

SUBMISSION TO NSW REVIEW OF FEDERAL FINANCIAL RELATIONS

I felt I had to make a submission to the Review as there were some worrying comments by the NSW Treasurer in a Sydney Morning Herald article when the Review was announced and the Review discussion document (page 22) made similar though less strident comments.

The Treasurer's article included:

"..for me an eternal frustration is to see funding effectively heading across the border to benefit less reform driven and fiscally responsible states."

The Review discussion document poses the question:

"How can Commonwealth – state relations encourage states to innovate and reform?"

These are worrying comments because they foreshadow efforts to push for even more changes to the fiscal equalisation arrangements that were made in 2018 to give Western Australia a much larger share of the GST.

Prior to those 2018 changes to the GST distribution arrangements, access to government services did not depend on what state a person lived in. That did not mean that everyone was treated the same, but rather similar residents in one state (eg remote WA) were treated the same as similar resident in another (eg remote NSW). The objective of the fiscal equalisation process was to give all equally efficient jurisdictions around about the same financial capacity to provide government services to match their particular circumstances. It is then up to the government of the day to decide how those resources are allocated.

Unfortunately, the public is not sufficiently aware of the fiscal equalisation arrangements Australia had and now has. The Productivity Commission had the opportunity to properly explain the position but instead, used spin to make its case for change ⁽¹⁾ and in doing so, misled decision makers and the Australian community. While the Productivity Commission should be castigated for its report, it is important that the New South Wales Treasurer's comments and the question above in the Review discussion document don't compound the situation. The Australian community needs to be aware that the fiscal equalisation arrangements have served Australia very well and have been a key element in shaping Australian society.

The principle that access to government services should not depend on what state you live in was strongly supported by Prime Ministers' John Howard and Bob Hawke, two of Australia's standout Prime Ministers.

The fiscal equalisation arrangements are designed to be policy neutral so that any inefficiency by a jurisdiction, such as from not innovating or reforming, is not rewarded. (See the definition of fiscal equalisation below. ⁽²⁾) If a jurisdiction is overspending in a function because it hasn't adopted the reforms of other jurisdictions, then that "inefficient" jurisdiction will not have enough funds to continue that level of inefficiency without taking some action. Either local taxes will have to increase or standards of service elsewhere fall. There may be a relatively short time period when the less efficient jurisdictions aren't penalised due to

assessment timing issues but over the medium term, any inefficient jurisdiction will have to bear the brunt of being inefficient.

Note too ⁽¹⁾ that the Productivity Commission made similar types of comments to those I am concerned about in its various releases and reports using words like “could”, “may” and “might” but found no evidence of this despite over 12 months research and submissions from all jurisdictions.

These efficiency/innovation/reform concerns with fiscal equalisation could be eased further if there was greater transparency and analysis of the impact of different State policies. Such a process would help identify the policy change options and put pressure on any recalcitrant jurisdiction/s.

If the processes used to measure efficiency/innovation/reform in the fiscal equalisation arrangements are inadequate, focus on those processes but don't abandon the principles that underpin horizontal fiscal equalisation.

Australia would be a very different country to what it is now if fiscal equalisation is not the cornerstone of Federal/State financial relations. Fiscal equalisation has been an important part of making Australia what it is, a good place to live. A former Chair of the Commonwealth Grants Commission, Justice Else-Mitchel, summed it all up when he described the fiscal equalisation arrangements as “the glue that binds the Federation”.

Footnotes:

- (1) There are three overarching areas where the Productivity Commission knowingly used spin to mislead the Australian community.

First, the Productivity Commission stressed that under the then current system of the distribution of the GST funds to States and Territory's, the equalisation is to the fiscally strongest State. To the “person in the street”, that intuitively sounds wrong and the continual reference by the Productivity Commission to this benchmark set the scene for a change needing to be made. However, the Productivity Commission definition of fiscal equalisation is a mathematical interpretation AFTER the equalisation calculations have been completed. The equalisation process actually equalises revenue and expenditure requirements to the average of all jurisdictions not to the strongest state. The Commonwealth Grants Commission, which does the calculation, makes no reference to the “strongest state” as the equalisation standard. The Commonwealth Grants Commission and several jurisdictions made submissions to the Productivity Commission that their interpretation was incorrect and misleading. That advice was ignored by the Productivity Commission. The correct definition was explained in the Productivity Commission report/s but it was downplayed, receiving the same weight as the small print in an insurance policy.

Second, the Productivity Commission stressed the fiscal equalisation processes distorted decision making processes of Governments. Yet after more than a year of investigation, the Productivity Commission did not report any examples of this “distortion”.

Third, and this is spin by omission, the Productivity Commission never canvassed the second round implications of WA receiving significantly more GST revenue. Two examples of the implications that should have been analysed are tax competition and higher public sector wages. Both are an inevitable outcome of WA having a greater financial capacity and both will have material adverse implications for NSW and Australia as a whole.

(2) This was the definition of horizontal fiscal equalisation before the decision to give WA a larger share of the GST

State governments should receive funding from the pool of goods and services tax revenue such that, after allowing for material factors affecting revenues and expenditures, each would have the fiscal capacity to provide services and the associated infrastructure at the same standard, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency