

PRODUCTIVITY COMMISSION INQUIRY INTO HORIZONTAL FISCAL EQUALISATION

SUBMISSION FROM Wealth Wisdom Pty Ltd

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1 Executive Summary

This submission is coming from a simple premise – just exactly what is the best solution to the problems plaguing the GST / HFE – from a “**National Interest**” perspective.

This submission has looked at the history of the HFE and GST; at the various State and Territory interests, the Commonwealth’s interest - and also at the interests of the Federation itself.

This submission has looked to see if there is a solution that can deliver for All, States, the Commonwealth, the Federation AND be consistent with both the 1998 reform of Commonwealth State Financial Relations and the Australian Constitution (which binds the Commonwealth on what it can and cannot do).

We have found one such solution. Interestingly, it is not a new solution. It does however identify it as the only solution that solves the issue once and for all – and does so on a “nobody is worse off” basis.

It supports the solution where all the recipient States and Territories **are no worse off**. It supports the solution where Western Australia is not being financially decimated. It also supports NSW and Victoria in achieving their Per Capita share of GST.

The solution supported in this submission satisfies all three objectives as stated in the GST legislation – something the current HFE solution does not.

The solution supported in this submission satisfies the objectives of the GST as stated back in 1999 as being a “consistent, reliable, growing, source of revenue” for ALL States and Territories – something the current HFE solution does not.

This submission includes ALL the necessary evidence in full support of the supported solution.

Rather Ironically – the solution is a solution **already** proposed by the Commonwealth itself – in 2014 – by the Commonwealth’s own National Commission of Audit, delivered to the then and current Commonwealth Finance Minister – Senator Mathias Cormann. It is unknown why no action was taken on this pre-existing recommendation.

This submission provides a different perspective, in full support of the Commonwealth’s own National Commission of Audit: Recommendation 9 from its Interim Report from 2014 – **EXACTLY** as per implementation steps a, b and c.

Recommendation 9: Reforming the Federation – arrangements for addressing horizontal fiscal equalisation

The practice of fiscal equalisation between the States is a central and longstanding feature of our Federation. The Commission recommends that, as part of a reformed approach to addressing vertical fiscal imbalance, new arrangements also be implemented to address issues with horizontal fiscal equalisation. This would involve:

- a. sharing all GST revenue on an equal per capita basis;
- b. the Commonwealth providing an additional grant to current recipient States to ensure that no State is worse off compared to the existing equalisation process; and
- c. distribution of the additional equalisation grant from the Commonwealth being determined by the Commonwealth Grants Commission.

2 Response to Submission Questions

2.1 How does the current HFE system impact the Australian community, economy and State and Territory governments?

Response:

The HFE impacts negatively on the Australian community, the economy; and State and Territory Governments.

It impacts on the Australian Community by dragging down successful States by reducing their GST share in order to “equalise” the service they can deliver with those states and Territories that are not as well able to. This inhibits the economies of the successful States whilst incentivising those recipient States and Territories to “do nothing and take the welfare”. This impacts Communities that would otherwise be free to grow as much as possible, which would also benefit Australia as a nation by growing the nation.

It impacts the Economy significantly, by shifting financial resources from those states being most successful to those being least successful. Australia, and the individual State and Territory economies are best served by a system that encourages and rewards growth rather than one that penalises growth. Western Australia, knowing the faults of HFE, embraced the Mining boom on the expectation that once it was seen that WA was being financially decimated – but that Australia as a nation was winning economically, that the HFE would fix that anomaly. That fix has not happened – with WA heading for \$42 billion in Debt, running budget deficits – yet the other States and Territories receive 89% of WA’s Royalties – all for doing nothing.

The current HFE has decimated the finances of Western Australia. The other States and Territories argue for “no change” however if WA truly believed that there would be no change, there would have been no embracing of the Mining Boom – and no extra \$500 BILLION in income for the Commonwealth over the next 40 years from WA’s Mining Boom.

Had WA acted on the basis of no HFE change – it would not have embraced the Mining Boom, there would be no \$500 Billion in additional Commonwealth Revenue over the next 40 years – BUT it would mean WA would have no debt and would be receiving 100% of its GST share. From an economic perspective, the HFE is destroying WA and is using WA’s Royalties to fund the welfare style payments that the recipient States and Territories are receiving.

The recipient States and Territories need equalising – there is no doubt to that. The solution, however, is not to punish economically successful States, but for the Commonwealth to equalise from the additional revenue that activities such as that engaged in by WA generate for the Commonwealth. WA is already generating more than sufficient revenue for the Commonwealth for the Commonwealth to be able to fund this.

As you will see from the submissions from the various States and Territories, the recipient States and Territories will argue for “no change” to protect their welfare payment yet the successful States will argue for Per capita – enabling them to grow as much as possible.

Per Capita with Commonwealth equalising solves both sets of outcomes – no State or Territory is worse off and the successful States are freed to expand their economies – to the benefit of the nation and the National Economy.

