# Chapter 2

# Views on the bill

## General views on the bill

2.1 There was enthusiastic support for the proposed changes to the horizontal fiscal equalisation (HFE) system from the Western Australian Government.

> The Western Australian Government strongly supports the passage of the Bill. The current GST distribution system is broken and needs to change.
>
> …
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> While the Bill is expected to give Western Australia lower funding than the changes recommended by the Productivity Commission, Western Australia accepts the reforms as a reasonable and pragmatic response.[1]

2.2 The Hon. Mark McGowan, Premier of Western Australia, provided a personal endorsement of the proposed changes:

> …I do think that the outcome that has been reached, which is by necessity a compromise, is a good compromise and a reasonable compromise and ensures that no state is worse off. It does largely resolve the issues confronting Western Australia.[2]

2.3 Various bodies representing the business community also supported the proposed changes to the HFE system.[3] For example, the Chamber of Commerce and Industry Western Australia (CCIWA) outlined some of the benefits from the proposed HFE system update:

> Reforming the distribution formula of the GST is in the national interest and can stimulate national economic growth by strengthening development incentives for all states.
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> …
>
> The proposed legislative change to equalise to the higher of New South Wales or Victoria will minimise the adverse effects of outlier outcomes, such as a mining boom, from the equalisation task. It will also restore Western Australia's incentive to develop its own economy.[4]

2.4 Mr Rick Newnham from CCIWA provided an interesting perspective:

> There are really good reasons why we don't equalise everyone's personal income in Australia to the same point, because again, it removes the

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1 Western Australian Government, *Submission 3*, pp. 1, 3.

2 The Hon. Mark McGowan, Premier of Western Australia, *Committee Hansard*, 26 October 2018, p. 20.

3 See also The Chamber of Minerals and Energy of Western Australia, *Submission 12*.

4 Chamber of Commerce and Industry Western Australia, *Submission 1*, [p. 2].

> incentives for people to get out and have a go. For the same reasons, states shouldn't necessarily be equalised to exactly the same point…[5]

2.5 Similarly, the Minerals Council of Australia welcomed:

> …the Federal Government's initiative to reform the GST distribution which has for some time not delivered an equitable share of funding to states that promoted economic growth through the development of their natural resources.[6]

2.6 Rio Tinto submitted that:

> The legislation provides a more stable and predictable source of revenue for all States and Territories and helps ensure states that develop their natural resources are able to retain a greater share of the benefits.[7]

2.7 But less enthusiasm was forthcoming from other states for a change in GST distribution arrangements.

*Tasmanian Government*

> The Tasmanian Government remains of the view that the current system of HFE is not 'broken' and that the PC did not make a convincing case that it needs changing.[8]

*Northern Territory Government*

> The Northern Territory Government is a strong supporter of the current definition of Horizontal Fiscal Equalisation (HFE) and strongly rejects the view that the current system is broken.[9]

*Victorian Government*

> Victoria considers the Commonwealth's proposal to be inequitable, as it moves away from the principle of giving each State the potential to fund government services to the same standard.[10]

*Queensland Government*

> The Palaszczuk Government is a strong supporter of the current system of horizontal fiscal equalisation.[11]

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5 Mr Rick Newnham, Chamber of Commerce and Industry Western Australia, *Committee Hansard*, 26 October 2018, p. 32.

6 Minerals Council of Australia, *Submission 6*, [p. 1].

7 Rio Tinto, *Submission 11*, [p. 1].

8 Tasmanian Government, *Submission 2*, p. 2.

9 Northern Territory Government, *Submission 4*, [pp. 1–2].

10 Victorian Government, *Submission 5*, p. 3.

11 Queensland Government, *Submission 7*, p. 1.

*Australian Capital Territory Government*

> The claim that the current equalisation system is broken has been made by a variety of commentators and political leaders. This view is not shared by the ACT Government.[12]

