SUBMISSION TO PRODUCTIVITY COMMISSION

HORIZONTAL FISCAL EQUALISATION

Submitted on behalf of the Put Western Australia First Party

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Contact: Charles Hopkins

PRODUCTIVITY

- This submission looks at the outcomes from the current Horizontal Fiscal Equalisation model and considers how HFE impacts productivity.
- The Grants Commission does not consider the impact of its work on the nation's productivity. The document "How does the CGC do its job" on the Grants Commission website includes two statements that demonstrate this:
  - "No activities are prioritized over others"
  - "States are neither penalized or rewarded for their policy choices"
- Therefore the Grants Commission acknowledges that activities that improve productivity are not encouraged and that States that take the initiative in developing nation building industries are not rewarded.

HAS HORIZONTAL FISCAL EQUALISATION WORKED?

- The stated objective of HFE is the distribution of Commonwealth financial support to ensure that "each State has the capacity to provide its citizens with a comparable level of Government services". This is done based on relativities recommended by the Commonwealth Grants Commission which assesses each State's capacity including the capacity to raise revenue and its costs of providing government services.
- In looking at the outcomes in the most recent year it would seem that the result is that states are not treated equally or fairly.

Compare two States Tasmania and Western Australia on 2016/17 data

STATE	TASMANIA	WESTERN AUSTRALIA	TASMANIA % of WA
Area (Km2)	68,401	2,529,875	3
Population	519,800	2,623,200	20
People per KM^2	7.6	1.0	733
Population Growth (%)	0.5	1.0	50
Budget Revenue ($M)	5,574	25,681	22
Budget Expenditure ($M)	5,496	29,596	19
Surplus ($M)	77	-3,915	
Budget Revenue per capita ($)	10,723	9,790	110
Budget expenditure per capita ($)	10,574	11,282	94
GST ($M)	2,299	2,035	113
GST % of Budget Revenue	41.3	8	
GST per capita ($)	4,423	776	571

Area – Geosciences Australia
Population – Australian Bureau of Statistics census 2016
Budget - Budget papers 2016/17

- An examination of the above data shows, Tasmania, a state with 3% of the area of WA, 20% of the population, half the population growth and 22% of the budget of WA received 13% more of the distribution of the nation's GST collection.
- On a per capita basis, the amount of GST paid to a Tasmanian at $4,423 is nearly 6 times that paid to a Western Australian at $776.
- Tasmania relies on GST revenue. It makes up 41% of the Tasmanian budget revenue while GST is 8% of the Western Australia budget.
- In looking at the surplus/deficit of the respective states, Tasmania was able to show an operating surplus while WA shows a deficit.

- It could be argued that these two states are at the extremes but a similar comparison between Queensland and Western Australia provides another indication that HFE, as applied, is not achieving its stated aim.

Compare Queensland and Western Australia on 2016/17 data

STATE	QUEENSLAND	WESTERN AUSTRALIA	QUEENSLAND % of WA
Area (Km^{2})	1,853,000	2,529,875	73
Population	4,864,000	2,623,200	185
People per KM^2	2.6	1.0	253
Population Growth (%)	1.4	1.0	140
Budget Revenue ($M)	53,449	25,681	208
Budget Expenditure ($M)	52,582	29,596	178
Surplus ($M)	867	-3,915	-22
Budget Revenue per capita ($)	10,989	9,790	112
Budget expenditure per capita ($)	10,810	11,282	96
GST ($M)	14,297	2,035	703
GST % of Budget Revenue	27	8	
GST per capita ($)	2,939	776	379

Area – Geosciences Australia
Population – Australian Bureau of Statistics census 2016
Budget - Budget papers 2016/17

- In examining the above data, Queensland, a state with 73% of the area of WA, 185% of the population, 140% the population growth and 208% of the budget of WA received 7 times more of the distribution of the nation's GST collection.
- On a per capita basis, the amount of GST paid to a Queenslander at $2,939 is over nearly 4 times that paid to a Western Australian at $776.
- GST makes up 27% of the Queensland budget revenue while GST is 8% of the Western Australia budget.
- In looking at the surplus/deficit of the respective states, Queensland was able to show an operating surplus while WA shows a deficit.