Evidence:

- a) 2011 Hansard records of WA Parliament where motion for GST Floor discussed. Was identified that the Infrastructure costs would not be recovered by current formula – but WA would **go ahead** in the “hope” the HFE formula would be fixed or a “Floor” would be introduced. WA went ahead – resulting in **WA Debt of \$43 Billion** – but generating over **half a trillion in additional revenue** for the **Commonwealth**, over the next 40 years.
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- b) 2011 WA Treasury submission to GST Distribution Review - \$1.885 Billion in WA annual expenses not factored in to HFE calculations.
http://www.gstdistributionreview.gov.au/content/submissions/downloads/interim_reports/wa_correspondence.pdf
- c) 2011 submission by WA Premier Mark McGowan to GST Distribution Review – included example showing how WA would be \$300 Million worse off by supporting development of resource project – but WA does this “in the National Interest”
http://www.gstdistributionreview.gov.au/content/submissions/downloads/supplementary_ip/McGowan.pdf
- d) CMEWA Documents – Benefits of WA Resource activities - \$10.7 Billion in additional Revenue P.A to Canberra and \$5.2 Billion P.A to WA in taxes and Royalties. <http://www.cmewa.com/policy-and-publications/policy-areas/economic-competitiveness/preview?path=Fact-sheet-WestAustralia.pdf>
- e) 2016 WA Budget paper – Page 60 - Sensitivity – GST Grants - “For every \$100 Million in Royalties WA generates, WA will lose \$89 in GST Grants” – turning \$5 Billion in Royalties into a net benefit of just \$550 Million for WA – with NSW, Vic and QLD each getting over \$1 Billion each, every year, – for doing absolutely nothing – simply due to Royalties being “equalised”.
<http://static.ourstatebudget.wa.gov.au/16-17/2016-17-wa-state-budget-bp3.pdf?>
- f) CGC HFE Formula – Asset sales excluded from HFE formula consideration – unless those assets are state owned Resources, in which case the proceeds (Royalties) are included.
<https://www.cgc.gov.au/>

2.1.a Is the current HFE system getting in the way of States pursuing higher economic growth and productivity, and at the expense of higher national prosperity? If so, how?

Response:

Our view is yes – HFE is getting in the way, and at the expense of higher prosperity.

Western Australia, instead of further pursuing expansion of its economy, with “National Interest” benefits, is going backwards in having to service \$42 Billion in Debt which it incurred as a result of the current HFE system which prevents WA from recovering the costs and expenses in generating the \$500 Billion in state and Federal revenue that WA is generating over the next 40 years.

The rest of Australia has watched WA destroy its finances by embracing the mining boom, to the benefit of the nation’s finances, hoping that the Commonwealth would see the damage HFE was doing, and implement Per Capita GST. As the Commonwealth failed to implement Per Capita GST – which both the National Commission of Audit and the GST Distribution review advised would be the “ideal” distribution method, WA has been sunk – with the other States and Territories not only refraining from incurring their own expenditure which would largely not be recovered, they have been able to bask in over \$23 Billion in WA’s

“equalised” Royalties – removing any incentive from other states or Territories to embrace to development of their own resources.

The only activity has been the selling of State Assets – which is excluded from equalisation.

If all Asset sales were treated equally – excluded from equalisation - States and Territories would have a genuine incentive to develop their own Resource projects – selling the Resources that they own – and getting 100% of the sale proceeds. As it stands now, selling Mineral Resources is equalised at the Royalty level, but not at the expense level, producing the absurd result of the State incurring all the costs, but getting only a small percentage of the benefits.

There is simply no economically rational model where developing resources works out in the States financial best interest – whilst Royalties are equalised. Exclude Royalties from equalisation – via Per Capita GST Distribution – and the equation is completely reversed!!

It is this “reversed” equation that WA expected the Commonwealth would pursue, when it fully embraced the mining boom – with the \$ 500 BILLION benefit in the “National Interest” resulting. There is no chance of this happening again whilst the current HFE is in place as nobody, including WA, would be stupid enough to make WA’s mistake – again.

Evidence:

- g) 2011 Hansard records of WA Parliament where motion for GST Floor discussed. Was identified that the Infrastructure costs would not be recovered by current formula – but WA would **go ahead** in the “hope” the HFE formula would be fixed or a “Floor” would be introduced. WA went ahead – resulting in **WA Debt of \$43 Billion** – but generating over **half a trillion in additional revenue** for the **Commonwealth**, over the next 40 years.
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[http://www.parliament.wa.gov.au/Hansard%5Chansard.nsf/0/884c478d5c14642f482578e9002c41b4/\\$FILE/C38%20S1%2020110519%20p3672b-3682a.pdf](http://www.parliament.wa.gov.au/Hansard%5Chansard.nsf/0/884c478d5c14642f482578e9002c41b4/$FILE/C38%20S1%2020110519%20p3672b-3682a.pdf)
- h) 2011 WA Treasury submission to GST Distribution Review - \$1.885 Billion in WA annual expenses not factored in to HFE calculations.
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- i) 2011 submission by WA Premier Mark McGowan to GST Distribution Review – included example showing how WA would be \$300 Million worse off by supporting development of resource project – but WA does this “in the National Interest”
http://www.gstdistributionreview.gov.au/content/submissions/downloads/supplementary_ip/McGowan.pdf
- j) CMEWA Documents – Benefits of WA Resource activities - \$10.7 Billion in additional Revenue P.A to Canberra and \$5.2 Billion P.A to WA in taxes and Royalties. <http://www.cmewa.com/policy-and-publications/policy-areas/economic-competitiveness/preview?path=Fact-sheet-WestAustralia.pdf>
- k) 2016 WA Budget paper – Page 60 - Sensitivity – GST Grants - “For every \$100 Million in Royalties WA generates, WA will lose \$89 in GST Grants” – turning \$5 Billion in Royalties into a net benefit of just \$550 Million for WA – with NSW, Vic and QLD each getting over \$1 Billion each, every year, – for doing absolutely nothing – simply due to Royalties being “equalised”.
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- l) CGC HFE Formula – Asset sales excluded from HFE formula consideration – unless those assets are state owned Resources, in which case the proceeds (Royalties) are included.
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- m) 2015 WA Noongar Native Title Settlement - \$1.3 Billion – with WA to fund 99% of it – not “equalised”. Commonwealth to fund a meagre \$10 Million of it – yet major beneficiaries are “equalised” Royalties (WA itself only gets 11% of the Royalties) and Commonwealth which receives taxes of \$10 Billion P.A. (Commonwealth only contributed \$10 Million to Settlement – a once off contribution). This should have been funded 75% by Commonwealth and remaining 25% from Royalties on a non-equalised basis (prior to being equalised). <http://www.abc.net.au/news/2015-04-23/noongar-native-title-federal-government-to-pay-1-per-cent/6416610>
<https://www.dpc.wa.gov.au/lantu/south-west-native-title-settlement/Pages/default.aspx>

2.1.b What evidence is available on whether and how the current HFE system affects the movement of labour and capital across State borders, particularly if a region is experiencing high labour demand?

Response:

As per the evidence at (a) below, WA was well aware back in 2011 that the HFE would not cover the expenditure it would be incurring in both securing and developing Mineral, Oil and Gas projects in and around WA; that the influx of Labour and Capital, across the State borders into WA, that would require expenditure on. WA will end up with a peak debt of around \$42 Billion, purely as a result of the HFE systems failure to properly allow the recovery of the expenditure of Capital and on Labour expenses as a result of embracing the Mining Boom. Had there been a Per Capita GST Distribution with Commonwealth equalising, as per the Commonwealths own NCOA and GST Distribution Review Interim Report recommendations, WA would be receiving 100% of its GST, peak debt would be less than half at less than \$20 Billion, would not be asking for handouts – and would be running Budget Surplus’s.

However....

WA, knowing the financially devastating consequences, went ahead in full support of the Gas and Mining Boom, ensuring that the necessary Labour and Capital entered WA (and the National) economy, such that the Mining Boom and Gas Boom was a major success – delivering \$15 Billion in annual tax and royalty benefits to Australia for the next 40 years – over half a TRILLION dollars in “National Interest” benefit.

The HFE system, as predicted, has produced a ludicrous outcome where WA is producing record amounts of Gas and Mineral exports, generating over \$ 15 Billion in annual Tax and Royalty revenues, yet has a contracting economy and record jobless, because WA only retains 11% of the Royalties(\$550 Million) out of that \$15 Billion in annual tax and Royalty income being generated.

WA receives a little over 4% of that revenue, yet incurs 100% of the “social and infrastructure cost”, which is why WA is heading for a Debt mountain of \$43 Billion. WA did not ask for a greater share of GST than was fair – it just asked for Per Capita, which would have allowed the \$43 Billion in Debt be recovered from the Royalties that Debt burden was incurred to generate.

The bottom line:

Had WA exercised “prudent financial restraint” and waited for the HFE formula to have been fixed such that the expenses and costs in support of the mining boom were fully recovered (never), there would have been no Mineral and Gas boom – with other countries instead being developed – along with the associated benefits. That would be \$15 Billion Per Annum – over half a trillion dollars – in tax revenue over 40 years – lost to Australia – by maintaining the existing HFE formula. It would also have meant no Royalties to be

equalised – with WA getting 100% of its GST and the other States no longer getting 90% of those Royalties they have enjoyed.

The simple fact is that, in the “National Interest”, the exports from WA provide not only a major component of Australia’s exports (and balance of trade), but WA is still the only consistent net contributor to Commonwealth revenue – which is spent on the other States and Territories.

