

SUBMISSION TO THE COMMONWEALTH INQUIRY INTO STATE FUNDING

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Senate Select Committee on State Government Financial Management

Terms of Reference

That a select committee, to be known as the Select Committee on State Government Financial Management be established to inquire into and report upon:
Commonwealth and state and territory fiscal relations and state and territory government financial management, including:

- a. Commonwealth funding to the states and territories – historic, current and projected;
- b. the cash and fiscal budgetary positions of state and territory governments – historic, current and projected;
- c. the level of debt of state/territory government businesses and utilities – historic, current and projected;
- d. the level of borrowing by state/territory governments – historic, current and projected;
- e. an examination of state/territory net government debt and its projected level – historic, current and projected;
- f. the reasons for any government debt including an analysis of the level and efficiency of revenue and spending;
- g. the level of investment in infrastructure and state-owned utilities by state and territory governments;
- h. the effect of dividends paid by state-owned utilities on their ability to invest;
- i. present and future ownership structures of current and former state-owned utilities and the impact of ownership on investment capacity; and
- j. the effect of investment by state-owned utilities on Australia's capacity constraints.

That the committee present its final report on or before **18 June 2008**.

INTRODUCTION

The history of Western Australia's relationship with the Commonwealth is an example of both the best and the worst of inter-governmental relations, and the current enquiry could be a timely reminder of the need to constantly review and improve that relationship.

The question that initially needs to be asked of course is one of the intentions of the Committee. Is the Committee genuinely seeking to improve the delivery of services and infrastructure throughout the nation by improving the funding mechanisms and planning mechanisms by which these things are delivered? Or is the committee another "wise heads from Canberra" group arriving to examine the failings of the State Government whilst ignoring those at a Commonwealth level? It is this question that will ultimately decide the value of your considerations and final report.

A HISTORY LESSON

The first great leader that Western Australia sent to the east to negotiate on our behalf was Sir (later Lord) John Forrest. As our first Premier, John Forrest was integral in the formation of the Federation that was to become the Commonwealth of Australia. He was our principal negotiator and was fiercely protective of the fledgling Western Australian colony, but was also a visionary in relation to the functioning of the soon to be formed nation.

John Forrest was also a visionary at home. He was instrumental in gaining funding for the Port construction at Fremantle and the water pipeline that was to become C.Y. O'Connor's finest hour. Such projects were to open the State of Western Australia for business, and Lord Forrest's achievements were unmatched until the leadership of Sir Charles Court some seventy years later.

In relation to the funding of the State and the proposed Commonwealth, John Forrest said this.

"All we desire to say is that three fourths of the customs revenue shall be returned to the states. Unless the States have some security of this kind the people cannot be expected to accept the constitutional bill ... it is like beating the air to tell us that we are to give up our great revenue producer – the customs – and that we are to have no guarantee whatever that any part of that money will be returned to us, although we shall each have to provide for the payment of interest on our public debts."

He was partially successful in this aim, and on formation the Commonwealth agreed to return 75% of customs duties but only for a ten year period. After that the position would be reassessed. It must

also be remembered that the States at that time collected income tax, and would continue to do so under the new federal model.

The power of the newly formed Commonwealth Government to control the States was recognised by then Commonwealth Attorney General Alfred Deakin, who noted that whilst the States were constitutionally independent, they were **“financially bound to the chariot wheels of the Commonwealth.”**

It must also be noted that the first Commonwealth Government was required to hand any surplus funds back to the States to deliver the essential services that State Governments were and still are required to deliver. This insured that money could not be used for political gain, or to undermine the States ability to manage their affairs. However this era of mutual respect and cooperation was not to last long.

In 1908, the Commonwealth Government stopped returning surplus monies, an act that was supported by the High Court. That the Court should support the undermining of the power of the States to manage their own affairs should come as a surprise to no-one, and set the precedent for a pattern that continues to this day. The High Court, established as a consequence of Federation as the highest court of the land, has a vested interest in empowering the body that empowers it. By expanding the sphere of influence of the Commonwealth it also empowered itself. This circle of positive reinforcement has been based on self interest as much as constitutional legality.

