

**GST DISTRIBUTION REVIEW**

**PAPER BY MR PETER EMERY**

Paradise, South Australia

September 2011



PROFESSOR L.F. GIBLIN, D.S.O., M.C., M.A., (Cantab.). 35 x 32 oil, 1945.  
Collection University of Melbourne

## CONTENTS

	<u>Paragraph Nos</u>
Why does this Paper begin with a photograph of a painting?	1
My role in fiscal equalisation	2-6
Summary of my views in earlier years and now	7-9
Some broad perspectives	10-16
Fiscal equalisation and incentives for economic development and reform	17-19
Equity and efficiency	20-23
Contrasts with other Federations	24-26
Independence of the Grants Commission and role of the Commonwealth Treasurer	27-31
Role of the Commonwealth Treasury	32-39
Local government finance	40
Summary of conclusions and recommendations	41
Final comment	42

## Why does this Paper begin with a photograph of a painting?

1. There are four reasons. First, it occurred to me that members of the Panel, being faced no doubt with hundreds of pages of material of varying quality and relevance provided by a range of interested parties might welcome something a little different and perhaps even encourage them to read further into this paper. Second, the painting by the great Australian artist William Dobell is obviously of a high quality. The original, I believe, is still located in the room of the Professor of Economics in the University of Melbourne. I recommend to readers of this paper that if they are at or near the University of Melbourne they take the opportunity to look at the painting. Based on my experience of some years ago they may have to do battle with the Professor's secretary to be given permission to enter but it would be worth it! Third and more importantly, Professor Giblin was a most interesting character and was very influential as a member of the first Commonwealth Grants Commission. He was the first person, amongst many other achievements, to introduce the concept of taxable capacity of the States and to publish some data on this (see "Giblin The Scholar and the Man" edited by Douglas Copland and in particular piece by H.P. Brown "Giblin and the Grants Commission"). Fourth, to my mind, particularly having seen the original the portrait conveys a feeling of the avuncular – a combination of intelligence, wisdom, calmness and kindness, qualities which I would like to regard as epitomising the Grants Commission over the years.

## My role in fiscal equalisation

2. My perspectives on the issues facing the Panel are influenced by my years of active participation in the practical workings of the fiscal equalisation system in Australia. From 1967 to 1979 I worked in the Commonwealth Treasury in Canberra, the majority of that time in the Commonwealth-State Financial Relations Branch including a period as head of that Branch. I prepared numerous submissions to the Grants Commission, briefings for Treasurers or other Ministers on Grants Commission recommendations, material for distribution at Premier's Conferences etc. I initiated, amongst other things, the proposal that the Commission move away

from its indirect budget result equalisation approach (which it had used from the beginning of its work) to direct calculations of relative taxable capacities and expenditure needs; although this change was initially resisted by the Commission it was adopted and has been used by the Commission, with refinements over the years, since then. More important, I initiated and implemented the move away from what had been the “claimant” States special grant system to the current system whereby the Commission analyses the relativities between all six States and two Territories. One of the many advantages of this change is that all States and Territories (mainly through their Treasuries) now have full and equal opportunity to put forward views about methodology.

3. I was closely involved in the negotiations with Western Australia and South Australia which led to those States leaving the claimant State system in return for higher financial assistance grants. I also believe that I was influential in convincing the then Treasurer and Under Treasurer of Queensland that it would be in the interest of their State to join the claimant State system which did happen and which did lead to substantial financial benefits to that State.
4. From 1979 to 1993 I worked in the South Australian Treasury, for the latter part of that period as head of the Department (“Under Treasurer”). I prepared or supervised the preparation of submissions to the Grants Commission and participated in various Commonwealth-State meetings on relevant topics. As both a Commonwealth and State Treasury officer I participated in numerous hearings of the Commission and attended many of what the Commission used to call its “inspections” around the States.
5. After leaving the State Treasury I became an independent consultant. Along with a colleague I did considerable work for the Local Government Grants Commission in South Australia which led to that body having a much improved methodology to the point that it was acknowledged by the staff of the Commonwealth Grants Commission as being the best amongst the States and Territories. We also undertook consultancy for the Commonwealth Grants Commission at the time of its

early ponderings on the question of the treatment of capital expenditures. I also worked in Africa in this area notably helping to prepare the first major report on the distribution of grants to the regions from the National Government in Ethiopia.

