

Submission to the Productivity Commission's Draft Report on Horizontal Fiscal Equalisation

10 November 2017

1. INTRODUCTION

The Parliamentary National Party (PNP) have long argued the GST distribution is the most pervasive issue impacting Western Australia's economic and social development. The Nationals have been consistent in our message arguing for change since 2011, when O'Connor MHR Tony Crook introduced a Private Members Bill in Federal Parliament calling for an immediate 75 per cent floor to be implemented. This was followed by motions in the Western Australia Parliament by Former Nationals Leader Brendon Grylls and current Deputy Leader Jacqui Boyde.

The PNP maintains WA faces a structural budget deficit. This has emerged as a consequence of a range of factors, including significant spending growth as a result of a mining, construction and population boom; dramatic and sustained public sector wage growth; and the falling GST share.

The Productivity Commission's draft report highlights deficiencies with the current horizontal fiscal equalisation (HFE) formula, calling it an "undeliverable ideal" where the current full degree of fiscal equalisation is taken too far. In the quest for policy neutrality, the system discourages states and territories from undertaking industry expansion and productive reform measures. It is evident current redistributions are more extreme than was ever envisaged when the GST was first conceived. This is to the detriment of Western Australia and the nation. Indeed in WA, confidence in the HFE model and Federal politicians has eroded significantly among the business and non-business community.

To that end, the report recommended a revised objective and a more reasonable form of equalisation to the second strongest state or an average of all states, and called for leadership by the Commonwealth to drive this reform. The Productivity Commission considered "a revision to the objective of HFE would be in the best interests of national productivity and wellbeing" (p17).

The Productivity Commission has delivered a report that presents a clear mandate for change. Scott Morrison said in his media release dated 9 October 2017 that the findings of the report "establish[ed] a national interests case" and it is the "Turnbull Government's goal to deliver a fairer, more durable and more efficient system for implementing HFE into the future"¹. However, the Productivity Commission's inquiry is at risk of becoming a farce when one considers recent comments by WA Federal Liberals, namely Julie Bishop and Christian Porter, who have shown complete disregard for its findings.

At a recent Chamber of Commerce and Industry function, Christian Porter suggested that WA's political and business leaders needed to do more to convince Eastern States of the need for change². Similarly, Julie Bishop suggested that "only in a 'parallel

¹ Hon Scott Morrison MP 2017. *Productivity Commission releases draft report on horizontal fiscal equalisation* <http://sjm.ministers.treasury.gov.au/media-release/098-2017/>

² Kagi, J. 2017. We're seen as whingers': *Christian Porter urges WA to step up GST fight* <http://www.abc.net.au/news/2017-10-31/wa-viewed-as-gst-whingers-says-christian-porter/9104156>

universe' would the Federal Government give WA a fairer share of the GST at the expense of other States"³.

Alarming, the Federal Labor Party under the leadership of Bill Shorten has shown even less of an appetite for change. Chris Bowen, the would-be Treasurer in a Shorten Government, has said his party would not even consider changing the GST system if elected. Labor's policy to have a piecemeal 'fair share fund' is nothing but a band-aid solution, which was also a finding of this inquiry.

Given the report's findings are a clear mandate for change, the PNP implores the Commonwealth show leadership in this space and deliver new terms of reference to the Commonwealth Grants Commission that is in the national interests, irrespective of the agreement of COAG.

In this submission, we will outline our support for a revised objective and suggested model.

2. REFORMING HFE IN THE NATIONAL INTEREST

A key finding of the Productivity Commission's first report was that "reforming HFE would deliver benefits to the Australian community" (p2). The report found that a new method of distribution would improve national productivity and wellbeing. This is because the current model undermines economic growth by discouraging efficient reform measures as well as industry development and expansion, particularly in the context of the resource and minerals sector. As a result, these findings present a case that goes beyond a 'WA versus the rest of the Federation' argument, and falls on the Commonwealth to show leadership and deliver a model that is in the national interest.

The PNP have long argued the current modelling encourages a status quo mentality, and penalises states that seek to advance industry or undertake fundamental reforms. There is a major problem when a state's decision to approve mining activity or create new revenue streams can have a very significant effect on the GST distribution. The Commonwealth Grants Commission (CGC) in their recent 2020 review position paper also conceded that the current methodology had the potential to "risk undue conflict with the policy neutrality principle", particularly in the context of mining dominated states⁴ (p2).