In 1910 the Commonwealth compounded its grab for control by refusing to continue to return three quarters of customs duties to the States. Instead it proposed a “Grants” system, which were not based in the constitution and would be distributed at the whim of the Commonwealth.

Dissatisfaction with the financial stranglehold the Commonwealth exerted over Western Australia resulted in a referendum in the 1930's on secession which was upheld two thirds to one third. However it was determined in London that only the Commonwealth could dissolve the Commonwealth. The positive outcome of this debate however was the development of the Commonwealth Grants Commission, which was to de-politicise the funding arrangements (an outcome not universally accepted as being achieved).

During the Second World War, Western Australian Labor Prime Minister John Curtin asked the States to cede their income taxing powers to fund the war effort. This was perhaps a worthy notion, however the States refused, instead maintaining their belief that the Commonwealth should ask the States for additional funds.

The response of the Commonwealth Government was to enact legislation stripping the states of their income taxing powers for the term of the war. The States appealed to the only body they could, the High Court, which of course continued its agenda to empower both itself and its empowering body, the Federal Parliament. Naturally enough the States lost.

Emboldened by the support of the High Court, new Prime Minister Chifley kept the income taxing powers after the war, refusing to hand them back. The States were, and still are, able to impose their own additional income taxes. It was, and remains, foolish to suggest two separate income taxing regime from different levels of Government.

In the 1970's, there was an interesting development. A Prime Minister offered to return taxing powers to the States, both income tax and payroll tax. Whilst payroll tax was transferred in 1971, the State Governments of the day did not take up the offer of the return of income tax. Opinions vary as to the wisdom of this decision, but the State leaders of the day had no idea how for the Commonwealth would go in undermining their financial and planning independence.

From the seventies there has been a constant, and up until recently gradual, undermining of the independence of State Administrations. There is of course a political imperative in this – that is the need of Commonwealth Governments of both Parties to attract votes by attaching themselves (and funding) to positive issues whilst being able to blame state administrations for politically and electorally unpalatable ones. This driving imperative is naturally not limited to the Commonwealth – the States have taken up the same rhetoric to gain political advantage. There is a significant use of “self-interest” in this process.

There are abounding examples of how this process, the result of many years of poorly planned financial arrangements, results in wastage.

Many of the decisions of both State of Commonwealth Governments are now based upon media impact and Ministerial photo opportunities. This is no better evidenced than by the plethora of signs around Government institutions claiming credit for minor developments, many of which might be delivered some years into the future. It is this requirement, often held more important than service or infrastructure outcomes, that really damages good planning and delivery.

This brings us to the issue of tied grants, a tool the Commonwealth increasingly uses to deliver political outcomes in areas of State administration. This trend cannot be allowed go continue. Whilst some indication of how the Commonwealth would like the States to manage their functions and funds is proper and useful, the current politicisation of the process is damaging. The obvious and proper alternative is of course to allow a State which mismanages such funding to face the wrath of its own electors; an action in which a Commonwealth Government could then engage by pointing out that State Government's failings.

The Commonwealth has, under both major political parties, involved itself in areas our Nation's founding fathers never envisaged them engaging in. They have done so often for political gain. Never before though has a Government and the High Court damaged the relationship between State and Federal authorities as much as the decision to allow the Commonwealth to use Corporations Law to undermine the independence of the States. This one act of constitutional irresponsibility is the first nail in the coffin of the current constitutional arrangement; it questions the ability of Australia to maintain the current form of Federation.

THE CURRENT SITUATION

The Carpenter Labor Government is the highest taxing executive the State of Western Australia has ever had. Despite Labor's election promise in 2001 to make Western Australia the lowest taxing per capita in the nation, it has pushed tax revenue to the highest per capita. In 2001, Labor promised to -

Maintain or increase our tax competitiveness, as measured by taxation revenue per capita

Labor recognises the importance of competitive taxation levels in attracting business to Western Australia and enabling existing business to flourish.