*New South Wales Government*

> New South Wales has always played a key role in supporting the smaller states, however it is not responsible for funding states that receive revenue windfalls from its resources and then fail to plan for the future. [13]

*South Australian Government*

> The South Australian Government has been a long standing supporter of the current objective of horizontal fiscal equalisation (HFE), which is to provide states and territories with the capacity to provide services and the associated infrastructure at the same standard…
>
> In line with these views the South Australian Government's preferred position is that the current GST distribution arrangements are retained.[14]

2.8 Ms Kate Phipps from the Treasury drew attention to the fact that an extensive and independent review had been undertaken by the Productivity Commission (PC), which did find that while there was support for the principle of HFE there were advantages to moving to a new standard of equalisation, consistent with that contained in this bill:

> As you would be aware, the Productivity Commission undertook a review of horizontal fiscal equalisation. The PC found that there was unanimous support for the principle of HFE across all jurisdictions and all states and territories, but the PC also recommended that there were advantages in moving to a standard of reasonable equalisation rather than full equalisation, and the changes that are implemented through this bill represent that change.[15]

2.9 One submission argued for a complete overhaul of the GST distribution system. The Institute of Public Affairs believed that equalisation should be abandoned as a policy objective:

> In its place, the principles of decentralization and competitive federalism should be adopted. To unlock the benefits of competitive federalism, the states would require the power to set the rate of GST that applies in their respective jurisdictions, with an associated entitlement to claim the proportion of the GST that is attributable to that particular state.[16]

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12 Australian Capital Territory Government, *Submission 8,* p. 2.

13 New South Wales Government, *Submission 9,* [p. 5].

14 South Australian Government, *Submission 10*, [p. 1].

15 Ms Kate Phipps, Treasury, *Committee Hansard,* 26 October 2018, p. 46.

16 Institute of Public Affairs, *Submission 13*, [p. 2].

## Specific comments on the bill

### *Concerns about forecasts and alternative scenarios*

2.10 Many state and territory governments raised how GST relativities are forecast. Mr David Martine from the Victorian Department of Treasury and Finance noted that:

> It is important to understand that neither the Commonwealth nor the states forecast relativities past two years. Beyond that, forecasters formulate projections which generally assume a return to long-term trends…[17]

2.11 The Tasmanian Government provided its interpretation of the methodology adopted by the PC:

> …the PC failed to take into account that relativities are generally very volatile. For this reason States generally do not forecast relativities beyond the Budget and Forward Estimates period and if they do, they are heavily caveated…
>
> The PC has also assumed the States' relativities trend to their long term average at the end of the Forward Estimates period.[18]
>
> …while projecting an increase in Western Australia's relativity, the PC has not projected a corresponding decline in other States' relativities. This outcome is not possible under the GST distribution methodology and the assumption would appear to distort the 'zero sum' outcome of the GST methodology where any financial distribution to one State must be offset by a redistribution away from other States.[19]

2.12 However, Mr Simon Atkinson from the Treasury confirmed the forecasts are based on ten year Budget projections, using relativities from the PC:

> …our modelling of the government's proposal is outlined on page 21 of the government's interim response, and that's based on the PC's modelling, which is based on our central projection that underpins the Commonwealth budget and the 10-year forecasts as well.[20]

2.13 A number of state governments noted that there are various feasible alternative scenarios, based on different assumptions, which would appear to indicate that the proposed changes to the GST distribution may be detrimental, rather than beneficial, to the fiscal position of some states.

2.14 Modelling undertaken by the Victorian Government illustrated that:

> …most States could get less GST in future years compared to the current distribution method based on several scenarios. Therefore, the use of

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17 Mr David Martine, Victorian Department of Treasury and Finance, *Committee Hansard*, 26 October 2018, p. 13.

