is about equalising fiscal capacity and WA is going to be the fiscally strongest state for the foreseeable future, do you see I'm - - -

MR BUTLER: Yes, I do. Is it fair to - the whole argument of bringing everyone to the same level, is that not discouraging things? If you had one state that was stronger than the others, wouldn't people think - just for example, if Western Australia was allowed to take some greater benefit of what was happening over there, more people would be coming to Western Australia, there would be greater money there to spend on greater development and guess what, the pie would probably grow. I think any system that - it's almost Communist. That's exaggerating it, but trying to make every state equal I don't think that's economically - the economists themselves say it's not a system that's particularly good.

MR COPPEL: Equal capacity.

MR BUTLER: Yes.

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MS CHESTER: Yes.

MR COPPEL: I think many of the recommendations in the draft report get to addressing a lot of the misunderstanding about what HFE is and how it's actually conducted is extremely complicated. So those sort of governance type reforms, which I think by and large have been largely sort of endorsed, but I'd be interested in getting your view on those specific reforms that we've made in the draft report in the final chapter.

MR BUTLER: So are you talking about the equalisation to the equalisation levels or - - -

MR COPPEL: No, I'm talking about reforms that - a role for the CGC to better explain the outcomes of its calculations and what the purpose of HFE is, as it is today. A better explanation of what it's doing and why it's doing what it's doing, so you can see a similar analogy with the central bank, Reserve Bank of Australia. It's been given the objective of deflation at a steady rate. It then communicates in terms of explaining why its policy decision on the interest rate is such and such and the factors that are influencing the deliberations. It's a similar analogy that is suggested that could be done, both by the CGC and a stronger leadership role played by the Commonwealth and the state governments.

MR BUTLER: I'm not an economist; I'm an advisor to a senator, so I'm not really the person to ask as far as detailed economics, but I don't think - to have an independent body that's genuinely politically independent I think might - you know, I think most people's view is that's probably the way to go, as the Reserve Bank is. You've got, you know, the Reserve Bank so it's not toyed with politically. How the changes are made and the details of it, that's something for you guys to look at.

MS CHESTER: Sean, I do appreciate your courage in coming over from the west to Brisbane to share your views.

MR BUTLER: It's a long way, for sure.

MS CHESTER: I guess the other thing that would be good to get your thinking on, a lot of the discussion we've had today - and largely it's a function of the Queensland government's views as well, that there's only so much you can do within HFE. There need to be broader federal financial reforms. Does the senator have a position on state taxing rights and funding responsibilities between the Commonwealth and state as part of broader federal financial reform?

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MR BUTLER: One of the issues that Catherine brought up - and this isn't really so much to do with the HFE as royalties - Australia has got huge reserves and countries like Qatar - I think we've got more gas than Qatar or we're going to have soon - and yet we make a very small proportion in royalties compared to what some foreign jurisdictions do, so I think there's some other bigger issues - and this isn't to do with HFE; this is to do with royalties - where Australia could probably do better.

As far as developing resources, you know, again I'm not from Queensland; I don't know all the ins and outs, but you know, there's resources in all states that could be developed to a greater extent and at the end of the day, schools, hospitals, roads, they all need money. So by growing the pie, we've got the money and we're able to grow services, so whatever's - I think there's a bit of a feeling in Western Australia, rightly or wrongly, that maybe some states aren't doing as much as they could or they're being a bit conservative in their opening up of their resources for various reasons.

MR COPPEL: Excellent, well thank you very much and thank you for travelling over to Brisbane for today's hearing.

MR BUTLER: Thank you for listening.

MS CHESTER: Thank you.

MR COPPEL: Thank you. We're going to take a break now and we'll reconvene at 1.30 with the Townsville City Council. Thank you.

ADJOURNED **[12.37 pm]**

RESUMED **[1.31 pm]**

MR COPPEL: Welcome back, everybody. Reconvene the hearing starting with Matt Thompson from the Townsville City Council. So if you could give your name and affiliation for the purpose of the transcript.

MR THOMSON: Sure. Matt Thomson, the Chief Financial Officer at Townsville City Council.

MR COPPEL: And would you like to give an opening statement?

MR THOMSON: Sure, yes, absolutely. Pleasure to be here. I'm

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presenting here on behalf of the Mayor of Townsville, Mayor Jenny Hill. Townsville provided a written response. I guess today I was just hoping to expand on a couple of those issues, particularly some of the key concerns we raised in that written submission. Just for the benefit of sort of painting a context of Townsville, Townsville is a large regional city. It's just under 200,000 people. It's actually the largest city north of the southeast corner of Queensland, certainly in the state and, in fact, across the country.

The local government area of Townsville is about 3700 kilometres squared, fairly diversified economy. So we have some prominent industries, including defence, health, mining, agriculture and tertiary education. Recently Townsville has been in a pretty challenging economic position, certainly as a result of the mining industry downturn. We've seen some related industries close with some of the large industrial and manufacturing industries close recently. However, on the flip side, we've seen a number of recently announced projects which, I think, give some confidence moving forward.

Townsville City Council supports the principles raised in the Queensland Government's submission following the request from the Commission. To be clear, the proposed changes to the current HFE model, as suggested, Townsville believes will be detrimental to the residents and businesses of Townsville. Certainly any change in the HFE model in terms of funding restricts the ability of local governments like Townsville to play the role that they play in the community.

The concern, I guess, that we have raised is in the context of a demonstrable gap and one that is widening, it seems, in the opportunity between city and regional communities in Queensland. So our submission reflects, I guess, the dichotomy of an increased cost to serve local regional communities and the constraints that are faced in terms of capped out own source revenue for local government.

I'm happy to provide any comments around some of the specifics in our submission, but perhaps I'll pause there and we can explore those through question time.

MR COPPEL: Thank you, Matt. You make the point, and a number of others have made the point, particularly in the context of Queensland, that the cost of delivering services is greater, given remoteness and geographic spread of the population. The CGC does make adjustments for disability factors, for higher costs of providing services. Do you have any – I mean, in a sense they try to compensate for those higher costs. I mean, you can make arguments for why it may not be done right or not. But there's usually legitimate arguments for why it's difficult to do that.

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Do you have any more systematic or systemic concern that the system isn't making sufficient adjustments for the differences in costs of providing services across different jurisdictions or within jurisdictions?

MR THOMSON: I think, Commissioner, I'll perhaps leave some of the mechanical formula, if you like, perhaps to others who are well versed in that. I think the fundamental concern that certainly the mayor of Townsville and city council wanted to table is that the increased cost of services are real in regional communities. And with outlined energy costs, we've outlined things such as environmental costs, the importance of Townsville particularly as a tertiary health centre for a very, very large region of Queensland, et cetera.

We've outlined a number of things in our submission. To the extent that there's detrimental impact on potential state government funding in order to fund those essential services I think is our primary concern; certainly the mayor's primary concern. Based on the draft paper, we understand that the models being proposed do have a potential detrimental impact on funds to the state and, as a result or as an outcome to us, we're very concerned around some of the infrastructure and the ability to continue providing that local government support to Townsville.

We talk a little bit about energy costs specifically. Energy costs have been on businesses and ratepayers and residents of Townsville for some time. We are 675-odd kilometres from the nearest base load generator and, of course, the losses along the transmission and distribution lines are very significant. The Queensland State Government provides a community service obligation to assist in terms of supplying electricity at a rate consistent across the state. Any impact on that, I think, will have a disastrous effect.

In fact, we've seen a number of industries recently, large industries – I'm talking some of the very, very large manufacturing and industrial companies – raise energy costs as one of the primary determinants in their international competitiveness. And I'm talking organisations such as Sun Metals and Glencore. Both of them have very, very large industrial activity in Townsville. I'm aware Glencore wrote to the state and federal governments recently and in three years their energy price has increased a hundred per cent in three years. These are very heavy energy industries.

So energy is one thing that we're particularly concerned of and the ability to continue funding community service obligations. We're very fortunate to have the Great Barrier Reef on our doorstep and its custodians, or certainly as Townsvillians feel, that they are, in part, custodians of that

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for the broader Australian population. We take the environmental regulation very seriously. But that does add significant cost to our doing business in Townsville. We're currently upgrading a sewerage treatment plant at Cleveland Bay, which is just on the southern outskirts of Townsville, but it is the treatment plant that treats majority of Townsville water.

That upgrade has significantly increased in cost because of the very, very high standard we hold ourselves to in terms of environmental regulation prior to pumping treated water out into the Coral Sea. So it's those costs that are absolutely real and certainly in the provision of services from council we feel that any potential reduction in HFE funding has a very significant impact on local businesses and local economies at a time when Townsville, I think, has had its fair share of challenge over the last five or six years.

MR COPPEL: It's often drawn out as an analogy the way in which certain Commonwealth and state funds are distributed to local governments. There's a slightly similar process as for the Commonwealth Grants Commission to the states and territories. But they don't have a sufficiently sized pool to provide an equal level of services. I'm wondering if you could share with us your views on how the state system or grants to local councils works. You made the point about providing similar level of services. Is that realistic to expect that to be possible, particularly in – I'm referring to Townsville that is very remote. But Queensland has some very remote areas.