Labor is committed to maintaining or improving our tax competitiveness in comparison to the other states, as measured by taxation revenue per capita.

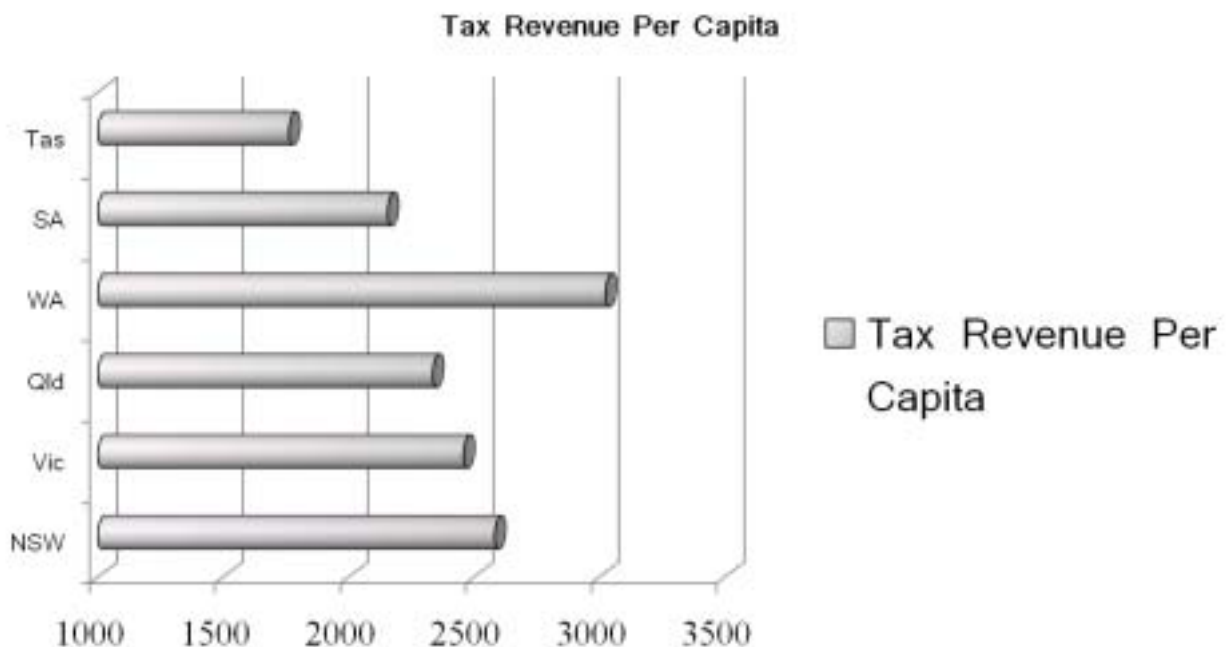
Currently Western Australia is the third lowest taxing state, behind Tasmania and Queensland, as measured by taxation revenue per capita.



Labor will:

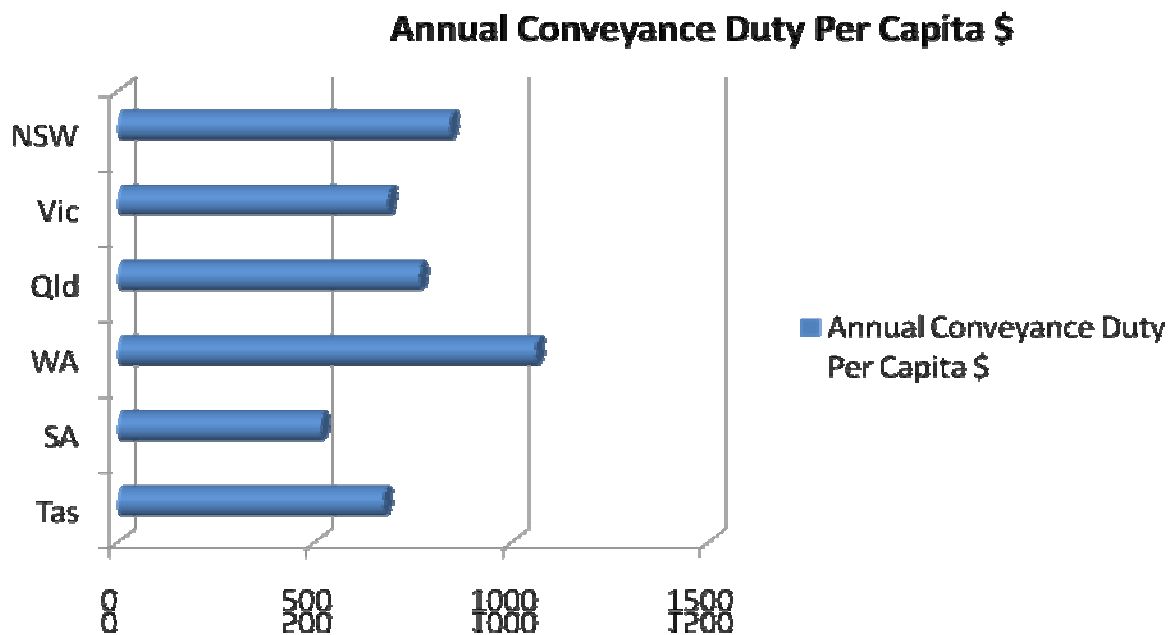
- **maintain and strive to improve this relativity.**

Instead of achieving this, they have taxed Western Australian taxpayers to the hilt. The 2007-08 mid year reviews showed as below.



Much of the growth in revenue has been in the form of stamp duty, in which Western Australia also leads the field.

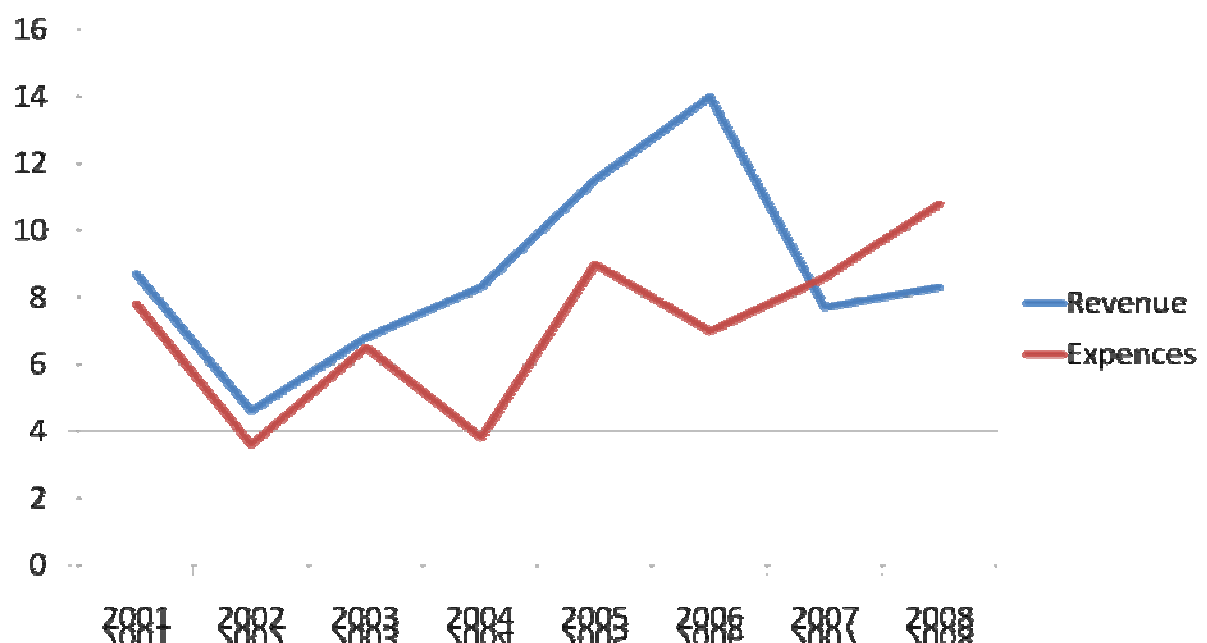
Mid Year Conveyance Duty per Capita 2007-08



