



Marjorie Black House
47 King William Rd
Unley SA 5061

P. 08 8305 4222
F. 08 8272 9500
E. sacoss@sacoss.org.au
www.sacoss.org.au

ABN 93 197 662 296

The Productivity Commission
Canberra
Submitted via online portal: 10/11/2017

Re: Comments on the Draft Report on Horizontal Fiscal Equalisation

The South Australian Council of Social Service is the peak body for the non-government health and community services sector in our state and has for a long time been aware of the revenue challenges facing state governments around the country. Over the last 4 years SACOSS has made a number of submissions to government inquiries, both state and federal, arguing the need for a fair and adequate tax base to fund the public infrastructure and services that the community relies on.

SACOSS welcomes the opportunity to comment on the *Draft Report* of the Productivity Commission's review of horizontal fiscal equalisation (HFE). In doing this, we have had the benefit of reading the submission of the Tasmanian Council of Social Service and, just as the TasCOSS did for their state, SACOSS wants to highlight the importance of a fair share of GST revenue to the South Australian state budget and to the provision of vital services in our state. GST revenues amount to a projected \$6,302m or 33% of total revenue in the 2017-18 South Australian state budget, so any proposal which resulted in a decrease in GST revenue would have a substantial impact on the ability of the state government to provide services to the South Australian community.

SACOSS endorses the broad direction of the TasCOSS submission, and in particular the support for maintaining the current equalisation objective:

State governments should receive funding from the pool of goods and services tax revenue such that, after allowing for material factors affecting revenues and expenditures, each would have the fiscal capacity to provide services and the associated infrastructure at the same standard, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency.
(CGC, 2015, p. 2)

Accordingly, we reject the proposed changed objective of reasonable rather than full equalisation (Draft Recommendation 2.1).

TasCOSS rejects the move to equalisation based on a "reasonable standard" on the basis that the proposed standard is "nebulous, inadequate to ensure equality of opportunity of residents between states, and would be highly liable to political erosion". SACOSS would add that that even pegging of equalisation to a set standard like the second strongest state

by definition undermines equalisation. It allows one state to have a much greater capacity to provide services.

The argument for the proposed change seems to be based largely around WA as an outlier state. We find this argument less than convincing, not least because the WA issue seems to be in part a time-lag issue and in part a result of poor management and gambling on a rule change. While the time-lag problem is real, we would be concerned that any attempt to shorten the averaging period or timing would increase volatility for all states and make state budget planning more difficult.

Overall, we do not believe that the WA outlier argument points to a problem in the objective and or in the HFE system as a whole. Rather than being an outlier problem, the WA example is the system working as it was set up to – to redistribute funds from stronger states to ensure all state and territory governments have capacity to provide services at the same standard. To change that system to a lesser target of redistribution means that citizens in states like South Australia would inevitably get poorer standard or less services than the stronger states. This would be unfair and would exacerbate existing differences between state populations.

Because SACOSS supports the principle of equalisation as currently articulated, we are particularly wary of any proposals which rely more heavily on EPC. This is unfair and would penalise those states and populations who were most in need of equalisation assistance, or alternatively create greater dependence on the Commonwealth for top-up funding. Commonwealth funding is often tied, or potentially tied depending on the politics of the day, and is far less certain than a *right* to a share of a common fund. Our experience is also that Commonwealth funding directed through the state government is often far less adaptive to local needs and conditions. We are often told when highlighting problems or trying to negotiate programs with the South Australian government that their hands are tied because it is federal money. In this context, we welcome the Productivity Commission's Draft Finding 8.2 and most of Draft Finding 8.3, although we would remain wary of such a "top-up" proposal even in the context of broader financial reforms.

Given our position outlined above, we are particularly concerned with the language and implications of Draft Finding 8.5 and the subsequent information requests. There are of course semantic debates to be had around definitions of equality, but we question whether there are a "spectrum of fiscal equalisation outcomes" – or just outcomes which either do or don't deliver equality. However it would be dubious (if not Orwellian) if the language of equalisation was used to promote approaches which move away from the current equalisation goal in favour of outcomes which, by definition, are less equal and result in some states have greater capacity for delivery of services than others. For this reason we reject Draft Finding 8.5, and given that, we also decline the subsequent information requests which seek feedback on how to change the objective that we do not want changed.

Finally, there is one area where SACOSS may diverge slightly from other submissions arguing for maintenance of the status quo. That is around the concerns about the current HFE system creating disincentive for reform. While we do not want to get into arguments over

evidence and absence of evidence, it would appear to us quite reasonable that any state Treasury would consider and model the impact on GST receipts of any tax reform – it would be negligent not to. The outcome of this consideration may not determine the decisions made or policies adopted as it is just one of a number of considerations and our observation of recent tax reform proposals is that political rather than fiscal considerations have been paramount. However, this may not always be the case.

SACOSS is particularly are concerned about any potential HFE disincentive for tax reform because our engagement with debates around the digital economy suggest to us that in the coming years there will be major changes that will impact substantially on state tax bases. This may require new revenue streams, not just tweaking existing taxes. A couple of obvious examples:

- The introduction of driverless cars would mean no drivers' licence fees, substantially fewer vehicles and therefore less registration tax, and no traffic fines (as computers by definition follow to rules). At \$634m, motor vehicle fees and taxes constitute 13.7% of the 2017-18 South Australian budget (SA 2017-18 Budget Paper, No. 3) so an erosion of this tax base would have significant budget impacts.
- The rise of the "gig economy" and the conversion of employees to contractors hired by "app" will undermine the capacity for payroll taxes. South Australia is already seeing Ubercare, the first app-based operations in the health and community services sector – which is supposed to be one of the sectors most resistant to digital disruption. Whatever the pros and cons of such a care model, the gig economy will be a challenge for the payroll tax base – particularly in South Australia where it is dependent on narrow range of large firms.

Given these future scenarios, SACOSS believes it is imperative that the HFE system does not provide disincentives for future tax reform. However, we do not see this as a reason to abandon the full equalisation goal. Moreover, in our view, the proposed move to a "reasonable standard" of equalisation (which is not equal) would do little to address any disincentives for state tax reform.

To the extent that there are HFE disincentives for tax reform, these should be addressed in their own terms – for instance, with some provision, exemption or discount for first-mover states. However, such changes are probably not best done in the current environment and are not really relevant to the key recommendations of the Draft Report which are primarily around outliers and the objective of HFE. And in this context, our primary concern is to express support for the current HFE objective of full equalisation.

Thank you for your attention to this submission.

Yours,

Ross Womersley
CEO