MR THOMSON: Yes, sure. I won't comment perhaps on the mechanism by which the state government – that's a matter for the state government to distribute funds. What I will say in terms of the comparable level of service, I think that there's certainly a fundamental belief the mayor holds that basic level of services are absolutely required to be comparable. So I think that there's an expectation that – for example, we're a very large garrison city, defence is a very, very significant industry in Townsville.

Secondly, the Townsville Hospital serves one-eighth of Queensland in terms of its catchment area; very, very significant public infrastructure. So both federally and state, there are significant infrastructure that council provides to state and federal governments as part of our role. That infrastructure can be things like sort of trunk works in development but also be infrastructure such as sort of lifestyle and recreational infrastructure in Townsville.

Those types of activities we need to continue to encourage and support and retain talent in Townsville. Certainly the model that's been proposed

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here, we feel, has a potential to restrict our ability to do that. We feel as certainly a very significant regional city north of the southeast corner that there is an obligation for us to be able to – council I refer to – to provide services. That service must be at a reasonable level. So I think in answer to your question, the mayor is committed to providing within the remit of council, within that remit, providing a measurably consistent level of services to our residents and constituents.

MR COPPEL: When you talk about essential services you're talking about essential services provided by the local council?

MR THOMSON: Yes, absolutely. So council provides a number of sort of social-type services, you know, parks and gardens and other things that typically council provides. In addition to that, we support the state and federal government with some of the delivery of services in the north because of the remoteness of Townsville. An example is the current pipeline which is securing long-term water supply. Council and state government are working together on that to ensure we deliver those services. So it is within the remit of a local council, albeit we do certainly support in terms of the delivery of broader services as the sort of regional local government.

MR COPPEL: Can I ask you about the notion of fairness? I'm sure you were here earlier today. But it's been brought up in submissions and our consultations during this inquiry that the HFE system has lost a bit of confidence in the community because it's seen as not being fair. If you probe a little bit more it seems to be linked to a notion that there's not a sufficient element in the HFE system to give reward for effort. I guess, loosely speaking, putting it in the context of Townsville, if Townsville were to develop a major – make a major development or support a major development, the extra revenue that may come from that would be partly redistributed. That's seen as not acting as a sufficient incentive to undertake that initial development. Do you have any views on this notion of reward for effort as something that constitutes one part of fairness, fairness in the HFE system?

MR THOMSON: One of the things certainly the city council has been very committed to recently is trying to activate the city. So if I take a broad sort of answer to the question around fairness is the council, and certainly the mayor and the councillors, are committed to supporting economic activation within the remit of what council can do. The current system, as I understand it, it does have its redistribution impact. It is a secondary impact to counsel. But certainly the commitment of council in Townsville is to stand up and to, within the constraints of where we operate within the local government, act to provide an economic platform for businesses to

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thrive.

So we certainly recognise the potential – it seems like an adverse incentive mechanism. But it's not a primary concern. The primary concern is activating the city and supporting businesses and reducing red tape to be able to support business. Business has been pretty tough in Townsville. In fact, business has been pretty tough in many places across the state, but certainly in Townsville we've had some fairly prominent and very public closures of major industrial facilities. So jobs in the city are key priority of council. I guess we, through the decisions made by council and through the mayor, that's our first and foremost priority. The second priority, of course, is considerations around any sort of redistribution following that.

MS CHESTER: Just, Matt, having a better understanding of it from a budget management perspective from Townsville City Council, so one of the priorities that we have post-draft report, apart from letting people keep the ties on our draft report and us better understanding their submissions to us, is also looking at, if we were to contemplate recommending a change to government, what would be a sensible or a reasonable transition path such that particularly smaller states not be materially disadvantaged.

Looking at it then from a local council perspective and a budget management perspective, so you've got your own source revenues and then grant revenues from the state governments. What's the breakup between own source and grants for your budget at the moment?

MR THOMSON: Yes, so own source revenue is the majority of that. Grants go up and down, as you'd appreciate, on a sort of annual basis. Certainly over the past little while we've been receiving some funds for the delivery of major infrastructure. I mentioned the pipeline, for example. So certainly commitments around that. But grant funding goes up and down. What I did do – what I certainly can share is over the last 10 years the allocation of grant funding has been reducing over time. So we are more reliant now on forcing own source revenue in local government, certainly in Townsville in any case. So the grants overall have been reducing.

MS CHESTER: And that's important for us to get a bit of an understanding from a budget management perspective in terms of what sort of year-to-year variability or variance do you already have with your own source revenue and grants? Do you know what that is sort of over the last - - -

MR THOMSON: Sure. Own source revenue is not particularly variable. I mean, the primary levers for own source revenue and council are twofold. One is rates, so property rates, and secondly, utility charges. Townsville,

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perhaps unlike some of the councils in the southeast corner of the state, we still maintain and own and operate our water and waste water businesses. So there's a sort of business unit within council that deals with water and waste. So that's the utility charges side of our income statement. Then, of course, the rates revenue. So that's relatively stable. That's relatively stable. I mean, obviously things that impact that are fluctuations in population, fluctuations in tariff charges, et cetera. But, by and large, that's fairly stable and quite forecastable year to year.

The grant funding typically tied to major projects. We see a fair way out because of major projects lead time in terms of that. So certainly some of those major projects are well planned in advance so we can budget some of that type of initiative as well. But from year to year, that's a little bit trickier than own source revenue.

MS CHESTER: But the financial assistance grants that you're getting from the state government year to year for your fiscal capacity as part of their version, state level of HFE, what's the variance or the variability? I'm just trying to work out what sort of variance are you able to manage in a budget sense.

MR THOMSON: The financial assistance grants vary, absolutely they vary. The transparency of those – we won't typically know the final number of those until toward the end of the year. There's still – in terms of an ability to budget, we make some assumptions in there based on last year's, et cetera. So they're not a fundamental driver on our ability to budget. Certainly the ability to budget is mainly own source revenue, plus the major projects, so the massive capital investments that we need in things like we've been doing a lot with upgrading the CBD and the utility program within the CBD. That's an expensive capital program and certainly there's funding for those types of things that we source from state government. So the financial assistance grants in and of themselves don't, I guess, create budget uncertainty. But certainly the major project revenue is a little bit lumpy from time to time.

MS CHESTER: So then if you put it – then trickle it back up to the state level where what we're – well, one of the options that we raised or flagged on our draft report of equalising to less than the higher state, there's some numbers that people point to which were assuming very bravely – indeed, we said we'd never recommend this to government. But you did a cold turkey one-year implementation. I think they're the sort of numbers that you've heard about.

Even there, that would only represent 2 to 3 per cent of state revenues. So if you were to sort of then think of that within normal budget

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management of a state government where they've got variability of their own source revenue of anywhere between sort of 7 and 8 per cent year to year, I'm just trying to work out how that then trickles through to Townsville and sort of the Armageddon picture that we're hearing here today.

MR THOMSON: So certainly I'm not sure that we're painting an Armageddon picture. What we're certainly raising concern of is over time the ability of councils to continue to provide a level of service and a comparable level of service for those typical sort of community-based infrastructure. So in our submission I'm hoping we're not being interpreted as suggesting Armageddon. But certainly there is some genuine concern around our ability to continue providing those services to the constituents.

In terms of the transition part specifically, I haven't given that significant thought. But certainly in terms of the ability of councils to continue to generate rate revenue is actually constrained. At some point you cut out the rate base and you simply can't afford to continue to keep levying rates and charges on the residents. I'm not sure where that number is, but I don't think we're too far from that number in terms of the Townsville demographic.

So certainly as I look forward in a budgetary sense I say there's limited ability to be able to drive own source revenue from that. Certainly the mayor has been quite committed to not more than a sort of a CPI based adjustment, so the real costs are capped out.

MS CHESTER: So then that maybe sort of leads us then to, I guess, the broader scheme of things, and indeed, we intimated in our – well, we don't intimate it, we actually state it in our draft report. There's only so much you can do with HFE. There's a role for broader federal financial reforms, which opens up issues like vertical fiscal imbalance, the state taxing powers and funding responsibilities. Does Townsville view changes to HFE more so in the context of broader federal financial relations or is that something that the council has a view on reform that might be needed that would then trickle through to council's own revenues?

MR THOMSON: Yes, I'm not sure that we've got a view on the sort of federal/state relationships. One of the things we are doing in that response in terms of creating agility within our community, I think, is the way we can sort of deal with those types of issues certainly is around these economic activation pieces. So doing what we can within the Local Government Act to reduce the constraints for people to foster and grow economic-generating activity in Townsville. So that's what we're primarily focused on, something that's right at the coalface to say, "Well, how do we actually

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generate a better environment for local businesses to go and actually engage labour to reduce the burden of red tape, to create the infrastructure within the community that supports that?"

We've had some great examples of things recently where, for example, Central Queensland University has just recently opened a campus in Townsville. It's those types of things that we can sort of encourage at council in order to be able to make that transition in terms of funding. Certainly the mayor is very keen to drive innovation in terms of within the parameters of which we operate, drive innovation in terms of revenue as well.

So rather than sitting and just assuming the rate basis caps out is what can we do as council locally to encourage sort of economic activation? Because ultimately, if we activate the city, the city becomes more desirable to live and people move into the city, development occurs. Of course, that has a sort of indirect benefit to council and revenue. So that's the role we see us play primarily and that's what we'd be really focused on delivering.

Anything that challenges us even further in terms of revenue I think is sort of eroding some of that ability of Townsville to create the place that we're certainly committed to creating.

