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Mr Allan Raine
Acting Committee Secretary
Economics Legislation Committee
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CANBERRA ACT 2600

Dear Secretary

Thank you for the invitation to make a submission to the inquiry into the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018*. Please find attached the ACT Government's submission.

The distribution of the Goods and Services Tax between the States and Territories is an issue of significant importance to the ACT and I welcome the inquiry as an opportunity to continue the public discussion of the Commonwealth's proposed changes to Australia's system of horizontal fiscal equalisation.

The ACT has been a consistent advocate of horizontal fiscal equalisation and its application through the work of the Commonwealth Grants Commission, regarding it as a vital part of the Australian federation. Changes to this system, in my view, should not be made lightly. That said, I also recognise a strong impetus for changes to the system.

The legislation before the Committee incorporates the key features of a transition period from the old system to the new, ongoing top-ups to the GST pool funded by the Commonwealth from consolidated revenue and the introduction of a relativity floor. It also responds to concerns raised by the States and Territories, by incorporating a no worse off guarantee during the transition, with a further review by the Productivity Commission at the end of the transition period. The ACT Government's view is that the no worse off principle should not be seen only as a feature of the transition process, but rather as fundamental to a better system of equalisation.

Once again, thank you for the opportunity to make a submission to the inquiry.

Yours sincerely


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24 OCT 2018

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**SENATE ECONOMICS
LEGISLATION COMMITTEE
INQUIRY INTO THE TREASURY
LAWS AMENDMENT (MAKING
SURE EVERY STATE AND
TERRITORY GETS THEIR FAIR
SHARE OF GST) BILL 2018**

ACT GOVERNMENT SUBMISSION

OCTOBER 2018

**ACT GOVERNMENT SUBMISSION TO SENATE ECONOMICS LEGISLATION COMMITTEE
INQUIRY – TREASURY LAWS AMENDMENT (MAKING SURE EVERY STATE AND
TERRITORY GETS THEIR FAIR SHARE OF GST) BILL 2018**

INTRODUCTION

This submission responds to the invitation of the Senate Economics Legislation Committee, which is conducting an inquiry into the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018*.

The ACT has been a full participant in Australia’s horizontal fiscal equalisation (HFE) system since 1993. We strongly support the principles of HFE and the associated work of the Commonwealth Grants Commission (CGC).

The system has performed well over time in ensuring that all states and territories have the fiscal capacity to deliver services to their residents at a comparable standard. In our view that is a fundamental requirement of a decent, fair and democratic society and change to the HFE system is not something to be undertaken lightly.

During the past ten years, however, the system has come under unprecedented strain as a result of the mining boom. The boom transformed one state, Western Australia, into a resources powerhouse for the foreseeable future, and temporarily raised the fiscal capacity of that state far above that of all the other states and territories. As a consequence, the HFE system moved into a level of redistribution that it had never experienced before.

This led to two major inquiries into the distribution of the Goods and Services Tax (GST): the GST Distribution Review of 2011-12 and the Productivity Commission Inquiry of 2017-18. The first of these inquiries delivered a comprehensive endorsement of the current system of fiscal equalisation. However, as Western Australia’s share of the GST continued to decline because of the sustained increase in their capacity to raise own source revenue, the HFE system remained under pressure.

That situation eventually triggered the second major inquiry by the Productivity Commission, which came to very different conclusions from those of the previous review. The Productivity Commission concluded that, although the current HFE system was functioning “reasonably well” in terms of achieving fiscal equality, independence of process and supporting state budget stability, it functioned less well in terms of policy neutrality, fair reward for effort, and transparency and accountability. Accordingly, the review recommended substantial changes to the current system, in particular the adoption of a “reasonable” rather than “same” standard of equalisation.

The legislation now before the Commonwealth Parliament reflects the Productivity Commission’s findings and the Commonwealth Government’s response to those findings, including the result of consultations with state and territory governments.

CURRENT EQUALISATION SYSTEM IS FUNDAMENTALLY SOUND

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.

