



Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO HORIZONTAL FISCAL EQUALISATION

MR J COPPEL, Commissioner
MS K CHESTER, Commissioner

TRANSCRIPT OF PROCEEDINGS

**AT MAJESTIC ROOF GARDEN HOTEL (NANDINA ROOM) 55
FROME STREET, ADELAIDE
ON TUESDAY, 21 NOVEMBER 2017 AT 11.22 AM**

INDEX

	<u>Page</u>
SOUTH AUSTRALIAN COUNCIL OF SOCIAL SERVICE MR ROSS WOMERSLEY	212-222
BUSINESS SOUTH AUSTRALIA MR ANTHONY PENNEY MR ANDREW McKENNA	223-232
SOUTH AUSTRALIAN CENTRE FOR ECONOMIC STUDIES MR JIM HANCOCK	232-242
URBAN DEVELOPMENT INSTITUTE OF AUSTRALIA MR PAT GERACE	243-249
MR PETER JOHN EMERY MS LINDA EMERY	249-258
SOUTH AUSTRALIAN TOURISM INDUSTRY COUNCIL MR SHAUN DE BRUYN	259-266
MR JONATHAN PINCUS	267-270

5 **MR COPPEL:** Okay, ladies and gentlemen. I think we will start today's public hearings. First of all, good morning. My name is Jonathan Coppel and I'm one of the Commissioners on the inquiry along with Karen Chester, who is also Deputy Chair of the Productivity Commission.

10 I would like to begin by acknowledging the traditional custodians of the land on which we meet today. I would also like to pay my respects to elders, past and present.

15 If we begin just by giving a bit of context and information about the inquiry hearings. We are today on the fourth day of public hearings into the HFE inquiry. We had two days in Perth and a day in Melbourne last week, and next week we will be completing the public hearings with hearings in Darwin and Hobart.

20 Once the hearings are out of the way we will be taking the information from those and from the submissions on the draft report into further analysis to complete a final report which will be submitted to the Australian Government early next year.

25 Those participants who have registered their interest in the inquiry will be advised when the final report is released by the Government, which may be up to 25 days, Parliamentary sitting days, after the completion of the report.

30 Just a little bit about the purpose of these hearings. It is to facilitate public scrutiny of the Commission's work and to get feedback on the draft report. So where you think we may have got it wrong, where we may have got it right, where we may have missed important aspects. That sort of feedback is very important to us.

35 We do like to conduct all hearings in a reasonably informal manner, but I do remind participants that a full transcript is being taken, and for this reason comments from the floor cannot be taken. However, at the end of the day I will give an opportunity for those who are not registered participants if they wish to make a comment before we close today's proceedings.

40
45 In terms of how we conduct these hearings, participants are invited to make short opening remarks. We would like to keep those brief, to five to seven minutes maximum, and this will allow us time to discuss matters raised in submissions and in your evidence today in greater detail. We don't require participants to take an oath, but they are required under the Productivity Commission Act to be truthful in their remarks. And participants are also welcome to comment on issues raised in other submissions.

5 In terms of the transcript, it will be available from the Commission's website following the hearings. That usually takes a couple of days. And also on the website you will be able to find the complete set of public submissions to the inquiry, both pre-draft and post draft.

10 Are there any media in the room here today? We have a couple of ground rules, but if there are no media then I will skip those. The other requirement that I'm obliged to inform you about relates to the event of an emergency evacuation from this building. In that case you should follow the green exit signs which are not visible, but they're essentially out to the rooftop deck and over in the far corner there are fire stairs, and then follow instructions from fire wardens to the meeting point and avoid obviously at all times using the lifts.

15 So, let me now invite the first participants from the Australian Council of Social Service to talk. First of all for the purpose of the transcript if you can give your name and then, when you're ready, a short opening statement. Before you do that, let me thank you for your submission on the post draft report. Thank you.

20 **MR WOMERSLEY:** Thank you. Thank you, Commissioners. My name is Ross Womersley. I am the CEO for the South Australian Council of Social Service. So just to be clear, we're the South Australian Council rather than the Australian Council of Social Service. I am joined today by one of my colleagues, Dr Greg Ogle, who will speak to some of the issues, the more particular issues in a second.

25 But I think by way of opening what we would be saying to the Commission and what I think is reflected in our submission, is that in fact we should be working to retain the current patch of the objective. We think that equality remains the core and most - the highest principle that ought to be sought, and we would point in that instance to our colleagues at TASCOS's submission in which they argue why GST is so important to States like Tasmania and South Australia. And note that in the South Australian context GST as a component of our tax base is about 33 per cent. So in effect it's a very substantial form of income that's available to the State and that supports that objective of equality across the States which we think is ultimately as important as fairness and economic efficiency.

30 35 40 45 We support the goal of equity in the current objective, but the suggested change we think takes us away from equality. We were pleased that the PC had rejected options that relied on per capita sharing and/or the Commonwealth top ups, but an objective of revenue sharing to some reasonable level of capacity we think falls short of equality and would leave the most vulnerable people in the fiscally weaker States worse off. And so on that basis we reject the idea of transitioning away from that objective.

5 Most of the argument, we think, is about Western Australia as an outlier, and that's essentially the rationale for why the Commission has been charged with the job. We do note that our colleagues at Business SA - I'm not sure if they'll be in the room at the moment - but their submission provides quite a detailed history of State budget surpluses across Western Australia and we certainly support their submission on that point.

10 We do have some sympathy on the time lag part of the Western Australian argument, and Greg will say more on that. Overall though, we believe that when one State has massive mineral wealth this is how HFE was and is supposed to work to provide equality. Hence on that basis we support the current objective of equalisation. And I think Greg is going to talk to the issue of time lag and volatility and impairments to change.

15 **DR OGLE:** Thanks, Ross. I'm Greg Ogle. I'm senior policy officer at SACOSS. Yes, just those two issues. On the time lag, when you look at Western Australia and you just look at how the system is set up, I think the time lag is a real issue and, you know, we would support if there was a way to tweak that without increasing the volatility of the system. You know, if that was about, you know, potentially taking the last year of data as budget rather than waiting for the actual data to come in some time later, we might support that because we do recognise the issue the time lags are causing.

25 But what we wouldn't support, I think, is a shortening of the averaging period because that would simply see much more volatility in the system, that we're sharing the - extending the analysis over the period and averaging it out gives some level of stability to the system. So I think we'd support that, and because obviously the more volatility you have the harder it is to budget, and particularly for smaller States with limited revenue streams. And South Australia is already heavily reliant on conveyance taxes and land taxes, which are relatively volatile. If the GST stream becomes more volatile because of trying to fix other issues that creates even further problems for South Australia.

35 The other issue that we wanted to address that is possibly a bit different from others is just the idea of whether or not the current HFE arrangements are an impediment to change. And I know there's debates about whether the cameos that were in the draft report are appropriate or not, and pretty sterile debates in our view about evidence of change and absence of evidence, but it just seems to us it's pretty obvious that any Treasury should be modelling the impacts on GST receipts of any tax changes they're going to do. That's part of their job. And as such that should feed into the system. It might not be determinative, but a decision about a particular tax reform. But it should be on the table and it should be modelled.

And therefore if there is an impediment that comes out from that then that could be a problem because our focus is actually much less about arguments about what's happened in the past and whether or not there's evidence, but looking into the future. And when we look at the implications of digital technology and the wave of technological innovation that's coming our way with the 5G networks and the next iteration of the digital revolution, that has serious implications for some traditional State tax bases. Driverless cars will mean the end of a huge wad of our current motor vehicle taxes. That's 13 per cent of the State's own revenue here.

The rise of the gig economy might undermine the payroll tax base. We've already seen gambling taxes declining in recent years in South Australia as the pokie industry flattens off. People are changing gambling habits to go online. That's a lesser taxed area and a more difficult to tax area.

So they're just some of the things we've been looking at, and looking ahead at what's coming, and so we need a system that can adapt to that. And yes, without an artificial impediment to change.

Having said all that, I don't think that any of that is actually addressed by a change to the reasonable standard of equalisation. I don't see that - yes, it just doesn't seem that that addresses it at all. If there are impediments to change and penalties for first movers, then I think they should be - the system could be adjusted for those particular things with particular adjustments to overcome those impediments, and probably now when you've got quite a different push is not the best time to be looking at that. But it's something that should be kept in mind.

But yes, when you've got pushers that are actually about mining and old industries it's probably - I think it's quite a different issue and a different problem. And because those changes don't address those issues about where the future tax base is, we don't see any real need to, in a sense, sacrifice the goal of equality in the interests of addressing those issues. That's the impediment issues. And we will leave it there.

MR COPPEL: Thank you, Ross. Thank you, Greg. Our inquiry Terms of Reference asked us to look at the impacts of HFE on the incentive for substantial tax reform, or reform in the State jurisdiction, the effects on efficiency, on migration. It still keeps the equity objective as the primacy objective, and our draft report has identified, particularly in the area of substantive tax reform, that there is a first mover disadvantage, which is particularly large for the larger economies, given the way the HFE works. Your submission also makes a number of areas where there may be a disincentive to consider new tax bases in the event of major digitalisation of the economy.

What we're suggesting is that there is an ability for the system to give greater weight, relative weight, to the efficiency objectives of jurisdictions, and to that extent what we're proposing mutes that first mover disadvantage. Now, you and a number of others are saying that it doesn't directly target the problem of that first mover disadvantage.

So my first question to you would be that if you rule out a mechanism that provides greater scope for some form of trade-off between the objectives, what changes would you make to the HFE system that could address this disincentive for substantive tax reform?

DR OGLE: We don't have a shopping list of changes that we think would address that, but I think it just seems to me to be much more specific and if there is a first mover disadvantage then maybe it's something that looks more like a concession for that particular move for a very limited time, is a much more targeted response than a change in a sense to the way the system is set up. So in that sense it looks - as I say, I'm not - I guess I was less convinced about how the proposed changes would address that first mover disadvantage, but even if they did it seemed to me a fairly blunt instrument to change it in the sense that it potentially sacrificed more for what was, I think, a limited disadvantage of the current system.

MR COPPEL: So this is an argument that many have put to us and we sometimes struggle with that argument and the way in which within a State, State Grants Commissions try and equalise between different levels of Local Government where clearly they are not seeking to achieve full equalisation. I am wondering whether you have views on why within a State jurisdiction something less than full equalisation is appropriate, whereas across jurisdictions the goal standard of full equalisation and any movement away from that, even if relatively small, for other goals is a non-starter.

MR WOMERSLEY: I'm not entirely sure that we would be advocates of not full equalisation at a State level in that context. I think we've maintained the principle for the very same reasons, that ultimately - and the people, I guess when you think about the people that SACOSS worries about most, and they are the most disadvantaged citizens in the community, it's them that always are most likely to suffer if in fact resources aren't available to them. And one of the best mechanisms that we have for ensuring resources are available is through an equalisation measure. So I think in both instances we would be strongly arguing that equalisation is a relevant and important thing.

MR COPPEL: So on that point, the way equalisation functions is that it brings every jurisdiction up to a level where they have the same capacity to provide the average assessed levels of services, but there's no obligation on a State jurisdiction then to match the assessed level of expenditure with the actual level of expenditure. And there's been quite a bit of work looking at how those two travel across jurisdictions. And typically in the areas of

community services, public housing, the actual level of expenditure, particularly in the case of South Australia, is quite a lot lower than the assessed level of expenditure. So I wonder if you have any views on that aspect of how HFE works because you say it guarantees, but my point would be that it doesn't per se guarantee.

MR WOMERSLEY: It makes it available, I suppose, to the degree that that can guarantee. And what you identify is that of course governments along the way make decisions about how they will spend, and that's certainly true. I guess what we are then able to do as an advocacy group on behalf of that part of the electorate is to be able to point to where those differences exist and to call on our State Governments to answer the question as to why there is such a disparity across, if that disparity exists, to call on them to explain why the disparity exists. Because we know that the money, in a broad sense of the word, is available.

So I suppose it's a kind of - it's not a sufficient mechanism for making sure that the States do actually deliver to the - and I think as a COSS network we have spoken at some length about the idea that around a whole series of jurisdictions it might be helpful to have a set of standards that all States were obliged to fulfil. I'm not sure that it fits necessarily in this part of the discussion, but it may - it is certainly a piece of work that we talked about, particularly when we were thinking about the potential for Federation reform.

MR COPPEL: What do you mean by a set of standards?

MR WOMERSLEY: Well, as service standards, I suppose, that each of the States would be expected to be able to deliver in providing those specified range of supports to people.

MS CHESTER: So Ross, do you mean there that there is an assessed expense that they should be making to be able to provide the average level of service standard to the citizens of South Australia as akin to the citizens of New South Wales that they're obliged?

MR WOMERSLEY: Broadly speaking, yes.

MS CHESTER: Because we didn't sort of stray into that territory because I guess we're quite comfortable with States having autonomy, and indeed this whole area is quite difficult. If you looked at the CGC's post draft report submission to us it actually points that HFE can only do so much of the heavy lifting. Indeed, WA with the highest fiscal capacity at the moment, even when it's equalised to the highest itself it can't meet its assessed expenses. And the real problem is vertical fiscal imbalance which comes to longer term Federal financial reforms around the taxing powers of States versus the Commonwealth.

But the reason we go into the territory of what's assessed versus what's actually spent is because there's a whole bunch of commentary now saying, you know, that what we're proposing is going to cost 1,000 teachers' jobs and all the rest of it, but when you kind of look through to what happens, for
5 South Australia it's only 32 per cent that's spent on public housing that they're assessed for, 80 per cent on services to community. And over the last five years they've been sort of three percentage points below what they've actually spent on their assessed expenses.

10 So when you look at the metrics of what we're proposing, going back to your 33 per cent which is a really important figure, South Australia under our two proposals would only lose 1.2 to 2.4 percentage points of revenue as a percentage of the GST's (indistinct) to the revenue. So when you look at that and then when you look at the assessed versus the actuals, you kind of think
15 well, I don't see Armageddon here.

And I guess our whole perspective is really well, if it need not translate into lesser services, particularly if we get a transition path right and there's growth in the GST pool, but there are net economic benefits from not holding
20 back - and it's not just tax reform, it's also development activities and decisions that States might make at the margin there - then that's where we're coming from, that perhaps there is - you can make a little bit more of a trade-off between equalisation and efficiency. Because the CGC do have efficiency as one of their subsidiary principles, but when you're equalising to
25 the highest and it's such a high bar at the moment with WA there's just no wriggle room for efficiency.

And then we get into the world of sort of trying to do carve outs, and I guess we landed in our draft report on suggesting that that probably, that was
30 quite arbitrary and would have elements of a symmetry across States. And I know this is bit more conversational, we're not just having questions but - - -

MR WOMERSLEY: No, it's an important conversation.