MR COPPEL: I think we're done, we've covered the questions we had for you; so thank you again for coming down and participating in today's public hearing.

MR THOMSON: Thank you very much. Thanks for your time.

MR COPPEL: The next participant is the Local Government Association of Queensland; Greg Hallam and Roland. Make yourself comfortable.

MR HALLAM: Thank you.

MR COPPEL: Give your name and affiliation for the transcript and then a brief opening statement.

MR HALLAM: My name is Greg Hallam, I'm the Chief Executive Officer of the Local Government Association of Queensland. I have some considerable experience in the government or financial relations. I am an economist. I did my Honours thesis in the early 80s on comparative federal financial relations around the world but focusing on countries that had similar political systems. So America, Canada, India, Pakistan.

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I was part of the Self Inquiry in the 80s into local government, finance and the grants commission system, then transferred across to the National Office of Local Government where I helped draft the FAGS Act. I have been the CEO of the (indistinct) shire and my immediate (indistinct) before I came to the LGAQ was CEO of Townsville City Council. We are concerned that the current methodology that a move away from the current methodology would really end up in a less egalitarian, less fair system, particularly for rural and remote indigenous communities in Queensland.

I know Queenslanders are known for telling the sad story about how different we are, but that is the truth; the most decentralised state. Certainly Western Australia is a very large state. When you look at the population distribution, it's not just in the provincial cities but across the state it's extraordinary. It's equally a problem for councils – for the state as it is councils. Because I regularly visit places like the Torres Strait Cape, the Gulf, they're two days to get there; I mean, literally.

Every time the state has to deal with health, policing and medical issues, courts, whatever, the cost of flying people in and out is horrendous. So we represent all 77 councils in Queensland, including the 17 indigenous councils. They're all our members. I personally spend a very large amount of time, on average 60 or 70 nights, away a year in those communities, so I have a very clear sense of their issues.

Our written submission I won't speak to in great length. But effectively, we did talk about baseline shares of revenue. The thing that startles, I think everyone, is with 3 per cent of the revenue or 4 per cent if you adjust it for shares, we've got 25 per cent of the asset responsibility. So the cost of every small community having to have the most fundamental services – water, sewerage, a hall, parks, sporting facilities – is enormously costly. I think, to that end, the current federal grants commission methodology on the expenditure side does over decades over work properly reflect that circumstance, that there are – not so much on the revenue side but on the expenditure side there are these very considerable costs.

Some things are less obvious than others. Water and sewerage is a lot more expensive to run in Brisbane because of the topography of the setting. It's a hell of a lot cheaper to do it in Melbourne. It's $10,000 a block cheaper to run water and sewerage because of their flat terrain. So I believe that the current methodology works well. Bearing in mind that if we have significant changes in the allocation, it inevitably flows onto local government. And I'll evidence the last financial crisis in Queensland, I guess, if that was the word.

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We had substantial cuts on the order of $400 million a year. That meant we simply stopped providing – we stopped doing a lot of infrastructure work, which affected local economies and still is an issue. I mean, we dropped our capital spend from 3 billion a year to 1 billion a year on the back of cuts to what was then the water and waste water subsidies. We dropped our workforces by 5000 people. So towards the end of what was the Bligh Government when they had their financial problems and then the adjustments made by the Newman Government, as I said, we stopped spending capital essentially. We did the very basic, put 5000 people off and - - -

MR COPPEL: How big were the cuts from the state government to the local government?

MR HALLAM: In the order of $400 million a year.

MR COPPEL: And relative to revenue as a percentage?

MR HALLAM: My colleague might be able to help me, but it would certainly – prior to – put it in another term. Prior to that time, the federal government – the state government would fund 70 per cent of local government's activities and the federal government would fund 30. It's reversed. The state government has started to as the state budgets improved and things have got better and their revenues has increased – it's probably more like 60:40 still, but allocated at the federal government's way.

The difficulty was – and my colleague sort of talked about it before, the CFO from Townsville – if you look at us as a sphere of government we're less (indistinct) than the states. But that's as a sphere of government, the numbers lie because that's probably the top dozen of 15 council. If you talk about the councils that I'm concerned about, talk about less fair, they raise anywhere between zero and 10 per cent own source revenue.

So those cuts are of enormous consequence. For instance, main roads department used to fund a lot of work through the councils on the main roads own network. That was in the order of 30 or 40 million dollars out in what I would call the outback sort of from southwest Queensland to the northwest. Hundreds of jobs disappeared. That left those communities quite incapable in some ways of dealing with disasters when they turned up. We had to bring in crews from elsewhere to deal with roads.

So I guess if I can answer it in these terms: it's far more challenging for a small remote council with no other sources of revenue who have anything between zero, if you're indigenous, and up to 10 per cent for probably another 20 non-indigenous councils to deal with those sorts of

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cuts; and those cuts were across the board, as I said. It was water and sewerage programs, it was roads programs, it was basic infrastructure work. These weren't nice to have; these were fundamental programs.

MR COPPEL: Thank you. If I begin, given your expertise and your current position and also your thesis on the way in which state and Commonwealth governments attempt to do a similar thing to HFE among local governments. You mentioned that many local governments only have zero or 10 per cent own source revenue. So the way in which state grant commissions functions is very different from the Commonwealth. They tend to provide a much lower level of fiscal equalisation. The level of service, the type of services that are provided is also quite different.

But given that diversity and the specific features that make for such large variations in the cost of providing these services, do you think it is realistic to aim for an equal capacity among – equal capacity to provide those services among local governments? And does that extend, in your view, to the broader sphere?

MR HALLAM: I think it's very difficult to achieve. I mean, since 1987 when the FAGS Act was borne out of the pits (indistinct) the whole idea was we had a share of revenues, a share of growth. The fundamental difficulty in local government we have to fund growth and we don't have access to a growth tax. If you look at local government rates over 20 years they increase just at or above CPI. There is some natural growth in terms of new blocks being knocked out. That in a boom is 2 per cent and ordinarily it's less than 1 per cent.

As I said, the nature of the FAGS Act, the Commonwealth legislation as it applies and is operated through the state grants commissions, has really focused on HFE and not BFI. We do have a flaw in our Act, which is the 40 per cent – sorry - - -

MS CHESTER: Thirty.

MR HALLAM: Thirty per cent, sorry. So I guess I come back – my learning is almost 40 years ago as a student. But in relative terms, even compared to a country like Canada, we are far less disparative(sic) than say Saskatchewan to the Maritimes. That's a great thing. I mean, I think if you look at why we're a civil society, why we haven't had all the ructions that other places have had, that is because there's a reasonable level of equity in how distributions occur. I think it's fundamentally important that people on Horn Island or in Kowanyama or in Birdsville can aspire to some reasonable level of – without having a great civic theatre or massive sporting facility, they do need to have a level of – there's got to be some

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sort of fundamental CSO about the standards people can expect. As I say, Queensland through its history has many more of those communities.

MR COPPEL: Remaining with state to local – or Commonwealth/state to local government system of HFE, are there any lessons, in your view, from that system that would be relevant for the Commonwealth/state HFE system?

MR HALLAM: I have seen in my lifetime – include my time in Canberra – three ministers (indistinct) about changing the system. They all died with the politics. It's very difficult to do.

MR COPPEL: Vis-à-vis local government or vis-à-vis Commonwealth/state?

MR HALLAM: Both. So I can remember various treasurers, I can remember Wendy Fatin, Minister Fatin. I can remember Minister Tacki(?) and Minister McDonald all having a look at – so there's both sides of politics there. When it comes to changing the methodology, there are so many – because of the complexity of it, there are so many unintended consequences. If you had what we would call an equal distribution model, which is the – this is a model that is used in some places – there are no losers, if that's makes sense.

I mean, you never go backward. You can only go forward. But it limits what a winner might get. But one of our models do take money away from people; and that's quite difficult. I've been in that situation when I was at Townsville city when – goodness, it would have been '90, '91, it was Minister Tacki, from memory – Minister Fatin, sorry. We lost a million dollars. That was really tough.

MR COPPEL: When you refer to equal distribution, is that equal per capita? That's the equal distribution model?

MR HALLAM: Yes, it is, in essence. So it basically – it's not ignorant but it doesn't have huge regard to the revenue side; it looks more at the expenditure side of the equation. As I said, that hasn't been practised for some time. But that was a model that Self looked at, other countries had used it. I think it was – so it was essentially looking at that sort of approach, equal distribution, and the modifying by the sorts of matters I talked about before; your disability factors on the spend side. I'm not recommending that, by the way; I'm just simply saying that was the alternative model.

MR COPPEL: You did mention in your response the sheer complexity of the system, which is one of the factors that may be undermining sort of

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public confidence in the HFE system. Do you have any more specific views on complexity, how it could be – is it so complex that it doesn't matter if it is?

MR HALLAM: We used to always joke we could sort of stand in a phone box and still fit in all the people in the country that could understand what we did. I think it is over-elaborated at times. I mean, as a matter of history in '87, Commonwealth took over the distribution of Queensland grants. They had a provision in the Act. The Queensland Government wouldn't agree to the federal government paying indigenous communities. So I and an external colleague developed a model from scratch in six weeks, which was no mean feat.