18 Tasmanian Government, *Submission 2*, p. 3.

19 Tasmanian Government, *Submission 2*, p. 3.

20 Mr Simon Atkinson, Treasury, *Committee Hansard*, 26 October 2018, p. 46.

> forecasts to determine the compensation required for States may still result in a negative financial outcome for an individual State.[21]

2.15 Similarly, the South Australian Government noted that:

> Modelling undertaken by the states and territories shows that under different assumptions jurisdictions could be worse off as a result of the new arrangements with an overall reduction in GST revenue compared to what would have been delivered under the current arrangements.[22]

2.16 While acknowledging that the relativities presented in the Australian Government's policy response to the PC report were not fixed, Mr Simon Atkinson from Treasury noted that:

> …if you fundamentally change the relativities you actually need to understand what economic circumstances would have driven those and calculate through the other side of the equation.[23]

2.17 Hence, in relation to the alternative scenarios modelled by the states:

> The challenge with those scenarios is that they just deal with relativities. They don't model the full range of economic parameters that would need to shift to create those relativities and the flow-through that that would mean to the GST pool, which is fairly fundamental in the calculation to how much funding each state gets.[24]

### *No worse off guarantee*

2.18 With such a significant proposed change to the GST distribution system, Mr David Martine outlined the position of those states and territories that would not be unambiguously better off under the updated HFE system:

> …the challenge for most states and territories has been to ensure that we receive at least as much GST going forward under the proposed new methodology as we would under the current system.[25]

2.19 While welcoming the insertion of the 'no worse off' guarantee into the bill, the Victorian, Tasmanian, Australian Capital Territory and Northern Territory Governments advocated for the extension of the guarantee in perpetuity.[26]

2.20 The Victorian Department of Treasury and Finance undertook analysis of the proposed update to the HFE system and concluded that:

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21 Victorian Government, *Submission 5*, p. 3.

22 South Australian Government, *Submission 10*, [pp. 1–2].

23 Mr Simon Atkinson, Treasury, *Committee Hansard*, 26 October 2018, p. 46.

24 Mr Simon Atkinson, Treasury, *Committee Hansard*, 26 October 2018, p. 46.

25 Mr David Martine, Victorian Department of Treasury and Finance, *Committee Hansard*, 26 October 2018, p. 13.

26 Tasmanian Government, *Submission 2*, p. 5; Northern Territory Government, *Submission 4*, p. 8; Victorian Government, *Submission 5*, p. 4; ACT Government, *Submission 8*, p. 3.

> …without a guarantee that is enforced in perpetuity, as a result of enacting the Bill most States may be financially worse off beyond the transition period, possible substantially so.[27]

2.21 Noting the Australian Government's reluctance to provide a guarantee beyond 2026–27, Mr Martine argued that:

> …part of the policy rationale by the Commonwealth in making this change…is that they make the statement that the original architects of the GST distribution system could not have envisaged GST relativities changing so much over a period of time…In that world, it is a bit hard to accept a proposition that the architects of the new system can be so certain that the GST relativities can be projected for the next eight years, 10 years, and even 20 years. That's why the ongoing guarantee is important.
>
> …
>
> If the Commonwealth wants to make this change and say it is not going to affect anyone, then the guarantee should be in perpetuity.[28]

2.22 Concerns were also raised about the cumulative nature of the guarantee. The Northern Territory and Queensland advocated for the guarantee to be applied to single years, rather than over the entire transition period as outlined in the bill.[29]

2.23 The New South Wales Government submitted that transparency of the operation of the guarantee would be welcome:

> This could include publication by the CGC [Commonwealth Grants Commission] of the old and new relativities directly after they have produced them rather than waiting for the Commonwealth Treasurer's permission for those to be released.[30]

2.24 Mr Martine echoed these sentiments on behalf of the Victorian Government:

> Our view would be that transparency and visibility are really important. There's nothing in the legislation that actually says that the CGC's calculations of the old system would be made available to the states, or even made public. So, transparency is very important, along with a stronger role for the CGC to be determining what additional amounts would be to honour the guarantee commitment in the legislation.[31]

2.25 In response to the concerns about transparency, Mr Chris Leggett from Treasury noted that:

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27 Victorian Government, *Submission 5*, p. 4.

