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CHAMBER OF COMMERCE AND INDUSTRY
WESTERN AUSTRALIA

GST Distribution Review
The Treasury
Langton Crescent
PARKES ACT 2600

20 February 2012

To the Review Panel,

RE: GST DISTRIBUTION REVIEW SUPPLEMENTARY ISSUES PAPER

Thank you for the opportunity to provide a submission to the GST Distribution Review Supplementary Issues Paper.

CCI is the leading business association in Western Australia and the second largest organisation of its kind in Australia. CCI has a membership of over 6,500 organisations in all sectors of the economy. About 80 per cent of members are small businesses, and members are located in all geographical regions of WA.

While CCI supports the review into the GST distribution methodology, it is concerned that the expanded terms of reference will shift the focus of the Review from the underlying problems with the system and limit the opportunity for genuine reform. The current process is complex and inequitable, and has the potential to limit the nation's growth prospects over the longer term if left unaddressed. CCI has enclosed a copy of its initial submission to the review, which outlines its concerns with the system and recommendations for reform.

In regard to the additional terms of reference and objectives outlined in the supplementary issues paper, CCI makes a number of points for the Review's consideration.

Ensure that horizontal fiscal equalisation does not provide a disincentive to State tax reform.

The ability for States to reform inefficient taxes is currently limited by the imbalance between the revenue raising and expenditure responsibilities of the States and territories (known as Vertical Fiscal Imbalance (VFI)). This means that the States are heavily reliant on grants from the Commonwealth (in particular GST grants) to ensure they have sufficient revenue to fund services and infrastructure demanded by the community.

The state's reliance on GST revenue means that horizontal fiscal equalisation (HFE) can provide a disincentive for tax reform. Any reduction in GST revenue as a result of the HFE process would

180 Hay Street East Perth
Western Australia 6004
PO Box 6209 East Perth
Western Australia 6892
Ph: (08) 9365 7555
Fax: (08) 9365 7550
email: info@cciwa.com
www.cciwa.com
ABN 96 929 977 985

limit the ability of the state to undertake any significant tax reforms that would further reduce their revenue base.

Removing this disincentive will require an ambitious tax reform agenda that will provide the States access to a sustainable source of revenue and reduce the level of VFI. CCI believes that this would best be achieved by extending the GST, or an income tax sharing arrangement. These options were discussed in CCI's recent discussion paper, *Tax Reform: Building the Foundations for a Strong Economy*. A copy of this is enclosed.

Changes to the GST distribution process will also go some way to remove this disincentive by ensuring a more appropriate allocation of revenue. CCI's initial submission to the Review recommended the following reforms to achieved this outcome.

- *Move to revenue-only equalisation* - This is the simplest and most objective method of equalisation, and is in line with international standards. Revenue equalisation would need to include all own-source revenue, including that which the Grants Commission has been reluctant to assess such as gambling taxes.

- *Discount mining revenue* - Ensures states can retain a reasonable share of mining revenue generated locally and will ensure the incentive to develop their resources base. This is particularly important, given the significant costs involved in developing the industry, and the benefits to the nation overall.

- *Exclude Commonwealth payments from equalisation* - Excluding Commonwealth payments would cut out one of the most complex and subjective parts of the methodology, while reducing the administrative burden created by the double-handling of payments.

Utilise HFE to provide incentives and disincentives to promote future State policy decisions which improve the efficiency of State taxes and mineral royalties.

CCI's initial submission to the Review noted that the nature of the GST distribution process as a closed pool of funds means that it is possible to link GST grants to economic and tax reforms.

However, CCI believes that the most efficient means of providing incentives for the states to introduce economic reforms is through direct payments, rather than adding additional complexity to the already complex GST distribution system. Tying GST grants to economic or tax reform also undermines State autonomy, as States would have to meet certain benchmarks which would likely be set at the Federal level.

The best way to facilitate reforms that will improve the efficiency of the tax system is to address VFI. Providing States access to a sustainable source of revenue (as outlined above) will improve the States' ability to abolish the most inefficient taxes.

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985

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CCI believes that a move to revenue only equalisation is the most appropriate way to distribute GST revenue. However, if the GST distribution system were to include reform incentives, these should be focused on incentivising the states to be more efficient in the delivery of their programs to help drive down growth in recurrent spending, given that this is what ultimately determines the size of the tax burden.

Examine the incentives for States to reduce Minerals Resource Rent Tax or Petroleum Resource Rent Tax revenue through increasing State mineral royalties.

The current design of the Minerals Resource Rent Tax (MRRT) is flawed, in that it introduces a tax on top of an existing royalty regime. This has resulted in a system that creates the perverse incentive for states to increase royalties to the extent that they are rebatable under the MRRT. This is not good tax design, and reflects the lack of consultation or consideration for how the MRRT would fit within the broader tax system.

Using the GST distribution system to address this problem with the MRRT is would simply make the system more complex, which is at odds with the objective of the review. It also goes against the States' autonomy and ability to control their revenue base, and would penalise New South Wales, Queensland and Western Australia, where the majority of mining revenue is generated.

Instead, a solution should deal directly with the flawed design of the MRRT. The Henry Tax Review urged negotiation between State, Territory and Federal Governments on the design of the MRRT. CCI believes that such consultation would be a more appropriate way to address the perverse incentives that the MRRT currently creates.

Should you require any more information, please contact Dana Mason (Manager, Economics) on 9365 7701 or dana.mason@cciwa.com.

Yours Sincerely,

John Nicolaou
Chief Officer, Member Services and Advocacy
Chief Economist

180 Hay Street East Perth
Western Australia 6004

PO Box 6209 East Perth
Western Australia 6892

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Fax: (08) 9365 7550

email: info@cciwa.com
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ABN 96 929 977 985

Chamber of Commerce and Industry of Western Australia (Inc.) ARBN 099 691 611 Incorporated in Western Australia