The Senate

Finance and Public Administration Legislation Committee

Commonwealth Grants Commission Amendment (GST Distribution) Bill 2015

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Senator Jenny McAllister (Deputy Chair)	ALP, NSW
Senator Joanna Lindgren (from 23.02.2016)	LP, QLD
Senator Bridget McKenzie	NAT, VIC
Senator Janet Rice	AG, VIC
Senator Nova Peris	ALP, NT
Senator Dean Smith (from 13.11.2013 until 23.02.2016)	LP, WA

Participating Member

Senator Zhenya Wang	PUP, WA

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Referral

1.1 On 12 November 2015, the Senate referred the Commonwealth Grants Commission Amendment (GST Distribution) Bill 2015 (the bill) to the Senate Finance and Public Administration Legislation Committee (committee) for inquiry and report by 16 March 2016.[1]

Purpose of the bill

1.2 The bill is a private senator's bill, introduced by Senator Zhenya Wang on 13 October 2015.[2] The bill seeks to:

> [instruct] the Commonwealth Grants Commission (CGC) in preparing its annual recommendation on GST distribution when considering mining revenue to only take into account the most recent completed financial year data available.[3]

Conduct of the inquiry

1.3 Details of the inquiry, including links to the bill and associated documents, were placed on the committee's website at www.aph.gov.au/senate_fpa.

1.4 The committee directly contacted a number of relevant organisations and individuals to notify them of the inquiry and invite submissions by 11 December 2015. Submissions received by the committee are listed at Appendix 1.

1.5 The committee prepared its report on the basis of submissions received. The committee thanks those who assisted by providing submissions to the inquiry.

Views contained in submissions

Western Australia Chamber of Commerce and Industry

1.6 The Chamber of Commerce and Industry (CCI) supported the bill, commenting that the current three year assessment and distribution of GST does not account for the true revenue raising capability of Western Australia (WA).[4] For this reason the CCI summarised that:

> Altering the calculation for GST distribution for mining revenue from a three year average to an annual basis [would align] a State's GST grant for a particular year with the actual fiscal capacity in that year and [allow] for improved economic and social outcomes.[5]

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1 *Journals of the Senate*, No. 126, 12 November 2015, p. 3373.

2 *Journals of the Senate*, No. 122, 15 October 2015, p. 3258.

3 Explanatory Memorandum (EM), p. 1.

4 *Submission* 2, p. 1.

5 *Submission* 2, p. 2.

Western Australian Government

1.7 The Western Australian Government supported the intent of the legislation. However, it had concerns about the specific proposal in the bill and instead suggested another way to address the time lags in the CGC process.[6]

Tasmanian Government

1.8 The Tasmanian Government concluded that it is inequitable to 'make significant one-off changes to benefit one or two states at the cost of all others.'[7] Tasmania indicated that it:

> …strongly believes that the current three-year averaging of assessment years achieves an appropriate balance between the competing principles of attaining a contemporaneous assessment of States' circumstances, whilst also ensuring the assessment is practical and reliable and delivers a level of stability in States' shares of GST revenue.[8]

Queensland Government

1.9 While the Queensland Government expressed concerns about revenue volatility under the current GST system, they did not support the bill, indicating that:

> …the bill is too narrowly focussed on providing special treatment for mining royalties and may result in a piecemeal and partial approach to the revenue difficulties of States.[9]

Conclusion

1.10 The committee notes that as a result of the 2010 review, after extensive consultation, the CGC shortened the averaging period for assessments from five to three years.[10] The CGC explained:

> The averaging process smooths the effects of data irregularities and short term events thereby making State shares of the GST less volatile. Many States value this over a more up-to-date assessment because it provides some stability in a major source of revenue, despite volatility in State own-source revenue.[11]

1.11 The committee further notes that since 1985, the CGC has regularly reviewed the methods used to distribute payments,[12] and since the 1988 review 'the calculations have been updated annually by applying the methods from the latest review to the

6 *Submission* 4, pp 1-3.

7 *Submission* 1, p. 3.

8 *Submission* 1, p. 2.

9 *Submission* 3, p. 1.

10 Commonwealth Grants Commission *GST Revenue Sharing Relativities, 2010 Review*, p. 4.

11 Commonwealth Grants Commission *GST Revenue Sharing Relativities, 2010 Review*, p. 38.

12 In 1988, 1993, 1999 and 2004.

most recent data'. The CGC states this process 'is intended to ensure the current circumstances are reflected in the distribution and the methods used to calculate it'.[13]

1.12 In the committee's view, ad hoc legislative amendments to address declining revenue in a specific area, is contrary to the CGC process agreed by states/territories.

1.13 The committee notes that the Commonwealth can operate outside this system and in the 2015-16 Budget, Western Australia was provided with $499 million in infrastructure funding in response to the 'special circumstances facing Western Australia as a result of their GST revenue shortfall next financial year (2015-2016)'.[14]

Recommendation 1

1.14 **The committee recommends that the Senate does not pass the bill.**

Senator Cory Bernardi

Chair

13 Commonwealth Grants Commission *GST Revenue Sharing Relativities, 2010 Review*, p. 22.

14 The Hon Tony Abbott MP, Prime Minister, the Hon Warren Truss MP, Deputy Prime Minister and the Hon Mathias Cormann, Minister for Finance, *Joint Media Release*, 'Commonwealth Support For Infrastructure Projects in Western Australia', 6 May 2015.

Additional comments by Senator Dean Smith, Senator Chris Back, Senator Linda Reynolds and Senator David Johnston

1.1 It is abundantly clear that the present formula used by the Commonwealth Grants Commission (CGC) to determine GST allocations his having a significant, ongoing and deleterious impact on Western Australia.

1.2 If revenue distribution is intended to meet current needs, then logic compels us to conclude it should be based on current circumstances.

1.3 The problem with the present formula used by the CGC is that it is based on data that is between two and four years out of date.

1.4 This means that far from acting as a revenue stabiliser – which was the original purpose of the tax – it is instead generating revenue instability in the case of Western Australia.

1.5 Perversely, this means that when Western Australia's mining royalties fell in 2014-15 and 2015-16 as a result of the slump in the iron ore price, so too did Western Australia's GST share.

1.6 The WA State Government estimates that the use of this out-of-date data will see Western Australia lose $2.1 billion per annum in revenue over the period 2014-15 to 2018-19.

1.7 In effect, the current formula means WA's revenue capacity is being significantly overestimated. In fact, WA is forced to borrow money to make GST payments to other States and Territories, based on mining royalties that don't actually exist.

1.8 The Commonwealth has effectively conceded this point, and has already had to take remedial action to address the situation.

1.9 For example, in May 2015, the Commonwealth provided a payment of $499 million to Western Australia for use on road infrastructure, to make up for a significant decline in GST revenue.

1.10 Some of the projects supported by this arrangement included the extension of the Mitchell Freeway from Joondalup to Clarkson, the upgrade of Reid Highway and the NorthLink WA project.

1.11 It appears that another such payment is likely again this year. On 2 March 2016, the Minister for Finance told the Senate:

> "Our commitment to Western Australia is that we will consider what might be required in a similar fashion this year."[1]

[1] Senate Hansard, Wednesday 2 March 2016, p. 53

1.12 The WA State Government has suggested a modification to the instructions given to the CGC by the Treasurer that may negate the need for these adjustment payments in future.

1.13 The WA State Government has suggested the Commonwealth Grants Commission be instructed to prepare first estimates of each jurisdiction's GST entitlement in February for the upcoming year, using State mid-year review revenue estimates.

1.14 These relativities could then be reviewed twice within a financial year, in line with the content each State and Territory Budget and mid-year review.

1.15 A further final correction could then be made in the following financial year, once each State and Territory's final budget outcomes were released.

1.16 This approach is easy to understand, and would be far more transparent, given it is based upon data that is both current and publicly released by the States and Territories themselves.

1.17 Adoption of this methodology will reduce the impact of time lags that bedevil the current system, and ensure that each jurisdiction's GST entitlement is based on revenue reality, rather than the air of unreality that pervades the current calculations.

1.18 If we are now in a position where the Commonwealth is required to make adjustment payments to an individual jurisdiction each year, the system is clearly not working as originally intended.

1.19 There is little merit in having an independent process for determining the GST revenue entitlement for each State and Territory if the Government is then required to intervene every year to address imbalances in the results the process delivers.

1.20 At a minimum, the Government should request that the Productivity Commission undertake its own, independent, wholesale review of the current GST distribution model, which could then make recommendations for reform that would improve the transparency and efficiency of the system.

