TECHNICAL QUERIES FROM THE PRODUCTIVITY COMMISSION ON THE COMMONWEALTH GRANTS COMMISSION (CGC) SUBMISSION – RESPONSE BY STAFF OF THE CGC

Question 1

Para 16 suggests the PC's approach would effectively introduce a relativity floor, with minimum per capita payment being the level of the floor. Is this a correct characterisation in your view, and why? Are we talking about a dynamic floor in this sense?

A State's relativity is derived by dividing its per capita assessed GST by the per capita GST. So, a relativity floor actually means a minimum per capita GST payment.

The draft report (page 230) says a relativity floor sets a minimum value below which relativities cannot fall. Table C.8 (page 231) shows Western Australia's relativity does not fall below the minimum value. Although the table refers to relativity value, lying behind that value is a minimum per capita GST payment.

Both Table C.2 (equalisation to the average) and Table C.3 (equalisation to the second strongest State) on page 227 show something similar. In Table C.2 the minimum value is the average relativity of the fiscally strong States. Western Australia's relativity does not fall below this minimum. In Table C.3 the minimum value is the relativity of the second strongest State. Western Australia's relativity does not fall below this minimum. Again lying behind each minimum relativity value is a minimum per capita GST payment.

We can illustrate the same effect over a longer period. Table 1 shows States' full equalisation relativities since 2010-11. The relativity of the second strongest State is coloured red and bolded.

Table 1 Relativities — full equalisation

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
2010-11	0.952	0.940	**0.913**	0.683	1.285	1.621	1.153	5.074
2011-12	0.958	**0.905**	0.929	0.717	1.271	1.599	1.116	5.357
2012-13	0.953	**0.921**	0.985	0.551	1.285	1.581	1.198	5.528
2013-14	0.966	**0.904**	1.056	0.446	1.262	1.615	1.221	5.314
2014-15	0.975	**0.883**	1.079	0.376	1.288	1.635	1.236	5.661
2015-16	0.947	**0.893**	1.128	0.300	1.359	1.819	1.100	5.571
2016-17	**0.905**	0.910	1.171	0.303	1.417	1.777	1.156	5.285
2017-18	**0.877**	0.932	1.188	0.344	1.440	1.805	1.195	4.660

Source: 2010 Review to 2017 Update reports.

Table 2 shows the implied relativities when equalising to the second strongest State. It shows:

- In a specific year, Western Australia's relativity does not fall below the minimum value – the relativity of the second strongest State
- across years, this works as a dynamic floor – the minimum value changes as the fiscal capacity of the second strongest State changes.

Table 2 Implied relativities — equalising to the second strongest State

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
2010-11	0.930	0.918	**0.891**	0.891	1.263	1.600	1.131	5.058
2011-12	0.939	**0.886**	0.910	0.886	1.252	1.581	1.098	5.343
2012-13	0.915	**0.883**	0.947	0.883	1.248	1.545	1.160	5.501
2013-14	0.919	**0.857**	1.009	0.857	1.215	1.569	1.175	5.281
2014-15	0.922	**0.830**	1.026	0.830	1.236	1.584	1.184	5.622
2015-16	0.885	**0.830**	1.066	0.830	1.298	1.760	1.039	5.522
2016-17	**0.842**	0.847	1.109	0.842	1.355	1.716	1.094	5.233
2017-18	**0.821**	0.877	1.133	0.821	1.386	1.751	1.140	4.613

Source: 2010 Review to 2017 Update reports.

So, in answer to your question, yes we can characterise equalising to the second strongest State as imposing:

- a (dynamic) minimum per capita GST payment or equivalently
- a (dynamic) relativity floor.

Question 2

Para 24 suggests our approach would treat assessments and industries differently but we don't understand the logic here. Our view is all we do is treat States differently, and while the strongest States may have different revenue/expenditure mixes, this may well change over time. Could you explain in more detail?

The iron ore assessment/industry is probably the easiest example to use.

Under full equalisation, any changes Western Australia makes in relation to its iron ore industry (royalty rates for example) affect its revenue capacity and its relativity. Similarly, any changes Queensland makes in relation to its coal industry affects its revenue capacity and its relativity.

Equalising to the second strongest State would mean that any changes Western Australia made in relation to its iron ore industry would affect its revenue capacity but have almost no effect on its relativity. Any changes Queensland made in relation to its coal industry would continue to affect its revenue capacity and its relativity.

But the Commission's point is not limited to a specific industry. Some Canadian research papers describe Alberta as a low taxing province — some commentators uncharitably refer to it as a tax haven. Alberta can have lower provincial taxes because it has high natural resource revenues. Its low tax status has led industry to relocate to Alberta from other provinces. Equalising to the second strongest State approach means Western Australia would receive a 'strong State premium', which would give it additional capacity to compete with other States on tax rates.