6. It will be clear from the above that my interest in fiscal equalisation is of long standing and I would like to think that my contribution to improvement has been significant. My roles have changed over the years but my views about the strength of our system of equalisation have not. I take this opportunity to emphasise that the views expressed in this paper are not based at all on the particulars of what might or might not be of financial benefit to South Australia. By this I do not mean that I lack interest from this point of view but rather these particulars are properly dealt with by the current crop of State Treasury officers while my continuing interest is in the proper understanding of our system and broad issues of approach, “philosophy” and structure.

#### Summary of my views in earlier years and now

7. Of the thousands of words I have written on fiscal equalisation and the Grants Commission most are in documents attributed to the Commonwealth or South Australian Treasury, Prime Ministers, Treasurers etc. One exception to this is a talk I gave at the Australian National University in 1988, the text of which is reproduced in a booklet edited by Professor Cliff Walsh entitled: “Fiscal Equalisation Allocative Efficiency and State Business Undertakings: The Commonwealth Grants Commission 1988 Report on Relativities”. I believe its contents remain relevant to current issues and I commend it to readers.
8. Following is a quote from the beginning of my paper summarising the views I put forward in my 1988 talk:-  
  
“1. that the changes made in the work of the Commonwealth Grants Commission over the last 15 to 20 years obviously constitute major reform, all of it in a desirable direction;

2. that there is no inconsistency between the principles and methods of the Commonwealth Grants Commission and economic efficiency objectives; on the contrary, the one promotes the other;
  3. that perhaps we are just starting to see wider acknowledgement of the fact that we now have in this Federation a sound and proven system of fiscal equalisation between the States;
  4. that, following from the above, the emphasis should now be on the efficient maintenance of that system rather than making of major changes to it, thus providing an opportunity to scale down the administrative and intellectual resources devoted to Grants Commission activity, both in that Commission and in the Commonwealth and State Treasuries and to direct those resources into areas where there remain very real economic and financial problems to be solved;
  5. that, notwithstanding the above, there are some simple tidy-up jobs to be completed, one of the most obvious of which is in the area of local government finance.”
9. Points 1, 2, 4 and 5 certainly remain my views. On the face of it point 3 may well be seen as a premature conclusion particularly in the light of the establishment of the current review and especially the remarks made by the Prime Minister in announcing the review. However, in trying to remain an optimist I express the hope that this review will prove to have provided an opportunity for a calm and reasoned statement of the benefits of the current system of equalisation while not failing to point out any areas of potential improvement.

#### Some broad perspectives

10. An impression which may have been gained in some quarters is that the Australian system of fiscal equalisation has been around for a long while and that it now may need a major jolt through an independent examination of the kind that is now under way. This would not, in my view, be a useful way of looking at the matter. In the first 30 years of Federation the less popular States did face financial problems and there were numerous enquiries of one kind or another to try to determine the reasons for this and what might be done about it. One of the notions, for example, which attracted attention was whether Federation itself produced disabilities on the part of the States concerned. Finally the need for an independent body was recognised and the Grants Commission was established in 1933 and of course it soon after in its Third Report set down its well-known statement of principle which has remained firmly in place since then. This was a great step forward. In the following decades it recommended special grants for the so-called claimant States which were variously (on the basis of their own applications) South Australia, Western Australia, Tasmania and finally Queensland. These special grants represented an addition for these States to the grants which over most of this period were paid to all States. The independence of the Commission was well respected and its recommendations were always adopted by the Commonwealth Government and Parliament. Throughout this period there were numerous debates between the relevant States, the Commonwealth Treasury and the Commission about methodology and numerous changes took place over the years. However, it probably would be fair to say that over much of the period between the establishment of the famous principle in the Commission's Third Report and the 1970s there was relatively little change in the fundamental structure of the Commission's work. There were various reasons for this including the fact that New South Wales and Victoria did not have any direct interest in the process. It was also the case that the Grants Commission staff remained for many years in Melbourne out of the mainstream of the Government and key departments in Canberra. From today's perspective I also believe that it was a mistake to appoint several Judges as chairmen of the Commission in terms of the required skills and "atmospherics". However, as alluded to earlier in this paper, major change occurred in the 1970s with the adoption of the direct assessment of relativities, methodology and the decision by the then Commonwealth Government,