As a result, the CGC suggested it will, in future, undertake measures to ensure any state's discretionary revenue policy changes will not excessively change the GST distribution. The CGC suggest states would then retain at least half of its revenue measures from tax or royalty rate changes. The CGC also indicated it would ensure to not unduly penalise or reward states that adopt very different policy approaches toward

³ Emerson, D. 2017. *Fair GST share only in parallel universe: Julie Bishop*. <https://thewest.com.au/news/wa/fair-gst-share-only-in-parallel-universe-julie-bishop-ng-b88646242z>

⁴ Commonwealth Grants Commission 2017. *R2020 – Commission Paper on the Principle of HFE and its Implementation*. https://cgc.gov.au/index.php?option=com_content&view=article&id=269&Itemid=564

potential mineral and energy developments, and will seek to minimise tax reform disincentives.

This in itself would lead to a positive step forward in the HFE methodology. The Nationals WA proposal to increase the Special Lease Rental fee contained within legacy State Agreements held by BHP and Rio Tinto as a mechanism to develop a new and much needed revenue source would not have been undermined by the current GST methodology. A key line of argument driven by industry and other parties was that any revenue streams would be redistributed away to the Eastern States. Similarly, this GST redistribution argument was central to the Chamber of Minerals and Energy campaign against the Special Lease Rental as well as the Labor Government's slated gold royalty hike. It is increasingly found within the Western Australian psyche that any revenue reform or tax increase proposals proposed by the State Governments is pointless and most revenue will be lost in the GST carve up. This is compounded by modelling which shows the majority of WA's mining royalties have been subject to redistribution via the GST.

While the CGC's mechanisms would substantially improve the methodology – and deliver a better outcome for Western Australia – it will not rectify the fundamental failings of the model, that being, its inability to deal with extreme circumstances. In the PNP's initial submission, we suggested a number of minor improvements as well as suggestions for fundamental reform. In particular, the PNP put forward a new model that delivers partial equalisation and per capita sharing, allowing a more balanced assessment. While this was not canvassed in the Productivity Commission report, the suggestion of implementing a more reasonable form of equalisation by modelling to either the second strongest or an average of all states was suggested to deliver more reasonable relativities and remove the impact of extreme outliers.

According to the CGC submission to this first draft report, such a change would deliver an additional \$3.244 billion to WA. However, the CGC also indicate that such a model would provide the fiscally strongest state with a considerable advantage, thereby delivering a level of service that is above the average. The PNP suggest that the CGC's alternative model which involves a discount factor would not deliver a fair outcome to Western Australia and therefore is not supported by the PNP.

The PNP seek fundamental reform that delivers a fair return to Western Australia, and the model suggested by the Productivity Commission would deliver a better return. In the interim, the implementation of a floor in the first instance, in conjunction with the CGC's proposals to achieve greater policy neutrality would provide the immediate benefit of limiting perverse and unintended economic outcomes.

Moreover, the PNP continue to make the case that the methodology used fails to capture the seismic change that occurred throughout Western Australia in terms of population growth and demand for services during the resources boom. Our concerns with the way remoteness is assessed were highlighted in our original submission, but unfortunately this was not discussed in the Productivity Commission's inquiry. Given Western Australia's expansive geographic remoteness as compared with other states

and territories, we continue to stress that the current methodology appears to be limited in its assessment of remoteness and the cost of providing services and infrastructure for Western Australia's expanded population, especially in regions associated with mining. This is another key aspect that undermines the usefulness of the methodology.

3. CONCLUSION

The Productivity Commission has identified fundamental failings in the HFE model that the Commonwealth must no longer ignore. As reform is considered to be in the best interests of national productivity and wellbeing, this in itself warrants change. The PNP supports a revised objective in line with the terms identified and work toward implementation of a partial equalisation model suggested. It also calls for Commonwealth to be the leader and in doing so not hide behind the need for COAG agreement. As this is in the nation's best interest, the PNP strongly calls on the Commonwealth to introduce a revised objective, introduce an immediate floor and achieve greater policy neutrality in the terms suggested by the CGC, with the ultimate goal of transitioning toward a model of partial equalisation.