Before deciding that the current system is “fair”, Consider the position Australia would be in now, had WA “**acted prudently**”, as advocated by the other States and Territories, **and waited** for the HFE system to properly reflect ALL the costs and expenses WA would incur – such that WA would not have to go into debt:

- There would have been no mining and gas boom in WA
- Australis balance of trade would be significantly worse
- Australia would have already entered into a recession
- The Commonwealth would have lost its AAA credit rating
- The economy would not have achieved its World record longest run of expanding every quarter
- The **\$100 Billion** in tax and royalties generated by WA over the last seven years would not happened
- The other States and Territories would be \$23 Billion worse off as WA would receive 100% GST.
- The Australian Economy would be between 5-10% smaller
- The Commonwealth budget would be significantly worse off

Instead, as WA did not wait, none of the above occurred.

Evidence:

- a) 2011 Hansard records of WA Parliament where motion for GST Floor discussed. Was identified that the Infrastructure costs would not be recovered by current formula – but WA would **go ahead** in the “hope” the HFE formula would be fixed or a “Floor” would be introduced. WA went ahead – resulting in **WA Debt of \$43 Billion** – but generating over **half a trillion in additional revenue** for the **Commonwealth**, over the next 40 years.
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- b) 2011 WA Treasury submission to GST Distribution Review - \$1.885 Billion in WA annual expenses not factored in to HFE calculations.
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- d) CMEWA Documents – Benefits of WA Resource activities - \$10.7 Billion in additional Revenue P.A to Canberra and \$5.2 Billion P.A to WA in taxes and Royalties. <http://www.cmewa.com/policy-and-publications/policy-areas/economic-competitiveness/preview?path=Fact-sheet-WestAustralia.pdf>
- e) 2016 WA Budget paper – Page 60 - Sensitivity – GST Grants - “For every \$100 Million in Royalties WA generates, WA will lose \$89 in GST Grants” – turning \$5 Billion in Royalties into a net benefit of just \$550 Million for WA – with NSW, Vic and QLD each getting over \$1 Billion each, every year, – for

doing absolutely nothing – simply due to Royalties being “equalised”.

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- f) CGC HFE Formula – Asset sales excluded from HFE formula consideration – unless those assets are state owned Resources, in which case the proceeds (Royalties) are included.
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- g) 2015 WA Noongar Native Title Settlement - \$1.3 Billion – with WA to fund 99% of it – not “equalised”. Commonwealth to fund a meagre \$10 Million of it – yet major beneficiaries are “equalised” Royalties (WA itself only gets 11% of the Royalties) and Commonwealth which receives taxes of \$10 Billion P.A. (Commonwealth only contributed \$10 Million to Settlement – a once off contribution). This should have been funded 75% by Commonwealth and remaining 25% from Royalties on a non-equalised basis (prior to being equalised). <http://www.abc.net.au/news/2015-04-23/noongar-native-title-federal-government-to-pay-1-per-cent/6416610>
<https://www.dpc.wa.gov.au/lantu/south-west-native-title-settlement/Pages/default.aspx>

2.1.c Does the current HFE system create perverse incentives or unintended consequences for reform at the State level? What evidence is there on how these incentives affect State policies and ultimately outcomes for the Australian community?

- Does the HFE system impede State tax reform over time, including States’ decisions on developing their revenue bases and rates? If so, how and to what extent?
- Does the HFE system impede the efficiency of State service delivery, infrastructure investment and policies affecting where people live? If so, how and to what extent?
- Is policy neutrality adequately addressed under the average state policy approach? Why or why not?

Response:

The HFE system does create perverse incentives and unintended consequences for reform.

Effect on State Policies:

The recipient States all depend on the existing formula to deliver GST distributions that are not only significantly larger than their “Per Capita” share, but are further significantly enlarged by the equalisation of WA’s Royalties - \$5 Billion in additional revenue every year that is distributed.

Steadfast rejection of any change:

As per evidence (a) to (b) below, there is simply no incentive to agree to any change as to do so, would cause a decrease in revenue for the recipient States – for no benefit.

The ACT submission to the 2012 GST Distribution Review, puts a very detailed and well-argued case for no change, arguing very strongly against why any change that would benefit WA should occur. This submission, like all others, fails to look at the “National Interest” picture. WA was not proposing a solution that left Canberra worse off; it was simply pointing out that the HFE System was going to financially devastate WA if it embraced the mining boom.

WA, NSW, VIC and WA’s solution – Per Capita with Commonwealth equalising, which the Revenue from the Mining Boom more than covered, provided a solution where nobody was worse off, yet WA would be able to fully cover the expenses – would have worked.

It was the State Policies to oppose at all times ***any change in the HFE system***, that prevented ACT, NT, TAS and SA from supporting that proposal. Had that proposal been supported – unanimously – and implemented, there would be a real incentive to develop Royalty generating projects, which would be

growing the Australian economy – “in the National Interest”. Unfortunately, self-interest overrides National Interest.

Financial disincentive to develop Royalty activities.