What we did though is we collapsed what were probably 40 indices into 15. Then we did all the sensitivity testing and it didn't make much difference at all. Some are really important like your population distribution, like your – like the physical distribution of population, the number of indigenous persons, people under 5, people over 65; those things are really fundamental and important. Some of the rest of it is a bit overcooked, I suspect. It doesn't make a lot of difference.

MR COPPEL: One of the specific areas which has been often questioned as very difficult to make an assessment relates to sort of indigeneity, providing services for indigenous people, which is closely linked to remoteness. Some have suggested that it may be easier just to take that out of the HFE calculations, assessments for indigeneity, and deal with it by a separate Commonwealth grants. I'm interested in whether you have any views or thoughts on that idea.

MR HALLAM: I think that's fraught with difficulty in the sense of where do you stop? You take the under 5s out. I mean, we're a little different here in Queensland because whilst we have lot of indigenous people living in non-indigenous councils, we have 17 discrete communities. So if you went 2 and a half thousand northwest of here you'd end up in Cherbourg. Then between Rocky and Emerald you've got Woorabinda and then the other 15 communities are all in the Gulf Cape and the Torres Strait.

They function as fully-fledged local governments. They do everything other councils do. I acknowledge my colleague in the back. So our model is somewhat different. I mean, they do get their services – and in those instances it's really quite a decent model. All the services are delivered through the council. So if you went to collect any sort of welfare payment or had to interact with an agency of the Commonwealth, you'd be doing it through the council; they act as the agent. So as I said, I can't speak for the other jurisdictions and I acknowledge there are many indigenous people that

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don't live in Aboriginal and (inaudible) community. I think it's over 30,000 that do live in an indigenous community in – a functioning indigenous council in Queensland. I think as a matter of record we have the highest level of indigenous population of 4 per cent, including the Torres Strait Island people.

MR COPPEL: I think we're done. Thank you very much.

MR HALLAM: Pleasure.

MR COPPEL: We may even be running a little bit ahead of schedule. Well, we are. The next participant is the Queensland Government. What we normally do at the end of the day's proceedings is ask if anyone who hasn't registered who's in the room that would like to make some very brief comments or remarks, we give that opportunity. So if there anyone, since we've got about 15 minutes, that - - -

MS CHESTER: Not that we're allocating 15 minutes for - - -

MR COPPEL: No, we're not. Yes? Again, like others, you have to give your name for the transcript.

MR TUNNY: Thanks, Jonathan. Thanks, Karen. My name is Gene Tunny. I'm from Adept Economics, I'm the director of Adept Economics, which is an economic consultancy firm. As background, I'm formally of the Commonwealth Treasury and I've worked for the state government here in Queensland, so have some knowledge of the system and I have a concern for not just the state of Queensland but concern for the nation as a whole and also for the long term.

Now, where I think we need to go with this is to analyse what this means over the longer term. I think you've been probing the people who spoke here today about well, have you thought about the longer-term issues? I think what we've heard is that there are a lot of people concerned about what this means immediately for Queensland, what those cuts mean for the ability to deliver services, what it means for state taxation. And I can understand where those concerns are coming from.

Perhaps what needs to be done is more modelling, simulations of different paths of budgets over time, because I think – was it, Karen, you mentioned – or it might have been you, Jonathan, you talked about how – well, okay, Queensland is a recipient state, so we've got a high relativity at the moment. We have had a low relativity, we've been below line at times. But, on average, we've been around I think it's 1.02 or 1.03. So on average, we've been the net beneficiary. But that may not be the case all the time.

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So what may help some of the people who presented today, it may help me even change some minds – you never know – is if you have an analysis of how that could change over time, what's that variability? What happens if we have another resources boom? Or what happens if gradually some of those disability factors in Queensland diminish? So it needs some more modelling, some more simulations of different possible futures would be useful so that people understand what that longer-term perspective is and so we're not just so narrowly focused on that short-term impact, which is definitely of concern to people; I understand that.

That's essentially what I'd like to say. I think, in my view, it would help, your report would be improved by more modelling, more simulations of different alternative paths.

MR COPPEL: And that's exactly what we're doing.

MR TUNNY: Okay.

MR COPPEL: For the draft report we're seeking feedback on some of the options that were put forward. We're looking at those both from the perspective of what those options mean in terms of their relative merits, obviously, but also putting it into the perspective of looking forward. That's a lot trickier than looking backwards because you have greater elements of uncertainty over the size of the GST pool and how it's distributed. But it can make quite a substantial difference to the orders of magnitude that are involved in the distribution across jurisdictions. As you say, that may give a different light on some of the options and their relative merits. So there's like eight pieces of work and part of the reason why the length of term of this inquiry has been extended a little bit.

MR TUNNY: Okay, good then. Because particularly in Queensland there's concern about that longer-term impact because you probably heard we're on that trajectory to $81 billion in total state debt. So there's a lot of concern about that and well, if you do lose revenue, then, well, where do you end up? Because there will be a lot of resistance to cutting expenditures and also there'll be resistance to raising taxes. I think if you do the modelling where you have that long-term framework, you look at what happens to that, the trajectory of debt and your net debt or net financial worth, that would be useful.

MR COPPEL: Queensland is one of those unique states which has actually moved from donor to recipient about four times over the last few decades.

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MR TUNNY: Exactly.

MR COPPEL: It's quite unusual in that regard and it's partly linked to natural disasters and the impact that that has on recovery expenses.

MS CHESTER: And one of the state governments that's also raised the other longer-term issue which is broader federal financial relations and taxing and funding responsibilities, which makes that longer-term trajectories that you're talking about look very different.

MR TUNNY: Yes, I understand. I mean, I'm a great believer in looking at this holistically, but I understand you have a particular terms of reference. Whenever we try to have that bigger conversation it ends up going – doesn't go anywhere. I mean, we had that White Paper which I thought was a fantastic idea, but I think that's been stopped and that's been stalled. Let's get this right. I think – anyway, I wish you luck and thanks for the opportunity to speak here today.

MR COPPEL: Thank you.

MS CHESTER: Thank you.

MR COPPEL: Is there anyone else who'd like to make some brief comments now before the next participant, before the State Treasurer? If not, we'll break for a few minutes, stretch your legs, have another cup of coffee, and we'll start again at 2.30, hopefully.

ADJOURNED **[2.17 pm]**

RESUMED **[2.21 pm]**

MR COPPEL: Okay, well we will start and I'd like to begin by welcoming Jackie Trad, the State Treasurer for Queensland and your colleagues from the Queensland Treasury. If for the purposes of the transcript you could give you name and affiliation, that would help us then with the transcript and then some brief opening remarks. Thank you.

MS TRAD: Thank you very much, so Jackie Trad, Deputy Premier of Queensland, Treasurer of Queensland and the Minister for Aboriginal and Torres Strait Islander Partnerships. This of course is Jim Murphy, the Queensland Under Treasurer and I'm joined by our members of staff from my own personal office as well as from the Treasury.

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Can I first thank you, Commissioner and Deputy Commissioner, for coming up to Queensland at our invitation to hold a public hearing and I also want to thank you for the opportunity to present on behalf of the Queensland government here today as well. Before I launch into my opening remarks, can I acknowledge the traditional owners of the land on which we meet, the Yuggera and the Turrbal people, and can I pay my respects to elders past, present and emerging.

Can I start - and quite directly and bluntly - by saying that the draft changes being proposed by the Productivity Commission are really unacceptable to Queensland? All Australians should be treated fairly and have access to quality essential services no matter where they live. However if the proposed changes are enacted they will entrench inequality of service delivery, giving some states and territories the ability to deliver better services to their residents than others.

Queensland is unique amongst Australian states and territories. We are a vast and a very decentralised state, significantly more so than any other state. We are the only state where more than 50 per cent of the population lives outside the capital city. While this creates significant service delivery challenges, we are also lucky to be endowed with an abundance of natural resources. This combination of both having high costs but also the potential for high revenues is why we are one of the only two states that have been both a recipient and donor state of GST revenue distributions over time. Our unique situation is reflected in our average relativity of 1.028 since 2000.

From this position, we would like to express our strong support for the principle of horizontal fiscal equalisation. We are a state that values fairness and equality. We believe all states should have the capacity to provide similar levels of service. State governments can decide exactly what services are provided and we are held to account by our voters for the decisions that we make, but HFE means that all states have the capacity to provide similar levels of service. At its core, this means that all Australians, regardless of which state they live in, should be able to receive similar levels of service. It avoids the situation of people in one state being clearly worse off, through no fault of their own or their government.

HFE reflects an understanding that while there are many factors beyond the influence of an individual state's control, the effect of these factors can be shared across the nation. This is the ideal which our federation was founded on. Queensland, like Western Australia, benefitted from the mining boom. We recognise that. For a number of years we did not receive an equal per capita share of GST because we generated enough revenue to

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meet our own spending needs and we shared our fortunes with other states who are less fortunate.

When the mining boom came to an end we were exposed to the same budget challenges that came with the averaging mechanism to the current system. However through sound fiscal planning and discipline management we are able to keep our deficits in check and continue to provide quality services to Queenslanders. More recently, from factors beyond the government's control, private investment in mining, which helped with the growth of our state for much of the last two decades, has declined. This has adversely impacted not only on the growth of our royalty revenue but also our other taxation revenue. At the same time, we continue to face significant service delivery challenges experienced by a vast and decentralised state with a large indigenous population.

