

31 July 2012

The Secretary
GST Distribution Review
The Treasury
Langton Crescent
PARKES ACT 2600

Business
Council of
Australia



GST Distribution Review - Response To Interim Reports

Dear Secretary

The Business Council of Australia (BCA) is pleased to provide this submission to the GST Distribution Review in response to the review panel's first and second interim reports.

The Business Council encourages the review panel to use the final report to map out a path for major reform to the way the GST is distributed.

Further, we particularly note the review panel's observation that the fiscal imbalance is set to become even more acute in the future and that at some stage the structure of state tax systems will need to be reformed; and its finding that the process needs to be cooperative in order to reap the maximum benefits.

Why the distribution of the GST is important

Horizontal Fiscal Equalisation (HFE) should work to ensure that Australian citizens are able to access comparable standards of services regardless of the state in which they reside, and to ensure that state governments have the fiscal capacity to support the economic development of their state. The method by which the distribution of the GST is calculated is one important element in achieving the goals of HFE.

As noted in the BCA's first submission to the review, the GST Distribution Review should be mindful of current and future challenges facing state and Commonwealth governments:

- The ageing of the population will place pressure on the budgets of all governments. This will put a premium on the efficient delivery of government services (particularly health services) and will require national tax reform to provide an efficient and sustainable tax base to fund these services.
- The Commonwealth collects more tax revenue than it spends, while the states are responsible for expenditure that far outstrips their own revenues. This extreme vertical fiscal imbalance means that major fiscal transfers from the Commonwealth to the states will remain a feature of the Australian Federation for many years.
- The current capital investment boom is causing structural changes to the Australian economy. This change is driving major shifts in the labour market, with strong growth in demand for labour in the resource states. Increased investment is also driving economic and social infrastructure requirements around the country.

The GST pool and the methodology for its distribution are important elements in responding to these challenges. The way the GST is distributed needs to support the objectives of efficient delivery of services, ensure there are no barriers to national tax reform and facilitate the investment required to manage rapid growth as a result of structural changes in the economy.

Given these objectives, GST distribution cannot remain a black box.

The BCA strongly supports the review panel's finding (in its second interim report) that national tax reform is worth pursuing and that this should be done on a multilateral basis. This is consistent with the findings of the Australia's Future Tax System report, and the BCA's submission to the 2011 national tax forum.

While reforming the GST distribution is an important first step towards national tax reform, on its own it will not be enough to meet all of the challenges of an aging population, structural change in the economy and delivering better and more efficient services. This can only be done through comprehensive national tax reform that more closely aligns revenue raising capacity with expenditure responsibilities, including a shift to a more sustainable and efficient tax base.

The need to chart a long term plan for reform

The Business Council urges the review panel to chart a path for moving to an equal per capita distribution (EPC) of the GST over the long term. This should ensure that smaller jurisdictions are able to plan for, and manage, such a transition. It would also allow the Commonwealth to provide any necessary assistance to ensure the sustainability of budgets of the smaller states.

An EPC distribution would be simple, and transparent and would assist states to respond to the issues associated with rapid economic development. On the expenditure side, an EPC distribution would provide a policy neutral incentive for state governments to undertake difficult reforms in order to deliver efficient services and develop the economies of their states. An equal per capita distribution would achieve this in a sustainable way, that does not unnecessarily respond to temporary circumstances in particular economic sectors.

The costs of moving to an EPC distribution in the short term would be high and will necessitate the Commonwealth Government providing financial assistance to states that may be worse off under an equal per capita distribution.

The BCA acknowledges the current tight fiscal situation faced by all governments. However, this should not prevent the review panel from mapping out a transition path to an EPC distribution. Such a transition path should lessen the short-term fiscal impact on recipient states and possibly the requirement for Commonwealth support. The BCA outlined several possible options to achieve this type of transition in its first submission to the Review:

- Quarantining a certain percentage of the GST pool for equal per capita distribution (say 50-60 per cent initially) with the remainder being equalised through a simplified process. This would represent a first step towards long-term equal per capita distribution.
- The equalisation of expenditures could be confined to focus on comparable levels of service for an identified safety net of services relating to health, education and other agreed services.
- Tackling Indigenous disadvantage through targeted financial transfers from the Commonwealth, including clear and transparent performance measures for closing the gap. This would leave the total funding allocated to Indigenous Australian's unchanged, but improve transparency and accountability for Commonwealth and state expenditure.
- Territories and smaller states could be removed from the equalisation process, so that they receive only an equal per capita share of GST. Their remaining revenue requirements would be 'made good' through direct transfer payments from the Commonwealth. This payment would guarantee that the smaller jurisdictions have the minimum level of funding required to meet additional costs per person of providing government services to smaller populations.

Whichever option, or combination of options, is chosen to transition to an EPC distribution, the Commonwealth Government will need to play a part in assisting recipient states make the necessary adjustments.

