QCOSS Queensland Council of Social Service

Submission

The Productivity Commission Inquiry into Horizontal Fiscal Equalisation - Queensland Public Hearing (5 February 2018)

The Queensland Council of Social Service (QCOSS) welcomes the opportunity to lodge a submission to the Productivity Commission inquiry into Horizontal Fiscal Equalisation (HFE). QCOSS is the state-wide peak body representing the interests of individuals experiencing or at risk of experiencing poverty and disadvantage, and organisations working in the social and community service sector. For more than 55 years, QCOSS has been a leading force for social change to build social and economic wellbeing for all people and communities in the state.

QCOSS supports the current HFE objective for redistribution of GST revenue to the States and Territories. QCOSS also supports the recommendations of the submissions to the inquiry by the Tasmanian Council of Social Service (TasCOSS), South Australian Council of Social Service (SACOSS), WA Council of Social Service (WACOSS), and the Queensland government.

HFE is critical for social investment and for fairness

Any federal government is responsible to all its constituents for a fair redistribution of GST revenue to support universal service delivery, regardless of where people live. The HFE is currently the best way to redistribute GST revenue. The Productivity Commission's recommended changes to HFE will undermine the principles of fairness and equity that underpin fiscal equalisation between the States and Territories.

QCOSS shares the TasCOSS view that "*all Australians are entitled to the same access and quality of essential services, such as health, education, and transport, and to corresponding equality of opportunity in life.* [and] *that this expectation is shared by the Australian public."* (TasCOSS, 2017). Similarly, the Queensland government states *"The community expects that all Australians will receive similar standards of services regardless of the State in which they live and HFE is a key element in meeting this expectation …. The equity that underlies this principle is fundamental and must be preserved."* (Queensland Government, 2017). Likewise, the Commonwealth Grants Commission says, *"Australians should have access to similar standards of State services, with comparable levels of taxation, regardless of the jurisdiction in which they live*" (CGC, 2017).

QCOSS supports social and economic wellbeing in strong, thriving communities, and we recognise the positive impact on that wellbeing from social investment by the Queensland government. QCOSS is therefore concerned about a potential loss to the Queensland's budget of $729 million, $1.588 billion or $2.399 billion (depending on different models). This would likely impact greatly on the delivery of essential social services such as health, education, transport and housing, which would negatively impact on the wellbeing of individuals and their communities across the state.

As the Queensland government submission states "*the most immediate benefit brought about by the current system of HFE is arguably in the services it allows States to provide. Any change proposed to HFE … must be balanced against the social costs of any potential reduction in services in some parts of the country – and the important role those services play in the long-term health of the economy*" and "*For a number of States the estimated fiscal impacts would be significant and may prevent them from delivering the services required by their communities while other States would have excess capacity to deliver services",* (Queensland Government, 2017).

A History of Horizontal Fiscal Equalisation

The Vertical Fiscal Imbalance (VFI) - The Australian Constitution provides for equal representation of all States and Territories in the Federation, facilitating equitable government services regardless of jurisdiction. The constitutional division of power limits the areas that the Commonwealth and the States and Territories can legislate and tax. As a result, a Vertical Fiscal Imbalance (VFI) exists between Federal revenue and State spending. The tax transfers between the Commonwealth and the States and Territories are a mix of tied and untied grants to which the Commonwealth Grants Commission has applied principles of equalisation since 1978.

The GST and Horizontal Fiscal Equalisation - With the introduction of the Goods and Services Consumption Tax (GST), all States and Territories signed on to the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations in 1999. This enshrined HFE as the mechanism, (administered by the Commonwealth Grants Commission), for resolving the VFI. "*The achievement of HFE among the States and Territories is a strength of the Australian federation"* (CGC, 2017). Although some states have supported an 'Equal Per Capita' adjustment, there are clearly more material differences between States and Territories than just population. The HFE is intended to adjust GST revenue according to differences between the States and Territories for both revenue and spending issues that are outside of each of their governments' policy control:

On the *spending* side	**On the *revenue* side**
• regionalisation (infrastructure and services) • age of population (health and education services)	• natural resources (mining royalties) • properties (land tax) • businesses (payroll tax)

Recent HFE Reviews - This Productivity Commission Inquiry follows other recent HFE and GST Distribution reviews. The '*2012 GST Distribution Review'* (Brumby, et al, 2012), thoroughly investigated and resolved the issues being considered by this Inquiry. It found no evidence that HFE acts as a disincentive to State efficiency policy reforms. Likewise, the Commonwealth Grants Commission expressed their expert view to retain the HFE 'as is', in their Position Paper for '*The 2020 Review - Principles of HFE and its Implementation'* (CGC, 2017).