on Treasury advice, to extend the Commission's work to include all States and Territories.

11. These changes had a profound effect. The system became much more transparent and open to critical examination and all States and Territories had an incentive to understand the Commission's methodology and to analyse it critically from their respective points of view. Related to this is the fact that the distribution between States and Territories now took place within a given aggregate in contrast to the previous situation when grants to the less populous States were an "add on" to the Commonwealth's expenditures. There is no doubt in my mind that this system has, amongst other things, represented a much fairer approach from the point of view of New South Wales and Victoria in particular and almost certainly led to an improvement in their share of grants compared with what would otherwise have been the case.
12. Another feature of the arrangements which have now been in place for three decades or so is that it has been possible for changes in the relativities between the States and Territories to be tracked quite easily and for the reasons for this to be thought about. This is surely a good thing.
13. One of the interesting things which comes out of an analysis over time is that there may and indeed have been changes in the position of individual States as to whether they receive above or below average per capita grants. Again this should be considered as a good thing as reflecting underlying changes in the relative economic and other circumstances of the States and Territories. In recent years prominence has been given in particular to the decline in Western Australia's relative share of grants and this seems to have played a part in the decision to undertake the current review. No doubt what has happened to Western Australia's share can be looked at in various ways. For those of us with a broad and long term perspective we see this as a natural and appropriate working out of a well designed system which, more or less "automatically" adjusts to changes in the circumstances of the various States and Territories. As the current Minister of Defence (and a Western Australian) has

pointed out Western Australia was in earlier times happily sitting on the other side of the fence.

14. This point is, of course, a more general one. From a longer term perspective (which is the one I take and which I believe the Panel should take) it should not be assumed that the current pattern of per capita relativities between the States and Territories will remain indefinitely. For example in South Australia there is much talk of an expected mining “boom” which could well have the effect of reducing this State’s per capita share of the grants. Of course this will depend on how events unfold not only in South Australia but elsewhere and only time will tell. The point is not to try to make predictions about these things but to accept that changes will occur over time for good reason.
15. It is appropriate to mention here the issues raised in particular by Western Australia around the fact that some States receive a proportion of GST grants which is less than the proportion of GST collected from their State. There are some arguments which deserve a blunt response which in this case might be “So What?”. The kinds of figures which have been quoted by Western Australia are irrelevant. There is not meant to be a relationship between tax collected and grants paid. Obviously the relatively low figure quoted by Western Australia reflects its good economic and budgetary situation and it is appropriate that this is so given the objectives which fiscal equalisation is intended to serve. It is a relatively recent innovation that the general revenue grants to the States are determined in aggregate by the amount of GST collected and this is not a necessary feature of the grants system. Prior to the introduction of the GST the kind of figure quoted by Western Australia did not exist but the fundamental arguments and calculations with respect to Western Australia’s share of grants would be and were the same. It would, I suggest, be appropriate for the Panel to firmly reject arguments which seek to relate levels of Commonwealth grants to a particular State to tax collections in that State.
16. One way to view the work of the Commission especially since the adoption of the “all in” system is as one long Continuous Improvement Program. This improvement