As evidenced by (d) to (g), it also means that, with Royalties being equalised, yet all the associated infrastructure expenses are not, ALL States and Territories are likely to be financially better off NOT developing Royalty generating projects. NSW, with just under 30% of Australia’s population, gets to keep the biggest share of its own Royalties – which is still not even 30% of its Royalties. If the HFE System is not going to change, why incur the significant expense of supporting royalty generating activity if, at best, you don’t even get to keep 30% of the revenue from your own resources being extracted, yet incur 100% of the costs.

Financially, better to leave the resources in the ground till at HFE System allows you to keep 100% - ensuring full cost and expense recovery, including related expenses such as Native Title settlements - AND generate a return for the people of the State - and that is before any political or environmental considerations such as fracking, uranium, global warming etc.

Evidence:

- a) Zero Sum Game. In order for WA to get a “fairer share of the GST”, somebody must lose.
- b) Being a Zero Sum Game, even a GST Floor means somebody must lose
- c) The NCOA 2014 Recommendation 9 and the 2012 four State submission had no losers.
- d) 2012 GST Distribution Review interim report
- e) 2011 WA Hansard
- f) 2012 GST Distribution Review submission – Mark McGowan
- g) Mineral Resources are State owned assets.

Consequences for reform:

WA discussed this in 2011, as per evidence (a) and (c), that without reform, WA would be financially devastated under the existing HFE system, if it fully embraced and supported the mining and gas boom. That it would be generating \$10 Billion every year in revenue for the Commonwealth, \$4 Billion in Royalties for the other States, and ending up \$43 Billion in Debt itself – is still seen today, by the other states and Territories as “completely fair”.

Evidence:

- a) 2011 Hansard record of WA Parliament where motion for GST Floor discussed. Was identified that the Infrastructure costs would not be recovered by current formula – but WA would **go ahead** in the “hope” the HFE formula would be fixed or a “Floor” would be introduced. WA went ahead – increasing population by over 500,000 - resulting in **WA Debt of \$43 Billion due to HFE formula failure** – but still generating over **half a trillion in additional revenue** for the **Commonwealth**, over the next 40 years.
- b) The CGC in its interim report in 2012, acknowledged the HFE did not fully cater for the social and infrastructure costs incurred by WA due to its massive population growth in support of the Mining Boom.
- c) 2011 WA Treasury submission to GST Distribution Review - \$1.88 Billion in WA annual expenses not factored in to HFE calculations.

- d) 2011 submission by WA Premier Mark McGowan to GST Distribution Review – included example showing how WA would be \$300 Million worse off by supporting development of resource project – but WA does this “in the National Interest”
- e) 2011 submission by ACT to GST Distribution Review – advocating a “no change” to treatment of Royalties and that it was “completely fair” for WA to have 90% of the Royalties it generated be equalised – yet leave WA incurring 100% of the “social and infrastructure costs”.
- f) Interestingly, advocating for inclusion of Mining Royalties in equalisation effectively trigger Section 114 of the Commonwealth Constitution by treating those Royalties as a Commonwealth tax on State property, to be distributed to the other States – which the Commonwealth is expressly prohibited from doing.
http://www.austlii.edu.au/au/legis/cth/consol_act/coaca430/s114.html

2.1.d Does the current HFE system influence State policies to facilitate, restrict or tax the development of economic activity, and in particular energy and mineral resources?

- What evidence is there for the HFE system affecting State policy choices relating to resource extraction (including regulatory restrictions on development)?

Response:

Incredibly, the WA Nationals, in full awareness of how horribly low WA would benefit, proposed to increase the Mining Lease payment BHP and Rio Tinto pay to the WA Government. The WA Nationals, knowing that 89% of that tax increase would leave WA and be shared by the other States, are nonetheless still supporting implementing that increase.

This is expected to have an adverse reaction by both BHP and Rio-Tinto, such that WA's attractiveness as a commodity supplier is reduced – potentially reducing the volume of minerals exported from WA – reducing both State and Federal incomes accordingly.

With such a small return on the sale of State owned Mineral Resources, any State that currently engages in Resource sales is effectively robbing the people of that State the amount that is equalised as those resources can only ever be sold once – and once sold, and the Royalties equalised – they can never be recovered.

At least by leaving them in the ground till a better HFE is implemented, the State will get 100% of the benefit from the sale of its own assets – once a HFE that allows for 100% retention of Revenue from the sale of state Assets (any asset) is adopted.

2.1.e How does the current CGC relativity process affect States' fiscal management from year to year and over time? How does this affect policy outcomes and economic activity in each State?

- Does the current process impact the ability and propensity for States to manage budgets through cycles, especially for those states relatively more reliant on large and volatile revenue streams?
- How does data reliability and the three-year averaging process affect fiscal management? Is there a better trade-off between GST relativity precision and timeliness?
- What is the ability (and track record to date) of States to project and anticipate their own GST relativities, including any impacts of major State initiatives?
- What resources do individual States expend dealing with HFE matters?