- Has HFE accurately assessed and adjusted for "each State's capacity including the capacity to raise revenue and its costs of providing government services"? The results would indicate otherwise.
- This holds true when comparing Western Australia to a State with a smaller size, population and budget as it does for a State with a size in the same order of magnitude and a larger population and budget.
- By using HFE, the Grant's Commission aims to assess "each State's capacity to raise revenue and each State's costs in providing services and associated investment." It also works out on a per capita basis "an Australia-wide" average of State capacity to raise revenue and provide services" in determining which States should get more of less GST.

- In the broad examination of the state budget data shows that Western Australia has a lower per capita revenue and a higher per capita expenditure than the other two states, yet it receives a lower per capita distribution of GST.

- In summary, there is nothing equal or fair in the outcomes from the application of the Grant's Commission's model of Horizontal Fiscal Equalisation in the most recent financial year.

- While it might be argued that the inequity in 2016/17 is the result of the application of the three-year averaging of revenue and expenditure, the reality is that the inequity started in 2009/10. In each year since then, WA's return from the GST revenue raised has been below the 79 cents in the dollar that caused New South Wales to now identify the GST distribution as a "tax on our success".

IS THE NATION'S PRODUCTIVITY IMPROVED BY HORIZONTAL FISCAL EQUALISATION?

- Included in the Productivity Commission's "legislative instructions" are some relevant considerations:
    - Improve the productivity and economic performance of the economy.
    - Encourage the development of efficient and internationally competitive Australian industries.
    - Promote regional employment and development.
- It is useful to consider the Commonwealth Grants Commission's work against these criteria.
- The Grants Commission makes no distinction between revenue raised from export industries like the iron ore industry and that raised from domestic recycling of wealth through gambling taxes, land tax etc
- States are not rewarded for increasing the wealth of the nation rather than by taxing domestic activities.
- States are not penalized for failing to develop industries that could potentially provide revenue, especially export revenue.
- It is interesting that the document "What is fiscal equalization?" on the Grant Commission's website, discusses the Commission's inability to estimate the revenue forgone by States in the application of different gambling policies and so it imputes that each State could raise the same amount per person. However, it fails to discuss how it imputes the opportunity cost of a failure to develop all available natural resources.
- It is equally interesting to note that the imputation of gambling revenue is in contradiction to the CGC approach documented earlier - "States are neither penalized or rewarded for their policy choices". Imputing revenue from gambling would seem to be penalizing the one state without widespread deployment of poker machines.
- The lack of a similar imputation of the revenue possible from undeveloped gas resources in States such as New South Wales and Victoria means that they do not suffer any penalty for this. While the impact of the current model of HFE may not be the overriding consideration in the deciding not to develop resources, equality and fairness should require an imputed cost in the same way as the treatment of gambling.
- The current model used to determine the costs of delivering services to remote locations does not reflect reality. The current model measures distances from other States and fails to recognize that services cost more in remote areas. In WA, there are settlements that are more than the 1,254km, beyond which the Commission fails to consider a additional costs. In WA, 1,254 Km from Perth will nearly get you to Karijini National Park (1,475 Km) but not to the resource industry towns of Karratha (1,538 Km), Port Hedland (1,640 Km) or Broome (2,237 Km).
- From this standpoint, the current model of HFE does nothing to encourage regional employment and development.

HOW COULD HFE BE CHANGED TO IMPROVE THE NATION'S PRODUCTIVITY?

If a model of Horizontal Fiscal Equalisation is required, changes are needed to ensure it encourages a growth in productivity and the overall standard of living for Australians and more particularly for those Australians in the States driving the productivity growth.

- The broad parameters of the States' economies should be reviewed to ensure that the outcome delivered by the HFE model is demonstrably fair not just that it achieves an academic measure of equalization. Where the assessment shows an unfair distribution, adjustments should be made.
- The HFE model should include discount for revenue raised from export industries, to encourage all states to maximize their exports and thereby increase the wealth of the nation.
- A more logical model for assessing the cost of remoteness is needed so that a realistic assessment of the cost is considered to encourage employment and development in remote regional areas.
- The HFE model should be simplified so that the parameters leading to the distribution of GST can be communicated clearly.

When the GST was introduced, the intention was for the Commonwealth to collect the revenue and distribute it to the States in exchange for the States eliminating inefficient State taxes.

The unequal distribution resulting from the current model, not only fails to recompense States fairly but it discourages improvements in Productivity.

If the model cannot be made fair, it should be scrapped in favour of a straight distribution of GST funds raised on a per capita basis.