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Mr Alan Raine
Acting Committee Secretary
Senate Economics Legislation Committee
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Dear Mr Raine

Thank you for the opportunity to provide comment on the provisions of the Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018 as referred to you on 18 October 2018. I am pleased to provide you with the attached Northern Territory submission.

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.

GST revenue is the largest single fiscal transfer from the Commonwealth, representing around 47 per cent of the Northern Territory's total revenue, compared to 24 per cent of total states revenue.

Since 2016, the Northern Territory's GST revenue forecasts have seen a cumulative decline of $3.4 Billion over the forward estimates. This reflects significant declines in the Northern Territory's GST relativities between 2016-17 and 2018-19 from our 10-year average, including recent declines from 5.28 to 4.66 to 4.26 – the lowest GST relativity in the Northern Territory's history.

The watering down of the principles of HFE as enacted by this Bill will only serve to entrench this worsening position, which has already seen a reduction in the Northern Territory's GST revenue of around $500 million each year, and increase the risk of further reductions.

As such, it would be more appropriate to legislate, in perpetuity, a relativity floor at the Northern Territory long term average relativity of 5.10. This is the average of the Northern Territory's relativity on a consistent three year basis since GST was introduced in 2000-01.

The Commonwealth's response, which will be given effect through the Bill, will dismantle the foundations on which the Australian federation has existed for close to a century, result in a more complex system for distributing the GST and set a precedent for further changes to unwind HFE in the future.

This move away from full HFE will detrimentally affect the most vulnerable members of the Northern Territory's society, widen the gap on Aboriginal disadvantage and, given our stage of economic development in relation to the rest of the federation, further disadvantage the Northern Territory in reducing its significant infrastructure deficit.

I trust that you will give due consideration to the Northern Territory's submission. I look forward to the recommendation the Economics Legislation Committee put forward to the Senate on this legislation.

Yours sincerely

[redacted]

NICOLE MANISON

24 OCT 2018

NORTHERN TERRITORY GOVERNMENT

Northern Territory Submission to the Senate Economics Legislation Committee Inquiry into the Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018

October 2018

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On 18 October 2018, the Senate referred the provisions of the Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018 (the Bill) to the Economics Legislation Committee for inquiry (Inquiry) and report by 8 November 2018.

The following sets out the Northern Territory's submission to this Inquiry.

1. Background

The Northern Territory has always been, and continues to be, a strong supporter of the current objective and definition of Horizontal Fiscal Equalisation (HFE). HFE is central to the achievement of fiscal equity between states, a principle that has been a key cornerstone of the Australian federation since the 1930s.

GST revenue is the largest single fiscal transfer from the Commonwealth, representing around 47 per cent of the Northern Territory's total revenue, compared to 24 per cent of total states revenue.

As expressed in its response to the Productivity Commission's Inquiry into HFE (PC Inquiry) and Explanatory Memorandum to the Bill, the Commonwealth is of the view that the recent mining boom introduced unprecedented levels of volatility in the distribution of GST revenue, resulting in high levels of GST revenue redistribution between the states and a structural reduction in Western Australia's share of the GST revenue. Given these factors, the Commonwealth considers the current system of HFE is not capable of dealing with economic shocks, such as the most recent mining boom spanning the decade to 2013, and is therefore broken and requires a fairer, more reasonable and sustainable fix.

However, the PC Inquiry Final Report did not provide any substantiated evidence to indicate that the current system of HFE is either inefficient or unfair. Rather it set out a range of cameos that suggest, in theory, the current system of HFE provides a disincentive for states to unilaterally undertake major tax reform or develop mineral and energy policies.