Response:

Volatility, by its very nature, means the three year averaging will have positive and negative impacts. The trade-off between precision and timeliness, needs to be balanced. Rather than using outdated three year averaging for Iron Ore prices, why not just exclude the volatile items and manage them on their own.

Royalties, for example, given they are equalised, could simply involve stating what the “equalisation” rate is – and have each State distribute them to the other States and Territories, on receipt. Eliminates completely the volatility that royalties cause to the HFE process.

Given that Royalties, generally speaking, are income from the sale of a State Asset (Minerals) and should be excluded from HFE the same way other Asset sales are; the next best system is Per Capita GST Distribution with Commonwealth equalising – which also does not include considering Royalties.

HFE, from a fiscal management perspective, is bazaar. Western Australia, knowing the impact of HFE, embraced the mining boom, knowing that HFE would, without change, destroy WA economically. It would result in excess of \$40 Billion in Debt, budget deficits with structural imbalances that cannot be rectified; “equalisation” of income that rightfully belongs to the people of WA, and burdens each person in WA with the equivalent of over \$20,000 EACH – whilst the rest of the people of Australia get 89% of WA’s Royalties at zero cost.

Colin Barnett and Christian Porter, in the best interest of the people of WA, should have tripled the Royalty Rate such that there was no mining boom – or if there was, WA itself would receive a genuine return on its Resources that would have avoided budget deficits and avoided the \$42 Billion Debt.

Unfortunately, that did not happen, and WA is now heading for financial ruin. The people of WA are in for an abysmal financial future till they are taxed to the point that the \$42 Billion Debt is reduced significantly – meanwhile the rest of Australia will bask in over a hundred of Billions in Royalty income generated by WA – at zero expense and zero effort. No wonder nobody wants the HFE to change!!

2.2 What preferable alternatives are there to the current HFE system (as adopted by the CGC in its calculation of GST relativities) of equalising States’ fiscal capacities?

Response:

The preferable alternative to the HFE System is Per Capita Distribution with Commonwealth funding equalisation. This is as per the 2012 four State joint submission and as per the Commonwealths own National Commission of Audit 2015 Recommendation 9.

It is the only option that delivers on all three objectives of the 1998 Reform of Commonwealth-state Relations agreement. It is currently failing this as Objective(ii) has not delivered revenue that grows over time for Western Australia – exactly the opposite. It is also failing Objective (iii) as the financial position of Western Australia has not improved. As a result of the current HFE, Western Australia is heading for over \$42 billion in Debt, years of budget deficits, Structural imbalance in its budget and an atrociously poor 34 cents in the dollar GST share.

The Commonwealth is lawfully obligated to deliver the Objectives as per Section 1.3 of the GST Act - http://www.austlii.edu.au/au/legis/cth/consol_act/antsasta1999402/s1.3.html - which can only be met by implementing a Per Capita GST Distribution with Commonwealth equalising – exactly as per the NCOA Recommendation.

The **OBJECTIVES**:

Objectives 2. The objectives of the reforms set down in this agreement include:

- (i) the achievement of a new national tax system, including the elimination of a number of existing inefficient taxes which are impeding economic activity;
- (ii) the provision to State and Territory Governments of revenue from a more robust tax base that can be expected to grow over time; and
- (iii) an improvement in the financial position of all State and Territory Governments, once the transitional changes have been completed, relative to that which would have existed had the current arrangements continued.

Recommendation 9: Reforming the Federation – arrangements for addressing horizontal fiscal equalisation

The practice of fiscal equalisation between the States is a central and longstanding feature of our Federation. The Commission recommends that, as part of a reformed approach to addressing vertical fiscal imbalance, new arrangements also be implemented to address issues with horizontal fiscal equalisation. This would involve:

- a) sharing all GST revenue on an equal per capita basis;
- b) the Commonwealth providing an additional grant to current recipient States to ensure that no State is worse off compared to the existing equalisation process; and
- c) distribution of the additional equalisation grant from the Commonwealth being determined by the Commonwealth Grants Commission.

Evidence:

NSW submission to GST Distribution review – explains Per Capita succinctly; including Per Capita with Commonwealth funding equalisation as the solution.

http://www.gstdistributionreview.gov.au/content/submissions/downloads/issues_paper/NSW.pdf
http://www.gstdistributionreview.gov.au/content/submissions/downloads/interim_reports/wa_correspondence.pdf

Joint NSW, VIC, QLD and WA submission to GST Distribution review (90% of Australian population being represented) – explains it all.

http://www.gstdistributionreview.gov.au/content/submissions/downloads/interim_reports/NSW-QLD-WA-VIC-Joint-Submission_coverletter.pdf
http://www.gstdistributionreview.gov.au/content/submissions/downloads/interim_reports/NSW-QLD-WA-VIC-Joint-Submission.pdf

Commonwealth's own agency recommended Per Capita – Recommendation 9:

<http://www.ncoa.gov.au/report/phase-one/recommendations.html>

This is also the solution as we have detailed, based on the objectives of what the GST was to deliver. Section 1.3(b) refers back to the 1998 COAG agreement

http://www.austlii.edu.au/au/legis/cth/consol_act/antsasta1999402/s1.3.html

The COAG agreement from 1998. Objectives are listed

https://www.coag.gov.au/sites/default/files/agreements/reform_of_comm-state_financial_relations_PDF.pdf

and

<http://www.standingupforwa.com/solution/>

2.2.a. What should be the objective of HFE?