35 **DR OGLE:** But I'm not sure you can assume that because South Australia might be spending under its assessed expenditure for a particular area that that difference is not being spent usefully and productively somewhere else.

40 **MS CHESTER:** No, I'm not. I'm not, but I'm just saying when you look at the numbers and then you have people in the public domain now saying that this is going to translate to X less teachers, X less police forces, and then when you actually look at what the impact it has on SA's revenue as a percentage - GST as a percentage of its revenues, it doesn't translate to that.

45 **DR OGLE:** But if you assume that that money may be being spent productively elsewhere then that one percent-odd reduction in revenue has still got to come from somewhere, and that might limit the ability to provide

tax breaks. So it might not be teachers and nurses that are the sort of populist response, but it still has a budget impact that we've got to address somewhere, and whether that's from the revenue side or the expenditure side. And, you know, for the poorer states like South Australia there's just not that much room, and we're already at a geographical disadvantage in a sense in terms of where head offices are located and all that sort of stuff. Our tax system might need to be better than other States, our services might need to be better than other States to make up for our climate and water et cetera.

MR COPPEL: In our draft report we did note that there would be fiscal impacts, and we quantified those fiscal impacts on the extreme assumption of a shift overnight. We plan to do a lot more analysis looking at issues of transition. But I just pick up a point that you made in your opening remarks. I think you mentioned that you don't believe in the notion of top ups from the Commonwealth, which would be one dimension of a transitional arrangement. Can you elaborate on why you don't see Commonwealth top ups as being part of a package?

DR OGLE: We'd be less concerned if it was a short term defined transitional arrangement, but as the general principle the Commonwealth top up funding, or Commonwealth funding, is inevitably - ends up in a political fight as to responsibility between State and Federal Governments. It ends up being tied, so that when we're having issues on the ground with, you know, service providers telling us that there's a particular condition that they're funding that's not working, we go to the State Government and they say, "Our hands are tied." It's just not as flexible and efficient a system as having one Government with its own bucket of money. As I say, less issues if it's transitional but as a starting point, as a building block for a system, it's not very useful.

MR WOMERSLEY: I mean, I think it also points to States not necessarily taking responsibility for all of the circumstances that they've got, and so the more those top ups are identified as a mechanism for supplementing or complementing other funds then the more States will seek to use it. And of course what we see, and again I'd go back to the Business SA submission, for that list of, massive long list of essentially surplus budgets that are being delivered in the west, and they're still asking for top ups. And so it's kind of a very interesting question as to how you arrive at what's a reasonable circumstance within which to top up versus what's not.

And I guess that goes back to Greg's point about if it's part of a designed transition and it's short term, then in fact that has a clear purpose and it's more evident and more transparent what it's there to do. It's much more problematic if we start to do this stuff on a, sort of every couple of years. One State says we're diabolical and being punished because we didn't do the right thing ourselves, we need to be saved. Now, I don't think we'd want a system that operated in that kind of way.

5 **MS CHESTER:** And I think unfortunately some people may have
mischaracterised our draft report and its reference to WA being an outlier.
The problem with - because we had quite a frank exposition of WA's fiscal
arrangement. It's because the equalisation task becomes so great when you
10 have such a fiscal outlier, which - the Saul Estlake(?) quote is quite apt - you
know, they're like the pensioner that won the lottery and doesn't want to give
the pension back. But because it makes the equalisation task so great and it
moves you even further away from EPC, which we're not recommending, it
15 means that that scope for trade-off between efficiency and equity becomes
even more difficult and amplified, and thus - and it's fair to say that we didn't
have time before the draft report to model what would happen under the
cameos if we moved to one of our options, and we're now doing those
numbers to be able to sort of provide an evidence base that would actually
address the disincentives as part of finalising our report.

20 **MR COPPEL:** I just want to come back to the points you make about
digitalisation potentially having quite a substantial effect on State revenues.
In your submission you talk about particular solutions associated with
discounting or providing an exemption, which we considered in a broader
sense. We considered a slightly different version of that which would be just
discounting that part of the methodology, not some transitional period or
fixed period of time of discounting or an exemption.

25 And one of the reasons that we were not in favour of those sorts of
mechanisms was that it's quite ad hoc, obviously. Some people have made
the same criticism of what we're suggesting. But it's also less transparent
and it doesn't really provide a structure that may be able to anticipate the next
30 source of stress, like you have done in your report. But above all they
amount to something which is less than full equalisation themselves. So
there's a tension between trying to be targeted and with achievement of a
goal of equalisation.

35 **DR OGLE:** I understand that, but to be clear we're not suggesting that those
incentives, if you like, are a permanent part of the system or a permanent
carve out for a particular area or a particular tax base. We're simply saying
that it might be that it's a one-off for a first mover, or something just to
remove that first hurdle and then it would disappear. So it may still have the
40 deficiencies you're pointing to, but it's much less than - and we're not
proposing building carve outs into the system permanently.

45 **MS CHESTER:** But a State not pursuing tax reform, or a State not pursuing
a controversial development activity, because of effectively being punished
for the GST relativities for doing so is a permanent impact on the - it's an
ongoing impact on an economy. It's not a one-off.

5 **DR OGLE:** I guess - well, that's true for as long as that development happens. I think we were probably just more focussed on examples where if you're trying to develop a new tax base - and the point of consumption of gambling tax is one that comes to mind. South Australia was the first mover on that. Now, I know gambling tax is calculated differently so it's not a direct translation, but we're there. We've got this tax which is a response to a new digitalised gambling base. It's, in our view, a good tax because it actually taxes at the point where the gambling harm is done and that services are required, et cetera.

10
15 Now, you know, it hasn't gone to the High Court much against our expectations. It may well be that others will move, other States will move and we would anticipate that in the next few years other States will move in behind that. So that first mover difference won't be there in two or three years.

20 Now, as I say, it's not a great example in the sense that gambling is treated somewhat differently, but I think we were focussed on examples where a State is moving to create a new tax base or to make a change in relation to that where others will follow, and it's that transition bit that's the impediment.

25 **MS CHESTER:** Yes, and I think it's a really important point that you raised earlier on about revenue bases are changing with disruption and with new technologies, and I guess we do see a future where both Commonwealth and State are going to need to be a bit more nimble about what tax bases they have and how they optimally taxing them. So I guess in that context are there areas of tax reform from SACOSS' perspective now that you would want to see, and it doesn't need to be South Australia, but any sort of typical State or Territory Government pursue? Also in the context of longer term Federal financial relations, would you want to see greater taxing powers reside with the State such that they can have greater autonomy in managing their budgets, given the point the CGC quite eloquently make that even WA with all its mining royalties still can't meet their own assessed expenses?

35
40 **MR WOMERSLEY:** We've advocated for a number of reforms, and I guess - I don't know whether I'd name things like death duties.

40 **DR OGLE:** I was going to point out that even in a digital world we know that people will die, so the - - -

MS CHESTER: It doesn't have any elasticity effects, that one, I have to say.

45 **DR OGLE:** I mean, in terms of economic theory it's a good tax in the sense of not having fiscal drag.

MR WOMERSLEY: It's a good tax in terms of it's the one time in your life where you don't actually need the money.

5 **DR OGLE:** From our point of view it's a good tax in terms of equality and fairness, but it may be - like, that's just an example of a tax that - you know, if we lose revenue bases that are traditional State revenue bases like payroll tax or motor vehicle taxes then we're going to need to have other alternative tax bases. That's one that has traditionally been a State tax. Logically it probably needs, given the demise of the inheritance taxes in the '70s, we
10 would need a COAG agreement for all States to implement it. And that may well be true of a lot of new tax bases or else you end up with competitive disadvantages.

15 **MR WOMERSLEY:** I mean, I think we've seen - yes, whether it's disadvantage or the capacity to oppose. So I think the interesting thing is when we reflect on things like the introduction, or the proposed introduction, of mining tax, or indeed the bank tax as it existed in South Australia. I think what we've seen there is that the capacity to have a really informed, sensible conversation about tax reform is extremely difficult. And so what's
20 happened is people that are cashed up and have been prepared to spend enormous amounts of money have won the day in both instances.

So that makes it very difficult for those of us that might be deeply concerned for a longer term equitable tax system to be available in order to
25 deliver the services that we want. And I think it points to - while it's again not directly in the context of this inquiry - it points to the complexity of negotiating agreement across our nation at this point in time about what good reform might constitute. And just creates some extra impediments to us being able to advance those discussions in a way that enables us to arrive at
30 something that is sensible.

MR COPPEL: I've just got one other question which is on a different area, and it relates to the public understanding of HFE and confidence in the HFE actually delivering on its objective. And intertwined with that is quite a
35 substantial amount of lack of understanding of how the actual system works. And we've got a number of recommendations in the draft report that seek to address that particular issue, and I was wondering whether you had any comment on that aspect of the draft report.

40 **DR OGLE:** We did some research earlier this year on State based taxes and public knowledge and understanding of State based taxes, and the sort of balancing act of expenditures and taxes, and at the State level - and I think it's fair to say, you know, the understanding of taxes and the knowledge of the State tax base particularly is very low. The understandings of how the tax
45 system fits together, even at the level of which level of Government levies which tax, is similarly low. So I think from that point of view it sort of - on the basis of that I find it hard to conceive that many people understand the

HFE system. And that leaves open, unfortunately that leaves open the sort of populist rhetoric around sharing. It doesn't really address the equality goals or the range of goals even. It creates a very false debate.

5 So, I think without going into detail of the recommendations, I think frankly our position would be any recommendation and any move for greater public information and education would be welcome because I don't think - well, we know that the understanding of the tax system isn't high generally because it is complicated.

10

MR COPPEL: Do you have any specific measures that could be adopted to improve that confidence in the HFE system?

MR WOMERSLEY: Can we take that on notice?

15

MR COPPEL: Sure.

MS CHESTER: The other one you might want to take on notice because I'm conscious of time, but it's one that we struggled with and it's probably a more important outlier, and that's how HFE deals with indigeneity. And there has been quite a bit of work done by some academics drawing out that when we looked at assessed expenses they're adjusted for disabilities and then when you look at the assessed expenses versus the actual expenses there's quite a large gap.

25

We kind of struggled with that, whether HFE can really deal with that outlier issue, given the policy imperative. Some have suggested taking indigeneity out of HFE, but from our perspective we struggled with just doing that because Commonwealth/State responsibilities there still require some addressing.

30

So I'm not sure if that's an area of our report that you had a chance to focus on. I don't want to put you on the spot today, but it is an area where we'd like to get some feedback in terms of how we've dealt with it in the context of HFE, and it also overlaps with some of the recommendations in our five year productivity review about assessing Commonwealth/State responsibilities in some of those areas, and we sort of suggest that, given the gaps that remain and the difficulties in overcoming indigenous disadvantage, that was really our priority, first cab off the rank.

40

MR WOMERSLEY: We'll take it on notice and spend a bit of time with that. There is absolutely no doubt in our mind that the issues that arise for Indigenous Australians, while there are many people who are doing quite well they are vastly over-represented on a whole lot of measures that speak to poor life expectancy, poor outcomes, schooling, tertiary education, et cetera. So yes, we would be concerned that they are a group of people in the population who are very vulnerable and therefore removing them may

45

actually be - or removing an acknowledgement of that may actually be problematic. But we will give it some more thought.

5 **MS CHESTER:** That would be great, thank you.

MR COPPEL: Well, that's all from us so thank you. Thank you both for appearing today. I now call on our next participant from Business South Australia, Andrew McKenna. Anthony Penney, sorry.

10 **MR PENNEY:** Good afternoon. Welcome to the promised land.

MR COPPEL: Thank you.

15 **MS CHESTER:** Hello. Nice to meet you.

MR COPPEL: Make yourself comfortable and when you're ready for the transcript can you give your name and then a brief opening statement, thank you.

20 **MR PENNEY:** Sure, very good. So it's Anthony Penney, Executive Director of Industry and Government Engagements at Business SA, Business SA being South Australia's peak business body, 179 years old with over 3,500 members, represented are everything from sole traders up to ASX 1 in 200 listed companies. So very much the voice of business, and obviously
25 because of that this discussion, what brings us here today, is very topical and potentially very impactful to South Australia and South Australian businesses.

I guess as you can tell by my accent I'm not from here. I'm originally
30 from Canada, the Tasmania of Canada, and I will weave that in a little bit later into my opening remarks. But having lived in WA, New South Wales, South Australia and spent an immense amount of time in Queensland and in Victoria, I can honestly say Australia is very much a lucky country, and it is very much built upon equity and fairness. And that is the underlying
35 principle of HFE.

We're talking about a system that has existed for over four decades, and one would argue even longer before that, coming up to close to a century. So if it has existed for so long and it's put the country in such good stead, why
40 make changes now? I will talk about HFE as a system, the WA example and then the opposition, or I guess the proponents for changes to HFE regarding it acting as a disincentive for governments to make change.

If we look at the Productivity Commission Act it's all about achieving
45 higher living standards for all members of the Australian community, not just West Australians. If we look at the independence of the Commonwealth Grants Commission, it's a Government body that no one has heard of. And

that's a good thing because it means that they're doing their job, and it means that up to this date HFE has worked, and it has worked for all of the States.

5 With the draft report in terms of adjusting HFE to a reasonable level, have you defined "reasonable"? For us, and for our members, opening it up to a reasonable level would be opening it up to political interference, which would undermine the concept of HFE and distort GST distribution across the country.

10 Changes to HFE could see South Australia \$256 million worse off, and we know that governments are always about raising taxes to underpin the services that they provide to the constituents. But we have great fear that new taxes, inefficient taxes, would be introduced. The productivity mandate of encouraging the development and growth of Australian industries that are
15 efficient in their use of resources, enterprising, innovativeness and internationally competitive, would not be achieved.

20 Business SA and a number of the other associations in the room have spent the better part of the last five months convincing the general population and the South Australian Government that the bank tax is bad for the State and bad for business. If there are changes to HFE we run the risk of more inefficient taxes being introduced, not only in South Australia but in any other jurisdiction that could be worse off.

25 The fiscal capacity of South Australia differs to other jurisdictions, including a number of factors such as demographics, density, urban distribution of population, and it is a known fact that the ageing population of South Australia - and we do have the oldest work force in mainland Australia - does contribute to the Government's and South Australia's ability for
30 revenue raising capacity. If we look at the participation rate in South Australia, 61.8 per cent versus a national average of 65.1 per cent. So that puts us on the back foot.

35 If we look at WA, and I know that there's been a lot of information and a lot of, I guess, criticism levied towards West Australia Governments, and having lived in WA and having family there I've got nothing against West Australians, but when you consider they've had 14 consecutive budget surpluses totalling over \$14 billion with only the last three years dipping into deficit territory, the misconception that WA has been stiffed by the HFE is
40 just that. It's a misconception.