takes place not only through the researches of the Commission staff and the thought put in by staff and Commissioners but also through submissions made by the States and Territories. There is probably no other area of public life in this country which is the subject of such a high level of continuing argument and counter-argument, backwards and forwards, thrust and counter-thrust and thesis and anti-thesis leading to development and refinement over the years. A veritable hive of Hegelian dialectic! I also note the high intellectual qualities brought to the work of the Commission by such people as Giblin, Melville, Matthews, Rye, Barnes and Argy to mention only a few of the many notable Commissioners and the work of numerous academics perhaps epitomised by Professor Cliff Walsh. The point here is that nothing could be further from the truth than any suggestion that the work of the Grants Commission hasn't been the subject of high level review and much change over the years.

#### Fiscal equalisation and incentives for economic development and reform

17. One of the suggestions which has cropped up from time to time is that Australia's system of fiscal equalisation or perhaps the way the Grants Commission undertakes its calculations has the effect of producing a disincentive for States or Territories to pursue economic development or reform initiatives. Let me cite an example of this taken from a speech given in June 2011 by the then Secretary, Mr Terry Moran, then Secretary of the Department of Prime Minister and Cabinet:-

“This imbalance also weakens the ability of the federation to maximise the welfare of its citizens. It is agreed by many that the procedure for reallocating GST revenue from wealthier to less-wealthy states, called Horizontal Fiscal Equalisation, dulls the incentive for the states to pursue important economic reforms. Somewhat perversely, it may also compensate major errors in economic management leading to sustained slow growth that hurts a state's ongoing ability to raise revenue.”

18. The first point to be made in response to this proposition is that if, hypothetically, it were to be true then it would apply equally to those States currently receiving lower than average per capita grants as to those receiving higher than average per capita grants. Secondly, to the best of my knowledge (I am happy to stand subject to

correction) there is no evidence of a factual nature to support this proposition and no-one putting forward this kind of view has cited a specific example of this happening in the real world. As a senior official in the South Australian Treasury involved in both Grants Commission and State development issues over a significant period I can recall no instance of any connection whatsoever of this kind. Each of the members of the Panel have had personal experience in major economic development proposals. I have not spoken to any of them on this matter but I would be extremely surprised if they were able to give any support to the proposition under consideration based on their practical experience. This is one aspect of the Review which can be tested from a factual point of view and mere speculation about a possible disincentive effect is of no value at all in this context.

19. If it were to be felt that this issue needed to be pursued further there are additional points which could be made- e.g. there are strong motives supporting economic development or reform going well beyond State budgetary effects. I would like to think this is one of the areas where the Panel could provide quite firm and definitive advice.

#### Equity and efficiency

20. I made the point earlier in this paper that one of the good effects of the change from the claimant State system to the "all in" system was that the debate was broadened out and in particular gave an opportunity for New South Wales and Victoria to put forward views and have them considered. One of the many issues raised by these States was whether there might be some conflict between the work of the Grants Commission based on fiscal equalisation and equity principles and economic efficiency. The issues here have become somewhat tangled over the years. My own view – as reflected in my 1988 talk attached to this paper – is that the best way to look at this is by comparing what now exists in Australia with what would exist under a unitary system without States and how people would analyse this in terms of economic efficiency. Without going into the matter step by step and at length the truth is that if Australia were a unitary State with only one level of Government tax

rates would be uniform across the nation with the consequence that there would be large differences between the various parts of Australia in the amount of taxation collected per capita. Similarly on the expenditure side some parts of the nation would attract higher levels of per capita expenditure than others – e.g. areas in which there was a higher concentration of young families with more children to educate. In these circumstances it is unlikely that these differences would be regarded as causing economic inefficiency. The variation in terms of what actually exists in Australia is, of course, that there can be and are differences between the States in the precise pattern of tax rates and expenditure levels etc. but of course the Grants Commission's calculations are such that the grants to individual States are in principle not affected by their particular policies – what the Commission calls its “effort neutral” approach.