Higher costs in regional and remote communities can be found in almost all services delivered by Queensland. In health, the cost of providing public hospital services to acute patients is around 40 per cent higher in very remote parts of Queensland than it is in Brisbane. The cost of constructing health facilities such as hospitals in rural and remote areas such as Cape York and in the Torres Strait can be almost double the cost of building similar infrastructure in metropolitan areas.

In education the Queensland government spends around 40 per cent more on a public school in remote areas and 75 per cent more in very remote areas compared to a student in Brisbane. In public safety it is estimated that the cost of a police officer in remote and rural areas of Queensland is around 15 per cent higher than in urban areas such as Brisbane. In Queensland there are nearly 100 police stations that are more than 1,000 kilometres away from the capital city. This is approximately 30 per cent of the number of Queensland police stations. The cost of building a police station in these areas is also over double the cost of building in Brisbane.

In addition to these challenges Queensland, due to our geographical location and the location of our population centres, is prone to destructive natural disasters. Rightfully, the current HFE system recognises the significant cost of natural disaster recovery and provides additional GST funding to compensate for these costs. While payments under the natural disaster relief and recovery arrangements are essential, they do not compensate for the full cost Queensland incurs in rebuilding and it is appropriate that the net expenses we incur are recognised in the current HFE system.

This system ensures that despite these challenges we can continue to deliver the services our communities expect. However, if a fundamental

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change to the principle of HFE were to occur which results in one or more of these challenges no longer being recognised in the GST distribution process, it will result in a significant deterioration to the Queensland budget and have a damaging impact on our people and our communities.

To put this in context, if the Productivity Commission's option of equalising to the average state were to be adopted, the resulting reduction of $1.588 billion a year in GST revenue to Queensland is equivalent to about 5,000 teachers, 5,000 nurses, 3,000 police officers and 1,135 fire fighters. Such losses mean the Queensland government will no longer be able to deliver services to many parts of our community or at least not be able to deliver services of the same standard as other states.

The Productivity Commission should proceed with caution before recommending major changes to the current HFE system. It is a significant part of state budgets and the ramifications of change are enormous. Before any change is contemplated we must fully understand the benefits and costs of not just the options open to us but also of what we choose to leave behind.

Queensland recognises the current HFE system is complex and some parts can be difficult to comprehend. As a result, it's often criticised for being an opaque process. We have in our submission asked the PC to explore options which could simplify the current system to increase its transparency and accessibility without fundamentally changing the outcome it delivers. We also believe the Commonwealth Grants Commission should play a more active role in publicly explaining HFE, including the processes and decisions.

However, the options of equalising to the average state or the second strongest state which the PC has put forward do little to help improve the current system in that regard. On the contrary, these options add to the complexity of the current system while delivering an inequitable outcome that jeopardises the cohesiveness of our federation. If there is a need to introduce a new system, Queensland believes it should come as a part of real and meaningful reform to broader federal-state relations. This would include options to properly address vertical fiscal imbalances in Australia. The states and the Commonwealth should rethink how payments can be made so the states can have the certainty, the security, the flexibility and funding to consistently deliver on their responsibilities.

In conclusion, Queensland continues to support the principle of horizontal fiscal equalisation. Like many other states, we value the principle of equality. While we recognise the current system can be improved, we believe introducing a fundamental change to combat the potentially temporary situation faced by one state is not prudent, especially

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when it comes at the cost of long-term certainty and stability for most of the other states.

If the Productivity Commission finds the current system is in a state of disrepair - and we do not agree that the evidence suggests that it is - it should argue for real and meaningful reform for federal-state relations in Australia and recommend a system that can endure the test of time and deliver long-term benefits for all Australians. Thank you very much. I'd now like to ask the Under Treasurer to make a couple of comments as well, if that's okay.

MR MURPHY: I'll just give a few quick points because I know you wish to have time to give question and answers. There are two things we agree on with the Productivity Commission and that is there's a need for more fundamental reform of Commonwealth-state fiscal relations and that is fundamental; it is an overarching problem that we have at the present time. We also agree that the HFE system is complex and could be reformed through adjustments to the methodology and assessment conducted by the Commonwealth Grants Commission.

We do not agree that the equalisation process should be changed on the grounds of, firstly, that incentives distort policy decisions and stop policy reform - we do not agree with that - or on the grounds of an outlier impact showing, to us, the impact through the equalisation process shows that where increased revenue raising capacity occurs it's reflected in impacts on relativity and so the actual process of HFE is working in relation to Western Australia's increased revenue capacity.

So in summary, Queensland Treasury does not think that there is a case being made for substantial reform of the equalisation principle for removing to relativities based on the average state or the second strongest revenue state, but overall we think this has been a very useful exercise. To some extent, we think there should be reform, but maybe a freer hand should be given to the Commonwealth Grants Commission to simplify their processes and explain it better, but retain the equalisation principle a part of the federalist construct.

So that's where we - I might say we've put a lot of work into looking at this and as it's easy to categorise Queensland as always a recipient state, but as the Deputy Premier pointed out, there have been occasions where over a five year period we were a donor state because of the mining boom and so overall when we look at the whole process working, it seems that it delivers for Australia in particular a fair and equitable share of fiscal capacity to states.

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MR COPPEL: Okay. Thank you, Treasurer. Thank you, Jim. I think I'd like to begin by talking about the objective of HFE, because both in your initial submission and in your submission on the draft report you're the only jurisdiction that's made the point that there is a difference between providing the same level of services and a similar level of services. The CGC would accept that; they recognise that there are all sorts of reasons why the aspiration of providing the same level of services cannot be fully embodied in their calculations so in a sense you're sort of mirroring that.

But I'd like to also recall that years past the objective of HFE was to provide a similar level of services and that it has gradually elevated to an objective which is to provide the same level of services and that elevation has been led by the Commonwealth Grants Commission itself; it's not through government or an inter-governmental process. And that was part of the reason behind the draft recommendation that the objective of HFE should be defined by the government and it's given that background and given what you've said about providing a singular level of services I'd like to get your sense of what you actually see as the objective or the definition of HFE or even the principle of HFE, how it should be defined, so that the CGC then can go about its assessments with that definition in mind.

MS TRAD: Thank you very much, Commissioner. Can I start by saying that, as I said in my opening statement, we do value equality and fairness in Queensland, as I'm sure that most Australians do. Equalising to a level of service that is equitable amongst Australians is important and I think that in terms of the same and similar question which you had in your question to us - I'll get Jim, the Under Treasurer, to address the actual detail - but I mean, we recognised in our submission that the calculation of similar is incredibly complex. This went to the issue of how do we make this less complex so that jurisdictions and Australians could understand how the GST was distributed?

Fundamentally though, that is a process question and that is a question around technicality and detail. The principal question around ensuring that there is funding for an equitable level of service delivery for all Australians is the principle that I believe we should fundamentally adhere to. But Jim, if you want to address - - -

MR MURPHY: Yes. Well, I think yes, we said a similar fiscal capacity. What we're really driving at was to address the fundamental issue which we think arises with HFE and that is the complexity of the methodology and the Grants Commission's work, so the reason we were saying you could move from same to similar was to give greater flexibility and to move away from what we feel is false precision, which is being looked for by the Commonwealth Grants Commission.

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We think they've been pushed down a path where they've tried to suit various representations from states and actually if they simplify their methodology - and that was the idea of having a similar approach, not the same, because to us - I know I sound - it might be semantics, but the same means you've got to really be very precise with what you're doing, where similar means you can be roughly approximately similar fiscal capacity. But we don't agree that you should move to a reasonable level, which I think was what was in part of your draft report. So we would say the equalisation principle should stay as it is, but you could give more flexibility to the Grants Commission to review their practices and reform their methodology.

MS CHESTER: So Jim, you'd, sorry, keep the equalisation benchmark the same that they have at the moment; equalised to the highest state with an EPC overlay but allow more wriggle room for them to get rid of some of the complexity?

MR MURPHY: Yes. That's exactly - - -

MS CHESTER: So realising that that would never be full and equal?

MR MURPHY: Would never be what?

MS CHESTER: Full and comprehensive equalisation.

MR MURPHY: Well, I think it's going to go close to it. I think there's as I say, a false precision in what - there's going to be judgments embedded in any of these decisions made by the Grants Commission. But it's all right. You know, you can say well you're giving wriggle room, but at the same time until we had the outlier of Western Australia with the mining boom, which is another issue, the states quite happily accepted what was proposed by the Grants Commission. So the system does work, notwithstanding all the complexity and the black box of the Grants Commission.

What we're saying is if you want to improve the communication and the opaqueness, if you moved out from possibly same to similar - or it should not - which would be looked at, would that make the Grants Commission feel more comfortable in their methodology being simplified? That's the point of it; it was not seeking to say that you have a fundamental reform of HFE.

MR COPPEL: In a similar vein in your submission you were arguing that in that context there needs to be scope for give and take. If each jurisdiction looks at where they are today and where they would be tomorrow under a

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different regime, if there's a reaction to it being negative, therefore against any change; being positive, therefore being in favour of any change. The nature of how the system works is you will never get a consensus and you in your submission say that there needs to be some sort of give and take. I don't know how big that is.