28 Mr David Martine, Victorian Department of Treasury and Finance, *Committee Hansard*, 26 October 2018, p. 15.

29 Northern Territory Government, *Submission 4*, p. 8.

30 Mrs Natalie Horvat, New South Wales Treasury, *Committee Hansard*, 26 October 2018, p. 8.

31 Mr David Martine, Victorian Department of Treasury and Finance, *Committee Hansard*, 26 October 2018, p. 17.

> Section 25 of the Commonwealth Grants Commission Act, requires Commonwealth Grants Commission reports to be tabled in both houses of Parliament and, at that point, they all become publicly available.[32]

2.26 However, not all stakeholders considered that a 'no worse off' guarantee was required. For example, CCIWA did not believe that the guarantee was necessary and could be a costly drain on the federal budget:

> The proposed legislative guarantee could prove to be an expensive liability for the Commonwealth Government. In effect, it transfers the risk of a diminished GST share away from the leading state other than New South Wales and Victoria (currently Western Australia) to the Commonwealth Government in the instance of an outlier event, such as another mining royalty boom for Western Australia.[33]

### *Discretion afforded to the Treasurer*

2.27 A number of states, including New South Wales, raised concerns about the scope of ministerial discretion in decision making.[34]

2.28 The Victorian Government noted that the proposed legislation:

> …gives the Treasurer significant discretion in determining whether a State is to receive a payment under the no worse off guarantee. In particular:
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> - an assessment of the GST that a State would have otherwise been entitled to if the Bill had not been enacted, is based on 'the Minister's opinion'; and
> - in forming this opinion, the Minister must only 'have regard to any report of the Commonwealth Grants Commission that the Minister considers relevant'.[35]

2.29 Similarly, the Queensland Government was concerned that the discretion afforded to the Minister's opinion was too subjective in its application and should be replaced by a more objective test where the Minister is 'reasonably satisfied'.[36]

2.30 However, the Australian Capital Territory Government viewed the approach taken by the bill 'as a sound and practical way of implementing the Commonwealth's 'no worse off' commitment'.[37]

2.31 Mr Chris Leggett from the Treasury gave a comprehensive response to allay the concerns raised by the states:

> I think we would say it's perhaps incorrect to characterise the description 'in the minister's opinion' as giving the minister a discretion. It's consistent with the drafting of the bill and its current framework in the Federal Financial Relations Act, which gives the Treasurer the sole responsibility

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32 Mr Chris Leggett, Treasury, *Committee Hansard*, 26 October 2018, p. 52.

33 Chamber of Commerce and Industry Western Australia, *Submission 1*, [p. 2].

34 New South Wales Government, *Submission 9*, [p. 6].

35 Victorian Government, *Submission 5*, pp. 4–5.

36 Queensland Government, *Submission 7*, p. 4.

37 Australian Capital Territory Government, *Submission 8*, p. 4.

> for making decisions and determining entitlements under the act. The wording that we've chosen, which is 'in the minister's opinion', is a very common drafting technique at the Commonwealth level—for example, one of the income tax assessment acts uses the term over 150 times to describe actions by the Commissioner of Taxation.
>
> We use that in situations where the decision-maker is making a decision under an act that has to weigh a number of competing factors; where they have to make assumptions about facts they aren't aware of or can't get information on; or to determine an outcome in a hypothetical scenario. The last particular case is the one here, which is, with the no-worse-off guarantee, the Treasurer, as the decision-maker, has to determine what he would have done in the hypothetical world of not passing this act. Only the Treasurer is in the position to know what he may have done in the hypothetical world of not passing this act. Only really the Treasurer is in a position to know what he may have done in that particular hypothetical world.
>
> That said, the technique doesn't provide discretion in the sense that the states have used it. The Treasurer can't just decide not to provide or to calculate any random number. His actions have to be consistent with parliament's clear intention as set out in the bill and explanatory materials, and he has to do so, having regard to the advice from the Commonwealth Grants Commission, from us and from the states and territories as part of his consultation arrangements. His actions have to be considered reasonable from the court's position.[38]

