

## COMMENT ON PRODUCTIVITY COM.'S DRAFT REPORT OF 9.OCT. 2017

## CONCLUSIONS:

1. HFE is broad concept only & its application not prescribed in textbooks.
2. CGC should ensure HFE is applied only to commonest Services.
3. CGC needs better criterion of need than mere 'payments' for Services.
4. Applying HFE to Revenue items is unjustifiable.
5. Cwlth. creations: NT, ACT should be Cwlth. responsibilities.
6. Subsidies to SA, Tas, Qld: better left to Cwlth. Budget (To/For States).
7. Provide annual deductions in GST for Cwlth. as compo. for above 5/6.
8. Brumby, Greiner, Carter 2012 Report still has state support.

INTRODUCTION: The Draft commences with good points about the present system, then to some moderate criticism and after discussion, recommends what I would describe as tweaking changes. These completely retain what the PC would regard as the touchstone features of The Inter-Govt. Agreement Implementation (GST) Act 2000.

Obviously, the present system cannot be both excellent yet flawed. Tweaking by setting a floor, using averages, moving averages, ignoring extremes etc. will not correct the fundamental flaws existing in the system according to my perception, nor will tweaking provide a longer term solution rather than temporary relief, pending re-appearance of the fundamental flaws.

HFE: The fundamental flaws of the present system centre around the particular definition and application of Horizontal Fiscal Equalisation (HFE) which the Cw. Grants Com. (CGC) has chosen to adopt. As a long-term career economist, I am puzzled at the "broad support" which the PC attributes to the old-fashioned HFE. The HFE is essentially a broad concept only. Its practical application has no sanction in conventional economic texts. The HFE is entirely open to any reasonable criticism that may be levelled at its application. It is no wonder that the PC discovers that the present system "achieves an almost complete degree of equalisation - unique among OECD countries". General acceptance in this present decade, of the CGC's system, is unthinkable in my view.

APPLYING HFE TO COMMON SERVICES: The basic element of HFE likely to be acceptable is that in federated states, ensuring a minimum standard of the common range of Services per capita, could usually be reasonably acceptable, but not for unique, unusual nor exceptionable services of a specialised nature.

The CGC implicitly accepts this principle; for one recent year, I learnt that the CGC avoided applying HFE to about 40% of total state expenditure on services, ie it applied HFE to only 60 %.

Unfortunately the CGC's method of applying HFE to the 60% of state expenditure cannot be totally justifiable; the criterion used by the CGC for identifying above and below acceptable levels in the federation, is the basic amount of the "payment" per head in each state. In the 2000 year of the GST Agreement, basic payments were apparently acceptable as a criterion of need. By 2017, statistical methods have advanced into greater sophistication and the CGC should consider upgrading its procedures.

A ready example is School Funding for 2017 and beyond. A basic payment per primary and secondary student is merely the start; the amounts have to be adjusted to allow for at least six other categories of numbers: of disabled, isolated etc. In short, the CGC has applied HFE on payments for services; these may be considered a rough and ready criterion of need, in order to make the matter more manageable and in the hope that omission of special features will all be nicely cancelled out amongst the states.

APPLYING HFE TO REVENUE-RAISING: Another flaw in the CGC's method is its decision to extend the HFE concept to claim to equalise state capacity for Revenue-raising. The CGC claims it is achieving equalisation by having various types of state revenue redistributed in some cases which eliminate much of the revenue to the home state. The revenue lost to the home state would have been obtained via specific decisions to develop resources or to satisfy specific social needs.

Decisions on state Revenue-raising are matters for each sovereign state. States in most cases are best placed to make these decisions but the CGC's procedures tend to counter state decisions to no good purpose. In some cases, the development of resources may entail a state in having had to provide major superstructure of roads, ports etc. for which the CGC method pays little account. Decisions to explore or develop may have required negotiations to take account of views of farmers, indigenes, environment groups and other community interests. Australia's needs for exports, for assured sources of electricity and similar, may also be relevant.

Accordingly, states vary in their development policies (for good or ill) and the CGC is not in a position to make any proper allowance or this; eg NSW, Vic & NT are said to inhibit exploration for coal seam gas etc. but suffer no CGC penalty; development and use of coal may be opposed in principle; policies on gambling and poker machines etc. vary. In short, Revenue and Revenue Capacity are arbitrary matters and there is no place for applying HFE to the Revenue side. The existing CGC procedure has already caused extraordinary disruption in the GST distribution process, especially for WA. Both LCP and ALP govts. in WA have agreed the system is "broken."

NT/ACT: The use of GST proceeds to subsidise weaker states; Since NT & ACT are creations of the Cwlth., subsidisation of their finances should be the responsibility of the Cwlth. alone.

THE REGULAR SUBSIDISATION OF SA, TAS & QLD.: The practice should be removed from the GST Distribution and handled wholly within the budget process for Cwlth. Payments to and for the States. Here, the way should be made open for expertise, equity and priority-ranking to assist in the political decisions. 17.10.2017

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