But you don't explain then what sort of mechanism would sit around a way of moving to a simpler formulation for GST distribution that provides a basis for different jurisdictions to share their views and give their perspectives on different approaches. Who would lead that? Would it be the CGC, you seem to be implying, or would it be a process that involves state and Commonwealth government, in your view?

MS TRAD: Look, can I just take a step back from that please, Commissioner, because I think fundamentally we are missing the key issue here and the key issue is Commonwealth-state financial reform. What we're doing here today is sort of looking at the peripheral issues surrounding one component of what is a large and complex relationship between multiple jurisdictions and responsible for a whole range of arrangements, so the GST is one component of that. Tied grants are another.

So there are a lot of issues of complexity that make up the Commonwealth-state financial relationship that I think need to be on the table in terms of what I articulated and what the Under Treasurer articulated in terms of important, significant, enduring reform, because that's what we fundamentally need to talk about, not you know, the minutiae of the methodology used by the Commonwealth Grants Commission in distributing the GST. As important as that is, because as I've outlined in my submission, you know, a change to the relativity to the second strongest state or the average state will have a detrimental impact on our state budget and our capacity to provide services to Queenslander.

So I do have to make that point and I think it's an important point to be made, but Jim, just in relation to the crux of that question, I don't know if you want to answer it in a technical sense, but I do feel like we are missing the main point here in terms of full reform of our system.

MR COPPEL: Well, why don't we come to that - - -

MS TRAD: Sure, yes.

MR COPPEL: - - - because we do make that point in the draft report, but our terms of reference limit us to looking at the HFE system. We've made that point; we've recognised that point. We also recognise that the CGC

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has its own process for how to improve their assessments, so we're not getting into that space either. But let me put the question then to you: if there is a reset of Commonwealth-state financial relations, I mean what would you then see as the end goal of that reset from the perspective of Queensland?

MS TRAD: Well, from the perspective of Queensland, can I say that I think any sort of reset has got to embed flexibility in the approach, certainty in the funding arrangement going forward, but also collaboration in terms of the reform agenda and the change agenda. I think all too often we see in terms of funding to the states and various jurisdictions, particularly under national partnership agreements, those agreements expiring. We have rolled over now the Early Childhood Education Agreement five times. Five times.

Now, I know how important early education is. As a parent I know that, but also as a policy maker I know how important early education funding is and we have now rolled over that agreement five times. That's an indication I think of a failed Commonwealth-state system where we need to nut out how we fund these really important years for children, Australian children, so that we are globally competitive in an environment where skills and knowledge are going to be key.

So that's just a demonstration of the fact that there are some areas of the relationship that are critical to the delivery of services that have just broken down and they need to be repaired. So I think the Finance Ministers' Forum is a good place to start to get a reform agenda, but of course we need the Commonwealth to agree to be part of that process.

MR MURPHY: Well clearly it's addressing, you know, vertical fiscal imbalance and of course it's the roles and accountabilities which state governments have for service delivery. I think if you look at things over time, increasingly states have responsibility for key areas such as health and education and it seems, you know, to be blunt, a little bit - how would I put it? Policy being set in Canberra in the education/health fields for delivery of services in Queensland. It just stretches the imagination.

MS CHESTER: Yes and they're the two levers for federal financial reform that we identified in the draft report and as Jonathan intimated - and some have even said to us - we probably dared a little bit greatly by saying as much as we did in our draft report, given our terms of reference, but - so if we were to look at a fundamental reform or a reset to VFI and getting accountability right in terms of spending responsibility so there is some level of accountability between Commonwealth, state and through to the

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electorate, what would you want to see happen there and then would you see the link then to greater scope to a reform of HFE?

We've seen others before head down this path in terms of the Commission of Audit had some reforms of HFE linked to giving the states greater powers - well, a share of income tax, as addressing - so we're just trying to get an idea of where you see that path going, because to some extent where we might take HFE would need to dovetail with that path and HFE might have more - we're quite constrained with what we're looking at at the moment.

MR MURPHY: Well, if you really were - if you had to draft this it would be a step by step process. I think the first step would be to sort out roles and accountabilities between the Commonwealth and the states, say on education. What we find at the present time is increased conditionality coming from the Commonwealth on how states spend money. I mean, Queensland is quite happy to report back in aggregates, macro terms, as to how it's feeling with money that's transferred from the Commonwealth, but at the present time it goes much more into minutiae and conditionality, which is just a waste of time for most people.

So your first step would be to solve that, then if were, as we put forward to the Commonwealth, where states had a share of - well all state treasurers put forward to the Commonwealth that states should have a share of personal income tax. It was only a small share to remiss funding of a number of the small agreements and that was just kicked into touch by the Commonwealth Treasurer. So I think there's a step by step process, but at the same time I would not be moving to be looking at anything on HFE until other things were done, because my point is, the fact is, other than this recent occasion with Western Australia and to some extent New South Wales jumping on the bandwagon - I point out Victoria are quite happy with the HFE, even though they're a donor state.

I think that should be left because it's served everyone's purposes over time and I don't think you'll ever find at a time in federation where all the states will be of the same political persuasion or agree all on the same policy terms. So that's why I'm very loathe to say why we should go tampering with HFE at the present time. If other reforms preceded it, well then there might be a rationale. I wouldn't do that yet.

MS CHESTER: Yes, I think there was a missed window in 2004, Jim, where we had all the state Under Treasurers agreed on equalising across the average of the four donor states and then WA left the party and it all crumbled, but anyway, just a little historical insight to share.

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MR MURPHY: But that's federalism, yes.

MS TRAD: Yes, and I do have to say that any system has got to recognise the inherent complexity and challenges associated with service delivery and costs for decentralised, remote locations and particularly ones that have high indigenous populations, so I think any system has got to recognise the inherent increased costs of providing services in that complex environment.

MR COPPEL: That's what the CGC does and we're not suggesting any change - - -

MS TRAD: Under the HFE principle. That's right, yes.

MR COPPEL: Yes. So it would - we've put forward two benchmarks that may lower that level of full equalisation, but in terms of the mechanics behind it all, they essentially remain unchanged. Although we are, like you, positively inclined towards using approaches that simplify the system, we know that this has been looked at many times. It's a bit of a holy grail, but there's still always hope out there and you've also outlined this as one area of work that may be a way of getting simplicity into the system and building through that simplicity greater public confidence across the states.

On that point of public confidence, that's very important because that's what really gives legitimacy to the system when there is that public confidence. Do you share our view that there is a lack of public confidence that has probably escalated in recent years and do you have any views on either what we're recommending to raise that level of understanding or other views that will achieve similar goals?

MS TRAD: I guess from a Queensland perspective I don't share the view that there is a sense amongst Queenslanders that the current system is unfair. I think that the work and the reason why we're here today is fundamentally because there has been a very long-lasting public debate in WA about whether 36 cents in the dollar is adequate in terms of their GST grants.

So I fully accept that for WA there is a different level of public awareness around their GST income, but I don't think - that is not the case here in Queensland, but I do have to say that, you know, if the federal government does want to pursue some of the lower levels of equalisation than what is currently being experienced today then we will have to explain to Queenslanders why we can't afford to fund or pay for 5,000 teachers and 5,000 nurses and 3,000 coppers and more than 1,100 fire fighters. That will have to be a big conversation that we will have to have with Queenslanders and I think that they will then think that the system is problematic. So yes, from my perspective this has not been a public debate in Queensland. We

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are here today because there has been a very big and loud public debate in WA.

MS CHESTER: Our report did have a very frank and fair exposition of the contributing factors to the current WA situation from a budget management perspective and indeed, as the Under Treasurer rightly pointed out, it showed the relativities moved just as they should move when you go through the mining investment and then mining boom cycle that WA has, which brings us to the point though of - and why the outlier matters is not so much what's there against the benchmark of equal per capita - which is not the benchmark of HFE; it's an anathema to HFE and we call that out in our draft report - but it does matter to the extent that if the equalisation task is very large, to the extent that there might be some trade-off between equity and efficiency within the way HFE is occurring, that it becomes greater.

One of the things we're looking at doing in this final phase of our report is looking - when we did the draft report it was all very backward looking and near term, like what happens next year if we went cold turkey on anything. We're now looking much more with a forward looking lens and looking at sort of projections over four to eight years and ten years.

One of the questions we're looking to ask and answer is to what extend is WA being an outlier a temporary blip versus a medium to longer term blip? Is that something that Queensland Treasury's done some work on or something that you've got a view on, because we've got some guidance from the west which would suggest that, you know, we're looking at this for the foreseeable future, you know; two forward estimate budget cycle periods. Which is a good thing for WA to some extent, because it means they remain fiscally the strongest state.

MR MURPHY: That would be determined by how the nature of the WA economy transitions to wherever it goes. I mean, to me that's another reason why one shouldn't react to a mining boom. I mean, say were any of the states - say for Queensland, if we had huge investment in technology or tech fields and had increased royalties or increased payroll tax or something - so I think it's hard to predict where Western Australia will go. Over time one would think that it will even out because the mining boom will gradually dissipate for them with the exports, but see, this is again - if we react China could in effect close the door tomorrow and that's the end of your exports of iron ore out of WA. Should we be changing the process because up to now they've done well?

MS CHESTER: No, so that's not the driver, Jim; it's more thinking forward to what's the transition path look like for other states and territory

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jurisdictions in terms of how quickly would WA come back in its relativities.