Budgetary mismanagement in the face of forecasted decline in GST revenue does not warrant a change in HFE. And if you consider how WA got into this pickle, the resources boom increased their capacity for revenue
45 raising more than any other States quicker. The CGC reduced their GST share accordingly as far back as 2005. The WA Government and subsequent budgets took this into account in their forecasting, and I quote from one of

the WA Treasurer's statements, "Although the State is expecting a significant penalty, \$1.4 billion by 2010/2011, from a declining share of national GST revenue as a result of the laggard CGC process, surpluses are expected across the forward estimates period. These surpluses provide the capacity for the Government to continue a substantial level of infrastructure investment, with a capital works program worth a record \$21.6 billion over the next four years."

There was a clear trajectory of a decreasing relativity for the WA Government, but yet they chose to ignore that and continue spending along the trajectory that they did. WA has received significant mining royalties, a primary driver of its low GST relativity. When GST payments are totalled with other forms of revenue sources, including payroll tax, and adding in mining royalties, a complete picture is formed, and the South Australian Government in their submission, I think on page six, did a very tidy graph on how combining the relevance of revenue sources equals out across all States and Territories.

If you consider there is a lack of evidence for change, particularly as Victoria, who has a lower per capita revenue than Western Australia, including the GST, is actually one of the States arguing the strongest for in fact no changes to HFE. And don't get me wrong, a prosperous WA is important for South Australia, and it's good for South Australia, but we are mindful of embedding long term changes to the HFE system which are reactionary to the commodity cycle.

WA too has benefitted from the longer term from HFE, and all States and Territories need to look beyond the existing GST distribution. If we consider HFE acting as a disincentive for governments and tax reform, it's no surprise that Business SA is not necessarily the best friend of State Government at all times, and I expect this Christmas we will receive fewer Christmas cards in light of the bank tax.

But we do have to give commendation to the Government in their efforts to try and reform the State. And if we look at resource development, for example, the so, the South Australian Government has actively and aggressively pursued the development of unconventional, onshore gas extraction and other resources.

As per our recommendation and our 2014 charter for a more prosperous South Australia, we lobbied for investigation into South Australia's role in the nuclear fuel cycle. Again, commendation to the South Australian Government for kicking off the Royal Commission into the nuclear fuel cycle, including mining, processing, nuclear storage and possibly even power.

5 The benefits as outlined in that Commission report could have seen South Australia bear the fruits worth \$51 billion. Now, nowhere in that discussion did HFE come up in the discussion as a possible disincentive for exploring this as an opportunity. Now, ultimately the citizen's jury stymied further conversation, but again credit to the Government for being as bold and pursuing it as aggressively as they did.

10 We reiterate that since 2015 the South Australian Government has abolished stamp duty on business transfers, and is part way through implementing the abolition of stamp duty on commercial property transfers. Given South Australia's move to abolish these business transfers and it is not recouped under HFE, it is hard to see how the current system of HFE acts as a disincentive for the Government to progress these tax reforms.

15 **MR COPPEL:** Can I ask you to - - -

MR PENNEY: Tidy up?

20 **MR COPPEL:** - - - tidy up in the next few minutes, thanks.

MR PENNEY: I'm almost done. I'm almost done. The Commission's draft report advises that there is scope for HFE in its current form to discourage major tax reform, but there is no analysis that we have come across where States like South Australia or even the ACT have actually implemented progressive tax reforms under the existing system. If the Commission is to recommend permanent changes to the current system of HFE which has served Australia well for decades, it cannot be on the basis of what might happen. It has to be on the basis and evidence of what has happened.

30 I opened up by saying I'm originally from Canada. Canada doesn't have full equalisation. It operates under a partial equalisation system.. And if you consider the States, it's similar but probably one would argue a worse system. And I know growing up in a "have not" province whereby our economy was founded on fishing and forestry compared to that of Alberta, which was mining, that the differences in services being able to be provided, net migration out of the province, and just the general overall wellbeing of people in the province, made a significant difference.

40 And that is why HFE, and again going back to the underpinning being equitable and fairness across all Australian States and Territories, is paramount. And therefore Business SA recommends no changes to the HFE system as it currently sits.

45 **MR COPPEL:** Thank you, Anthony. Let me just begin by making a couple of clarifications. You inferred that we were focussing in our draft report on just a sub-section of the Australian community in breach of our own Act.

5 The point that I'd like to make is that the inquiry is looking at the impacts on the Australian economy of the HFE system and the economic growth and productivity, incentives for major reform like migration, and our analysis suggested that, particularly in the area of major reform, there can be a disincentive for a State to pursue, given the HFE impacts that would be a consequence of those. And it's from that perspective that we see a number of problems with the HFE system that bear on the national economy. That's one point.

10 The other is looking at the consequences of HFE for budget management and there, as Karen intimated earlier, we did have quite a bit of analysis in the report and concluded that the HFE system shouldn't be an impediment to sound budget management. Where there was potentially an issue is with the contemporaneity, and again there we judged that moving away from the averaging could have consequences of itself for budget management so we were a bit more agnostic on that and didn't recommend any specific measures. So I just wanted to make that point for the transcript.

20 **MR PENNEY:** Sure.

MR COPPEL: But it's also a good kicking off point for asking you the first question, which is we've identified at least in principle where the HFE system can act as a deterrent to major reform. You've said that we can't look at what might happen. But the nature of that impediment itself could prevent something from happening.

MR PENNEY: Sure.

30 **MR COPPEL:** So that's why we undertook that type of cameo analysis because it's trying to extract from that. I'm wondering whether you then have any views on that particular cameo analysis, and if you make the point that you make that you can only look at what actually happens my question to you is isn't that limiting the scope of analysis to examine the impacts, or the potential impacts, of HFE? How would you overcome that?

35 **MR PENNEY:** So if I consider my opening remarks in terms of HFE being a disincentive, and I provided three very sound examples of where the South Australian Government is trying to look at ways to increase its revenue raising capacity and capability, and it is looking to undergo tax reform by abolishing business transfers, it is trying to head in the right direction. So I would throw the question, I guess, back to yourself and say, "Where have there been clear examples and evidence of HFE acting as a deterrence in the past?"

45 **MS CHESTER:** Well, I mean South Australia and ACT doing tax reform is actually consistent with the cameo because they're smaller States and Territories.

5 **MR COPPEL:** One example that was put to us, and it's a partial example, in our hearings in WA was the context of a change to the mining lease fee which was proposed by one of the parties in the recent election. That led to a lower commentary that 90 per cent of the revenue raised from that would be equalised through the HFE system. Why focus on this particular measure? We could pursue another tax base and the way the system works we would get a bigger share of that revenue back.

10 Now, I'm not saying that's the killer example, but I wouldn't say that pointing to particular - what we're saying is that it's not an incentive which would sort of kill reform over the head. So you can always point to examples where reforms go ahead and what we're suggesting is that the system is muting that incentive and the response that we're proposing provides more flexibility to look at multiple objectives. Governments always have multiple objectives. And it removes the primacy, if you like, of the equalisation objective.

20 Now, we're not proposing that we remove that equalisation objective. We think it actually should be quite the main objective, but it's just giving a little bit more weight in the system to provide that degree of flexibility. Can you then elaborate on what you think would be the consequences of a change in the objective of HFE for the State of South Australia?

25 **MR PENNEY:** Sure. If I consider the whole reason for Business SA's existence is to ensure that any impediments to growth for our members and for the larger business community put in place by Government, we lobby against it. So whether it's penalty rates, power prices or you name it, we do provide a voice for business. One of the things that we continuously have been lobbying against, or lobbying for, is portable, reliable, secure power. And granted this is a State and Federal Government issue and we're in the situation that we're in for a whole number of reasons, but to ease the transition for South Australian businesses the Government put in place an energy point to the program worth about \$40 million?

35 **MR McKENNA:** About \$30 million, yes.

40 **MR PENNEY:** About \$30 million. Now, if there were changes to HFE that would make programs such as that much more harder for the Government to deliver, for businesses to be sustainable, to continue employing people and to continue to compete on a national and international level. So any changes to HFE which has a negative impact to South Australia and the Government is going to naturally just flow on to the business community.

45 **MR McKENNA:** I think we're also concerned about the fact that GST is an inherently efficient tax, and as soon as we start to adjust the system of HFE leading to States like South Australia having a substantial hit - let's say we're

working on your basis that equalisation to the second strongest State, \$256 million a year. No doubt every State tax is on the table. They're pretty much without fail more inefficient than the GST, with the exception of land tax which the South Australia Government already has a significantly higher
5 land tax effort. It's about 1.31 on the relativity, so it's doing as much or more than it should be with a relatively efficient tax.

We're concerned about payroll tax changes. We're concerned about insurance tax, other inefficient State based taxes. We've only just had a
10 battle over the bank tax here, and one of the threats was to unwind payroll tax changes that had already been locked into the previous budget. So there's no doubt that if your proposals are formed in your final report and adopted by the Federal Government that there'll be a lot of pressure on States like South Australia to reintroduce or increase less efficient taxes than the GST
15 otherwise collects.

So our perspective is, as a business lobby who is looking for example for the ultimate abolition of payroll tax through increase in the GST, a position that we've made quite clear publicly, would find ourselves much further
20 behind in realising those longer term aspirations.

MR COPPEL: Sorry to ask you this, but could you give your name for the transcript so that we don't get - - -

25 **MR McKENNA:** Yes. Andrew McKenna, Senior Policy Adviser.

MR COPPEL: Thank you.

30 **MS CHESTER:** Sorry, the position of SA Business is to abolish payroll tax?

MR McKENNA: Eventually to abolish payroll tax through the GST, in some sort of like holistic tax reform that we've been advocating for a long time, and like many other organisations we're strong participants in the State
35 tax review, tax white paper processes that have obviously been at a Federal level cut short, but notwithstanding we continue to advocate these sorts of reforms which we believe are necessary, regardless of the political cycle and how palatable they are at any one point in time.

40 **MS CHESTER:** Is there other unfinished business that you see for South Australia in terms of how it uses and taxes its revenue bases?

MR McKENNA: As Anthony alluded to in terms of the national energy debate, we really have to be looking at a lot of these arguments from more
45 what's most efficient in a national perspective, and looking at how can we best use national taxes which are inherently more efficient. So it's not going to be just a case of what South Australia can do, it's going to be a case of

what South Australia can do with its COAG colleagues to implement efficient national base tax reforms like we have to implement efficient national base energy policies.

5 **MR COPPEL:** Your view is firmly that the system is working broadly as intended, and in light of that wholesale change isn't justified. Do you have areas where you think the system as it currently operates could be improved, maybe to address some of these issues that we've identified in the draft report or otherwise?

10

MR PENNEY: Specifically to HFE or overall?

MR COPPEL: HFE.

15 **MR McKENNA:** I think it probably comes down to the lag system, and we recognise that in your draft report at least you don't see significant value in adjusting that system for more contemporaneity. That has obviously played a significant part in WA's current situation, but the reality is Western Australia knew as early as 2005 approximately that the writing was on the wall, so to speak. How much should we change a decades old system because that State Government at the time wasn't willing to make difficult decisions that they needed to make in order to be in a position where they had sufficient revenues to cover their declining GST relativity.

25 I mean, we would argue perhaps that if you're looking at something that's going to mitigate against future possible scenarios, look at some sort of GST reserve type fund whereby if States go above a certain level based on a long term analysis that they're forced to essentially put away money in a GST reserve that can be there for the flip side of a mining boom, or whatever it might be, so that they do have that cushion against the way the current lag system works.

30

 So our primary, I guess, concern would be that the system works in a way that can best help States like Western Australia or Queensland, or perhaps South Australia in future, on either sides of mining cycles. But we don't want to throw the baby out with the bath water of HFE, and we need to be realistic about why WA are in the situation that they're in and not make long term, structural changes to HFE which, as Anthony pointed out, in other countries around the world where they don't have a system that equalises to the degree that we do, they typically have much more disparity across states or provinces in Canada.

35

40

 And we believe that's a highly valued aspect of living in Australia, being able to move around States and for businesses to move employees, et cetera, et cetera, and one that we don't believe the system of HFE needs to change to adjust to decisions that weren't made by the Western Australian Government when they clearly knew how the system worked at the time that they were

45

lobbying for a relativity floor, and they didn't hedge their bets and why should South Australia pay for it?

5 **MS CHESTER:** So Andrew, if you have read our report, and I think you have from your commentary, you would know that we have that frank exposition of WA's fiscal management in there.

MR McKENNA: I know.

10 **MS CHESTER:** And indeed we have to be careful that we've identified a separate problem to WA's fiscal management in that the outlier being so great means that there is such an equalisation task within the GST pool at the moment. But where you might need to get a trade-off between equity and
15 efficiency it's been amplified. And if we are to take the evidence that we're getting that the WA outlier is here to stay, that equalisation task will continue to be great. Thus if there are disincentives, and we pointed to some cameos, and indeed there's equally cameos and real life examples of where the current HFE arrangements reward what we would call poor tax changes, or non-tax
20 reform, then that trade-off is never going to be reached if we continue equalising to the highest State when it is such an outlier.

So I just didn't want our report to be mischaracterised as a solution to WA's fiscal management problems which it was never meant to be.

25 **MR McKENNA:** But I mean WA obviously wouldn't be in the position that they are in now had they sort of swallowed the pill back in the mid to late 2000s.

30 **MS CHESTER:** But that's not the problem we're looking to deal with. We've dealt with that separately in the report by saying poor fiscal management explains that part of the story. But it doesn't change the story that they're going to remain an outlier for the foreseeable future, and thus the trade-off problem with the disincentives within the system for tax reform and for development activity remains suppressed.

35 **MR COPPEL:** One of the specific issues with WA, given 97 per cent of iron ore is found in Western Australia, is the revenue assessment for royalties of iron ore where the goal of policy neutrality is arguably not met for that particular assessment because it's quite a unique one. So that's one specific
40 issue that's been identified with the HFE methodology itself. But that has implications in terms of the economic impacts of that can have implications for the WA economy. I've just got one final question. It sounds like you come from originally the far east of Canada.

45 **MR PENNEY:** Spot on. The Tasmania of Canada.

5 **MR COPPEL:** But our understanding is that Canada equalises I think it's on the revenue side or on the expenditure side. It's not on both as in the Australian case. But I haven't come across any work that suggested that the provinces have, as a result of less than full equalisation, been exposed to inefficient incentives for movement to the relatively richer provinces. That's something that maybe you can take on notice, but if you can point us in the direction of work in Canada that would be helpful.

10 **MR PENNEY:** Sure, and I will do. And even if you consider net migration - and again, it goes back to the creation of have and have not provinces. And Atlantic Canada has always been a have not region, partially due to the lack of natural resources that they are able to mine out and export. And considering hospital wait times - and there's data around that, it's generally longer in the Atlantic provinces - if you consider net migration from Atlantic provinces to the west of Canada, whether it's Ontario, BC or Alberta, all of the measures do point that due to the lack of - to a component due to a lack of full equalisation that the provinces are left to basically fend for themselves to a degree. And you don't get that in Australia because of full equalisation.

