

Productivity Commission

Inquiry into Horizontal Fiscal Equalisation (HFE)

Doug Buckley, 7 June 2017

1 . Effects of current HFE method on economic growth – long term

Economics Nobel Laureate Joseph Stiglitz argues that inequality leads to reduced efficiency and lower long-term growth (E.g. *The Price of Inequality: How Today's Divided Society Endangers Our Future*, 2012). The OECD reports that "when income inequality rises, economic growth falls [thus] tackling inequality can make our societies fairer and our economies stronger" (*Focus on Income and Growth*, December 2014). Investigation into the HFE's past and potential contribution to the long-term economic growth of Australia would appear to be a pertinent and worthy project for the Inquiry.

2 . Effects of current HFE method on economic growth – medium term

How much effect does HFE have on medium term economic growth? Does it matter? Other forces have certainly out-gunned it. Despite eighty years of the very best efforts of the Commonwealth Grants Commission (CGC), our Commonwealth has enjoyed an extraordinary twenty-five years of sustained economic growth, and from a high level.

In any case, though some of our best economists do not seem to engage with the fact, the CGC's main work is not to do with economics but public finance. Not economic growth but equity. Not about the creation of wealth but about the distribution of wealth, namely the common wealth of the Commonwealth.

3 . Use of non-contemporary data

Use of non-contemporary data appears to be a major current weakness. One way forward would be for the CGC to forecast certain key variables. When the data come in, retrospective adjustments would be made to distributions. Thus a set-up broadly as follows is easy to imagine: a state's grant in year three is calculated using data forecasts. To this is added or subtracted a correction due to data now available for year one. Sadly, my experience suggests that some people try to avoid forecasting. If such is an issue, CGC should be courageous to gird its loins and give it a go, safe in the knowledge that there will be a later opportunity to correct the effects of incorrect forecasts.

4 . Effects of current HFE methods on the productivity of state administrations – HFE causing states to lose the benefits of their productivity improvements

Let's suppose that the Inquiry decides that HFE somehow causes a state to lose the financial benefits of its productivity improvements. On the basis of a superficial acquaintance with HFE calculations, it seems that this would be a reduction rather than an elimination, leaving a net benefit to the state from any productivity improvements. Any such collateral damage, however aesthetically displeasing, in a small part of a larger and worthier project.

5 . Effects of current HFE methods on the productivity of state administrations – gaming the system

A flip side to this is the notional opportunity for a state to game the system by neglecting or compromising administrative productivity in order to increase a later grant. As one who spent fifteen years in senior positions in a state administration, I know that the forces and incentives promoting productivity improvement are much stronger than those promoting grant increases. Firstly, what are the chances that any such grant increase would flow to one's department? One's section? Secondly, productivity improvements are more immediate. Thus a counter-productivity decision in year 1 might affect a CGC report published in year 2, 3 or 4, and increase a grant made in years 3,4,5,6 or 7. State administrators have organisational horizons far shorter than this. Career horizons also. Moreover, almost no-one within state administrations apart from treasuries has any interest in or understanding of HFE.

6 . Effects of current HFE methods on fiscal reform

No doubt the Inquiry will seek specific or notional examples of the CGC compromising state fiscal reform. Such should be reviewed in the light of the same kinds of practical incentives and impediments covered in sections 4 and 5 above. Pressures for fiscal reform are far greater and more immediate than pressures to improve a future grant.

7 . Simplicity

Though the CGC's terms of reference are straightforward enough, they are not easy to communicate to a casual observer. Moreover the consequential calculations are necessarily complex. Surely there is a place for some competent PR and advertising. It is not clear who should have the responsibility. Why should the CGC not give it a go?

8. About Doug Buckley

From the mid-1970s to 1990, I was a submission-writer and witness for New South Wales, as well as being involved in a CGC tour of NSW. I was an observer at Victorian and Western Australian hearings in Melbourne and Perth and toured WA with the CGC as an observer.

This was while Corporate Planning Manager and similar with the NSW State Rail Authority on occasional secondment to the state treasury. Pertinent to sections 5 and 6 above, far from making decisions in order to game the CGC, most transport managers have barely heard of the CGC. From a transport administration numbering many tens of thousands of staff, I was, for well over a decade, the only person with any understanding at all of the CGC and mine was very much an in-passing knowledge. I am pretty sure that the same would hold in most state administrations. Even within the state treasury, only a handful need to deal with CGC.

The above followed nine years as a senior lecturer in engineering at the University of New South Wales.