Question 3

Para 25 (and 26) of your submission appears to suggest that equalising to the second strongest state would mean that 7 States would be unable to finance the average level of services. Do you mean here that the 7 States would not be able to deliver services to the average level that is currently provided?

Yes, we mean that the seven States would be unable to deliver services to the average level that is currently provided. If the average level of service continued to be derived from the average of services provided by all eight States, this would occur into the future.

Figure 1 shows how some States view the GST. In a submission to the GST Distribution Review, the NT said the GST acts to 'fill the gap' between States' assessed expenses and their sources of revenue. The dark green column is the CGC's estimate of what it would cost each State to provide the average level of service, adjusted for their expense disabilities.

Figure 1 GST distribution — full equalisation, 2017-18

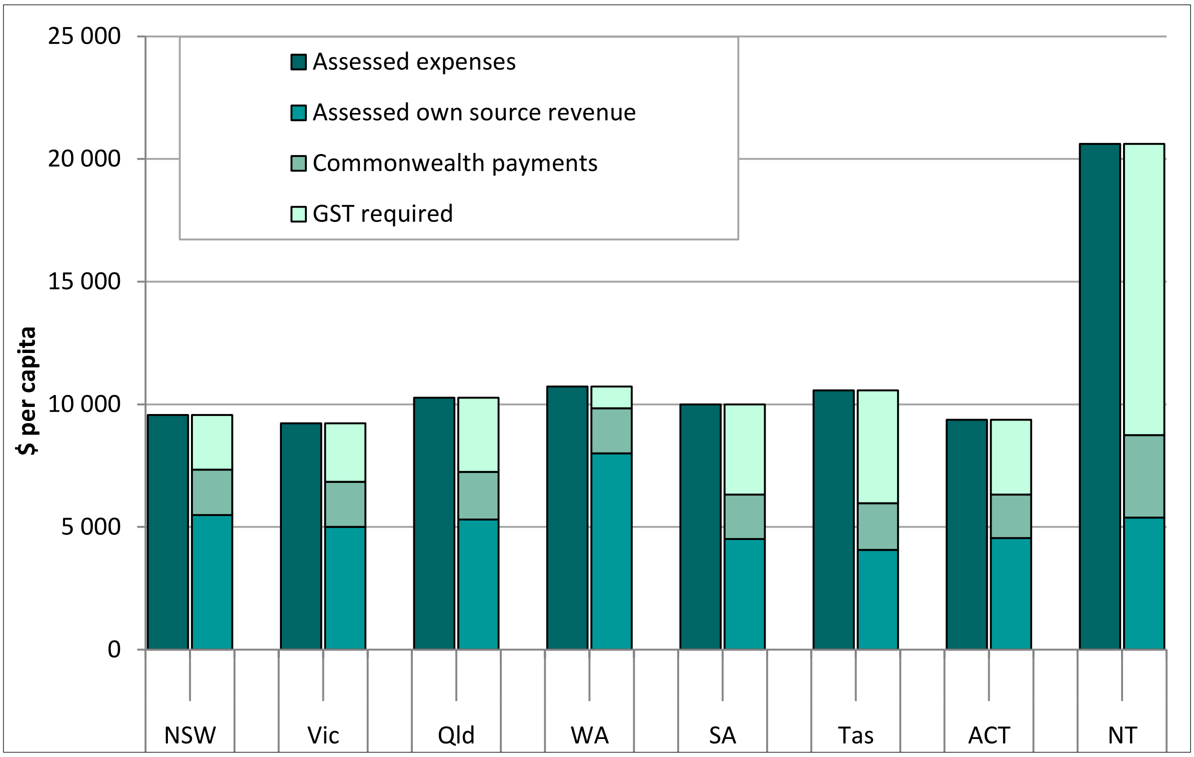
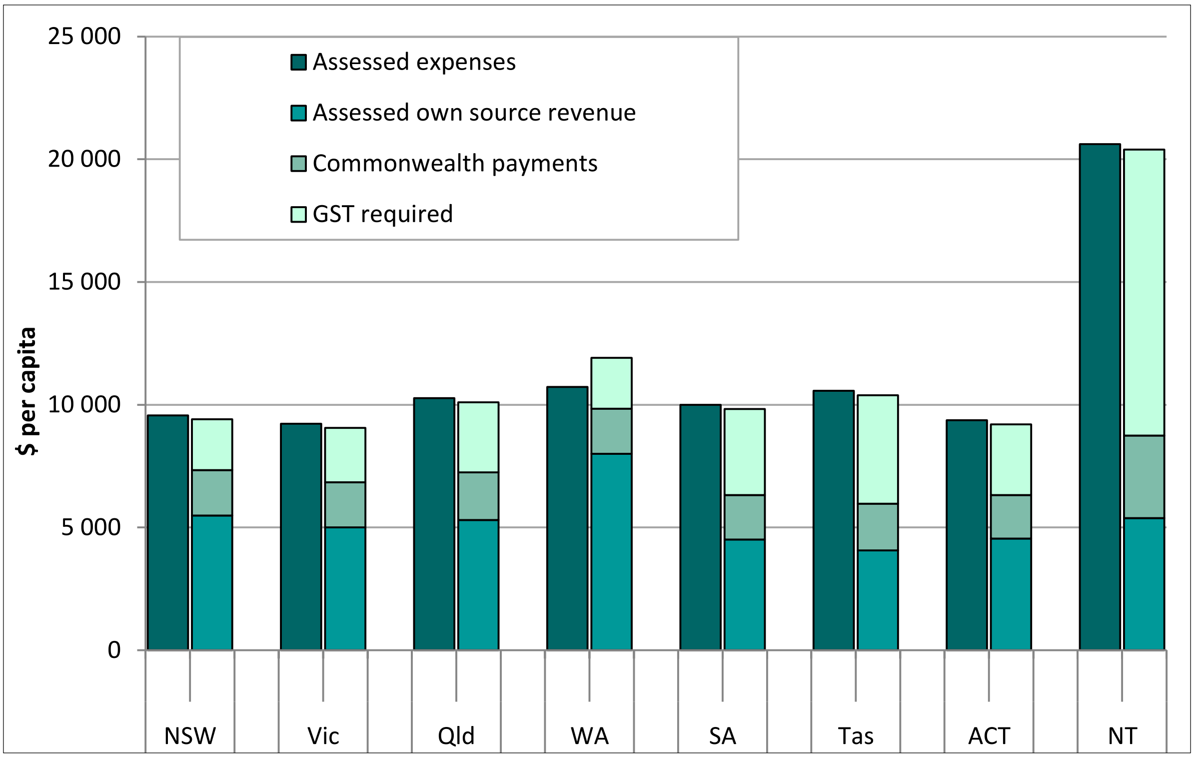