20 **MR COPPEL:** Great, thank you very much.

MR McKENNA: Thank you.

25 **MR PENNEY:** Thank you.

MR COPPEL: Our next participant is Jim Hancock from the South Australian Centre of Economic Studies.

30 **MR HANCOCK:** Thank you.

MR COPPEL: So when you're ready if you can for the transcript give your name and a brief opening statement?

35 **MR HANCOCK:** Yes, okay. My name is Jim Hancock and I'm Deputy Director of the South Australian Centre for Economic Studies, and I'm also a PhD candidate in the Research School of Economics at the ANU.

40 So today the issue that I want to pick up on particularly is that I think the draft recommendation to replace full equalisation with reasonable equalisation isn't supported by fundamental policy objectives of efficiency and equity.

45 Now, the recommended alternative objective is described as reasonable rather than full equalisation, but I'd make the point that there are many people, including in submissions made to you, who feel that full equalisation actually is reasonable equalisation. So I think the terminology "reasonable equalisation" is not very informative, and you might consider instead

speaking of either incomplete equalisation or attenuated equalisation, something that's sort of more descriptive of what it actually is that you propose and perhaps it's sort of less contentious in that wording.

5 Now, the basis for moving to full equalisation, which is set out in finding 2.1, is that firstly equalisation is always to the fiscally strongest State. Well, I'd accept that to be correct but it doesn't actually seem to me to be a basis for change in itself. Secondly, that the current system provides for limited consideration of efficiency, and I want to talk about that in detail. And then
10 thirdly, that it results in a complex system and I want to talk about that as well.

 But to summarise, I think that those two bases of argument don't give a strong case to move away from - well, they don't give a strong case to move
15 to the models that are considered, such as equalisation to the second State or equalisation to the third State.

 So in the report there are mentions of extreme GST distributions, and I accept that there are large differences in the relativities that apply from State
20 to State. But it's important to recognise that these differences in the GST relativities are merely offsets to large differences in other parts of State budget circumstances. And so their effect is actually to reduce extremities in State fiscal capacity. If you look at State budgets in their entirety comprising their own revenues and spending, plus the GST, then these differences in
25 GST relativities actually diminish differences in State fiscal capacity.

 Now, a qualification to that obviously is the lack of contemporaneity between State circumstances and GST distributions, and the fact that GST sort of adjusts with a lag to changes in States' fiscal circumstances. And
30 while I acknowledge that there are some difficulties around that, it doesn't seem to me that they're overwhelming. And I note the discussion that you did have of Western Australia's circumstances and you made the point that Western Australia was aware that its GST distribution would move in an unfavourable direction so it was able to forecast the direction of its GST
35 movement. Not perfectly, but it had an idea of where things were going.

 And so it doesn't seem to me that the lack of - well, it doesn't seem to me that a lack of knowledge was the fundamental problem. And perhaps in fact the issue was that Western Australia was pushing hard for a regime
40 change and decided to behave in a certain way to promote that outcome.

 So in terms of the mechanisms that you've talked about, equalisation to the second strongest State sounded to me as being very much like giving the strongest State a relativity floor equal to the second strongest State, and then
45 equalisation to the third strongest State would be giving the two fiscally stronger States relativity floors equal to the third strongest State. So I think there is a different way to look at what those models actually mean.

5 So coming to the efficiency issue, so there are essentially two efficiency issues here. They are location efficiency, so do we get labour and capital locating in the right regions of Australia. And for location to exist, locational efficiency to exist, you want to avoid a situation where there are particular regions that just have fiscal bonanzas or fiscal disaster situations that distort location decisions to sort of take advantage of that.

10 The other aspect of efficiency is that the equalisation system may impinge on the policy choices that States make, and the concern there is that then States change the way they behave, knowing that they can share the costs of their decisions with other States by the equalisation mechanisms.

15 Now, I'm not convinced that that second argument is very strong. There's not much evidence around it, but I note that in your report you said that an absence of evidence doesn't confirm that it's not happening. And I acknowledge that there is uncertainty around that. But it seems to me that there is still a way forward to address that issue.

20 So in most of the submissions that have emphasised these distortions to State policy choices - and I'll call it grant design efficiency. I think that's been used elsewhere that sort of captures what that means. So the grant design efficiency effects would arise when the GST distribution that a State gets is impacted on by the State's own policy choices. And in contrast to that
25 any GST distribution that is invariant to State policy choices won't suffer from those design inefficiencies. The point being that a State, if a State has no power to change its GST distribution - and we can say that the GST formula is not feeding back on the State's policy choices.

30 So there are a lot of GST distributions that are invariant to State policy choices. So the one that has received most emphasis in your submissions is an equal per capita distribution, but there are a lot of others that could be used as well. Just to illustrate, one would be to freeze in the current relativities
35 forever. If that were done then no State would have an incentive to distort its policies because its distributions would be set.

40 So given that there are a lot of GST distributions that avoid design inefficiencies, if indeed they matter, then which ones should be chosen? And I would argue that the desirable one would be the one that is likely to perform best on locational efficiency criteria and on horizontal equity criteria.

45 So what would that be? It would be the distribution that gives the best prediction of the future fiscal circumstances of the States. And if you adopt that model, then taking the current relativities, while it certainly won't give you a perfectly accurate prediction of what will happen in future, it is likely to be more accurate than taking something like equal per capita, certainly in

the near term. As we move further into the future it becomes sort of less and less certain.

5 So I think also even if we push aside the case of an equal per capita distribution, which you have sensibly, in my view, rejected, and consider say equalising to the second State - so equalising to the second State would say that Western Australia effectively, as the wealthier State at the moment, as any disincentives to tax reform or mineral development are removed because it gets to keep the benefits that come from that. So if you want to achieve
10 this outcome for Western Australia that could also be achieved by locking in Western Australia's current relativity. Obviously that wouldn't be popular with Western Australia.

15 **MS CHESTER:** You're not planning a trip to the west, Jim?

MR HANCOCK: Well, you know.

MS CHESTER: I'm just conscious of the time, Jim. Have you got much more to run through there? Sorry to interrupt.
20

MR HANCOCK: No, not very much.

MS CHESTER: Okay, good. No, I'll let you finish.

25 **MR HANCOCK:** If I can take another minute and a half? Now, so I think if you did put forward a model like this then some of the vigorous advocates of the view that the current system is inefficient, Western Australia and New South Wales, would not be at all enthusiastic about it. And okay, so that in my view reflects the fact that there probably aren't very big gains to be had
30 from that.

 But on the other hand if, as they suggest, there are a lot of dollars lying on the ground as a result of these inefficiencies, then you could say to them, "Well, here's these relativities frozen in. Go for your life. Now go and make
35 all these choices that you were impeded from doing under traditional HFE and make up the gains in that way." And I think at that point you're going to find that they're actually not very enthusiastic about that scenario because I don't think that those gains are really there in a large way.

40 Perhaps I'll stop there and we can sort of open it up to discussion and see what comes out from that.

MS CHESTER: I'm going to kick off because Jonathan is just going to take a momentary break. He had an early start. And thanks Jim, and thanks also
45 for your help earlier on at the meeting with us before we got anywhere close to finishing our draft report. That was really helpful.

I guess maybe if we just kind of go back to an earlier point that you made about there are sort of the two forms of efficiency, that the HFE could impact the economy, the first being around interstate migration, and I think we all kind of came to a pretty good landing there. The second one, so the non-locational efficiencies are the ones that we kind of honed in on. Indeed, when you sort of intuitively think about it, as you rightly point out when you depart from EPC if there are those incentive effects you're going to get non-neutrality outcomes.

So I guess in that sense if we want to keep equity as the principal or primary goal of HFE, do you still see there's scope or a need for some trade-off with efficiency at their margin, akin to - I mean, the CGC's current definition of its objectives in addition to full equalisation to the same standard does have those subsidiary principles, and I guess we're trying to work out how you - one, do you need to have that trade-off and two, then how do you achieve it under the current arrangements?

MR HANCOCK: I think as I have indicated my belief is that the distortions to State policies around tax reform and development aren't very large, and so there really probably isn't very much to be gained from moving away from full equalisation, which seeks to achieve that in a sort of full horizontal equity.

MS CHESTER: So with controversial development activities or what I call daring greatly tax reforms by a large State Government where we set out some cameos, take us through the logic as to why you don't think they play out.

MR HANCOCK: Well, it is an impressionistic view. It's based on sort of observing the behaviour of State Governments over 25 years. And discussions around tax reform and development it seems to me within the States are very much motivated by community opinion about those reforms, and community opinion - most people sort of aren't aware of any sort of dilution effect from fiscal equalisation. They simply form their judgments about whether they think substituting a land tax for a payroll tax is a good idea, or whether allowing fracking is a good idea or not. And I don't have any sense that the community views that drive the Government really are distorted by the operation of fiscal equalisation.

MS CHESTER: No, we're not suggesting the community views are. Indeed, for a lot of these changes like courageous tax reform by a large State Government or undertaking a controversial development activity, those community views are probably the primary factors that will impact a decision.

MR HANCOCK: Yes.

5 **MS CHESTER:** But where a State is penalised by the way the HFE impacts the GST relativities, it makes it even more difficult for them to dare greatly and undertake those reforms, if they are a reform minded government. So we're not saying that it impacts the community views or the impact that those community views will have on the decision, but at the end of the day would you agree that any sort of State or Territory Government would take into account the impact on GST relativities if they were material?

10 **MR HANCOCK:** Well look, I'd accept that in principle if a government thought that it was going to lose some of the benefits that it got from a reform, that it might be less inclined to make it than under a system where it knew that it wouldn't lose those benefits. As I said, my feeling is that that influence is not very large. But if it is significant then it can still be addressed in something sort of other than a system which delivers a large
15 rearrangement of financial resources to Western Australia. So it could be like, for example, freezing existing relativities. So if we think about it in terms of - - -

20 **MS CHESTER:** But freezing existing relativities flies in the face of - you've got quality and equity as the highest principle, and that's one area that we can agree on.

MR HANCOCK: Yes.

25 **MS CHESTER:** Then freezing relativities would be nonsensical because effectively you're not allowing that principle to remain primary over time.

30 **MR HANCOCK:** Well, I agree. I think if you freeze any relativity then you start to move away from that.

35 **MS CHESTER:** So we've already said in the draft report equity is still the primary objective of HFE. So that's not something we would countenance as a way of trading off the equity efficiency because it's not a trade-off, it's an abrogation of equity. So I think it's a neat way of having - saying to WA, "Be careful what you wish for." But that's not consistent with our draft report or the direction that we want to go in. We are reasonably trying to look at what's a way of still having HFE and keeping equity as the primary objective, but still being able to have a little bit of wriggle room for trade-off with efficiency.

40 **MR HANCOCK:** Yes, well I think - I mean, looking at say the example of equalising to the second strongest State, then the change in incentives occurs for Western Australia and not really for the other States, I think.

45 **MS CHESTER:** No, that's right in the current circumstances. Indeed we're doing some more work now as to how much of a muting effect you would have on the cameos. I mean, intuitively by having less of an equalisation task

overall there'd be a muting effect. Running it through the cameos will run through what impact that would have on the disincentives that we've calculated.

5 **MR HANCOCK:** Yes.

10 **MS CHESTER:** But I guess getting back to your point about the impact then on say South Australia, and I know a lot of people quote the larger numbers, i.e. if we did a cold turkey overnight and moved to equalising to the average how much is it going to cost the State Government? And that's not what we've recommended. We've talked about how we could go for the transition path. But even if we do get to a world of equalising to second highest or equalising to the average, the impact on a State Government I think from the calculations would suggest it's only 1.2 to 2.4 percentage points of the State revenues.

15 **MR HANCOCK:** I can accept that there are reforms that you can make that would have relatively small effects on certain States.

20 **MS CHESTER:** But that's the impact of moving away from less than full equalisation to - in terms of the GST revenues that a State or Territory would get, it would only decrease by 1.2 to 2.4 percentage points.

25 **MR HANCOCK:** And presumably the State with the large impact presumably is Western Australia who has a larger - - -

30 **MS CHESTER:** No, this is the decreases. So we're focussing - everyone is talking about what impact it will have on State Governments when you get to that point.

35 **MR HANCOCK:** Yes. Well look, I can accept that there are things that you do to have a relatively small impact. I'm still not convinced that that makes it a good idea to do so.

40 **MR COPPEL:** Can I ask you whether you think the CGC now achieves full equalisation in its processes for calculating the GST distribution?

45 **MR HANCOCK:** I think as well as we know. You know, the calculations require, or the CGC evaluations require judgments that are debated, and from time to time they change as the CGC accepts arguments that it could do better to get towards a truly equalising outcome. But I think that it does a pretty good job at the moment. You know, it has some caution. It generally speaking doesn't allow for elasticity effects. So where you have different State policies and therefore different sizes of revenue bases or spending bases, the Commission has traditionally been reluctant to make any allowance for that. Perhaps it could, but it becomes sort of a more speculative task to do so.

5 **MR COPPEL:** Because it has been pointed out that for other revenues of jurisdictions it accounts on average for about 40 per cent of a State's revenues, and that other revenues because of the reasons you've just outlined are treated on an EPC basis. And to the extent that they can be quite a significant share across the jurisdictions, that in itself would be a departure from full equalisation for the CGC.

10 **MR HANCOCK:** Yes.

MR COPPEL: So, I mean we're trying to make the point that the goal as currently outlined is it's full equalisation, but it's more of an aspiration than a reality. And when you sort of look at it from that perspective, vis a vis what we're suggesting, the actual change may not be - I mean, the actual change is a matter of degree rather than moving from full equalisation to something less than full equalisation.

20 **MR HANCOCK:** Yes, well I think - I mean, there's a question as to whether you judge a model by whether it falls short of perfection or whether you judge it by performing better than the alternatives. And so I think that the efforts that the CGC makes are likely to take you closer to full equalisation than a model in which you have a different goal that's set out.

25 **MS CHESTER:** Jim, you touched on earlier on in your opening remarks about - and I think the wording that we're using is "equalising to a reasonable standard" as opposed - - -

MR HANCOCK: Yes.

30 **MS CHESTER:** - - - to the current which is "equalising to the same standard." And, given this is an area of your expertise, I'm going to bravely assume you've read some of our report closely. But if you look through the history of that adjective, "same", it's never been decided by a government. It's not in any government legislation. It's just the way the CGC started doing it.

MR HANCOCK: The CGC's objective?