Productivity Commission Arguments for Reform

Western Australia as exception - Being a very large, regionally dispersed state, WA has been a long-term key beneficiary of HFE up until the mining boom. It is only due to the time lag of the HFE 'catching up' to the loss in royalties after the end of the mining boom, that has given rise to its current shortfall in the redistributed GST. Expert economist Saul Eslake (2017) asserts that this is something that was foreseeable and avoidable with proper planning. To now change the rules due to poor planning would introduce a new policy distortion. The WACOSS submission says that any change should "*not force States and Territories into overdevelopment of their natural resources"* (WACOSS, 2017).

'Reasonable', not same, standard - The Productivity Commission recommends reducing fiscal equalisation so that States and Territories are funded to be able to deliver just "*reasonable*" services rather than services "*at the same standard*". However, this may see the gap widen between outcomes in urban and remote areas. The Queensland Government suggests that "*framing of a reasonableness test, … requires careful consideration. … any change must continue to preserve the core tenets of HFE."* (Queensland Government, 2017).

Perverse incentives for reform - The Productivity Commission claims that current full equalisation has the potential to reduce incentives for governments to implement efficiency reforms. However, previous Inquiries found (and many submissions asserted), that this is only theoretically possible and there is no evidence that this has happened in practice in any State or Territory. The Productivity Commission goes further and suggests that "*absence of evidence is not evidence of absence*", which could be the justification for changing anything.

Productivity Commission Alternative Approaches
The Productivity Commission has not made the case for a need to change the HFE, and their alternative approaches to HFE also lack evidential support. They have themselves outlined the limitations of many of the alternative approaches:

1. **Equal Per Capita** (Draft Finding 8.2), is "*inimical to achieving the core equity rationale under pinning Horizontal Fiscal Equalisation*".
2. **Relativity floors** (Draft Finding 7.2), and **Discounts for** particular revenue streams, for example, **Mining** (Draft Finding 7.1), "*do not resolve HFE's deficiencies and must prove arbitrary, and likely have unintended consequences*".
3. **Equal per capita with top-up** funding (Draft Finding 8.3) "*would always be hostage to fiscal constraints faced by the Commonwealth Government".*
4. **Actual per capita** approach (Draft Finding 8.4) "*has significant risks for adverse efficiency effects … and on those grounds, is an unacceptable alternative*".

This leaves just one alternative approach: "***a spectrum of fiscal equalisation outcomes***" that includes equalising to the average fiscal capacity of States and Territories and equalising to the second strongest State (Draft Finding 8.5). This would result in a significant windfall (of $7,384 to $8,287 per capita for 2008-2017) for Western Australia, with all other States and Territories having their funding reduced, (including Queensland's by $898 to $1,561 per capita for 2008-2017). In addition, the Queensland Government stressed that "*equalising to the average or the second strongest State does not address the complexity and transparency issues that the current HFE model is often criticised for. Both models still require the current complex process to be carried out… This further adds to the complexity of the current approach, making it less transparent and less comprehensible",* (Queensland Government, 2017). Similarly, TasCOSS indicates "*efforts to privilege the strongest state, such as through alternatives to full HFE discussed in the Draft Report, are likely to increase disparities in net fiscal benefit and so increase the inefficient movement of labour and capital*" (TasCOSS, 2017).

QCOSS Recommendations
QCOSS supports a wider review of federal state financial relations, and of federalism in general. We agree with the Productivity Commission that "*greater benefits will only come from more fundamental reforms to Australia's federal financial relations*" (Productivity Commission, 2017). We likewise support the Queensland Government's statement that *"the distribution of GST forms only one part of a wider framework of federal financial relations" (Queensland Government, 2017).*

The alternative approaches for HFE proposed by the Productivity Commissions will significantly negatively impact the Queensland budget, and so also impact social investment in the wellbeing of people and communities. This would reduce the positive redistributive impact of equalisation, and therefore reduce the fairness of HFE. There is little evidence for the necessity of such a change, and it risks introducing new perverse incentives. For these reasons, QCOSS supports the established, essential principle of equity in the current HFE.

References

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