We consider that the system has worked largely as intended, though no-one could have envisaged that the differences between the fiscal capacities of states would become as large as they did at the peak of the mining boom. Despite the significant decline in Western Australia’s share of GST revenue, Western Australia’s capacity to raise own-source revenue

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continued to rise. However, what was not well understood by the community was that if the HFE system did not respond to this increase in Western Australia's capacity to raise own source revenue, Western Australia would have a much greater overall fiscal capacity than any other state or territory.

The view has become entrenched that the GST is a state tax, and therefore that each state and territory is entitled to a share of the revenue broadly in line with its share of the national population. This is not correct. Rather, distribution of the GST is the mechanism by which our nation achieves the objective of equalisation in the fiscal capacity of jurisdictions, and therefore ensures service delivery of equal quality to all Australians.

The ACT has welcomed a number of the Productivity Commission's recommendations to improve the transparency and accountability of the equalisation system for this reason. Ensuring the objectives and processes underpinning the GST distribution system are well understood will go a considerable way to maintaining and enhancing the credibility of HFE into the future.

On the other aspects of the Report and associated reforms proposed by the Commonwealth Government, the ACT Government has consistently taken the view that the current system works well and a strong case for wholesale change has not been made.

We consider the core objective of ensuring consistent standards of service for all the citizens of Australia, wherever they live, would be better served by refinements to the current system, rather than major change. In particular, we consider that weakening the standard of equalisation to a 'reasonable', rather than 'same', standard is a retrograde step, which will not serve the Federation as well as the current system.

However, we also recognise that there are strong calls for change, and that some reforms to the system may be required for it to maintain broad acceptance into the future.

THE LEGISLATION BEFORE THE PARLIAMENT

The legislation now before the Commonwealth Parliament reflects the Commonwealth Government's response to the Productivity Commission's inquiry, incorporating the key features of a transition period from the old system to the new, ongoing top-ups to the GST pool funded by the Commonwealth from consolidated revenue and the introduction of a relativity floor. It also responds to concerns raised by the states and territories by incorporating a 'no worse off' guarantee for all jurisdictions during the transition and mandating a further review at the end of the transition period.

The ACT Government's considers the 'no worse off' guarantee is fundamental to ensuring the proposed reform approach provides a better system of equalisation in the long term and should continue to apply beyond the transition period.

We recognise the value of a review of the new system once it is fully implemented. It will be essential that the Commonwealth Government undertake genuine consultation with states and territories on the terms of reference for that review.

Without a legislated guarantee of the kind now proposed, states and territories would have faced significant and unquantifiable financial risk into the future. The Commonwealth modelling on which the original assurances to jurisdictions were based made estimates of the future fiscal capacities of states and territories which assumed a convergence toward

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quite stable relativities over the period of the transition. Yet we know from recent history that such stability is far from guaranteed, or even likely. The Commonwealth has since recognised the validity of our concerns, and the ‘no worse off’ guarantee will provide much more stability for state budget management than would otherwise have been the case.

The provisions in the legislation which implement the ‘no worse off’ guarantee require the Commonwealth Treasurer to form an opinion on what states and territories would have been entitled to if the legislation had not been enacted. In forming this opinion, the Treasurer must take account of consultation with each jurisdiction, and of any relevant reports of the CGC. We view this as a sound and practical way of implementing the Commonwealth’s ‘no worse off’ commitment.

It is also our understanding that funding of the additional financial assistance required to achieve the ‘no worse off’ commitment will be separate from, and additional to, the GST revenue pool and pool top-ups provided for in the legislation and any other payments by the Commonwealth to the states and territories. We welcome this assurance.

CONCLUSION

Although the ACT continues to maintain that the current equalisation system is effective and has delivered good outcomes for the nation, we recognise that there is a broader appetite for change to that system.

The Commonwealth Government’s commitment that no State will be disadvantaged by the change to a new HFE system is critical to the acceptance of this system. It is therefore essential that this commitment be enshrined in legislation through the insertion of provisions which guarantee it.

There is also merit in requiring an independent review of the new system once it is fully operational. It is essential that this review be conducted on a basis of comprehensive consultation with states and territories, transparency in its consideration of evidence and full opportunity for all parties to respond before any proposed changes are finalised.



Chief Minister, Treasury and Economic
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October 2018