40 **MS CHESTER:** So the CGC Act has the old objective which I think is not materially substantially different. So it was never defined by any Government, State, Territory or Commonwealth, to be full equalisation. Because once you've got it you've got to equalise to provide a fiscal capacity to provide services of the same standard, that immediately and intuitively means you've got to equalise at least to the highest fiscal capacity and then you can see above that if there's anything left, which there typically is.

But so when we talk about it being what HFE is in Australia I'm just trying to work out whoever decided to do it this way.

5 **MR HANCOCK:** Well, I think you should probably ask Peter Emery who will be on a little later, who will be able to tell you - - -

10 **MS CHESTER:** We'll get a chance, and I'm sure South Australia has a good history here, but it is kind of interesting, and it wasn't even articulated by the CGC until about 10 or 15 years after they started doing it that way. And indeed when our draft report went out and we explained it in a heuristic sense, thanks to the CGC's help, that it is equalising to the highest then with an EPC above, we had calls from Government officials saying, "That's not how it works. It doesn't equalise to the highest." They'd understood that it equalised to the average.

15 **MR HANCOCK:** Well, I think - and I mean, I would have expressed it as equalising to the average, but I think that the term you use effectively means the same thing. And so I don't sort of want to get lost in semantics on that. My understanding - - -

20 **MS CHESTER:** No, no it's just that well you took us to semantics when you said reasonable wasn't good enough, and indeed you suggested we should use some other language.

25 **MR HANCOCK:** Yes.

30 **MS CHESTER:** So for us a reasonable standard of service would imply something slightly less than full equalisation, and so thus you could get the trade-off between equity and efficiency. Whereas if you're going to have equalisation for a fiscal capacity for the same standard it's going to have to be more comprehensive equalisation and there's no wriggle room. So that's why we went to reasonable.

35 **MR HANCOCK:** Yes, well what I'd come back to is I think there are many submissions that argue that full equalisation is reasonable, and I don't think you have that in mind. And so something that more accurately describes what you're proposing I would suggest is going to be more informative and sort of make the debate clearer.

40 **MS CHESTER:** So I just think we are getting into semantics now, but our term "reasonable" isn't about the overall system. It's equalising to provide a fiscal capacity to provide a reasonable standard of service, not the same.

45 **MR HANCOCK:** Yes.

MS CHESTER: Because same gets us to highest, and then gets us to full and comprehensive equalisation.

MR HANCOCK: Yes, well I - - -

MS CHESTER: So that's the logic that we're kind of following.

5

MR HANCOCK: And I accept that there is a substantive difference between the two models. Now, the full equalisation model that we have at the moment as I understand it was really sort of nailed down in the late '70s. Prior to that there was sort of more ad hoc sort of claimancy adjustments, but around the late '70s - - -

10

MS CHESTER: So going to the system where nearly everybody was in, so moving on from the non-claimancy era that's right, that happened in the late '70s. But if you look at what was defined as the standard in the CGC Act and in all the other Government literature it was not to the same standard. It was just how the CGC started doing it.

15

MR HANCOCK: Yes, yes.

MS CHESTER: And it's just kind of interesting how that evolved without any Government decision or changing the legislation. So indeed at the moment the way the CGC is doing it is inconsistent with their own Act.

20

MR HANCOCK: Yes. Well, I don't know if it is inconsistent with their own Act, but - - -

25

MS CHESTER: Yes. The Act has the old definition of but not substantially different standard. It's not the same standard in the Act. I can't remember who it was, someone when we spoke to a lot of wise people early on, and who had been involved in HFE and Commonwealth/State financial relations, and one of them did say to us history tells a lot here. So the team actually went and dug through that history, and I think it's quite revealing.

30

MR HANCOCK: Yes, well I'm aware that the wording around it has changed a bit over time, but I think for quite a long time that certainly the way the CGC has expressed its objective, it is what you could describe as full equalisation. I had heard New South Wales protest to the Chair of the Grants Commission about that but these - you know, what the CGC does is also discussed in Heads of Treasuries and Ministerial Councils, and those bodies can direct it to do otherwise if they want to, and as far as I understand they haven't.

35

40

MS CHESTER: Well, I think only the Treasurer can direct them. And it might be that I don't think people anticipated when they signed up for the GST what was going to happen today with the breadth and the band of the relativities, and that's what I guess has gotten people to focus on this.

45

MR HANCOCK: Yes.

MS CHESTER: Anyway, I will stop on semantics.

5 **MR COPPEL:** I've just got one more question to ask you which is quite a
specific one. In the CGC discussion paper for the 2020 review of
methodology they have a section that deals with this issue of policy neutrality
with respect to I think mining royalty assessment, where the suggestion is
10 that of a major new revenue stream 50 per cent would be discounted. My
question is do you have any view as to the efficacy or the merit of that
suggestion?

MR HANCOCK: I suppose it sounds like a large discount to me. The
motivation for it I assume is sort of an efficiency related one.

15 **MR COPPEL:** Well, it gets back to these judgments that are needed when
you're not quite sure whether you've got sufficient information to provide a
comprehensive assessment, and that there may be substance to some of the
arguments that are put that this is not treating one jurisdiction or a set of
20 jurisdictions fairly. So typically what they do is they can apply a discount,
and this is a new manifestation of that approach, but it is on the increment of
new revenue which is a bit different from the way they've typically applied
discounts.

25 **MR HANCOCK:** Well, I acknowledge that say for Western Australia there
are costs that Government has to incur to get major mineral developments up,
and so logically they would be sort of a deductible against a revenue stream
but it has traditionally been hard to assess what those costs are that they need
to calculate. So allowing a 50 per cent concession against the additional
30 revenue, it sounds high to me but that's just speaking sort of on the run, yes.

MR COPPEL: Okay, good. Thank you very much.

MR HANCOCK: Thanks.

35 **MR COPPEL:** So we will take a five minute break and then we will
reconvene with the Urban Development Institute of Australia, Pat Gerace, at
20 to 1.

40

ADJOURNED

[1.03 pm]

5 **MR COPPEL:** Our next participant is Pat Gerace from the Urban Development Institute of Australia. Welcome, Pat.

MR GERACE: Thank you. Thank you.

10 **MR COPPEL:** Like others if you can give your name for the transcript and brief opening remarks.

15 **MR GERACE:** Pat Gerace from the Urban Development Institute of South Australia. So good morning, and thank you for visiting Adelaide and coming down here. I represent the Urban Development Institute, and to be clear the UDIA operates under a Federated model and I speak on behalf of our South Australian members. Our membership represents most of the major developers and builders in South Australia and has been in operation since 1971, so I will make some statements and comments on the matter that relate to the property sector and then I'll do my best to answer any questions you have on the specific technical details of HFE.

20
25 But UDIA is always willing to provide encouragement for local State and Federal agencies to employ good policies to see South Australia and our country grow, and before speaking about the HFE specifically I just want to make a few quick remarks. We're at an interesting juncture in South Australia. We face the challenge of an economy that's in transition from traditional manufacturing to an advanced manufacturing focus, and there's no doubt there's many more challenges to come.

30 But a symptom and a cause of these challenges is the rate at which South Australia's population is growing. And we're seeing a declining population in certain geographical areas in particular age brackets as well as the overall share of the national total. And through a study commissioned by various groups, including the UDIA, the South Australian Centre of Economic
35 Studies actually found that South Australia faces a triple challenge of ageing population, labour force, regional depopulation and a disproportionate reliance on owner/managers, which are on average older. And in combination these three lead to and accentuate the skill and general labour shortages, particularly in regional South Australia.

40
45 But over the last three decades the State's annual population growth rate of .74 per cent was roughly half that of Australia as a whole, 1.37 per cent. The study also concluded migration has a potential to assist. So we're very firm about that. The State Government's aspiration is to increase the number of people who live in South Australia to two million, but to get there we need a growth rate of 1.4 per cent. At the moment South Australia's fertility rate is well below the rate of population replacement. Our shared national

overseas migration has declined from 10 per cent to 4 per cent, and over the last 40 years SA continues to experience high rates of net interstate migration.

5 Without growth in the work force population the taxation base to support Government will also decrease. In the 1960s the working age population was in the order of 63 per cent, and this has declined to less than 50 per cent today and it's projected to fall to below around 32 per cent by 2040. The net age in South Australia is 40, the oldest of any mainland State in Australia. We only
10 need to look at the figure of 6.2 in your report to see the trend in the population of South Australia, which is a big matter for us.

 In terms of the property sector, we congratulate the South Australian Government on a number of initiatives like the breaks in stamp duty, apartments, construction grants, but there's no doubt that we're over-
15 represented when it comes to taxation, or so the members believe. GST, stamp duty, lien tax, Council rates, and then indirect taxes like payroll tax and company tax. We did some work in 2011 and estimated on a \$400,000 house in the northern suburbs the tax incidence was about \$85,000.

20 So why worry about HFE? Well, before I answer that specifically I want to commend Business SA for the work that they've done in this area. We agree that the fiscal (indistinct) responsibility for Western Australia is a significant enough reason to ban the principles of equalisation, and it doesn't
25 seem fair that a State in the west with a significant amount of natural resources and revenue benefit can complaint later when the boom comes to an end. I won't go on any more about that. You've heard it all before.

 But I would like to add that while changes, the report's findings
30 conclude that changes to HFE are not likely to have any material impact on a State's propensity to initiate tax reform, what I can say through our recent observation is that a massive cut in revenue in South Australia is likely to have the impact of forcing the State to consider alternative revenue measures. With a population demographic that is ageing at a higher rate than others, and
35 a shrinking tax base, it's entirely foreseeable to see more inefficient taxes with spurious policy rationale behind them to plug the gap.

 Just last week we saw the State Government increase the foreign buyer levy on properties increase to 7 per cent from 4. We had asked the
40 Government to provide reasons why they're doing this. They say it's an affordability issue. That might hold true in New South Wales and Victoria. We don't believe we have an affordability issue here. We believe the Government simply used this as a revenue measure, and that's the kind of thing that our sector faces as we stare down the barrel of a Government
45 looking to try and find money from a shrinking tax base.

5 So we believe that there are a number of other big policy matters that put South Australia on the back foot a little bit. Mega cities are the - all the research suggests that more and more people are wanting to be in the really big cities. We see Sydney growing exponentially, like a chemistry experiment. We know more and more people are looking to be in Melbourne and Sydney, in those big cities, and geographically that puts a challenge on South Australia. You only have to look at the discussions that happened around high speed rail along the eastern seaboard. Something like that happens and where is South Australia?

10 So I'm picking up now a little bit on the comments that you made before about it only being a small percentage of a State's revenue in terms of the impact even on the cameos that were provided. What I would say is that when a State is facing a population decline like we are and the challenges that we have got, that every cent counts and every dollar counts, and that I'm not sure there's as much discretionary revenue in the South Australian budget once you look at health and education and some of these things that we are facing. I think that the impact being the order of 1 to 1.3 per cent, I think you said, is a lot bigger than in real terms than what it seems.

20 So they are my opening remarks and I am happy to have a talk to you about any questions you have.

25 **MR COPPEL:** Thank you, Pat. I'd like to ask you whether you think that the issues that are acting as pressures on the South Australian economy, to what extent are they linked to HFE or are they really just contextual?

30 **MR GERACE:** I suppose there's two parts. Obviously the propensity for a State Government to make tax reform, or initiate tax reform based on the HFE formula, my gut feel is I think as one of the speakers from the South Australian Centre for Economic Studies said before is that generally the decision makers will have regard to the HFE formula, but a lot of the times it's the community acceptance of tax, particular types of tax reform, that drive them. We saw stamp duty on apartments in South Australia. The reason for that was a change in the way that they wanted the urban form to look in Adelaide. And I'm driving particular policy agendas like the 30 year plan.

40 So I don't always think that the HFE component has a massive impact on the types of reform, but I might leave that to more learned people to explain that. What I would say is that if we are talking about - and I know you said before it's characterised by - talking about doctors and nurses - what I can say is that my membership tell me all the time that in South Australia we are at a juncture that is really critical, and that things are particularly tough here as we look at the way that our economy transforms. And to lose a couple of hundred million dollars is a lot. And you can say it's a few per cent, but I don't think we've got any kind of spare cash lying around and we're facing a

challenge in the future to service an ageing population. It's going to be a - I think it's important - we feel it's important to come here and say that what we were hoping the State Government would be doing is implementing policies that make South Australia a more attractive place to be, and differentiate from the other States.

So let's just assume it's \$250 million as a hit to South Australia. Well, the first thing that happens, the foreign resident or foreign buyer levy that's just been introduced wouldn't have to happen. That was \$80 million. We could tell the rest of the country that you can come to South Australia and buy and not have to pay a levy. But we can't do that now because the Government has decided to do the same as everyone else.

So it's those types of things that worry us. Unashamedly I will say a loss of revenue from any change to the calculation for South Australia I think is a bad thing for us.

MR COPPEL: So your main point is that you disagree with the recommendation of a reasonable standard for HFE equalisation on the basis that it would have a negative fiscal impact on the - - -

MR GERACE: Yes, I would say that but I also would say that personally I believe that the equalisation principle for me, from what I read, is the thing that - it should be the primary driver and I don't really - and I understand you have articulated a problem about equalisation versus efficiency, I would even say that I think the equalisation is more important.

MR COPPEL: Okay, but do you have any views as to whether the current, keeping within the framework of the current system, whether that leads to specific inefficiencies? Maybe you've mentioned the examples, or possible examples, linked to the design or the choice of tax bases, and do you have any views as to how then those specific problems could be addressed in a different way from what we've suggested in the draft report?

MR GERACE: I do have some suggestions about some of the tax reform that are probably not within the Terms of Reference of your report. I think that someone had - and again probably it might not be what you are considering - but I have the view that at some stage in the past somebody at the Federal level decided that tax reform was a great idea and the GST was an efficient tax and there was a program by our Federal politicians to get to that outcome. And we had a GST implemented, and there was a - a former famous Treasurer said something about a bucket of money and premiers.

But someone had some leadership to do that, and I think we're skirting around the edges when we look at the possible implications of HFE, in particular stamp duty is what we're worried about in the property sector. Yes, they will have some impacts on whether you might introduce a stamp

duty reform, but I firmly believe - and I have already put this to a senior Minister in South Australia - that the States - and Federal Government should take the lead and talk to all the States concurrently about the abolition of residential stamp duty. And I think that's probably the way forward. But again, like I said it's probably not part of the Terms of Reference.

MR COPPEL: What would you replace it - I mean, that's quite a substantial part of a State's source of revenue, stamp duty. ACT has gone in that direction very slowly and it's replacing it with greater reliance on land taxes.

MR GERACE: Two years ago, I think it was two years ago or maybe a little bit more, the Treasurer announced here in South Australia with great fanfare that he was going to do a tax review in South Australia and look at inefficient taxes, and he did a roadshow and said that broad based land tax was efficient, and I think he even maybe even said payroll tax was an efficient type of tax at that particular time, and stamp duty was not. And I don't think it took more than a couple of weeks for it to be, for broad based land tax to be ruled out.