Senator Dean Smith **Senator Chris Back**

Senator Linda Reynold **Senator David Johnston**

GST Distribution Bill – Dissenting Report of Senator Zhenya Wang

Overview of the Bill

1.1 The *Commonwealth Grants Commission Amendment (GST Distribution) Bill 2015* ('the bill') seeks to change the way in which the Commonwealth Grants Commission ('CGC') distributes GST revenue to the State and Territory governments by requiring the CGC to take into account the most recent financial year mining revenue data when preparing its annual recommendations on the distribution, as opposed to the current requirement of taking into account the three financial years' worth of mining revenue data. [1]

1.2 The purpose of this bill is to address the inequities of the distribution of the GST revenue to the states and territories, most of which has been caused by the economic volatility within the mining and resources sector.

1.3 Evidently there are other issues surrounding the GST distribution. For instance, in August 2012, the Western Australian government provided a submission in response to the CGC GST Distribution Review First and Second Interim Reports, reiterating the Review Panel's view in the First Report that the current GST distribution arrangements '*…do not appear to recognise mining related infrastructure costs, mining expenses and economic development costs appropriately*'.[2] Solutions of these issues will require agreements between federal and state/territory governments, and is beyond the capacity of a Private Senator's bill. Therefore this bill does not intend to address other problems.

1.4 The current model of distribution is evidently flawed when it allows a high contributor of GST revenue to receive as low as 30 cents to the dollar in the 2014/2015 financial year. WA received a GST distribution of only $2.215 billion in 2014/15. In the 2015/16 financial year, WA received a mere $1.935 billion. Modelling undertaken by the Parliamentary Budget Office and contained in the Explanatory Memorandum to this bill reveals the extent of the inequities arising from the current distribution model (**Annexure A**). If this bill was legislated, WA would have received $3.5 billion in 2015/2016. This is not a new issue and it is one that has consistently been raised over the last ten years.[3] In 2010 the CGC reduced the averaging period of distribution assessments from five years to three years following the review of grants distribution.[4] Then on 23 December 2014, the then Treasurer, the Honourable Joe

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1 Explanatory Memorandum, p. 2.

2 Western Australia's Submission in Response to the First and Second Interim Reports, p. 3. http://www.gstdistributionreview.gov.au/content/submissions/downloads/interim_reports/WA-Submission.pdf

3 GST Distribution Review, 2012 http://www.gstdistributionreview.gov.au/content/Content.aspx?doc=reports/finaloctober2012/00executivesummary.htm#P130_11433

4 Commonwealth Grants Commission GST Revenue Sharing Relativities, 2010 Review, p. 4.

Hockey, wrote to the Chairperson of the CGC requesting advice on the issue of mining revenue volatility. [5]

1.5 The CGC's 'time lag' approach of assessing distribution across three years' worth of mining royalties income when recommending the 'GST sharing relativities' to be used in calculating each state's entitlement of the GST pool has resulted in unfair consequences, particularly for Western Australia and Queensland. In practical terms, the assessment undertaken by the CGC does not allow flexibility in remedying the variances between three-year average mining royalties and actual annual mining royalties revenue.[6] As the CGC measures the tax base of the states and territories with reference to the *value* or *number* of transactions or assets subject to tax,[7] the assessment of relativities for any particular state or territory is more difficult to predict over three years than it would be over only one year. By reducing the assessment period, it allows the mining royalties collected in the prior financial year to be immediately reflected in the GST distribution to the particular state in the following year.

1.6 As a federated nation, the goal is for the Commonwealth to enable the financially weaker states and territories to offer services of a similar standard to those offered by their fiscally stronger state and territory counterparts by issuing contingent grants and funding.[8] The states and territories are unable to raise revenue to the extent that the Commonwealth can with a broad-based tax, meaning the weaker state and territory governments rely on the GST distribution to prevent them from reducing vital services or raising additional revenue by the imposition of further taxes and duties.

1.7 The inequity of the current distribution model is not lost on the Federal government, which recently provided a 'contingent' additional infrastructure grant of $499 million to the WA state government with a requirement that the WA government invest that money in 'key road projects'.[9] Whether the grant adequately addresses the inequity or not or whether it alleviates the WA state government's budget constraints, is outside the purview of this Inquiry, but it should be noted that this additional grant is a short-term solution not capable of fixing the continuous inequity caused by the current model.