Specific reform options

The BCA encourages the review panel to map a pathway to major reform of the GST distribution with an EPC distribution being the ultimate objective.

While some of the specific reform options canvassed in the interim reports are worthwhile exploring in their own right, most are of an incremental nature and unlikely to tackle the fundamental problems with the GST distribution – namely that it is a zero sum game and consequently does not support states to pursue reforms to deliver efficient delivery of services, foster national tax reform or facilitate the investment required to manage rapid growth.

Predictability and Stability

The best way to improve the predictability and stability of the GST distribution would be to move to an EPC distribution. In the absence of major reform, the BCA supports the proposal to fix annual relativities, subject to the Standing Council on Federal Financial Relations retaining the flexibility to make revisions on a case-by-case basis.

Other proposals to improve predictability and stability should only be adopted on the basis of a strong policy rationale.

Simplicity

The review panel should pursue reforms that will deliver major simplification, such as the use of broader indicators, equalising for only major items, and total budget indicators.

The review panel ought to explore a 'donor and recipient' approach, and notes that such an approach could form part of a transition to an EPC distribution if the recipient pool was reduced over time.

HFE and efficiency

The BCA acknowledges that it is difficult to demonstrate the incentive effects of HFE on state policy choices and notes the review panel's conclusions to this end. However, the fact that disincentives are present in the system for distributing the GST is well established, particularly on the revenue side, even though their materiality on government decision making is difficult to determine. These disincentives need to be tackled in order to maintain confidence in the GST distribution and as pre-cursor to national tax reform.

Absent a move to an EPC distribution, equalising to a minimum (or lower than average) standard, and providing compensation on the basis of actual costs rather than relative disadvantage are likely to be the most practical ways of removing disincentives for policy reform that promotes efficiency.

The idea of establishing a mechanism to reward states that undertake positive reforms (a reward pool) is worth further consideration. However, this should not be done by setting aside a portion of the GST for the reward pool. It would also be important for any reward pool to be allocated on the basis of outcomes, such as achieved efficiency gains and productivity improvements, determined by an independent body. It would not be appropriate for the Commonwealth Government to determine which reforms are eligible for reward payments.

HFE and Commonwealth Payments

The BCA supports the treatment of Commonwealth payments to the states (either by inclusion or exclusion) being made on a consistent and transparent basis, that is neutral in its treatment of different modes (payments for rail should not be treated differently from payments for roads, for example).

The idea of equalising capital payments over a longer time frame merits further consideration.

HFE and the mining boom

Current high commodity prices have increased royalty revenue for the mining states, which has led to a decrease in the share of GST payments for these states. The impact of the mining boom on the GST distribution, and of the Northern Territory's large cost disadvantage on the expenditure side, would best be dealt with by moving to an EPC distribution, or a partial equalisation approach, with appropriate targeted compensation for recipient states. Such an approach is neutral to the drivers of the boom (or cost disadvantage) and has the efficiency, simplicity and predictability advantages outlined above.

In the absence of a transition to an EPC distribution, it will be important for the GST distribution to account for the costs associated with rapid economic, regional and urban growth. The GST distribution should recognise the costs associated with rapid economic growth, including the public infrastructure necessary to fully exploit opportunities flowing from strong demand for commodities from resource states. Ideally these costs should be recognised in a way that is neutral to the drivers of the economic, urban or regional growth.

HFE and the costs of services to the Indigenous population

Strong consideration should be given to tackling the excess costs associated with Indigenous disadvantage through targeted financial transfers from the Commonwealth, including clear and transparent performance measures for closing the gap. This would leave the total funding allocated to Indigenous Australian's unchanged, but improve transparency and accountability for Commonwealth and state expenditure. Potentially it would also improve the effectiveness of providing services to Indigenous communities, as noted by Professor Garnaut in his submission to the review.

Ideally, the Commonwealth would fund the excess costs. However if there remained a requirement to equalize state revenue on the basis of Indigeneity, this could be achieved through the system of tied grants.

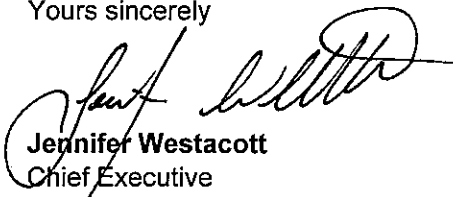
The Business Council does not think that any compelling arguments have been made against such a reform on the grounds of increased complexity.

Additional terms of reference

The BCA remains opposed to the MRRT as a poor example of how to undertake major tax reform. Any move to reform the MRRT should include consultation with business.

The distribution of the GST should not be unilaterally altered to provide incentives to reform specific state taxes. This would be contrary to the Intergovernmental Agreement on Commonwealth-State Financial Relations and the Business Council believes it would ultimately undermine the prospects for more far reaching national tax reform. However, if done well, improving the GST distribution could help generate the necessary good will to move towards national tax reform.

Yours sincerely



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