The Northern Territory's responses to the PC Inquiry strongly rejected the view that the current system of HFE cannot deal with economic shocks, such as the mining boom, and is therefore broken. On the contrary, it is clear that HFE has operated as intended, albeit with time lags that are an inherent part of the HFE system. As we are now witnessing, the impact of the mining boom is being appropriately accounted for by the GST distribution system, as it was always going to do, recognising it would do so with a lag. The redistribution task is now returning towards pre-mining boom levels, with Western Australia's relativity having increased to 0.47 in the latest Commonwealth Grants Commission (CGC) GST relativity Update and, according to the Commonwealth's interim response to the PC Inquiry, Western Australia's relativity is projected to further increase to 0.76 by 2026-27, without changing the current HFE system.

The Commonwealth's interim response, which will be given effect through the Bill, will dismantle the foundations on which the Australian federation has existed for close to a century, result in a more complex system for distributing the GST and set a precedent for further changes to unwind the HFE system in the future. Importantly such intervention in the HFE system ignores the self-correcting nature of the system, albeit with time lags, and sets the basis for further intervention in the event of another mining boom in the future.

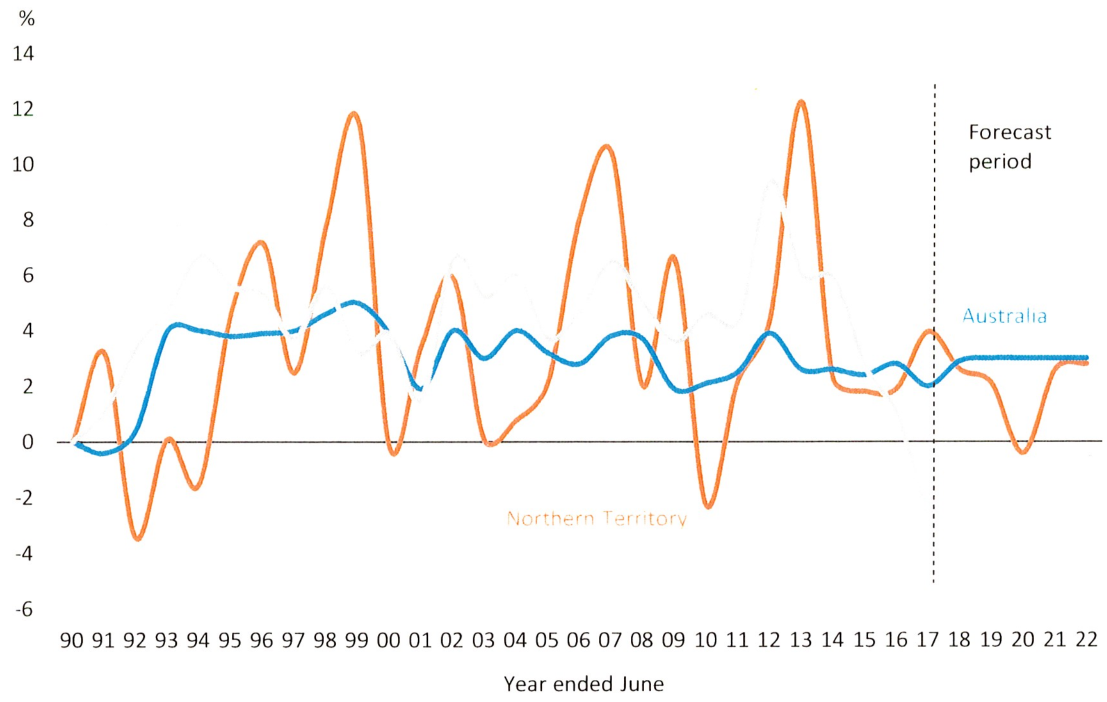
2. The Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018

The Bill will entrench a deliberate fiscal inequity between the states and territories, and in particular favour Western Australia and reward it for past poor budget management. The Bill ignores the self-correcting nature of the current HFE system, and as such entrenches permanent 'over and above fiscal need' GST distributions to Western Australia. In the Commonwealth's interim response, Western Australia is estimated to receive an additional $3 billion in GST revenue over the six-year transition period between 2021-22 and 2026-27, equivalent of 61 per cent of the Commonwealth's pool top up payments. In addition, Western Australia is estimated to receive $1.7 billion from 2019-20 to 2021-22 as a result of the short term transition payments which ensure no state will have a relativity below 0.7.