21. Another way of approaching this is to distinguish between implicit equalisation and explicit equalisation. The former is achieved by the Commonwealth Government in Australia through its uniform tax and expenditure policies across the nation which no-one (to my knowledge) argues is inconsistent with economic efficiency considerations. For example I am not aware that anyone has argued that it is inefficient for higher amounts of personal income tax per head to be collected in some parts of Australia than others. Explicit equalisation is achieved by the Grants Commission at the State level but in terms of economic efficiency the implications are the same as in the case of implicit equalisation. The view which comes out of this kind of analysis (which could of course be established in more detail than I have done here) is that the explicit equalisation achieved through the Commission, far from being inconsistent with economic efficiency actually promotes it.
22. If, notwithstanding this line of thought, there should be a State which believes that the current system is inconsistent with economic efficiency and that efficiency objectives should be paramount then logic would dictate that it should have higher tax rates or lower levels of expenditure in poorer suburbs or regions within its State than in richer suburbs or regions. This would, of course, be regarded as absurd.

23. I acknowledge that this question has provoked, and will probably continue to provoke, a much lengthier discussion than I have put forward here. It would be extremely useful if the Panel having gone through this debate could clearly state the position that fiscal equalisation, as practiced in Australia, promotes and does not conflict with economic efficiency considerations.

#### Contrasts with other Federations

24. One useful piece of work would be to examine in some detail what the consequences would be if Australia didn't have a fiscal equalisation system similar to the one it does have – e.g. in terms of how much higher tax rates would have to be in the less well-endowed States and Territories and/or how much less would be available to spend on social services etc.
25. Another useful exercise, which I would urge the Secretariat to undertake is a contrast by what is achieved in Australia compared with other Federations which do not have a good equalisation system of any note. An excellent example is the United States. There is a great deal of factual data which can be explored in this respect. Some years ago now I was struck by some facts quoted in a book entitled “The Work of Nations” written by a former US Secretary of Labor Robert B. Reich. Following is one brief extract:-

“The growing segregation of Americans by income, when coupled with the shift in the burden of financing public services from the federal government to the states and localities, has resulted in growing inequalities of service. Increasingly, where you live determines the quality of public service you receive. While Philadelphia's taxes were triple those of its suburbs, the suburbs enjoyed far better schools, hospitals, recreation, and police protection. In 1985, about \$323 was spent per resident of Erie, Pennsylvania, on infrastructure such as roads, bridges, sewage, and water treatment; \$872 was spent per resident of San Francisco. It is no coincidence that the average resident of Erie earned \$9,520 that year while the average resident of San Francisco pocketed \$13,100.”

26. Reich's book contains other examples and they are, of course, out of date. I have cited them only to illustrate the kind of dramatic differences which can emerge in

the absence of a good equalisation system. I would urge the Panel to ensure that an examination is made from this point of view.

#### Independence of the Grants Commission and role of the Commonwealth Treasurer

27. I would like to think it beyond dispute that the independence of the Grants Commission has been a crucial element in our fiscal equalisation system and that it should be preserved.
28. This does, however, raise the question of the role of the Federal Treasurer whoever he or she may be from time to time. Clearly the Treasurer has an important role in administering the relevant legislation and in setting terms of reference for the Commission. It is appropriate that these responsibilities be exercised in or after consultation with the States and Territories through COAG or between the heads of Commonwealth State and Territory Treasuries. This raises the question of what is appropriate or not appropriate to be included in terms of reference given to the Commission. It is clearly appropriate to include such matters as the period over which the Commission's analysis should be undertaken, the timing of its Reports and such details. It is also appropriate to reiterate in the terms of reference the basic principles which the Commission should continue to apply.
29. Beyond those matters there is another area where I believe it is appropriate for the Treasurer to give guidance in the terms of reference namely the treatment of specific purpose payments made by the Commonwealth to the States and Territories. I would not wish to argue against the "inclusion approach" which the Commission has adopted as a general principle in many cases. However, I believe that there can and should be exceptions to this particularly when it comes to "one off" payments made to particular States or Territories to achieve very particular national outcomes. It can in these kinds of circumstances be anomalous for special payments of this kind to be, in effect, redistributed among the States and Territories through the Grant's Commission's workings. I have myself in years past drafted terms of reference which included mention of this aspect.