- Should HFE address fiscal divergences across States due to both structural factors (beyond State influence) and cyclical factors (beyond State influence)? If so, over what time period should this be achieved?
- Should HFE compensate States for fiscal divergences where a State has by choice diverged from efficient tax arrangements and service delivery?

- Should past State policy decisions (such as on economic development, revenue bases and rates, or budget provisioning) influence the form or degree of fiscal equalisation? If so, how?
- What are the advantages and disadvantages of targeting full versus partial fiscal equalisation across States?
- To what extent should States be held accountable for how they use funds received via equalisation?

Response:

HFE should be simple and effective and its objective should be to provide sufficient funding to enable any recipient State to provide a base level of Essential Services at a Standard equal to a defined level. The “Essential Services” that should be provided on an “equal” basis, should be defined, and the Commonwealth should fund that equalisation. These would be reviewed over time, but would consist of Per Capita rates of Staff, adjusted for remoteness and actual cost of provision.

Remember – Clause 7 of the agreement stated that the GST Grants will be available to use for any purpose – which means that the GST Revenue is just that – Revenue. It was agreed to use HFE principles – but not to the extreme that it is today, where Objectives (ii) and (iii) are being breached.

In order to avoid the imbalance currently occurring, Per Capita as per NCOA delivers GST that can be used for any purpose – and the recipient States and Territories that need a higher level of support, can make their case to the CGC as to the extra “assistance payments” to enable the “Essential Services” to be provided at an equivalent level to the average of the top four States and Territories.

The States and Territories should, as a priority, be supported and encouraged to grow as fast as they can, providing the Commonwealth with income far greater than what it costs the Commonwealth in equalisation assistance funding (1% of Income). WA alone generates Annually more than additional Tax Revenue for the Commonwealth to fund the Equalisation amount.

Per Capita GST frees up the economies of each State to engage in economic growth activities and allows the Commonwealth to provide explicit incentives for recipient States to not just rely on the “welfare” equalisation payment – but to be actively engaged in trying to do as much as they can themselves so that more funding is available for economic enhancing activities rather than non-economic expanding activities such as the provision of Services.

2.2.b What are some alternatives to the current system and how would they affect States’ incentives to pursue higher prosperity? How would the alternatives perform, relative to the current system, in terms of efficiency, equity and simplicity, and ultimately which approach is best for national productivity and wellbeing?

Response:

As per the below Alternatives, if the Commonwealth wishes to pursue a maximum economic growth option, Alternative 2A option delivers that. If the Commonwealth wishes to pursue economic growth, but is unwilling to provide the necessary ongoing assistance, Alternative 2B delivers that.

Alternative 1: Per Capita GST

Though simple, this would perform worse than the current system as the beneficiary States would have insufficient revenue to provide all Government services at even a basic level. This is a **FAIL**.

Alternative 2A: Per Capita GST with Commonwealth Equalising. (NCOA Recommendation 9)

No State or Territory would be worse off. No successful State would be penalised either. Successful States would continue to be successful, with the extra Commonwealth revenue being generated would provide the necessary contribution to equalisation, the more they succeeded. The Commonwealth could simplify the equalisation based on ACTUAL equalisation requirements, removing completely any disincentive for any recipient State not to be as active as possible in developing its economy. No State or Territory would be worse off and the maximum incentive to expand the National Economy is provided. Each State would get an increase in GST Annually – relative to Per Capita – which is still a consistent and predictable basis. WA would receive 100% of its GST share – enabling it to exit the recession it is currently in, return to Budget surplus, repay the \$43 Billion Debt – AND further develop Resource projects – reducing its unemployment and resolving its structural budget imbalance. NSW and VIC and WA no longer penalised for their success – will be able to grow even faster. The recipient States and Territories would then be provided with “assistance payments” This is a **Complete PASS**.

Alternative 2B Alternate Funding Variation: Per Capita GST with Commonwealth Equalising. (NCOA Recommendation 9) Per Capita with Commonwealth Equalising option could be implemented with the GST Pool funding the equalisation, rather than the Commonwealth. This would be done by reducing the GST Pool by 10% - for equalisation – with the 90% distributed on a purely Per Capita basis. This would deliver nearly all the benefits of Alternative 3 – without the need for **ongoing** Commonwealth funding. It is a greater impost on the States and Territories (10% of GST) vs. the Commonwealth (1% of Revenue), resulting in a slight reduction in economic activity supported. In order to avoid any “worse off” whilst transitioning, the Commonwealth would need to provide short-term funding for the equalisation payments, progressively reducing, till the GST Pool increases by a further 10% at which this solution would be fully self-funding. This is no different than the original GST implementation. This alternative funding option is still fully consistent with NCOA Recommendation 9. This option is a **COMPLETE PASS**.