The propensity for a State Government - and I know there has been some glimpses of hope from some other jurisdictions - but the propensity for a State Government to go through that payment transition of a broad based land tax, the new tax all of a sudden becomes a really nasty thing that the public don't like and so governments just tend to walk away from it.

So when we saw that here I was hoping that there would be a reform. And it comes right down to the transaction, and I think that as soon as the Federal Government with the financial capacity, because of fiscal balance, can say right, we are - here's a carrot and here's a stick - maybe we might actually get some significant reform in that space.

MS CHESTER: So Pat, the issue you raised is actually - it's not tangential at all to our inquiry and where we're going. Indeed when our Terms of Reference asked us to ask and answer what impact, if any, does HFE have on the economy and you would have heard earlier there's kind of two impacts it can have. One is on interstate migration, locational decisions for people, and the second one - and capital - and the other one is how it might impact the decisions of States to do good policy. And that good policy can be either tax reform or development activities.

And it was indeed in the area of tax reform when we ran some cameos to have a look at what impact does HFE potentially have on the States making those tough decisions, the cameo we actually ran was halving stamp duty and replacing it with a broad based land tax. So it was revenue neutral, and for a large State to do that we identified that once you got through any transition path and they're in a state of equilibrium they could get hit by an impact on

the GST relativity such that they lose \$1 billion a year. So that for us was the efficiency, one of the efficiency arguments that we identified in the draft report.

5 So indeed when you say State Governments aren't daring greatly, we have identified that there is this potential trade-off between equity and efficiency.

10 **MR GERACE:** I did notice that and it made me think, ask a question about - and I don't know the answer to this - but what would be the impact if all of the States moved together at the same time?

15 **MS CHESTER:** And we ran that as well, and the disincentive is much less. The problem that we've got though is that States don't do that stuff multilaterally, and they would need to do it multilaterally.

20 **MR GERACE:** No, they do, and so this is where I go back to the leadership of the Federal Government saying, "Here's a bucket of money. You all do this together and you get it." Didn't John Howard do that?

MS CHESTER: Well, it hasn't happened since then.

25 **MR GERACE:** Yes, that's what I'm saying. So again, when I talk about the Terms of Reference of the Committee I'm maybe being a little bit more political than economic, but that's kind of why I'm saying that you can talk about HFE and you can talk about at the margins here and there and that, and I understand that proposition. And for me it seemed - and I'm maybe being a little bit focussed on stamp duty, but you can understand, but I'm thinking why wouldn't the Federal Government make that unilateral decision? But
30 again, that's about the stamp duty and if HFE was a problem I would say, put on the record, that it should look at enticing all States together to move away from that so that HFE isn't an issue.

35 **MR COPPEL:** That's sort of one of the areas that has been raised in some of our consultations and submissions, the role of the Federal Government in terms of sort of leadership in the area of HFE and possible changes to HFE. Do you have any other specific ways in which that leadership could be brought to the debate? Is it just up to the Federal Government?

40 **MR GERACE:** Well, I mean what we've - a man I used to work for said that he thought it was a disgrace that countries that were at war with each other in Europe managed to nationalise and therefore harmonise the rail system across Europe before Australia could. So if you look at our track record and you think about the capacity for all the States to come together,
45 even when they're all of the same political persuasion, for a short time nothing really happened, you wonder whether or not there's a capacity for that to happen.

5 So I do say that Federal Government leadership and maybe - and you know, maybe if this - if what you get out of this review is one thing, and that's that, that the Federal Government says, "Okay, we have identified that tax reform is just not likely to happen because of these HFE impacts and that we're going to take the leadership role", then that would be great.

10 **MR COPPEL:** Okay, great.

MR GERACE: Thank you.

MS CHESTER: Thank you.

15 **MR COPPEL:** Thank you for your contribution.

MR COPPEL: Our next participant is Peter Emery. Thank you, and welcome Peter and Linda. If I could ask you for again the transcript to give your name and then a brief opening statement. Before you do that, I do
20 appreciate that you are participating in these public hearings. I recognise even though you haven't put a submission into our particular inquiry, we have looked at your submissions to the previous review of HFE in 2012.

25 **MR EMERY:** That's good.

MR COPPEL: So thank you, and over to you.

MR EMERY: My name is Peter John Emery, and my wife?

30 **MS EMERY:** Linda Emery.

MR EMERY: I have foreshadowed with the Commission that my wife, Linda, will read my statement and I assume that's satisfactory.

35 **MR COPPEL:** It is.

MR EMERY: There's a couple of little things I wanted to say beforehand. First of all, I thank the Commission for organising this meeting on Tuesday and not Thursday. On Thursday, speaking for myself, I'm going to be more
40 interested in the productivity of the Australian cricket team than the alleged inefficiencies in HFE. The other thing is that for blind people like myself these kind of gatherings can be awkward, and I appreciate the fact that both of you introduced yourselves to Linda and myself, and I thought that was courteous and thoughtful and I do appreciate that. Over to my wife.

45 **MR COPPEL:** Okay.

MS EMERY: Let me begin my expressing my appreciation that the Commission has come here to Adelaide. South Australia has been involved in equalisation issues since the beginning, and I believe it has made an excellent contribution to discussions over the decades. I thank the
5 Commission for permitting me to make a statement today. It is being read on my behalf by my wife, Linda Emery, the reason being that I have become blind.

10 It is pleasing to Linda, and it may be for others as well, that my statement is quite brief. I emphasise that this is a personal statement, and not on behalf of the Government of this State or anyone else.

15 I have been involved in this area of work since a few weeks after joining the Commonwealth Treasury in February 1967. I have been involved in a number of ways, including as a preparer of written Commonwealth Treasury submissions to the Grants Commission, as a witness at Grants Commission hearings, as an adviser to the Commonwealth Treasurer and other Ministers, as a senior officer in the South Australian Treasury, including a period as
20 CEO of that department, as a consultant to the Commonwealth Grants Commission and the South Australian Local Government Grants Commission, and as an adviser in several countries in Africa.

25 I would like to think that my principle objective in all this has been not so much in advancing the causes of the Commonwealth or South Australia, but in doing my bit to support and improve the overall structure of arrangements in this area. I believe my main achievement in that respect was in initiating and implementing the move away from the old claimant State system to one which covers all six States and the two Territories. This has led to a fairer system, and in all probability the shares of grants going to New
30 South Wales and Victoria has been higher than it would otherwise have been.

35 Like everyone else, I bring to this inquiry my own personal perspective, namely that of someone who has long understood and supported our equalisation system and who has a very high level of respect, and in some cases affection, for some of the members of the Grants Commission who have served us so well.

40 I mention Professor Giblin, Sir Leslie Melville, Professor Russell Matthews and Messrs Ron Lane, Roy Daniel, Ron Barnes, Fred Argy and Dick Cry (? 1.33.32), men of great experience, intelligence and wisdom. I hope that in its final report the Productivity Commission can find room for some appropriate tribute to the work of the Grants Commission over its many decades of service.

45 I mention that although I do not read as much or as speedily as I used to, I am aware of the background to the current inquiry and of the principal views which have been expressed by, and to, the Commission, including in

relation to its draft report. Let me concentrate on two aspects of the background.

5 First, the complaints by Western Australia about what it regards as an unduly low share of the aggregate of grants being paid to the States which aggregate is equal to the GST revenue. Western Australia has advanced its cause by quoting the ratio of the grant it is receiving for the GST revenue coming out of Western Australia. I note that Commonwealth Ministers and media commentators appear to regard this low figure as itself demonstrating that Western Australia's share is too low and that the system needs to be changed in some way. This is, of course, quite wrong.

15 The low figure reflects the very high revenue capacity of Western Australia compared with the other States and Territories, and the very purpose of our system is to take account of differences of this kind so that States and Territories can all provide similar standards of services without imposing higher rates of taxation. The low figure quoted by Western Australia merely reflects the fact that the differences being dealt with by the Grants Commission are large. To those of us who understand the system, all this is of course elementary.

25 In this context I and others have been intrigued by the contents of box 2.4 in the Commission's draft report. It begins with this sentence, "Concerns that Western Australia's GST allocation is unfair are not invalid." What, I wonder, is the significance of the double negative? Is the Commission saying that the concerns are valid, or that it is not sure whether they are or not, or that they are valid in some respects but not in others? I believe it would be useful for the Commission to clarify this point.

30 I also take this opportunity to express my dismay at the way Mr Fred Argy has been quoted in this part of the report following the sentence I have quoted. His words have been taken completely out of context and misused to support something which I know he would not support. I have written to Ms Chester on this matter and she has promised that she would respond.

35 The second background issue is all about the relationship between the equalisation principle and the way it is being implemented, and questions of economic efficiency. These issues are by no means new. There is a theory that fiscal equalisation as currently implemented might somehow be inconsistent with economic efficiency or incentives faced by States and Territories to encourage the development of mining for other industries. The key word here is "theory". No evidence of a concrete kind has been put forward to illustrate, let alone prove, that this theory has any practical relevance.

45 I know from my own involvement in the massive Roxby Downs development here in South Australia that Grants Commission type

considerations have played no role in economic development decisions. There has been discussion about the reluctance of governments to accept advice that they should replace stamp duties on property purchases with general rates on property values. Take my word for it, this again has nothing to do with Grants Commission or equalisation, but rather with the politics involved with the fact that in any period there will be fewer voters buying properties than those who own properties.

Our fiscal equalisation system provides economic efficiency in the same way as do uniform Commonwealth Government taxes and expenditure policies across the country. The notion that economic efficiency would be improved if the less financially advantaged States were forced to have higher taxation or lower standards of service than other States is ludicrous. At the risk of stating the obvious, I note that the proposal to base the equalisation system on the financial position of the second best top State or Territory is completely arbitrary and rightly has attracted no general or useful support.

Conclusion. Karen, you and your Commission colleagues have a tremendous opportunity in front of you. Mainly as a result of the Western Australian situation there has been, and remains, confusion amongst senior Commonwealth politicians about our system of fiscal equalisation. They want something different. You and your colleagues have the opportunity to explain to these politicians and everyone else that we have a very sound system in Australia of which we should be proud. It promotes both fairness and economic efficiency. We have avoided the huge inequalities between parts of our country that exist in the United States, by way of example.

I can understand that in some sense the Commission may be reluctant to reach the conclusion that no fundamental change in our current system is either necessary or desirable. However, I believe there is sufficient brainpower within the Commission to come up with a wholly convincing report along the lines I have mentioned. This opportunity is unique to the Commission. We here in little old South Australia can toil away for decades in researching, thinking and writing about the virtues of our current system, and we can do so with a good appreciation of the facts and with clear conviction.

However, it will always be possible for such work to be regarded as merely self-serving. Your Commission does not have this problem. It is my firm belief that if the Commission's final report were to be at all similar to the draft we are now considering its reputation would be diminished. At this stage there remains open the possibility of a different approach being taken by the Commission which will enhance its reputation for strong, independent thinking.

Thank you again for the opportunity to put forward my thoughts. I would be more than happy to elaborate upon them if the Commission wished.

5 **MR COPPEL:** Thank you. Let me begin by just picking up on one of the points that you made and then Karen will pick up on the other, and that's the role played by the Grants Commission which has been tremendously helpful to the Productivity Commission in the draft report, and we expect that that cooperation will continue through to the final that comes in the terms of providing us with data and advice on the actual methodology and how it works. So that is recognised in the report. We think it is important to have an independent Grants Commission, and what we are proposing is to strengthen the role that the Commission plays in terms of informing the broader public and our political leaders, which I think gets to the point that you make about confusion as to how the HFE system works. And I'd be interested in your views on whether those sorts of recommendations, for example the CGC playing a greater role in public communication, would serve that particular goal.

But before I give you the floor to respond to that particular question let me just hand over to Karen.

20 **MS CHESTER:** And Peter and Linda, thanks for both being able to come today and Peter, we are very aware of your very longstanding history in matters of Commonwealth/State relations going back to Commonwealth Treasury, and then right up to and including some very fiscally challenging times as Under Treasurer here in South Australia.

25 I did manage to respond to the issue that you raised around box point 2.4, and I might just share that with everybody else for the purposes of the transcript. So I won't go to the nice salutations, but I did say that our draft report's citation and references to Fred Argy's good work and published works in the field of equity and fairness are intended to be read as separate to the opening sentence in box 2.4, and we will certainly ensure in finalising our report that any inferences, as you have obviously drawn, cannot be made. And that was certainly not our intention. So we will make sure that that inference can't be drawn, Peter, when we finalise our report.

35 **MR EMERY:** Well, I'd appreciate that. What you told me in your recent email I found odd, to be honest, that the material that followed that opening sentence was not related to that opening sentence. Which I obviously haven't seen the bit that we're talking about, but Linda and other people I had talked to had seen that it couldn't reasonably be interpreted that way. But anyway, I will follow up the correspondence.

45 **MS CHESTER:** The inference was never our intention. It's not how we meant it to be drafted or read, and we'll fix it in the final.

MR EMERY: Better still, you may want to remove it altogether might be more appropriate. But anyway, that's a matter for you.

MS CHESTER: Yes. I think if we just get rid of that first sentence the problem will be solved.

5 **MR EMERY:** Well, I think you should - in the meantime it would be useful if you would clarify what that sentence meant. I mean, to say that the Western Australian concerns are not invalid, what does that mean? I regard myself as fairly good with words. I'm not sure what you meant. Anyway, that's probably a peripheral issue, probably.

10

MR COPPEL: Okay.

MR EMERY: But it happens to be important to me.

15 **MR COPPEL:** Okay, well maybe if you would like to come back to the role that the CGC can play in terms of informing the broader public about how the system works, how the system achieves its goals and the value that comes from that?

20 **MR EMERY:** Well, I should say it's several years since I've studied the Grants Commission report or their worksheets, you know, which add up to some inches of material. I have often expressed, including to the Commission, a view that it could be more forthcoming, including explaining to people why its work on horizontal fiscal equalisation is good, that is the
25 positive effects that come from that. And I would have no problem with the idea that it should produce annually or whatever a simplified version of how it goes about its work. I would support a greater role for the Commission in this sort of thing. It has, I think, been unduly modest in explaining itself. I don't know whether that answers your question or not. Does it?

30

MR COPPEL: Well, I think it goes in the same direction to what we're proposing in the draft report.

35 **MR EMERY:** Yes. I think some of the references - I've heard people refer to the Commission's work as being a black box. I don't know whether you've heard those comments.

MR COPPEL: We've heard that, yes.

40 **MR EMERY:** Which I think is silly. I mean, you have to make - if you're interested then you have to make some effort to understand it, but I don't think it's as bad as that sort of terminology implies if somebody is prepared to make a bit of small effort. But on the other hand I agree that the Commission could produce some perhaps simpler and briefer material which
45 explains its work.