Figure 2 shows how the chart would look if we equalised to the second strongest State. It shows:

- Western Australia would have GST left over after financing the average level of service
- none of the other States would be able to finance the average level of service.

Figure 2 GST distribution — equalising to the second strongest State, 2017-18



That is, the sum of assessed own source revenue, Commonwealth payments and their GST would be less than assessed expenses for States other than Western Australia. That is the sense in which we mean the other seven States would be unable to deliver services to the average level.

Question 4

We would also be interested in getting your view on how different the results would be in a situation where full equalisation is applied only to the smallest States, provided that States were allowed to move between groups. This is mentioned in paragraph 43, but numbers aren't presented showing what the difference would be from the numbers presented in table 4 of the submission?

Under this approach, the fiscally weak States would continue to receive their full equalisation outcomes. The balance of the pool is then be distributed among the fiscally strong other States based on the size of their populations.

Table 3 shows the situation where a State (Queensland) shifts from one group to the other. As the Commission mentioned in its paper, this is primarily due to the effect of natural disasters.

Table 3 shows the change in GST from a full equalisation distribution. It shows:

- for the fiscally weaker States — no change in GST distribution compared to their full equalisation outcome. Queensland was a fiscally strong State in the first three years.
- for the fiscally strong States – a redistribution to the fiscally strongest State from other fiscally strong States.

These redistributions arise because, under this option, the GST distribution to fiscally strong States is based on the size of their populations not their relative fiscal capacities. Table 3 shows the size of the redistribution and its distribution among States varies by year.

Table 3 Change in GST distribution

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Redist
	$m	$m	$m	$m	$m	$m	$m	$m	$m
2010-11	-654	-364	-48	1 066	0	0	0	0	1 066
2011-12	-754	26	-200	929	0	0	0	0	929
2012-13	-792	-229	-804	1 825	0	0	0	0	1 825
2013-14	-1 748	-570	0	2 318	0	0	0	0	2 318
2014-15	-2 273	-517	0	2 790	0	0	0	0	2 790
2015-16	-2 282	-994	0	3 276	0	0	0	0	3 276
2016-17	-1 784	-1 480	0	3 264	0	0	0	0	3 264
2017-18	-1 276	-1 891	0	3 167	0	0	0	0	3 167

Source: Commission simulation.

Question 5

Re Figure A.3 — your calculations indicate that it doesn't pull up all recipient States equally, but the figure suggests that it does. Could you confirm this?