Taxation in Western Australia will remain high as long as the State Government continues to allow expenditure to blow out. Expenditure growth in the last two years has hit 10% per annum, a figure that should rightly be an embarrassment to the Government. There is a dangerous underlying trend in this state, where for the first time in a decade expenditure growth now exceeds revenue growth. This is another example of a State Labor Government out of fiscal control.

The Western Australian experience can be seen below.

General Government Revenue and Expenses Growth %



The State of Western Australia has been enjoying a resources based boom for the past eight years. This has led to significant increases in revenue, which has allowed (it is sometimes considered to have driven) significant blowouts in expenditure. For the first few years of this decade revenue growth outstripped expenditure growth, but this trend has now reversed and growth in spending is now greater than the growth in revenue.

This is a dangerous trend, and highlights the Carpenter Government's inability to manage its finances. The issue for the Western Australian community is that while the Labor Party is talking about economic restraint for everyone else it is indulging in economic largesse for itself.

The Sunday Times on March 23rd this year ran the headline in reference to the Treasurer –

We'll tighten belts

Apparently that refers to every belt but his. This double standard demonstrates a level of arrogance and hypocrisy that damages the standing of the Government and the State. The community of Western Australia feels that frontline services like health and education have suffered under the current Government despite record expenditure and massive budget surpluses. There is a general feeling that the boom is being wasted, and that many in the community are missing out. A two billion dollar surplus is an obscenity to someone waiting for hours in an emergency department.

THE NEXT STEP – WHERE TO FROM HERE?

In relation to the enquiry by this committee, I ask you to consider the mechanism of funding of state activity as of paramount importance.

You may decide that the easy fruit of imposing Commonwealth will further on state jurisdictional activity, both services and infrastructure, delivers you the best political outcome. Indeed it would probably present you best media opportunities. It will however deliver yet more uncertainty for those charged with good governance.

Instead, the Committee could focus on the how the funding of States is derived and then managed.

I recommend that the following key areas be addressed.

1. How the trying of grants politicises service and infrastructure delivery, and how holding a State Government to account for its expenditure might be better handled within its own electoral cycle.
2. How the Commonwealth can work cooperatively with the States to allow them to deliver those infrastructure and services.
3. The need for additional Commonwealth Government funding for infrastructure in developing regions in conjunction with State investment.

The last of these, the need for greater Commonwealth investment, is a key area for the development of Western Australia. The Commonwealth is the major winner of income from major resources projects including the harvesting of gas reserves from the State's North West. These projects require significant infrastructure to be built by the State to support the industry, including hard (ports and rail) and soft (housing, schools and hospitals) infrastructure. It is difficult for State Government to deliver these vital works when the Commonwealth takes most of the revenue stream and returns little.

The other great leader of our State, Sir Charles Court, was able to negotiate a fair and reasonable share of income from the North West Shelf project. This has not been able to be repeated, notwithstanding a Federal Labor commitment to return some income from another gas development that will provide another income stream at some vague time in the future. This is not the same as a fair and equitable share as negotiated by Sir Charles.

FINAL COMMENT

It is of course right and proper that the Committee would want to examine the way Commonwealth funds are expended. If the Committee is seeking however to involve itself in the management of State expenditure across the board, it is merely the next step in the Commonwealth trying to undermine the role of State Parliaments and State Governments. The State of Western Australia has an Auditor General, a Public Accounts Committee, and an effective opposition to keep watch over Government expenditure. It has an electoral process which is how a Government is kept to account. If the Commonwealth is suggesting these processes be overridden, it would have to suggest the same mechanisms are failing at a Commonwealth level at the same measure. Such a position would require an urgent review of the way the Commonwealth expends hundreds of billions of dollars annually, and would have to be the highest priority of any Government.

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