MR MURPHY: Well, under the process it would gradually come back in its relativities. I mean, but we can't escape the fact that at the present time it has increased fiscal capacity through fortunate events for them, you know, and then - but all economies will change over time. If the South Australian economy got a big influx of investment into the Defence industries, that may change theirs. So I think it's pretty hard to predict, other than you look now and you would flat line out as to what you think may happen.

MS CHESTER: Yes. I think this huge iron ore body, even with movement of commodity prices and what the production levels are coming out, it looks like those royalty revenues are going to stay strong for a very long period of time, but anyway we'll do the good homework on that. I think the area where we probably most agree to disagree is on the equity and efficiency trade-off. We just wanted to get a little bit more of a better sense from your perspective about why you feel so strongly that the impact of - so for example has the state government in the last four to five years contemplated any major state-based tax reforms during the period that you've been Under Treasurer, Jim?

MR MURPHY: Yes, we've been looking at state taxes at the time of the - when the debate was running on the level of the GST. We've looked very hard at replacing all stamp duty with land tax, but it's like other states, we've found it an incredibly difficult task to do that, especially as the impact on the state in the short-term. So we're always looking at payroll, changing payroll rates of taxes and I think the point you're getting to is that in any of those discussions on tax reform which go to the government before each budget as to what you could do and what you think Queenslanders should pay - motor taxes and you know, motor vehicle tax and all this - we've never looked at the impact of the GST on the increased revenue into Queensland.

I think we described it as a (indistinct) issue, but it's actually - we don't even - and I've never known a minister to say to us, well how would that impact on our GST distribution? So I think the taxing - I just don't see it that - in theory it may, but I just don't see it how we would hold back reform, which is always so difficult to do in any of these areas, on the basis of potential impact on GST three, four years out.

MS CHESTER: I think we were getting to it from the perspective of it's already difficult enough for a state government, particularly if it's going ahead unilaterally, to dare greatly and do tax reform like a stamp duty-land tax switch - - -

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MR MURPHY: Switch, yes.

MS CHESTER: - - - and then when you actually look through the cameos and see what the costs - how much out of pocket they are then through the GST, it sort of, kind of, beggars belief and that's why we raised it, so that's not theoretical; that's what the actual impact would be on the GST distribution. But I just wanted to get a sense of - so you're saying that - - -

MS TRAD: But it's a theoretical exercise. As Jim said, we don't look at tax reform and we certainly took a suite of tax changes to the last election. We did the heavy lifting and we took a suite of tax changes to the last election and we were re-elected and now we'll implement them. We didn't compile those additional revenue measures thinking about the impact of the GST on our relativity. That didn't even factor into the conversation, as someone who was sitting around the table at that time.

So I do understand, Deputy Commissioner, what you're getting at, but I do have to say from a practical perspective it is not part of our consideration when we look at tax changes and tax reform and if the point around tax versus efficiency, Queensland is still one of the lowest taxed states in this nation and we think in and of itself that is a status which does attract additional efficiencies and additional investment.

MR COPPEL: How about a new tax, totally new tax? I don't have a specific example in mind, but wouldn't the question be asked how this new tax would be treated by the GST, because that could - by the CGC. That could - the answer to that question could be quite significant in terms of deliberations and I accept that there are a whole bundle of other factors that enter into it, that decision.

But if there's uncertainty as to how the CGC may treat a new tax, we've identified that as a potential issue and we've suggested as a recommendation that there be some mechanism for where a state government can ask for an opinion on how that would be treated. We think that would provide greater clarity, greater certainty. I don't know if you have any views on that or whether you've had any experience of - whether you've asked the question or are uncertain about how a particular measure may be treated and how that then would bear on the distribution to Queensland.

MR MURPHY: Yes, well look, let me just say - I mean, this is all speculative. I mean, states have a very narrow tax base and it's hard to think of what would be a new tax which we could implement, so you know, that may be the case; floating something or a ruling from the Commonwealth Grants Commission could be helpful, but all I can say is at this stage it's

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hard to see what we could develop as a new tax and up to this stage we have never taken account of GST implications for any tax reform in Queensland.

MS TRAD: But I'm not sure what the exercise is here, given that, you know, from Queensland's perspective we could be facing a $1.6 billion shortfall in terms of our GST grants to the state. What is the purpose of the exercise? Is it about testing the theoretical capacity of a state to actually do the work necessary to introduce a constitutionally viable new tax for their system to replace inefficient taxes? But meanwhile at the same time you've got a $1.6 billion cut to GST revenues for the state. Like, I'm not actually sure what the purpose is here.

If the purpose is about driving efficiencies at a state level to look at revenue generating taxes and options, then again I get back to my point about Commonwealth-state financial relations. All of the tax reform that has happened, massive economic reforms that have happened in this nation, have been done over a long-term collaborative effort between multiple jurisdictions and that is a format that we know has worked successfully in the past and one that we should pursue. I think it would be very - it's not for GST relativity considerations, I would say as a politician sitting at this table; it's more for political ramifications or consequences to go out and float a brand new tax in isolation of any other jurisdiction.

MS CHESTER: No, so I think our terms of reference explicitly asked us to look at are there efficiency consequences for the way that HFE is currently done and so that's an area that we've delved into; we've delved into it greater than some previous reviews have through the cameo analysis. But we're just looking to ask and answer the question - and it draws on lots of - like the Henry Tax Review and others, which identified that separate to Commonwealth-state federal financial reforms and tax bases, there's still a lot of tax reform that's on the table for state and territory jurisdictions to do in isolation, individually.

So that's a question we've been asked to look at and to answer, Deputy Premier, and that's what we're doing. In that context, though - and it's this whole issue of incentives and policy neutrality; it's not just about tax, it's also about development activities. The CGC in one of their recent papers though have come up with a proposal to try to address one of the policy neutrality issues as it relates to a state making a decision to increase taxes, so they're accepting that there are these efficiency problems and policy neutrality problems within the current HFE arrangements, so their current proposal on the table is that if you're a state where you dominate a tax base, if you increase your royalty rates you get to keep 50 per cent of the dividend from doing so. Which in and of itself you can only kind of think of that

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being WA and iron ore at the moment, but it would be good to know if Queensland can see it applying anywhere else.

That to us would be a departure from full and comprehensive equalisation. So these are other options that are on the table by the CGC for formulaic changes to address policy neutrality and incentive issues. We're kind of looking at it holistically; we've got others looking at it a little bit more piecemeal, so it would be good to get your thoughts and feedback on that.

MR MURPHY: Well that's come on - that's going through - I think it's one of the Canadian jurisdictions introduced that 50 per cent retention of royalties and then 50 per cent gets redistributed. A mining state. I still go back to our principle that we think that we should just stick with the equalisation principle because that is what has proved the test of time, it works in practice and I mean, the majority of states for the majority of the time are quite happy with the way that's worked, so yes I can see it could benefit - like, it's directed at mining now but it could be directed at something else, but I just don't see the strength in the argument, actually.

MR COPPEL: But this suggestion from the CGC is keeping the principle the same. It's just an extension of one of many areas where they do apply discounts per capita because they don't have the information to be able to make the calculations with sufficient confidence, so it's keeping the principle exactly the same but in practice it's leading to something which is less than same level of services like you've articulated in your submission, which takes me back - what's the degree of margin that you have been the same and similar? You seem to suggest that it's almost one and the same thing, but the practice of how these calculations are made can lead to quite radical differences between the two.

MR MURPHY: Well, I don't know if that's right. I think if we get to debate same and similar, we were asked in that submission to come up with suggestions of how you could look at the process to make it fairer, make it a better process. We've come up - we suggested similar fiscal capacity because we thought that would give more flexibility. We haven't said - we said it should be looked at by the Commonwealth Grants Commission as to whether that would be of use to them to enable them to be less criticised for false precision as to what they do.

So that's the strength of what we've put forward: it's a suggestion for someone else to actually look at. So as I say, they should be looking at and getting submissions on what people think about having a 50 per cent retention and a 50 per cent redistribution on large windfalls. Yes, let's have people have their views.

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MR COPPEL: You made the point, Minister, that equalisation to the average as one of the options that was put in the draft report would mean one and a half billion into Queensland and that would be if it were effectively implemented overnight, given the current relativities. Has Queensland looked at what that would mean looking forward? So relativities do change depending on the economic fortunes and relative economic fortunes of the states. Has there been any work that's looked at what possible impacts of that measure would have for Queensland?

MS TRAD: Look, we obviously do our own forecasting, but that is, you know, simply forecasting. I do have to say, if the question is about whether or not, you know, absorbing a significant cut to GST revenue from the Commonwealth of $1.588 billion could be more easily absorbed over ten years than one year, then I make the point that a cut is still a cut. You will still have to account for the fact that there will be 14,000 less frontline public servants throughout our state providing the health, education and emergency services that Queenslanders need.

So of course, over the long term there will always be adjustments and changes, but you know, a significant cut of this size and scale will have a detrimental effect, whether it's over one year, three years or five years or ten years; it will have a significant impact on our ability to provide quality services to Queenslanders regardless of where they live.

MS CHESTER: Just from a budget management perspective - and this might be more a question for the Under Treasurer, but let you decide, Deputy Premier, who you want to answer the questions we put to you. From a budget management perspective, what we're looking at, even if we were to do it cold turkey overnight, sort of represents between 2 and 3 per cent of your revenues, because $1.588 billion always sounds large, but when you then look at it as a percentage of revenues it's a different quantum.

In terms of just budget management, Jim, are there sort of rules of thumb that you have as Under Treasurer in terms of what's kind of manageable in a fiscal management digestion sense year to year? What variance in own-source revenues can you cope with, what sort of levels of efficiency dividends to you require of different portfolios on an annual basis these days? I'm just trying to get a sense of really - we have to look at transition paths and we do want to get a pragmatic and practical sense of - - -

MR MURPHY: Well, I just reiterate what the Deputy Premier has said. It would be extremely difficult to absorb a significant diminishing in the level of the GST that we receive. We've got an ageing population - well, you've

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got an ageing population on one hand; on the other hand, we're still building schools in Queensland to cope with, you know, like influx of more children and we've got the remote issue, the remoteness of the whole place. So we run an expenditure and a revenue where roughly our revenue is about $55 billion and we're spending around $54 billion to meet the expectations of the community. It's not profligate; it's actually meeting the expectations of the community.

So I think it would be very difficult and it would have to be led from cutbacks and the reason we focus on the pubs is because that's where a lot of the funding goes. It's the service delivery by the public servants and so that's the obvious place, if you have to find savings, that's where you have to go. So yes, you know, we have - I think if you want to - the comprehensiveness of the Treasury's analysis and factual information, if you look at Budget Paper 2 for Queensland, it is a comprehensive and a - and it started before my time, but the people there produce a very good analysis and virtually every question you would have about the Queensland economy is in that budget paper, so it's pretty rigorous.

MS CHESTER: No, and the team are working through those documents. It's just we're here in a public environment talking about what you think the impact is on Queensland and we're trying to get an open and - - -

MS TRAD: Well, let me talk to you about the transition path, because in terms of the transition path from where I sit and from where Jim sits, it wouldn't just be in terms - it just wouldn't be about absorbing the changes to the GST revenue to the state. We are being asked to fund at an increased level changes under the Gonski Mach 2 model, find money for the Royal Commission reparation process, we've had the Commonwealth step back from providing $100 million for housing in remote indigenous communities. Now I'm not sure how we're going to close the gap if we're not providing houses to indigenous people in indigenous communities.

There's the Commonwealth stepping back from bowel cancer screening and treatment and that's a service that many Queenslanders have come to rely upon, because we've actually invested in communicating and raising awareness around the importance of bowel cancer screening. So just in and of itself there, there are a number of fundamental funding issues that have been driven by the Commonwealth vacating the space, as well as the prospect of a diminished amount of GST revenue and all of that has to be factored in from where I sit and from where Jim sits and the Queensland government. So any sort of transition plan, can I say, is going to be incredibly difficult considering the agenda that has been provided by the federal government.

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MS CHESTER: Which I think takes us kind of full circle back to medium to longer term federal financial reforms here - - -

MS TRAD: Yes, correct.

MS CHESTER: - - - finding responsibilities and thus seeing HFE reform as part and parcel of that, is that something then that the Queensland government would be more prepared to contemplate?

MR MURPHY: Yes, but I think it's one of these things that - there's so many fundamental things that would have to happen before you start looking at HFE. That'd be my view. Especially in roles and accountabilities. I just think that's where inefficiency lies. For someone who's worked in Canberra for a long time, that's where the inefficiency lies not at the service level, not at the service delivery level, in my view.

MR COPPEL: One of the - you mentioned that the - or at least that the Queensland Treasury does to forecasts and a number of other states do it the same and have shared with us that information. Is that something that you could share with us, from Queensland?

MR MURPHY: Yes, we can provide you with that.

MS TRAD: Yes, we'll have a discussion.

MR COPPEL: Thank you.

MR MURPHY: Actually, my comment is our forecasts are reasonably - we don't have difficulty in forecasting GST revenue, luckily.

MR COPPEL: You don't?

MR MURPHY: No. We find that there's not big variances with what we think will happen and we plan on that basis and what actually comes out.

MS TRAD: That's Jim saying his Treasury Department is pretty good.

MS CHESTER: He's doing a good job at saying that.

MR MURPHY: No, but that's what's happened and my people, my forecasters, tell me they can - we look at other states, we do comparisons and rule of thumb, because we won't overestimate, of course. We don't want to put the government in a position where it thinks it has more revenue than it will get. But no, that's what's happened. That's the information I've given the forecasters, that they do a reasonably good job.

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MS CHESTER: Just one final question that I have. It comes back to the issue of indigeneity. That was an area that we really grappled with long and hard in our draft report; it may not be obvious when you look at the press coverage on our draft report and it would be good to get your views and feedback in terms of where we landed. Where we struggled was people would point to indigeneity as it's manifested in the percentage of cohort of population and remoteness with the disability factors, with the CGC calculations.

Then some academics have done work that looked at, particularly for the Northern Territory, what sort of assessed expenses would go to the Northern Territory for indigeneity and what was actually spent on indigeneity, thus that people then said just take indigeneity out of HFE completely and then go back to a system of tied grants from the Commonwealth. Where we landed was to say it's not a simple issue of in or out. HFE is a much broader issue in terms of let's get roles and responsibilities and accountabilities right there. Indeed, that should be first cab off the rank in terms of the medium to longer term federal financial relations in terms of responsibilities and only then and there would you then work out what would need to still be taken into account in the context of HFE.

So sorry, that was just a shorthand way of saying the journey that we went through and where we landed, which is no change to the current arrangements, but first cab off the rank, the Commonwealth-state responsibilities. Just wanted to get your thoughts and reactions to that, Deputy Premier?

MS TRAD: Deputy Commissioner, look, I think that's spot on. I don't think indigeneity should be taken out of HFE. I think that there are - I think you're right in terms of roles and responsibilities. We, in fact, at a state level have done work through the Productivity Commission around the amount of money that we spend in discrete indigenous communities and the outcomes and we believe that there's a lot of reform that should be happening at both the state and the federal level in terms of ensuring that there are reasonable but good, effective management processes in place, ones that actually give rise to autonomy and self-determination in communities so that they can make the critical decisions around the provision of services, because they in many cases can actually provide excellent advice, guidance and do it better themselves.

In fact, in a lot of examples - particularly in an urban environment and you know, we're not just talking about indigenous populations in discrete, remote locations throughout Queensland, but in heavily metropolitinised or

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urban areas as well, where there is a discrepancy between the life outcomes and the life opportunities of people of Aboriginal and Torres Strait Islander background. So we have got, in Queensland, both; we have got a very big population - and in fact, our biggest indigenous population is in the south east Queensland corner - but we also have a lot of remote indigenous and Torres Strait Islander communities right throughout Queensland. So that's a piece of work that we are undertaking as well.

MS CHESTER: Okay, thank you.

MR COPPEL: It's tangential but I think it's related particularly to the principle of HFE and that is there's a similar system for how Commonwealth funds and state funds are allocated to local governments as there is from the Commonwealth Grants Commission to the states and territories. Similar aspirations, but it's not a system of full equalisation by any means and I was wondering whether you had any comment on the way in which the state system of equalisation among local governments functions and whether there are any sort of lessons or lessons of what not to do that may come from your experience with this system?

MS TRAD: Well, from a state's perspective I'm not sure it's quite the same system as the GST/HFE distribution principle, but certainly from a state perspective the way in which we approach funding local councils, local government areas is very much based on the capacities of those councils to raise revenues themselves. There are councils throughout Queensland that do not have a rates base whatsoever - a lot of indigenous councils - and of course the state needs to be able to assist in providing services and you know, support for those councils to function in and of themselves.

So it's not purely the same, but we do have a process of actually acknowledging and there are Commonwealth-state funding programs that are jointly funded to provide those levels of services, but as a state we are making big investments in terms of some of the ageing infrastructure in these local councils and communities through waste water treatment facilities; we have implemented the Works for Queensland program, which is a program ideally around stimulating local council workforces and local economies, but fundamentally it is about providing money to councils to get infrastructure projects that just never get funded because they don't have the capacity to fund it through their rates base as it is.

But we are in Queensland also moving away from that and you would have seen through the Townsville City deal a new approach to how every jurisdiction funds or creates a pipeline of projects that can be funded across the three jurisdictions to really encourage economic development and

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growth and self-sufficiency within communities. So Townsville has been the first cab off the rank and we are looking at other opportunities to partner with the Commonwealth and local councils around other sort of city deals for Queensland, so I think there's a lot of change that's happening at a council level through that process, but it's - yes, it's certainly one that we're still working on looking through.

MS CHESTER: Yes. Okay.

MR COPPEL: Yes, thank you very much, Treasurer. Thank you to Jim.

MS TRAD: Thank you. Can I close by thanking you very much for responding to our invitation and coming to Queensland? It's been great to have you here and I certainly thank you for the opportunity to present. Can I also thank the Under Treasurer and the Treasury officials who put a lot of work into today as well and Queensland's submission to the Productivity Commission. I'll put on public record my thanks, so thank you.

MS CHESTER: Our thanks as well.

MR COPPEL: We're going to end the hearings for today in Brisbane, unless there is someone else in the room that hasn't had a chance - hasn't registered, but would like to give a few brief remarks and if not, then I formally close this public hearing, which is the final public hearing for the inquiry into HFE. Thank you.

ADJOURNED INDEFINITELY **[3.24 pm]**

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