### *Review of the updated HFE system*

2.32 Stakeholders generally welcomed the proposed review of the updated system by 2026. The ACT Government supported an independent review of the new system once it is fully operational.[39]

2.33 Similarly, Rio Tinto believed the review to be:

> …the appropriate place to consider any further reforms that may be required to support states in the development of their natural resources and embed incentives in the GST system to encourage economic development.[40]

2.34 However, several state and territory governments expressed reservations about the proposed review of the HFE system by the PC.

2.35 The Victorian Government considered the aims of the proposed PC review to be unclear given that 'intent' is not defined, nor how 'efficiently' and 'effectively' will be measured. Further, it questioned the value of the PC review as no indication was

38 Mr Chris Leggett, Treasury, *Committee Hansard*, 26 October 2018, p. 47.

39 Australian Capital Territory Government, *Submission 8*, p. 4.

40 Rio Tinto, *Submission 11*, [p. 2].

given of how the recommendations of the PC's report would be applied by the Treasurer.[41] Similar concerns were expressed by the New South Wales Government.[42]

2.36 The Northern Territory Government considered that:

> The Commonwealth Government should waive its right to hold the PC inquiry final report for 25 sitting days, instead releasing the report immediately to the states to ensure any future negotiations around the HFE system are conducted in a prompt manner.[43]

2.37 Likewise, the Queensland Government called for the final inquiry report from the 2026 PC inquiry to be presented to the Council of Federal Financial Relations immediately on its completion.[44]

2.38 The Tasmanian Government provided the most pointed comments on this issue to argue that the PC should not undertake the review at all:

> Notwithstanding that the PC was unable to demonstrate that the current system was detrimental to national productivity, efficiency or growth, it recommended a broad ranging suite of reforms that would benefit one State at the expense of all other States.
>
> Given its demonstrated knowledge and evidence-based approach, the Tasmanian Government considers that the CGC is better placed to undertake the review proposed to be undertaken by the PC…[45]

2.39 The Minerals Council of Australia recommended that the PC review be brought forward to align with the Commonwealth Grants Commission's major update of distribution methods that is scheduled for 2025.[46]

## Committee view

2.40 Australia's system of horizontal fiscal equalisation provides an important source of revenue to the states and territories. While the HFE system works relatively well, it can deliver perverse outcomes that discourage states and territories from reforming their tax bases and pursuing some policies that could boost economic growth.

2.41 Given the GST distribution system has not been updated since it was introduced in 2000, the committee welcomes the transition to a new GST distribution system as outlined in the bill. The system will continue to provide Australians with access to vital government services no matter where they live, but also provide states and territories with incentives to undertake reform and foster economic growth. The committee notes that the Australian Government will inject an additional $9 billion in

41 Victorian Government, *Submission 5*, p. 5.

42 New South Wales Government, *Submission 9*, [p. 6].

43 Northern Territory Government, *Submission 4*, p. 9.

44 Queensland Government, *Submission 7*, p. 7.

45 Tasmanian Government, *Submission 2*, p. 5.

46 Minerals Council of Australia, *Submission 6*, [p. 1].

untied funding to the GST pool over the next ten years, and that this will not come at the expense of existing payments to the states.

2.42 The committee acknowledges the concerns raised by the states and territories regarding the implementation of the updated HFE system but considers that the 'no worse off' guarantee provides a safety net during the transition period. Further, the legislated inclusion of a completed Productivity Commission inquiry by December 2026 gives all stakeholders an opportunity to reflect on the updated HFE system and argue for ongoing improvements following the transition period.

**Recommendation 1**

**2.43 The committee recommends that the bill be passed.**

**Senator Jane Hume**
**Chair**