1.8 Of broader concern, as raised by Nationals Senator Matt Canavan in his second reading speech, is that the 'current system is creating perverse incentives and, particularly, not encouraging our state governments to develop their resources, their industries and their economies. Ultimately, that is what we want our state

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5 Explanatory Memorandum, p. 2.

6 2015 Budget Paper: http://www.budget.gov.au/2015-16/content/bp3/html/bp3_04_part_3.htm

7 2015 Budget Paper: http://www.budget.gov.au/2015-16/content/bp3/html/bp3_04_part_3.htm

8 GST Distribution Review Report, Executive Summary, http://www.gstdistributionreview.gov.au/content/Content.aspx?doc=reports/finaloctober2012/00executivesummary.htm#P130_11433

9 http://www.ourstatebudget.wa.gov.au/

governments to do because that will create more jobs and more opportunities for all Australians'.[10]

Summary of the submissions

1.9 The committee received only four submissions in relation to this bill outlined as follows:

1. The Western Australian Chamber of Commerce and Industry (WACCI) are in support of the bill, noting that if the GST distribution of mining revenue was altered to enable calculations on an annual basis, then it will allow for improved social and economic outcomes. [11]

2. The government of Western Australia provided strong support for the intent of the bill, citing the benefits of stability to the states budget management if the highs and lows of annual revenue collection were taken into account. [12] Further, the WA government noted that the CGC reliance on data that is between two and four years out of date is increasing the revenue instability, noting that their GST share collapsed in 2014-15 and 2015-16 concurrently with the mining sector. The WA government also noted that the time lag approach means that the calculations are run by the CGC roughly four months before the year commences, leaving the actual data for the current financial year and the upcoming financial year out of the equation. The WA government noted that the CGC 2015 Review considered the time lag issue, however in WA's view; the analysis was simplistic and misleading.

3. The Tasmanian and Queensland governments did not support the bill. Queensland government Treasurer, the Honourable Curtis Pitt, acknowledged Queensland shares concerns about state own-source revenue but believes this bill represents a piecemeal and partial approach to the states' revenue difficulties.[13] I note that the Queensland government in its submission to the 2015 CGC Methodology Review on the issue of mining revenue assessment recommended a 'broad-based review of issues relating to contemporaneity and volatility as opposed to any narrowly focussed special consideration for specific mineral royalties'.[14]

10 Matt Canavan, Second reading speech, 15 October 2015

11 Chamber of Commerce and Industry WA, Submission 2, p. 2.

12 Western Australian Government, Submission 4, p. 1.

13 Queensland Government, Submission 3, p. 1.

14 Queensland Government, Annexure to Submission 3, p. 34.

Recommendation

1.10 I am of the view that the Committee did not thoroughly consider this bill. The committee will not recommend support of this bill as it has formed the view that this bill is contrary to the CGC process agreed to by states and territory governments'. Further the bill has been construed as an '*ad hoc legislative amendment to address declining revenue in a specific area.'*[15] The committee further noted that the 'Commonwealth can operate outside this system and in the 2015-16 Budget, Western Australia was provided with $499 million in infrastructure funding in response to the special circumstances facing Western Australia as a result of their GST revenue shortfall in the 2015-16 financial year'. [16]I have previously outlined that this is a short-term and contingent measure and will not allow the state governments to effectively manage their revenue. I also note that the ability to direct the CGC is entirely within the remit of the Federal Treasurer and does not require the consent of the states and territories.

1.11 It is my view that this bill should be supported as it provides a platform to broader reform. Although I am a Senator representing the state of WA, my support of this bill should not be construed as non-support for other Australian states and territories receiving their just share of the GST revenue pool. In fact beyond this bill, I am advocating for holistic reform of the distribution system, particularly given the decline of the mining and resources industry and the need to encourage the states and territories with viable mining and resources option to continue contributing to the Australian economy. I note that the principle of horizontal fiscal equalisation (HFE) is fundamental to the agreement and formula; and remains intact with the measures proposed by this bill.[17]

Senator Zhenya Wang

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[15] Committee Report, page 3.

[16] Committee Report, page 3.

[17] Explanatory Memorandum, p. 2.

APPENDIX 1

Submissions received by the committee

Submissions

1 Tasmanian Government

2 Chamber of Commerce and Industry WA

3 Queensland Government

4 Western Australian Government