30. The whole area of the treatment of specific purpose payments is complex and which I believe would warrant very detailed review by the Panel and its Secretariat. This is particularly true now that the Commonwealth is making much larger payments, including for capital expenditure in various areas roads being a good example. Without going into detail the 50 per cent of some road grants currently excluded by the Commission in that particular area probably should be regarded as arbitrary and deserving of further examination and consideration in this review process. It would, I believe, be of particular value if the panel could prepare a detailed report on this area with a specific recommendation as to what might be included in the Commission's terms of reference in this respect.
31. Having put forward a view about what is appropriately included in the terms of reference set for the Commission by the Treasurer (the justification for which lies in the inter-reaction with other aspects of Commonwealth-State finances). I believe it would be desirable for the principle to be established that the terms of reference not delve into the details of methodology which are appropriately left for debate amongst the States and Territories (and I would argue the Commonwealth Treasury also – see below) and then decision-making by the Commission itself. I would give as an example of what I suggest as an inappropriate inclusion the reference to the detail of calculations in regard to iron ore royalties made by the Treasurer for a recent review.

#### Role of the Commonwealth Treasury

32. There can surely be no doubt that the most important development in fiscal equalisation in Australia was the establishment of the Commonwealth Grants Commission and its great statement of principle in its Third Report. I suggest that the second most important development was the change, already referred to several times in this paper, from the claimant State system to the current system. This was initiated by the Commonwealth Treasury and announced at a Premiers' Conference. In addition to this achievement, however, the Commonwealth Treasury



over many years made regular submissions to the Grants Commission commenting on the methodological issues of the day. Some of its comments were on views put forward by the States and some were its own thoughts about better ways of doing things. It would be possible to cite examples where this input by the Commonwealth Treasury proved valuable. This practice has not been continued by the Commonwealth Treasury over the last two decades or so. I believe this is unfortunate given the intellectual skills and objectivity which the Commonwealth Treasury could bring to bear to balance the views of the individual States and Territories which are, of course, most often related to what is in their particular interest. One area where solid analysis by the Commonwealth Treasury could well have been useful is the question of the relationship between equalisation and economic efficiency as referred to above.

33. I note, however, that the Treasury has from time to time made some brief public comments which are of interest in the current context. For example, following is a quote from the 2010-11 Budget Paper No. 3:-

“Horizontal fiscal equalisation provides the necessary budget support so that all States have the capacity to provide services at a comparable standard, while ensuring that the interstate transfers are not so large that they would significantly distort economic behaviour and reduce productivity growth.”

I confess that I have not read every paragraph of every volume produced by the Grants Commission in recent years. However, I doubt whether this is an accurate statement of what in fact has happened. It seems to imply that the Commission having worked out a grant distribution based on equity/equalisation grounds then applies or has applied to it a constraint based on the size of the resulting transfers to avoid economic distortions etc. Apart from being factually inaccurate I wonder whether this statement in the Commonwealth Budget Papers might not have given encouragement to the notion that increasing differences in per capita relativities between the States is a problem rather than an appropriate and desirable reflection of underlying economic changes – this matter was discussed earlier in this paper.

34. One of the interesting developments in public affairs last year was the publication of material provided by Government agencies to brief the incoming Government after the election. This material included some comments by the Treasury on Grants Commission matters including the following:-

“There are two key issues that will need to be addressed to ensure continued productive working relationships between the Commonwealth and the States: ensuring that the framework for federal financial relations provides an appropriate foundation for collaboration; and making sure that there continues to be strong state commitment to horizontal fiscal equalisation.”