MS CHESTER: And I think, Peter, they are making some efforts in that

area and we give them credit for that in the report.

MR EMERY: Yes.

5 **MS CHESTER:** I think the one area where - and we did have a
recommendation around this in our draft report - is that the data that the CGC
uses and their actual calculations using that data aren't made available in the
public domain. And I know we've had submissions and we heard from a
10 number of academics who - to some extent being able to use that data and do
further work and analysis around it would, I guess, one, wide and enhance
research in the area but two, also enhance an understanding of the work.

15 **MR EMERY:** Has the Commission ever, to your knowledge, ever refused a
request for access to some of the budget detail? I have in the past been
involved in things where I did request more material and talked to the staff
there in Canberra et cetera, and I never had any problems of that kind. I'd be
surprised, but I don't really know that they would go out of their way to
refuse such a request.

20 **MS CHESTER:** I think the stumbling - and look, we've had terrific
working relations with the CGC throughout our inquiry and they've been
very helpful for us, and so we've been able to get access and their help with
modelling to the extent we've needed, but I think the issue is around the data
25 that some of the States then provide the CGC, and to be able to replicate and
do the calculations you need to have access to that as well. I know, it's really
just something that we heard from, largely from academics.

30 **MR EMERY:** Yes. Okay, well I would be in favour obviously of everyone
having access to whatever data they like, unless there was something
genuinely confidential about something the State had provided, which I
suppose is possible.

35 Let me just in a very brief time comment on some of the discussion
that's taken place before. I think the material that you have heard from the
parties, that's been I think very commendable. I think it illustrates that it's
not just a matter of self-interest that people here are talking about. The issues
have been thought about very carefully by the bodies that were represented
earlier. I almost felt redundant at one stage.

40 The other thing is you referred at one point to the system of Local
Government equalisation that exists in all the States, and said that no attempt
is made to fully equalise by the States. Now, that's not a good representation
of the situation. The reason we don't fully equalise in that area is first of all
45 there's a severe limitation on the amount of money which is far insufficient
to fully equalise. And the other aspect is that there is a requirement in
Federal legislation for a minimum grant so that even the best off Councils get
this minimum grant. So the implication was that States don't try to fully

equalise within their sphere - well, that's just not a useful way of looking at the facts.

5 The other thing about this trade-off between equalisation and efficiencies, and that sort of phrase has been used quite a bit here, a consultant's report was undertaken in the context of the inquiry that was initiated by Julia Gillard which, to my mind, demonstrated very clearly that equalisation had pro-efficiency results. Now, I've forgotten the name of the firm or the individual who prepared that, but you would have access to it.

10

MR COPPEL: I think it's Chris Murphy. Is that the one?

MR EMERY: Exactly. Sorry I had forgotten his name. And that's not a surprising conclusion. We take for granted that Commonwealth tax policies and Commonwealth expenditure policies are uniform across this country, and that that is economically efficient. We sort of take that for granted. And what our equalisation system does is sort of approximate that to suit a Federation, so that there aren't huge differences between tax rates or expenditures between the States.

20

Now, there are some differences as a matter of policy, but the notion that to dampen the effects of what equalisation does for you away from let's call it complete equalisation would promote the possibility of economic efficiency just is away from the truth. We have a system, and as Chris Murphy I think proved - and he quantified what the effects of this pro-efficiency, effects of equalisation are. So I just think that discussion is just not, is just the wrong angle all together and I would hope that in your further, or your final, report that can be dealt with in a quite different way than it has been in your draft report, and indeed in the discussion this morning.

30

MR COPPEL: We did earlier on in the inquiry consider whether we would conduct general equilibrium modelling for the purpose of the draft report, and we did look at the 2012 report and most - the reason that we haven't pursued that is that for the 2012 report by Greiner, Brumby and Carter, there were two types of general equilibrium analysis and each essentially assumes the outcome, to put it very crudely, of an efficiency gain or a lack of an efficiency gain linked to HFE and migration decisions, for example.

35

And that doesn't provide - it doesn't take you very far. It can look at some of the sort of broader implications across the wider economy, but the actual mechanism that leads to an efficiency gain or efficiency losses is essentially set up by assumption, and that's why we took the alternative approach of working more with cameos that can, I think, pick up more of the detail of the HFE system itself.

45

MR EMERY: Well, are you asserting amongst other things that the Murphy analysis was wrong?

MR COPPEL: I'm saying that in the analysis it's important to make assumptions. They need to make assumptions, and some of the critical assumptions are ones that drive the results.

5

MR EMERY: Well, one of the assumptions that your Commission appears to be making is that there could well be distortions in, for example, tax policy as a result of the HFE system we have. And that to me is more of an assumption than anything is proven or even likely to happen. I mean, personally I've been involved in probably hundreds of public finance decisions of all kinds, including mining royalties and taxation and all sorts of things, and it's just not the case that Government decisions at the State level are influenced by what HFE calculation effects might or might not be. That's just not - and I don't believe your Commissioners have any evidence to the contrary on that.

10
15

And in the statement that Linda read I commented on this thing about stamp duties on purchases of properties and the fact that people think it would be better if we had a general land tax. I mean, that's just not the case that any of those decisions have been influenced by HFE calculations. If, by the way, there are such examples then the States who are putting them forward as examples can, and should, refer them to the Grants Commission which can take them into account in its normal, careful, methodical, wise way. Really, I think your Commission is way off track on this matter of efficiency.

20
25

MR COPPEL: Can I just pick up on your last point? Given your work in the past with the CGC you are very familiar with how the processes work and I ask you the same question that I asked one of the previous participants as to whether you think that the CGC methodology is successful in achieving full equalisation?

30

MR EMERY: Yes. I mean, subject of course to the fact that necessarily, if you went to one of the Commission's reports for any year, they have to make judgments because data is inadequate or there are questions that are slightly hypothetical so that no one, as I think Jim said quite straight forwardly, no one could suggest that it's a perfect system because it's not possible to be perfect because of any imperfections in data and judgments. But the Commission has over the years been very careful in explaining, in my view, what its judgments are and what they're based on.

35
40

So that what people like myself are suggesting is not a perfect system, but one that does achieve to the best possible degree a system of complete equalisation. And I believe that very firmly.

45

MS CHESTER: So Peter, just coming back to your remark before where you said so if our cameos which show the impact on GST relativities for a

large State embarking on first mover tax reform, so say if New South Wales were to go cap in hand to the CGC and say, “We actually want to do some half stamp duties in replacement of broad based land tax, but we’ve worked out by the time we’ve implemented doing that it’s going to cost our GST relativities of \$1 billion a year”, what could the CGC do with that? How would they deal with that, if that caused a neutrality issue?

MR EMERY: I wouldn’t off the cuff be prepared to suggest what they should write or say in response. But I would be happy to consider that sort of hypothetical question. As I said, what’s happened or not happened in that area has not - the State Governments haven’t given any consideration in practice, in their practical decision making, to what the HFE effects would be.

Now, what the Commission might say, or what the Grants Commission might say if this hypothesis was put to them I’m not sure. I’d be happy to draft something up for them if it ever became relevant, which it is not at the moment. I mean, I know damn well as I said - sorry, I know darn well why we haven’t made that move here in South Australia, although there has been something of a move sort of in that direction through changes with respect to business or commercial properties, as distinct from residences, which I think some of the earlier people explained that I think, or referred to it, the chap from the Business Council. Interesting.

MR COPPEL: Okay, thank you for that. I am conscious of time and we have one other invited participant.

MR EMERY: Sure.

MR COPPEL: So again, thank you Linda, thank you Peter, for your participation in today’s hearing.

MS EMERY: Thank you.

MR EMERY: Thank you particularly for your attention to what we’re trying to say. Thank you.

MR COPPEL: Good, thank you.

MR EMERY: I look forward to your final report.

MS CHESTER: Thanks, Linda.

MS EMERY: Thank you.

MR COPPEL: Our next participant is Shaun de Bruyn, if I can get that pronunciation correct, from the South Australian Tourism Council. Make

yourself comfortable at the table and when you are ready if you could give your name for the transcript and a brief opening statement?

MS CHESTER: Thanks for bringing your own ruler.

5

MR DE BRUYN: No worries. Thanks very much for the opportunity. My name is Shaun de Bruyn. I'm from the South Australian Tourism Industry Council and I'm the Chief Executive Officer.

10 Yes, thank you for making the opportunity available to receive our presentation. I must disclose up front that I'm not an economist and so I'm probably the least smart person in the room. So I won't focus on the detail of the work that is being done around the distribution of the GST and all the rest of it, but what I wanted to focus - I've got three key points I wanted to focus
15 on. One is to represent my tourism business members and make you aware of who they are. Two is to support the Business SA's position and throw my association's support behind their position and the submission that put forward, both I assume verbally earlier today and the written submission that I have received a copy of. And thirdly, just to talk about some of the larger
20 factors that are playing out in the economy here in South Australia that are impacting tourism businesses.

 So the South Australian Tourism Industry Council is the peak body for tourism businesses across this State. We have just over 900 member
25 businesses that work with us around business development and industry advocacy, and that's what sees me here today.

 The tourism economy here, or the visitor economy as we sometimes refer to it, is significant for South Australia. It's about \$6.3 billion at the
30 moment and we're looking to grow that to \$8 billion by 2020. And at the moment it employs 36,000 South Australians directly and there's a bunch more indirectly. And we're hoping to grow that to 41,000 by 2020.

 The other really important thing to mention about tourism is that it's not
35 just a capital city activity. Approximately 28 per cent of our population is based outside of Adelaide but 42 per cent of the tourism expenditure that happens, happens in those regional areas. So for many of our regional communities it's a very important part of their local economic activity and the things that create opportunity for young people to stay in those
40 communities.

 In terms of our Government's approach, over the last two to three years our Government has really focussed on tourism, and our Premier most recently at one of our functions talked about how they saw the transitioning
45 of the economy. Clearly the downturn in manufacturing, that's been going on for several years but accelerated through the Holden situation. The Government had to find new areas of opportunity to keep South Australia

ticking, so to speak. And they made a deliberate decision to invest in tourism. Prior to that it wasn't one of the economic priorities, but the Premier came out and announced tourism as one of the State's five economic priorities.

5

And so in doing that we have seen the South Australia Government have invested in infrastructure that supports tourism activity to a degree that we've never seen before. And that's particularly evident with the Adelaide Oval redevelopment, with the whole riverbank activity that's happened down there. Most recently the convention centre, there was a \$400 million project to upgrade the convention centre and that was around a business event market, a business incentive market that is fantastic again for creating jobs, creating economic opportunity.

15 But we've also seen the Government invest in the arts. There's been strong investment in the arts. There continues to be more investment in the arts with the Festival Plaza upgrade. But also the concept of the Royal Adelaide Hospital that was relocated, as I'm sure you're aware. And there's a three year project that's been initiated that is still ongoing to look at a contemporary arts museum, and potentially a significant investment in infrastructure that would again help tourism and provide cultural opportunity.

25 And also our Government has invested strongly in airlines. A key factor in driving tourism is access, and it's one of the things that is really challenging for our State is that we're not as easy to get to as other parts of Australia. And they worked hard to attract international airlines, and most recently we've had Qatar Airlines and China Southern come in, and obviously there's agreements that require resourcing to see those things happen.

30

So the correlation is hopefully obvious, but the investment that State Government has provided into tourism has obviously - part of that has been through the redistribution of GST revenue. And should our State receive a reduction in GST revenue to the order that's been discussed, several hundreds of millions of dollars, it's obviously going to impact future projects and future opportunities for investment, and Government investment in the tourism sector that will ultimately damage tourism businesses. So that's really my first point.

40 The second point that I wanted to just re-emphasise is the Business SA position, and having met with Business SA and received a briefing from our South Australian Treasury and being an interested observer in these issues over many years, I fully support Business SA's position and my association fully supports Business SA's position. And I think it's interesting that they led with the key issue of lag of payments clause issues. And to me that is an obvious thing. It's clearly - and again, I'm not an economist so I can't, I won't try to make an argument around the detail, but clearly there's a

45

significant lag that I understand between two, three, maybe even more time than that - between what's actually going on in economic activity and what GST is being redistributed. And that's caused some of the political anxiety that is being obviously generated, particularly in Western Australia. And to me that seems like an obvious issue that needs to be looked at and could potentially be addressed so that there is less lag in terms of what's going on.

I think the other thing which is really relevant is that this system has been in place for decades and it's worked well, and we see a level of consistency across the Federation through States and Territories that most other countries would be envious of. We don't compete at State level in a detrimental way around tax regimes and things like that because of the system that's in place.

I think the other argument that was made, and again all the arguments I've seen, is that the HFE actually acts as a disincentive for States to invest in future activities that might see their GST share reduced. That's certainly not the case here in South Australia. Our Government has aggressively pursued mining and gas development projects because clearly there's not just a Commonwealth revenue opportunity. There's State revenue opportunities around those sorts of economic activities.

And lastly it's a point that Business SA finished with, and we recognise and acknowledge the independence of the Productivity Commission and appreciate the work that you're doing in what is a difficult issue across the nation.

So the last point that I wish to speak to is the business environment here in SA, that in South Australia we've had a challenging few years with our State economy. We have slower population growth than most other States, particularly the eastern seaboard and I'm sure probably Western Australia. Our power costs are more than anyone else in the known universe if you read the paper, but that's a reality that at the moment businesses are being hit with 50 per cent price rises in terms of power. February earlier this year, our reliability of power was questioned and the place that we're sitting in today, you can imagine what happens when the lights go off in a place like this, the chaos that it causes for visitors and the visitor experience that we're trying to present.

I think it's also important to recognise that our regional cousins - and the Murray River challenges that were faced not so many years ago with the drought. What did they say? A 1,000 year drought or a 100 year drought. It was extremely tough for our river communities and they're only just now starting to recover from some of those difficulties, and some of them there'll always be scars in terms of what happened in those communities and the economic activity that was taken out of those communities.

5 We're an ageing population. We, as I understand it, have the oldest demographic in terms of age. And as I earlier alluded to, we are an economy in transition that - you know, Holden has closed down a few weeks ago. Prior to that Mitsubishi went the decade before. We have significant unemployment, although it's dropping, but I think what you'll find if you really looked at that issue, the under employment issue here in South Australia is significant. And so the unemployment, the headline number - you know, it's at 5 point something which is positive, but the under employment is a huge issue for us as a State.

10 And then the last point that I alluded to previously as well was access. So we do have challenges with people accessing our State. You know, Qantas recently announced flights out of Perth direct into London. They're going to hub out of Brisbane as well. Sydney airport, you know, they can hardly fit another plane in there. And so we have got some disadvantages when it comes to just being able to access us.