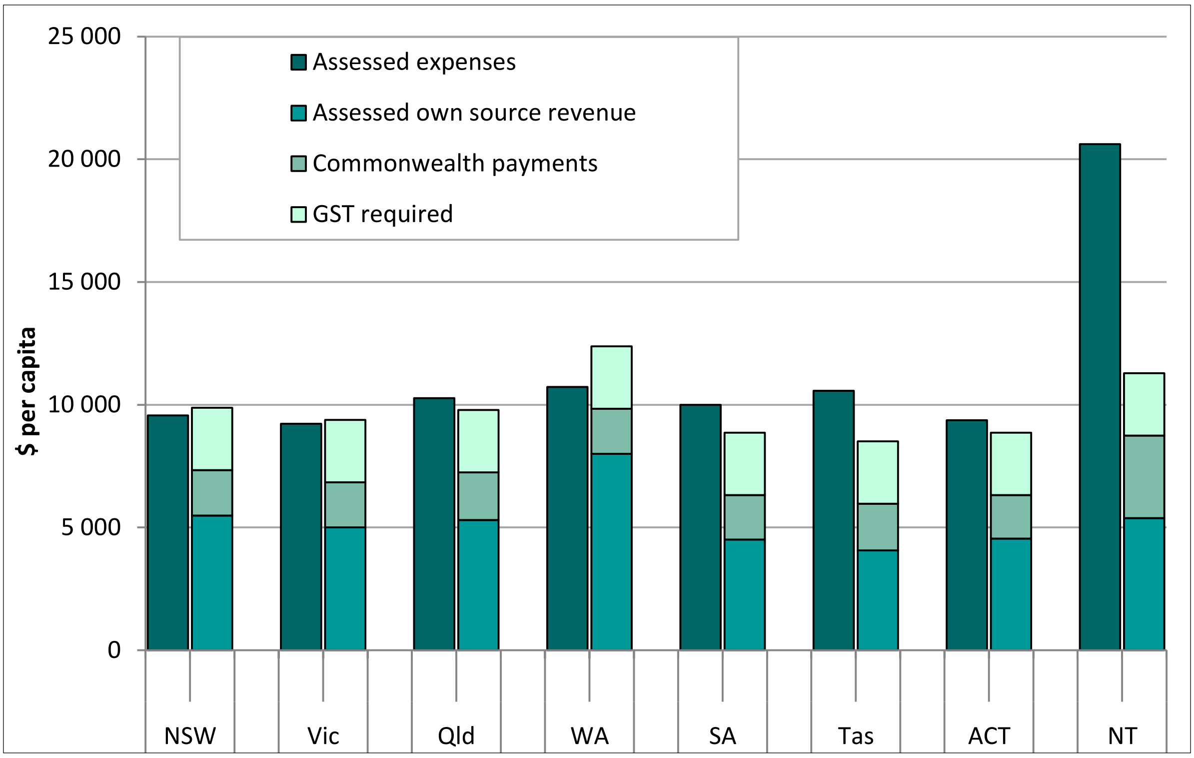
Table C.1 (page 226) shows the effect of an equal per capita distribution. The changes we showed in Table A-5 of our submission are 10% of these figures. That is, the changes affect each State in the same proportion. While this is so, Table A-5 showed the change affects States by differing per capita amounts.

Figure 3 shows what would have happened had we distributed the GST equal per capita in 2017-18. It confirms the Table A-5 figures — the change would affect States by different per capita amounts.

So why does Figure A-3 in our submission show an equal change? We saw your schema as a stylised way of illustrating options and made the assumption that the schema was based on States facing the same per capita assessed expenses. Having made that assumption, a symmetric approach would leave the fiscally weak States only able to finance a proportion of their assessed expenses — the same proportion as they faced the same per capita assessed expense.

In reality, States don't face the same per capita assessed expenses; they face different per capita assessed expenses. So, it's our fault that Figure A-3 doesn't match the figures in Table A-5.

Figure 3 GST distribution — equal per capita, 2017-18



Question 6

Your recent September 2017 paper pointed to an increase of threshold to $35 per capita for the 2020 Review. Is it possible to provide more detail on the potential effects of this on revenue and expenditure sides? Also effects of a further increase to $50 per capita?

We don't have that information readily to hand. Our assessment system isn't set up with a toggle on the level of the materiality threshold. To answer your question, we would need to examine each individual assessment. This can be done, but it would take time.

The reason we raise the threshold is to because expense/revenue levels rise year to year and we don't want the effectiveness of the thresholds to be diluted over time.

If we had to guess, it would be that the only existing assessment that would fail a $50 per capita threshold is the Insurance tax assessment.