The proportion of funding redistributed to Western Australia will provide a significant competitive advantage over all other states and have potential broader economic consequences. It could drive up the cost of wages, increase the cost of government service delivery and provide Western Australia with the ability to drop taxation rates, placing significant pressure on all other jurisdictions to do the same. Such a redistribution will also provide Western Australia the ability to provide above average government services, in comparison to other states. This would appear contrary to the original terms of reference of the PC Inquiry that the current system was getting in the way of states pursuing higher economic growth and productivity at the expense of higher national prosperity.

Conversely, as a small self-governing member of the federation, with a limited own-source revenue base compared to large jurisdictions, it is disproportionately more difficult for the Northern Territory to absorb significant changes to its GST revenue. Further, while all economies are subject to cyclical effects, as a small open economy the economic cycles in the Northern Territory are more pronounced than in other jurisdictions, even those that are heavily reliant on mining and resources such as Western Australia.

Chart 1 Northern Territory and Western Australia's GSP and Australia's GDP



Since 2016, the Northern Territory's GST revenue forecasts have seen a cumulative decline of $3.4B over the forward estimates. This reflects significant declines in the Northern Territory's GST relativities between 2016-17 and 2018-19, from 5.28 to 4.66 to 4.26 – the lowest GST relativity in the Northern Territory's history.

A significant portion of this decline was in relation to spending by larger states, for example a reduction in spending and therefore the cost of remote service delivery in some of the larger states where the Northern Territory has higher needs. The Northern Territory is working collaboratively with the CGC as part of its 2020 methodology review on this matter along with other aspects regarding specific exclusions for aboriginal disadvantage and infrastructure deficit funding.

The Northern Territory is of the view that the matters referred to above can be appropriately dealt with under the existing HFE system and that watering down the principles of HFE as proposed in the Bill will only serve to increase the risk of further cuts in the Northern Territory's GST share. In addition if proposed in-system changes, particularly around materiality thresholds are also introduced, there is further potential for the Northern Territory's and other small states GST revenue shares to be adversely affected.

The recent decline in the Northern Territory's fiscal position has occurred during our current sharp economic downturn. Further, like all states, the Northern Territory is facing significant budget pressures with demand for key services such as health and community safety continuing to increase, coupled with the need to manage its response to recent Royal Commissions – but unlike many states, and despite the Northern Territory Government adopting a responsible fiscal response through savings and efficiency measures, the Northern Territory has limited capacity to meet these challenges through its own-source revenue base.

It therefore remains the contention of the Northern Territory that the move away from full HFE will detrimentally affect the most vulnerable members of the Northern Territory's society, widen the gap on Aboriginal disadvantage and, given our stage of economic development in relation to the rest of the federation, further disadvantage the Northern Territory in reducing its significant infrastructure deficit. These are critical matters that align with the Commonwealth's own policy agendas of closing the gap on Aboriginal disadvantage and Developing Northern Australia. As such the changes to HFE in the Bill may be at odds, with other stated priorities of the Commonwealth.

In this regard, the watering down of the principles of HFE as enacted by this Bill will only serve to entrench the Territory's worsening position, which has seen a reduction in its GST revenue of around $500 million in each and every year since 2016-17 and will increase the risk of further cuts. This is despite the Commonwealth's commitment to provide the Northern Territory with short-term transition payments over the next three years between 2019-20 and 2021-22 should the Northern Territory's GST revenue sharing relativity fall below its determined relativity factor for 2017-18.

As such, to the extent that it will prevent further declines in the Territory's GST revenue, the Northern Territory considers that should the HFE system change as proposed, the Commonwealth's commitment to the three year transition payments and the no worse off guarantee for all states should be provided in perpetuity.

This would significantly increase budget certainty for all states, and ensure that in the Northern Territory's context the past efforts made by both the Northern Territory and Commonwealth Government in relation to closing the gap can be sustained and built upon into the future.

