



WA FEDERAL LIBERAL MEMBERS AND SENATORS

30 June 2017

Productivity Commission
Inquiry into Horizontal Fiscal Equalisation
By email: hfe@pc.gov.au

We welcome the Productivity Commission's inquiry into Horizontal Fiscal Equalisation (HFE). Western Australian Federal Liberal Members and Senators have long advocated for this inquiry and it comes at a critical time in the evolution of our federal-state relations.

This inquiry provides the opportunity to demonstrate that the current GST distribution formula is a disincentive to national economic growth and productivity.

Western Australia has experienced a rapid and persistent decline in its GST relativity, reaching an unprecedented low of 30 per cent in 2015¹. Estimates show that WA has lost \$23 billion from 2006 to 2016 compared to if it had continued to receive a per capita share of GST².

It is worth noting that the First Interim Report of the GST Distribution Review panel (which included former Victorian Premier Hon John Brumby and former NSW Premier Hon Nick Greiner AC) examined WA's share of GST revenue under the current formula.

In discussing WA's relativity that report concluded that "...it is conceivable that their relativity could reach zero..."³

It is our view that this is an unsustainable position and the current system has undermined public confidence in the GST distribution system. Additionally it is also reducing business confidence, with the Chamber of Commerce and Industry WA (CCIWA) annual member survey for 2017 finding around 60 per cent of WA businesses rank GST reform among their top concerns for the upcoming year⁴. This negative effect on consumer and business confidence is stifling Western Australian economic growth and productivity.

The deficiencies in the current system not only restrict growth in the Western Australian economy but also result in national inefficiencies that constrain Australia's continued economic expansion.

We know from our extensive discussions that many issues will be raised through this inquiry. In addition to those issues that will be included in other submissions we would like the Commission to also give close examination to the "three year lag"; the way in which the

¹ WA Treasury GST Fact Sheet, page 2 <http://static.ourstatebudget.wa.gov.au/16-17/factsheets/wa-gst-share.pdf?>

² <https://thewest.com.au/news/wa/other-states-siphon-23b-from-wa-ng-b88419572z>

³ First Interim Report, GST Distribution Review, March 2012, p. xiii

⁴ http://www.gstdistributionreview.gov.au/content/reports/interimmarch2012/downloads/Interim_Report_March2012_consolidated.pdf

⁴ <https://www.cciwa.com/about-us/media-statements/gst-bugs-wa-business-survey>

current formula acts as a disincentive to national economic development; a proper assessment of infrastructure costs; and the impact on the cost of energy for Eastern States families and businesses.

THREE YEAR LAG

The Commonwealth Grants Commission's (the CGC) use of final budget outcomes and three year moving averages to assess revenue capacity provides an unrealistic picture of a jurisdiction's actual revenue.

The CGC itself notes that:

Where revenues are trending upwards at an unusually fast pace, as in a mining expansion, the lagged average approach routinely underestimates actual revenues in the application year. Conversely, the lagged average approach regularly overestimates actual revenues in the application year during a larger than average downward trend.⁵

The CGC takes the view that this is an acceptable outcome as overestimations have the effect of equalising previous underestimates. However, in reality it also has the effect of worsening economic downturns.

For example, Western Australia's 2016-17 relativity of 30 per cent was determined using data from 2012-13 to 2014-15. Under the CGC's formula, the strong performances of 2012-13 and 2013-14 were combined with the rapidly declining performance in 2014-15. The result was an inflated picture of Western Australia's actual revenue raising capacity, especially as no regard is given to the continued fall of royalty revenue in 2016-17 – the year the GST relativity was being calculated for.

In 2016-17 alone the GST losses associated with Western Australia's historic royalty revenues are expected to exceed Western Australia's actual royalty collections by around \$900 million.⁶

The Productivity Commission should consider whether the lag assessment has the effect of further worsening economic downturns through constraining state abilities to diversify their economies in periods of declining revenue. It should also consider whether it is in the national economic interest for states with very low relativities and volatile revenue streams to continue to be assessed under the time lag approach.

DISINCENTIVE TO NATIONAL ECONOMIC DEVELOPMENT

The HFE formula currently acts as a disincentive to economic development⁷. This matter has been discussed in some detail by the Western Australian Treasury in its submission to the 2011 GST Distribution Review.

This view has also been put by many stakeholders, including BHP Billiton which said "*reform would not only be good for WA, it would be in the national economic interest*", and the

⁵⁵ CGC response to the Treasurer on the Treatment of Large and Volatile State Revenues

⁶ WA State Budget, Budget Paper 3, Page 82 <http://static.ourstatebudget.wa.gov.au/16-17/2016-17-wa-state-budget-bp3.pdf>

⁷ WA Treasury, Submission to the GST Distribution Review, 2011

Minerals Council which noted *“The GST distribution system isn’t working. It punishes states that develop their mining sectors and rewards states that don’t”*⁸.

The CCIWA believes that *“the GST’s Horizontal Fiscal Equalisation model means some states pick up more GST revenue than they would need if they grew their own state resource industries and created local jobs”*⁹.

This is in large part due to the fact that additional revenue gained from developing new industries is often largely re-distributed among states. We believe that this acts in a way similar to the way a high effective marginal tax rate discourages individuals to increase their earnings.