The point to be made here is that while it would be helpful if all State Governments well understood and supported fiscal equalisation and it would be even better if they were committed to it, when push comes to shove what is ultimately required for fiscal equalisation to continue in adequate form is commitment by the **Commonwealth** Government.

35. Following is a further extract from this material:-

“In addition, recent focus on the Commonwealth Grants Commission methodology, including the impact of Western Australia’s growing prosperity, has placed pressure on the principle of horizontal fiscal equalisation, a key element of federal financial relations since the 1930s.”

and

“Separate to the review, growing pressures on horizontal fiscal equalisation may require consideration of whether adjustments are needed to ensure sustainability of the arrangements into the future.”

All Governments, Commonwealth, State and local – have “pressures” on them from many quarters all the time. The trick is to distinguish between those pressures to which the response should be “adjustments” and those to which the response should be thoughtful explanation and polite but firm resistance and defence of sound policy. While recognising that brevity was required in the document from

which these quotations have been taken I wonder whether there might not have been scope for more emphasis on the latter of these two approaches.

36. I should emphasise that the above comments are not to be taken as reflecting negative views on my part about the Commonwealth Treasury. On the contrary I have had a great respect for the intellectual and policy “grunt” of the Commonwealth Treasury for about 45 years. My point is that I would like to see that “grunt” reflected in a more continuous and solid way in this area through contributions in the form of regular submissions to the Commonwealth Grants Commission and in other ways. I would like to see this both on detailed questions of methodology and on broader issues of principle of the kind referred to in this paper.
37. My respect for the Treasury has, if anything, grown in recent years particularly leading up to and including the Parkinson/Henry leadership period. Like many others I have been impressed by the quality of the Treasury’s contribution in recent years to economic policy making and the introduction of new thoughts and approaches into the Department. A good example of this which I believe to be relevant in a broad way to the current exercise is what the Treasury refers to as its “Wellbeing Framework” which can be accessed on the Department’s website. One good reference is a paper entitled “Wellbeing, living standards, and their distribution” authored by Dr Gruen, Mr Kelly and Ms Gorecki which was presented to a meeting in New Zealand as recently as this month (September 2011). This paper is of some sophistication and it is difficult to summarise adequately. However, one of the views expressed in the paper, is along the lines that organisations such as the Treasury should be “less reticent” (the authors’ words) about expressing “normative” views in addition to the “positive” work of the kind commonly undertaken in such organisations. To put this in layman’s terms the view is that Treasury and similar organisations should be more willing to involve themselves in discussions about values and to express views as to what is good or bad. The paper goes on to talk in some detail about distributional issues as between individuals or families. However, I would suggest that the kind of advice which the Treasury has given about being more willing to express “normative” views might also be relevant

to fiscal equalisation. As discussed earlier in this paper there is scope, following this theme, for the Commonwealth Treasury to be “less reticent” and indeed forthright, after due analysis, in talking about the good things that come out of fiscal equalisation. Also relevant in the current context is the statement in the paper by the three Treasury officers that “We are also now more aware of the importance of human capital, of education and good physical and mental health for the outcomes people achieve.”. The point here is that were it not for equalisation the standards of these kinds of services in the less well-endowed States and Territories would be severely jeopardised contrary to the kinds of objectives desired by the Treasury. I guess that what I am advocating is that the Treasury take its own advice and applies it in this particular area of work.

38. One of the other set of ideas referred to in the cited paper are those originally propounded by the philosopher John Rawls particularly in his great book “A Theory of Justice”. In this connection the paper uses the phrase “veil of ignorance”. Again to translate into crude layman’s terms the idea is that if one is seeking to come to a view on some issue of ethics or policy it is helpful to look at it from the point of view of a disinterested observer who does not know his own position with respect to the issue at hand. For example, what is one’s view on the aged pension if one does not know how rich or poor one will be at that stage of life? Wouldn’t it be nice if State Governments and Treasuries could think about things in these kinds of terms!?
39. It is perhaps stating the obvious to say that the preceding paragraphs do not purport to catch the subtleties in the thinking of our three Treasury authors let alone Professor Rawls. The originals are recommended.