3. Deficiencies with the Bill

The following sets out a number of issues that the Northern Territory considers should be addressed through further amendments to the Bill.

Source of additional funding

Correspondence from the Commonwealth Treasurer to state and territory Treasurers, on 18 October 2018, indicates that any additional financial assistance referred to in the Bill will not be offset or partially offset by a decrease in other grant funding to the states. Further, the Explanatory Memorandum highlights that the 'pool top up' will be sourced from Commonwealth revenues not related to GST (para 1.63). The Bill, as currently drafted, does not appear to stipulate either of these points. Further, it does not stipulate that the additional financial assistance will be in the form of untied funding, in line with the GST revenue currently provided to states. Addressing these deficiencies is necessary to ensure the no worse off guarantee is not undermined in the future.

Additional financial assistance

The provision of additional financial assistance, referred to in Schedule 1, section 5(3), of the Bill, appears to only be for the transition period from 2021-22 to 2026-27. To ensure states fiscal stability and that every state and territory gets their fair share of GST revenue, and that no state is worse off, it would be appropriate to legislate the additional financial assistance, in perpetuity. Further the Explanatory Memorandum (para 1.73 and example 1.2) indicates that the no worse off guarantee is calculated on a cumulative basis from the beginning of the transition period. This poses a significant risk to states fiscal stability given state budgets may have to absorb GST short falls up to five years after experiencing a gain from the updated system. To ensure every state and territory receives their fair share of GST, it would appear reasonable that the no worse off guarantee applies to single years rather than over the entire transition period to aid budget management.

Sharing of CGC reports with states

The Explanatory Memorandum (para 1.75) states that, for the transition period, the Commonwealth Treasurer will be referring the preliminary calculation of entitlements for the additional financial assistance under the guarantee to the CGC for verification. The Bill (Schedule 1, section 5(4)) gives effect to this, stating that in forming an opinion, the Commonwealth Treasurer must consult with each of the states and have regard to any report of the CGC that the Treasurer considers relevant. The Northern Territory supports this process. However, consistent with current practice, the Northern Territory considers that the Commonwealth Treasurer should ensure that any reports the Commonwealth receives from the CGC are also shared with states.

Northern Territory relativity floor

Step one of the Commonwealth's plan for the transition to the new GST distribution system involves short-term payments over three years from 2019-20 to 2021-22 to the Northern Territory and Western Australia with an effective relativity floor of 4.66 and 0.70, respectively. This aspect of the Commonwealth's plan is not included in the Bill, as they are given effect under existing laws. The Bill provides for an in-system floor of 0.7 in 2022-23 and 2023-24 increasing to 0.75 for 2024-25 onwards. The Northern Territory's small population, remoteness and relatively large, disadvantaged Indigenous population, 80 per cent of whom live in remote and very remote areas, all contribute to the Northern Territory's relativity being a significant outlier in the system. As such, it would appear appropriate to legislate, in perpetuity, a relativity floor at the Northern Territory long term average relativity of 5.10. This is the average of the Northern Territory's relativity on a consistent three year basis since GST was introduced in 2000-01.

Review of the new system

The Explanatory Memorandum (para 1.76) and the Bill (Section 4) state that the Commonwealth Treasurer will direct the Productivity Commission to conduct an inquiry to assess whether the updated system is working efficiently, effectively and operating as intended by 31 December 2026. Further the documents state that the PC Inquiry will examine the fiscal implications of the amended legislation on the states. The Northern Territory welcomes this inquiry, however considers that states should be consulted in regards to the Terms of Reference. Given economic circumstances may have changed significantly between 2018 to when the Inquiry is undertaken, the Northern Territory is of the opinion that the PC Inquiry should explore the future implications of the updated HFE system and determine if it will continue to achieve effective fiscal equalisation.

The Commonwealth Government should waive their right to hold the PC Inquiry final report for 25 sitting days, instead releasing the report immediately to states to ensure any future negotiations around the HFE system are conducting in a prompt manner.