Hon Mike Nahan MLA
Treasurer; Minister for Energy;
Citizenship and Multicultural Interests

Our ref: 48-15628

Senator Cory Bernardi
Chair
Senate Finance and Public Administration Legislation Committee
PO Box 6100
CANBERRA ACT 2600

Dear Senator Bernardi

COMMONWEALTH GRANTS COMMISSION AMENDMENT (GST DISTRIBUTION) BILL 2015

Thank you for the opportunity to provide a submission to the Senate inquiry on this legislation.

Western Australia is strongly supportive of the intent of this legislation.

The allocation of GST revenues on fiscal equalisation principles is intended to provide all States with the same capacity to provide services. If the GST revenue distribution reflected current circumstances, equalisation could help budget management by stabilising the highs and lows of States' annual revenue collections.

While other problems with the GST distribution would remain (e.g. questions around the adequacy of many of the Commonwealth Grants Commission's (CGC's) assessments; the lack of independent expert review of the CGC's assessments; and the disincentives created by equalisation), there would at least be a budget stability benefit.

However, the GST distribution is based on data that is between two and four years out of date. As a result, the GST distribution, rather than acting as a revenue stabiliser, often increases the revenue instability faced by States. As Western Australia's royalties collapsed in 2014-15 and 2015-16, so did our GST share.

The time lag arises because the CGC is currently required to calculate the GST distribution for the upcoming financial year about four months before that year commences, so it cannot use actual data for either the current financial year or the upcoming financial year.

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The Western Australian Treasury estimates that:

- over the period 2009-10 to 2013-14, time lags in the equalisation process increased Western Australia's GST grants by an average $1.4 billion per annum (in this case the time lag helped to give Western Australia closer to a fair share of the GST); and

- over the period 2014-15 to 2018-19, time lags in the GST process are expected to reduce Western Australia's GST grants by $2.1 billion per annum.

These revenue distortions have obvious implications for budgeting. The Commonwealth would be familiar with the difficulties created for its own budget management when revenues grew on the back of mining prosperity and then collapsed.

The CGC considered the time lag issue in its 2015 Review, but unfortunately its analysis was simplistic and misleading in many respects.

The CGC suggested that States have the capacity to budget for the time lags in the CGC process. They do not. Western Australia's 2014-15 Budget forecast balanced operating results across the forward estimates, based on moderating iron ore prices and detailed modelling of GST grants, including the time lags. Months later, the State's budget was heavily impacted by the sharp collapse in iron ore prices but GST grants staying stubbornly low.

The CGC has made many changes to its methods over time, not applied retrospectively, and never worried about implications for windfall gains and losses. For example, the CGC introduced an assessment of spending needs on infrastructure due to population growth in 2010, but with no retrospective application despite Western Australia having a long history of above-average population growth. The CGC has also equalised billions of dollars of Western Australia's North West Shelf grants while taking no account of the estimated $8 billion spending (in 2010 present value terms) incurred by Western Australia to ensure the project proceeded.

The CGC considered that time lags allowed States time to budget for changes in the GST caused by shifts in other States' circumstances. However, it is unfair that States benefiting from Western Australia's royalties should not also share in the volatility of those royalties.

The CGC also suggested that it would be distortionary to treat some revenues differently from others, and that it was not practical to remove time lags.

Analysis by the Western Australian Treasury in late 2014 suggests that since 2004-05 time lag impacts have been most material for iron ore mining royalties. Nonetheless, in principle, all revenues should as far as possible be treated in a like manner as revenues such as stamp duties are also volatile.

While I believe there is an overwhelming case to address the time lags in the equalisation process, I have some concerns about the specific proposal in the Bill that the CGC must only take into account mining revenue for the most recent financial year for which data is available.

This would still mean a two year time lag with continuing destabilisation of State revenues. For example, the 2015-16 GST grant distribution would be based on the peak iron ore prices in 2013-14 (which would give even more of a time lag impact than using the three-year average).

Instead, time lags could be definitively addressed as follows.

- The CGC could be instructed to prepare first estimates of the GST 'relativities' in February for the upcoming financial year, using State mid-year review revenue estimates.
- These relativities would be revised twice within the financial year, to reflect State budgets and then mid-year reviews.
- A final correction would be made in the following financial year following the release of State final budget outcomes. This correction would be an extension of the corrections already made for the final determinations of the GST pool and State population shares.

This approach is mechanically simple and transparent.

Under the current approach, a State's revenue capacity is over-estimated at a time of revenue weakness. This is clearly not desirable. It is also not consistent with States having similar fiscal circumstances in the grant year. Eliminating time lags will therefore improve fiscal equalisation.

I trust that these comments are of some assistance.

Yours sincerely

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TREASURER

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