#### Local government finance

40. While arguably not directly relevant to the Panel’s terms of reference I take this opportunity to make the point that the major deficiency in fiscal equalisation in Australia at present is in the area of local government finance. While the Commonwealth makes grants specifically to the States for equalisation between

local government units the amounts are small relative to the equalisation task and there is an unhelpful requirement for a certain minimum level of per capita grant to be paid to every Council regardless of its relative financial capacities and needs. In addition the State Government's themselves have made little, if any, contribution to reducing the financial inequalities between Councils. The current distribution of these grants between the States on an equal per capita basis warrants another review. This is another topic on which it would be desirable for the Commonwealth Treasury to make a good analytical contribution.

#### Summary of conclusions and recommendations

41. Following is a summary of conclusions and recommendations which I put forward for the consideration of the Panel:-
  - (a) It is neither necessary nor desirable that there be any change in the fundamental structure of how fiscal equalisation between the States and Territories is achieved in Australia – i.e. an independent Commonwealth Grants Commission, with full opportunity given to States, Territories and other interested parties to analyse and make comment on the Commission's methodology and with Terms of Reference set from time to time by the Commonwealth Treasurer after consultation with the States and Territories and with those Terms of Reference subject to (k) below.
  - (b) It would also be neither necessary nor desirable to change or to substitute anything different for the basic statement of principle contained in the Commission's Third Report.
  - (c) It would be desirable for the Panel's Report to include at least a brief survey of the development of fiscal equalisation in Australia noting that the system has adapted to changing circumstances and has been the subject of major improvements especially in the 1970s.

- (d) It would be appropriate for the Panel's Report to include an analysis of the desirable equity and other effects achieved by equalisation in Australia and to contrast the situation in Australia with a Federation such as the United States which doesn't have equalisation.
- (e) It would be desirable for a reasonably detailed explanation to be provided by the Panel as to why the achievement of fiscal equalisation is not inconsistent with, and indeed promotes, economic efficiency noting that there is, amongst other things, considerable academic analysis supporting this view.
- (f) It would be useful for the Panel to refute views put forward from time to time that current arrangements somehow provide a disincentive to States and Territories to promote economic development or reform within their borders.
- (g) It would also be useful if the Panel took the opportunity to explain why changes over time in the relativities between States (including marked changes of the kind recently experienced by Western Australia) do not represent a problem but are a natural and desirable outcome of an efficiently working equalisation system as it responds to changes in the economic and other circumstances of the various States and Territories.
- (h) It would again be useful for the Panel to explain why the relationship between grants paid to a particular State and tax collected in that State is not a useful measure at all in evaluating the quality of Australia's system of fiscal equalisation.
- (i) The Commonwealth Treasury should be encouraged to resume its earlier practice of making regular submissions to the Grants Commission both on detailed questions of methodology and on broader issues. It should be "less reticent" than it has been in putting forward views about the desirable features of current arrangements.

- (j) Similarly the Grants Commission should be encouraged to be more forthcoming in its reports about the desirable outcomes of its work in terms of equity and efficiency.
- (k) The Panel should aim to produce guidelines for the Terms of Reference given by the Commonwealth Treasurer to the Grants Commission those guidelines to include a precise and reasonably detailed set of wording about the inter-relationship between the Commission's work and the Commonwealth's specific purpose payments to the States (especially those of a capital or "once off" nature); these guidelines would also appropriately state that it would not be appropriate for the Terms of Reference to deal with the detail of Commission methodology such as the calculation of relative capacities to raise different forms of revenue etc.
- (l) If possible it would be desirable to note the considerable deficiencies in equalisation at the local government level.

#### Final comment

42. I have deliberately kept this paper quite brief. If there were to be any further contribution I could make by way of elaboration or extra detail which might be of assistance to the Panel or the Secretariat I would be happy to do so.