Alternative 3: Full consideration of expenses incurred in the HFE Formula.

This would leave recipient States worse off as WA would progressively receive the \$43 Billion to cover its costs and expenses, at the expense of the recipient States. This is a **Fail**.

Alternative 4: Excluding Royalties from HFE System

This is treating Royalty revenue the same way as revenue from any other Asset Sale – excluded - which the Commonwealth is obligated to as per the Note: below – and currently in breach of.

This does not alter the complexity of the HFE System, does encourage economic growth, is “in the National Interest” and would provide the incentive for each State. Its only negative is that it would “shrink the pool” of GST to be distributed as the inclusion of Royalties effectively adds Royalties to the GST pool, providing a GST plus ROYALTIES distribution. The Commonwealth could provide short term subsidisation of GST distribution till the GST pool grew to the size it is currently (2-3 years) – leaving no State or Territory worse off. NSW and VIC are still losers in this – but it would provide them with the incentive to develop Royalty generating projects to offset that loss. This would leave no Losers in the medium term – but would take time to achieve that. It does not address Objective(i) as HFE would still be an impediment to economic activity in recipient States as there is still no incentive to reduce the need for GST assistance. This Alternative is a **Borderline**.

Note: Including Royalties in HFE is effectively treating Royalty income alongside GST income for HFE distribution – which is a breach of s114 of the Australian Constitution. Royalties applying to Property of the State are barred from inclusion in the HFE by this Section – Royalties simply cannot be equalised.

http://www.austlii.edu.au/au/legis/cth/consol_act/coaca430/s114.html

Alternative 5: GST Floor

As calculated at <http://www.standingupforwa.com/a-floor-is-bad/>, a Floor does not provide a consistent benefit. When the Iron Ore price is high, the Floor will result in recipient States receiving a lower GST Share – for no other reason than the GST share would be lower due to higher Royalties. This is the worst reason to implement a GST Floor as the outcome is completely flawed in that it gives WA more GST – when it is receiving more Royalties. This makes no sense.

On the other hand, when the Iron Ore price is low, states such as WA will get a much higher GST share, but will still be carrying the burden of the \$43 billion Debt without any additional income to pay it off. This is when WA would need the benefit the most – yet it is exactly when it would benefit the least.

This alternative is a **complete FAIL**.

2.2.c How do these alternative approaches fit within the wider scheme of federal financial relations? Are some inequalities across States better dealt with outside the HFE system?

Response:

There are real problems with federal financial relations that the HFE system is causing that the HFE system needs to address. The above alternatives explain how they should be addressed. What follows is an explanation why.

Per Capita GST with Commonwealth equalising deals with the problems within, and from, a HFE perspective. It fits perfectly within the federal financial relations framework – and allows for how equalisation occurs. It eliminates inequalities and instead deals directly with recipient States and Territories on a basis which alters the “equalisation” contribution from the Commonwealth to become a true “equalising” contribution rather than the existing “welfare” style payment where recipient States effectively are rewarded for doing nothing.

3.2.d What practices in other federations offer pertinent evidence for the Commission’s considerations?

Response:

The most pertinent consideration is that of the options available to Western Australia if Per capita GST is not implemented. The people of Western Australia, in all likelihood, having already voted for secession once, will actively pursue this option again. This time, they can expect to be more successful. Federation is not delivering for the people of Western Australia – yet an independent Western Australia would.

Can it actually happen? – possibly so <http://www.wa2exit.com/how-will-we-do-it/>

Consider the detailed breakdown of the benefit to Western Australia of leaving the Federation – and compare that to the treatment Western Australia gets now. This benefit to the people of Western Australia is shown at: <http://www.wa2exit.com/>

As seen by www.standingupforwa.com, www.wa2exit.com and www.westralia.today; the people of WA are at a stage where they are starting to develop their own solutions that are aimed at delivering a solution that benefits WA that is not necessarily in the “National Interest”. There is already talk of “Put WA First” micro parties; in order to negotiate a deal with the incumbent party at the next Federal Election that delivers Per Capita level benefits for WA.

The first Micro party with this intent has just been created. It has been formed from renaming itself with the intent on delivering candidates at both a State and Federal level, with the explicit intent of obtaining the balance of power and delivering WA 100% of its GST via a pure Per Capita GST. This first party is <https://westernaustrialiparty.com.au/>

In Conclusion:

From a “National Interest” perspective, Per Capita GST, with Commonwealth equalising (either short or long term), delivers an outcome with nobody worse off. It also delivers the outcome where Western Australia has no incentive to leave the Federation – or to secede – or to vote for these micro parties. It also delivers the solution that delivers ***optimal*** economic growth for **All** of Australia and ALL Australians – which is, after all, the purpose of this inquiry.