20 So in the business community, as I'm sure you know, confidence is everything and we're starting to build confidence again here, and the last thing we need is to see the Commonwealth take GST revenue away from us that will dent confidence and further make the business environment here challenging.

25 So yes, hopefully my presentation in terms of some of the external factors that are happening here in South Australia are useful. We understand that it's obviously a very complex area, but as an association we fully support the Business SA position. Thanks very much for the opportunity to present.

30 **MR COPPEL:** Thank you, Shaun. So if I were to summarise in two sentences your view is that the HFE system as it currently operates is doing a good job and that you're against any changes to the system along the lines that we're proposing because that would have a negative implication in terms of the fiscal - in terms of the GST distribution for South Australia.

35 **MR DE BRUYN:** Yes.

MR COPPEL: Which would then have follow on consequences for the broader economy.

40 **MR DE BRUYN:** Yes, and obviously that will see, as I understand, several hundreds of millions of dollars go out of State Treasury and then they'll be looking to recoup that money, either by raising taxes or reducing services, and tourism will be hit.

45 **MR COPPEL:** Do your members have any issues that they raise vis-a-vis their business and how the HFE system impacts on their businesses?

MR DE BRUYN: Individually, no. I have not received any individual feedback from them. It's more about the business environment, and the fact that if Treasury has to run a budget with less money they'll make choices that will impact tourism businesses.

5

MR COPPEL: One of the points that you made is not too different from some of the arguments that have been put to us in WA, that the cost of natural resource development to the Government, maybe some infrastructure requirements, is one thing that's not recognised in the HFE process yet the revenues that come from that through mining royalties are largely equalised away, particularly with respect to iron ore. And you made the point that one of the implications of a change would be less revenue for South Australia and that that could bear on the resources that the South Australia Government puts for economic development of the tourism sector.

15

They're a little bit different. One is sort of a consequence and another is an implication. But do you have any sympathy for that, given you've mentioned that point because of the South Australia tourism development? Do you have sympathy for that argument that economic development does involve some up-front investment by the Government which is not recognised in the HFE system?

20

MR DE BRUYN: Again, I can't debate the detail and obviously I'm a passionate South Australian. But I am a political observer and I have looked at this issue over a number of years, and I think - and all the information I've seen is that the system works. Don't fix it. To me I think that if the Commission wants to take my advice, I think you should look at this lag issue because clearly that's where the political hot button is. Because what's - you know, WA as I understand it, while the boom was cranking up they were receiving, you know, they were almost double dipping, if you like. Not that that's a correct term, but they were receiving good distributions of GST at the same time as they were receiving significant royalties because the economics of exactly what HFE should be were two or three years down there - you know, were taken from two or three years previous.

35

But then coming out the other side, it plays out as a double negative for them, I guess. So they had a double positive up front and they got a double negative at the other end. So I think you could make that argument and go well, they've had to invest in rail and roads and airports and harbours and all those things, but I would also make the argument that a lot of that infrastructure is used for other activity. It's not just for helping mining companies make royalties off that.

40

I think in South Australia we see that the advent of mining activity in some of our remote areas has very positive outcomes for tourism. It allows us to get people to places that we otherwise couldn't get them to easily and comfortably and affordably. The commercial air services into Roxby Downs

45

is fantastic. It really helps us open up the north of the State, and that's only there because there's a mine there otherwise they wouldn't be there.

5 **MS CHESTER:** So Shaun, just coming back to your point then about a few people today have suggested to us that the problem in WA, well the purported problem in WA, the political problem, can be fixed by changing the averaging provisions under the CGC. I guess our motivation for our draft recommendations are disparate from what you referred to I think as a political button.

10
15 Our primary focus here is making sure that we manage if there's any negative impacts on the economy of HFE. So it's quite distinct, and indeed most of the other State and Territory Governments are comfortable with the current averaging provisions. Indeed, our Terms of Reference ask us to look at what impact HFE has on budget management, and in terms of budget management the averaging provisions actually work pretty well. So we're not looking at changing the averaging provisions for those two reasons.

20 You mentioned earlier on that you'd had a briefing from Treasury on the draft report and the implications for South Australia. Do you want to just talk us through what insights that gave you and how that helped you form your views that you've shared with us today?

25 **MR DE BRUYN:** It just - again, I disclosed up front that I'm not an economist. I'm not going to delve into the detail because others can do it better than me. What it did was it allowed me to actually ask them questions. It allowed me to ask things like the lag. You know, I've seen that report in the media. It allowed me to ask three or four questions around assumptions that I've seen reported in the media, and I've been able to ask them about what is this lag issue. Clearly it sounds like it's a - why does it exist? Why
30 can't distributions be worked out more timely? Is there some way that payments can be adjusted or whatever.

35 So I've been able to - so rather than them provide a hive of information for me to then regurgitate - and that certainly wasn't what happened. It was more an opportunity for me to hear, to actually ask them some questions about things that I didn't fully understand, in a layman way.

40 **MS CHESTER:** How do you understand - you mentioned I think before the \$255 million fiscal impact on the South Australian Government. What do you understand that to be because there doesn't - - -

45 **MR DE BRUYN:** I didn't mention that number. I haven't mentioned that number because I was told that - - -

MS CHESTER: Sorry, you mentioned the previous submission that - - -

MR DE BRUYN: Several hundred million to - - -

MS CHESTER: - - - you supported. Several hundred million, yes.

5 **MR DE BRUYN:** Yes, so that was what I - yes, and so Business SA have that number and we fully support that. Yes, just that it's going to have an impact on how State Treasury works and then that will have a - - -

10 **MS CHESTER:** So your understanding is if our recommendations were adopted by Government there would be a loss to the South Australian finances of \$255 million or something like that?

MR DE BRUYN: Yes.

15 **MS CHESTER:** Because that's not what our draft recommendations would actually result in. That number would only occur if you did a cold turkey immediate implementation of equalising to the average. Indeed, one of the things we did want to engage with the smaller States on, which we haven't
20 been able to very well, is what transition path we could pursue. One of the principles we identified in the draft report was actually ensuring that a transition path to anything less than full equalisation to the highest State, we would want to make sure that it didn't materially disadvantage the smaller States like South Australia, Tasmania and the NT.

25 **MR DE BRUYN:** So that's very helpful to understand. If I could ask another question, why change it? If it's been in place for so long and it's worked, from what I could tell, well over that period, why make a change?

30 **MS CHESTER:** Have you read any parts of our report?

MR DE BRUYN: No, I haven't. I've only read the first few pages of your report.

35 **MS CHESTER:** Okay.

MR DE BRUYN: But as I understand it, the system has been in place, the Grants Commission has been in place for many years and the way in which they implement the GST revenue, that was obviously happening prior to GST through wholesale tax and all those sorts of things.

40 **MS CHESTER:** I'll give you the readers' digest, but it's only 22 pages so it might be worth your while having a little read of it, but basically the nub of it was that the Terms of Reference asked to say what impact does HFE have on the economy? And we've heard earlier about there's two streams of the
45 efficiency impact. So we all agree that equity is the top objective and the primary objective of HFE, and indeed we endorse that and that's why we don't recommend going towards equal per capita as some others have

recommended.

5 But in terms of the efficiency impacts, we did identify that there were disincentives for particularly larger States embarking on serious tax reform, and there are some disincentives as well for States undertaking development activities, especially those that are controversial. So it was very much minded of the economic impact that HFE might have on those incentives facing State and Territory Governments, and making sure that we get the trade-off right between equity and efficiency.

10

MR DE BRUYN: So how long has the HFE system that we currently have been in place?

15 **MS CHESTER:** As we currently have it since the last '70s, with all the States in.

MR COPPEL: '81.

20 **MR DE BRUYN:** So I go back to my original question. Why if it's been in place and it's worked for 40 years, why is it being relooked at? Is it because of these new opportunities around tax regimes?

25 **MR COPPEL:** What we're saying - we're saying clearly that the system isn't broken, but we're saying that there are a number of issues that have been identified where there is scope to improve how the system works. Now, you can then think about those improvements in terms of making specific changes to the CGC methodology, which is something that the CGC is currently looking at, or you can look at something which is more aimed at the system as a whole, and that's the direction that we've put forward in the draft report.

30

But it really is to address some of the effects that the HFE system can have on efficiency, with a view to improving how the system works overall.

35 **MS CHESTER:** And if you use some of those efficiency effects, particularly for the larger States and cumulatively over time, it can have quite a material impact on the economy.

40 **MR DE BRUYN:** Thank you.

MS CHESTER: I don't have any other questions.

MR COPPEL: Great.

45 **MR DE BRUYN:** All right, thanks very much.

MR COPPEL: Thank you, Shaun.

MS CHESTER: Thank you.

5 **MR COPPEL:** So that concludes the registered participants for today's hearings. But before I close I would like to give the opportunity if there's anyone else here in the room that would like to make any brief remarks? Jonathan?

10 **MR PINCUS:** Now?

MR COPPEL: Yes, you may. I do put the emphasis on "brief".

MR PINCUS: Sure.

15 **MR COPPEL:** So just a few minutes, and like with previous participants your name for the transcript?

20 **MR PINCUS:** I'm Jonathan Pincus and I'm representing myself. Central to your work is the question of does a trade-off exist between equity and efficiency and, if so, how large it is. And I have to say I congratulate you for entertaining that seriously and making it such an important aspect of what you did. One of the disappointments of the Greiner report was their unwillingness to accept this as the central issue. I want to just make comments on that quite briefly. Not a large number.

25 First of all on modelling, all the models as Commissioner Coppel suggested depend on assumptions, and for the Greiner review Chris Murphy assumed away exactly the incentive effects that you are considering, both - they're not in the model. So it could not have had any negative effect because it's not there.

30 As you do know, because of the HFE workshop that was held in Adelaide recently, Chris Murphy has actually changed his tune a little bit by modelling a different way, and now has concluded that of all the things that the Grants Commission equalises for, not all of them act to improve efficiency. In fact, equalising on costs is a disadvantage and shouldn't be used. So that full equalisation would be better from his point of view that - sorry, less than full equalisation would be better than full equalisation.

40 The second lot of comments I want to make is just to say I don't actually agree on that line with your comment on page 14 that fiscal differences by jurisdiction are unlikely to play a significant role. I picked a single sentence in a context and I don't want to misrepresent you.

45 But I do find it terribly hard to believe that HFE for over 70 years hasn't made a significant difference to the size of the Tasmanian population. We get two sorts of stories. Tasmania would be the Appalachia of Australia, or

as we had it earlier it would be the maritime provinces of Canada in Australia, on the one hand and on the other hand it doesn't make any difference to where population goes. I just don't believe both of these could be true. Either HFE has had a significant and a large effect on people's population decisions, taken over the long term period of time, or it hasn't.

For the efficiency and equity both to operate you have to consider two separate sorts of populations. For the efficiency side, the population has to be mobile. For the equity side, the population have to be immobile. And obviously there are parts of populations which are mobile and parts that are immobile. Over time the parts that are immobile turn out not to be so immobile. Elderly people were allegedly flocking to Queensland when Bjelke Joh abolished death duties. So we can't assume that elderly people are immobile, and yet most of the equity arguments relate to immobile people who are like elderly people.

So my quick comments are I'm very pleased that somebody has taken seriously the possibility that there are disincentive effects. I think that scenario modelling is the appropriate way to go because there are no coefficients or elasticities that you could drag and put into a CGE model which relate to the behaviour of Governments in very unusual circumstances. And the trade-off between efficiency and equity is the central issue here.

MR COPPEL: Thank you.

MS CHESTER: Can I ask one question?

MR COPPEL: Go for it.

MS CHESTER: So Jonathan, it is a tough gig for us to try to unbundle the possible efficiency trade-offs and the incentives that the States face, particularly in the context within which we're doing this inquiry at the moment. It's kind of like dammed if you do, dammed if you don't. When you look at how we've approached it through the cameos, and that's the only way we could get our head around doing it because of the evidence base and the disparate views, did we miss any buckets of incentives that States might face? Were there other areas of revenue reform or development activities? Are there any other - because we have to put a great amount of stead into these cameos - - -

MR PINCUS: Sure, sure.

MS CHESTER: - - - we want to make sure that we've done them as well and as broadly as possible. One way of thinking about it would be we've focussed pretty much on good reform that's discouraged, but maybe we should also look at bad tax policies that are encouraged by it.

MR PINCUS: Yes.

5 **MS CHESTER:** But this is an area that you've spent a lot of time looking at and examining. Are there other avenues we should have pursued which we should now between draft and final?

10 **MR PINCUS:** Reading your report - I thought you picked the two most significant ones. When I say that I think there are some other insignificant ones. There's numbers that I could come up with so I will think about it. There are a lot of myths going around. The Commonwealth gave the States land tax. The Commonwealth gave the States payroll taxes. They had been
15 competed away not because of HFE. So at least in my opinion that wasn't the reason they were competed away. So I'm struggling to find other than the development of new resources or similar things which have great political costs on one hand and dramatic change on large tax bases on the other - they seem to me to be the two things that I am mostly interested in. I can't think of anything else. If I do I will let you know.

20 **MS CHESTER:** Good.

MR COPPEL: Is the example of death duties being abolished in Queensland an example then of HFE competing away a tax base?

25 **MR PINCUS:** I had never considered it. I thought it was Queensland thinking that we can attract people by reducing a tax. Whether it's a good tax or a bad tax is - I don't think that the HFE was a big driver for it.

30 **MS CHESTER:** Heaven forbid we would suggest a death tax to fund the transition path. Sorry, just a moment of mirth and frivolity at the end of the day.

MR PINCUS: No, no.

35 **MR COPPEL:** I always wonder whether the additional health costs were taken into consideration, but that's another matter.

MS CHESTER: Second round effects.

40 **MR PINCUS:** So just to make - sorry, the response I want to make, if it's been alleged more than once that State Treasury officials don't tell their governments what the HFE consequences of substantial changes are, and therefore they're never taken into account if the State Treasury officials don't do that, then they're remiss in their duties and I'm astonished to hear that they're so remiss.

45 **MS CHESTER:** Well, read the transcripts from our Victorian public hearings because we were told that there's no elasticity effects therefore

they're immaterial, therefore we don't need to (indistinct) upon them.

MR PINCUS: Yes.

5 **MS CHESTER:** It will be good reading for you, Jonathan.

MR PINCUS: Thank you.

10 **MR COPPEL:** Okay, thank you Jonathan.

MR PINCUS: Thank you very much.

MS CHESTER: Thanks Jonathan.

15 **MR COPPEL:** Are there any others who would like to make a brief remark before we close today's hearings? So if not, I do close today's hearings and the Commission will reconvene next Tuesday in Darwin. Thank you all.

20 **MATTER ADJOURNED AT 2.32 PM**
UNTIL TUESDAY, 28 NOVEMBER 2017