PROPER ASSESSMENT OF INFRASTRUCTURE COSTS

Insufficient consideration is also given to the infrastructure costs associated with developing new industries. For example, WA Treasury estimates that a discount to assessed mining revenue of between 25 and 50 per cent is required in order to properly account for the costs associated with supporting the industry¹⁰.

These expenditure requirements also include social infrastructure to support the labour migration that economic growth typically brings. During the peak of the mining boom WA’s population was growing by up to 90,000 people each year¹¹. This is equivalent to adding a city the size of Launceston and increases demand for schools, hospitals and roads both near remote mines and in metropolitan areas. These infrastructure commitments have long lead times and cannot be ceased if revenues decline sharply.

THE IMPACT ON THE COST OF ENERGY FOR EASTERN STATES FAMILIES AND BUSINESSES.

We note that jurisdictions such as Victoria choose not to develop its onshore gas industry, but still share in the redistributed WA mining royalties and continue to receive relativity in excess of 92 per cent.

We further note that at the same time the eastern states of Australia are experiencing an energy crisis, despite the ability to develop resources to remedy it.

This particular point was given some attention in the Independent Review into the Future Security of the National Energy Market by Dr Alan Finkel AO. The review found that *“Increasing gas supply will relieve supply tightness and assist in mitigating gas price rises.”* And *“Without further and extensive investment in undeveloped gas reserves, there may be significant unfilled demand and continuing high prices on the east coast.”*¹²

Gas prices affect both the cost and reliability of electricity supply in the National Energy Market.

⁸ <https://thewest.com.au/news/wa/bhps-gst-push-ng-b88501461z>

⁹ <https://cciwa.com/about-us/media-statements/wa-business-welcomes-gst-inquiry>

¹⁰ WA Treasury, Submission to the Commonwealth Grants Commission review into GST methodology, 2013

¹¹ http://business.nab.com.au/wp-content/uploads/2016/01/WA_Jan16.pdf

¹² Independent Review into the Future Security of the National Energy Market. Page 116

Dr Finkel recommends “*that government and industry should prioritise the exploration and development of gas reserves to build long-term supply certainty, given the timeframe of five or more years to bring new supply to market.*”

The current GST distribution formula provides no incentive for states to develop their onshore gas reserves, which would result in lower gas and electricity prices for their consumers, boosting economic growth and productivity.

Currently we have a system that rewards those states that choose not to develop new industries, and by extension their state economies. Instead, they can enjoy the redistributed earnings from States that choose to take the risk and invest in economic development. In the long term this constrains national economic growth.

The Productivity Commission should consider whether these policy decisions and the subsequent redistribution under HFE are in the national economic interest. It should also consider, as recommended by the Senate Select Committee on the Reform of the Australian Federation in 2011, whether clauses relating to the capacity of each State to maximise revenue would encourage economic growth.

POLICY OPTIONS

Western Australian Federal Liberal Members and Senators recognise the Australian Government’s publically stated commitment to a floor in the GST and support any such floor being implemented at each point where WA’s relativity returns to a higher level.

There are a number of other policy solutions which have been proposed that are worthy of the Productivity Commission’s consideration.

Chamber of Commerce and Industry Western Australia

The CCIWA has advocated a partial equalisation model that equalises each state to a national average of service delivery, with the excess GST distributed on a per capita basis¹³.

BHP Billiton

BHP, which employs more than 25,000 Australians, has proposed a HFE formula that allowed states to retain some royalties which would be exempt from the GST pool¹⁴. This would then encourage states to develop their own industries, creating state and national economic growth.

Minerals Council of Australia

The Minerals Council’s proposal, similar to that of BHP and the WA Treasury, is for mining revenue to be discounted by 25 per cent in order to encourage investment in resources.

Western Australian State Parliamentary Liberal Party

Our state colleagues in the WA Parliamentary Liberal Party have proposed that 55 per cent of the GST pool be distributed on a per capita basis, with the remaining 45 per cent distributed according to a modified HFE formula.

¹³ <https://cciwa.com/about-us/media-statements/wa-business-welcomes-gst-inquiry>

¹⁴ <http://www.afr.com/news/politics/national/bhps-mike-henry-says-gst-reform-would-benefit-national-economy-20170626-gwyv6w>

CONCLUSION

Continuing with the status quo in relation to the GST distribution formula is not an option and we urge the Productivity Commission to give careful consideration to the issues and policy options provided to the inquiry.

Western Australian Federal Liberal Members and Senators have a strong record of arguing for GST distribution reform and will work with the Government in response to the Productivity Commission's Inquiry to deliver long lasting and real reform that will deliver economic and productivity benefits not only to Western Australia but to all Australians.

Yours sincerely,



Nola Marino MP
Federal Member for Forrest



Senator Chris Back
Senator for Western Australia



Melissa Price MP
Federal Member for Durack



Ian Goodenough MP
Federal Member for Moore



Andrew Hastie MP
Federal Member for Canning



Steve Irons MP
Federal Member for Swan



Senator Dean Smith
Senator for Western Australia



Rick Wilson MP
Federal Member for O'Connor



Senator Linda Reynolds CSC
Senator for Western Australia



Ben Morton MP
Federal Member for Tangney

Western Australian Liberal Members and Senators of the 45th Parliament of Australia