Submission to the GST Distribution Review

Separating federal public goods and state productivity dividends

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1. Introduction

The problem with Horizontal Fiscal Equalization (HFE) in Australia is that it is carried out using the wrong revenue stream. The public expects HFE to uphold standards of equity, a purpose for which it is not designed and not suitable. HFE does not compensate for interstate externalities such as the burden to Tasmania of conserving the nation's forests. The strength of HFE its apolitical impartiality and economic sophistication, making it a potentially powerful tool for guarding the public interest against abuses of federal tied grants.

Equalizing all average state services without regard to national priorities, creates confusion for the public about which government to hold to account. A perception can arise that all public goods come from the commonwealth through state delivery agents, lowering the ability of the public to hold states to account, and hiding the true provenance of the revenues for funding state services.

Redistributing GST revenue is a waste of the potential performance signals that such an efficient tax could provide for states. The HFE formula assumes states can only control their revenue effort and spending efficiency; the underlying values of state revenue bases, and the effects of economic policy on those bases, are externalized to other states. This dilutes the fiscal gains with which governments could otherwise offer voters enticements along with tough economic reforms. The absence of fiscal success signals may make governments more risk averse than they would otherwise be: better to be re-elected by a poor population that doesn't know why it's poor, than be voted out by a rich one that doesn't know why the cost of living went down and things got better.

I would like to propose separating state revenue, including Goods and Services Tax (GST) revenue, from federal grants that might be funded from anywhere in the federation. The difference would be clearly visible to the public, and the two funding streams would be accountable to different levels of electorate. One income stream would go to states as a productivity dividend, completely fungible, available for use by state governments for funding state election promises and winning state votes. The other income stream would come from federal taxes, potentially to serve federal priorities for winning federal votes, and give federal voters the option of a say in how their interstate assistance tax dollars are spent.

The scheme I propose is simply a new way of connecting up instruments that we already have: the Goods and Services Tax, the Commonwealth Grants Commission, and the federal tied-grant power. In three steps:

1. ***A state productivity dividend:*** GST revenue would be divided between state governments in proportion to their respective Gross State Product (GSP) figures as published by the Australian Bureau of Statistics (and considered reliable headline figures since 2006).

2. ***Federal grants defined and funded:*** The commonwealth parliament would create a set of federal grant funds for the states, with or without conditions, as it sees fit. The parliament would set the total amounts for each purpose, without specifying amounts for particular states.

3. ***Independent and impartial distribution of federal grants:*** The Commonwealth Grants Commission would assess state fiscal capacities and expenditure burdens – as it does now, except that GST income would count towards capacity – and equalize capacities for providing state services consistent with any conditional terms.

In the base case of no federal grants at all to states, this would mean no redistribution. (At least no explicit redistribution; there is always some redistribution because progressive federal taxes make up a greater proportion of private goods' prices in high income areas – see Albouy, 2009.) States would have only their own-source revenue and GST revenue proportional to GSP, which in June 2011 ranged from \$48,743 per capita in Tasmania to \$93,593 per capita in Western Australia according to ABS figures.

In the next simplest case, suppose the federal government provided just one general purpose grant with no conditions, equal to the sum of SPP grants it is currently providing. Budget figures show this amount to be \$47.5 billion in 2011-12, about the same as the total GST revenue. HFE in this case would proceed in the same way as it does now, redistributing more because of the greater divergence in state fiscal capacities, to arrive at the same bottom lines for state budgets. Western Australia would receive a lot of GST income and very little of the federal grant. The main difference between this scenario and the current setting would be that no conditions would attach to grants, and state budgets would reveal a clearer picture of federal redistribution than they currently do.

Now suppose the federal government provided two grants instead of one: a general purpose grant of \$32.5 billion and an SPP grant of \$15 billion for support of Aboriginal and Torres Strait Islander communities, still adding up the same \$47.5 in federal grants. In 2010-11, states and territories spent in total \$15.4 billion on indigenous persons, \$10.8 billion more than they would have spent on the same number of non-indigenous persons (source: CGC), so \$15 billion in targeted assistance would imply increased concern in the national community for the fiscal needs of indigenous communities. (On the other hand, if the indigenous SPP were less than \$10.8 billion it would make no difference at all to the distributions.)

The \$15 billion would not be distributed evenly. The highest proportions of state expenditure on Aboriginal and Torres Strait Island communities are in the Northern Territory, followed by Western Australia, Queensland and Tasmania. But now the HFE formula comes into play. Western Australia, with its very high productivity and thus very high GST income, would be assessed as fiscally more adequate than Queensland, which in turn is fiscally much more adequate than the Northern Territory. To borrow an analogy from physics, WA is strong enough to bear more stress (bending with the pressure) without experiencing strain (buckling under the pressure). The increased weighting of indigenous need factors would shift more of the transfer to the Northern Territory, Queensland and Tasmania, compared with only a general purpose grant. As federal governments added more specific grants in place of general grants (assuming the specific grants are big enough to make any difference to the status quo), the weightings would shift according to state conditions.

Now suppose the federal government provided less grant assistance, say only \$40 billion rather than \$47.5 billion (perhaps lowering federal taxes commensurately to allow states more taxation space). Since HFE would be done using only these federal grants rather than GST income, the degree of HFE would be reduced. If HFE can be pictured as a levelling formula so that equalized states end up with the same capacity to provide services, we can now imagine that horizontal line being lowered. First one state, then another, would rise above the equalization level as their internal revenues exceeded the equalization level of other states more in need of federal grants. These equalization grants would come from the federal budget and in general would be sourced from federal taxes, not from the GST revenue of the most self-sufficient states.

In section 2, SPP grants and HFE are examined as complementary fiscal instruments, which could work better and with greater integrity if combined. In section 3 the advantages of indexing GST distributions to Gross State Product – a proxy for "state of origin" distribution, which is itself an imperfect proxy for state economic performance – are suggested, and why this would provide a performance incentive signal for state microeconomic reforms, even if it's partly or fully diluted by HFE grants added on top.

2. Filtering conditional grants through equalization – a dynamic framework for identifying and distributing federal priorities in areas of state control

In this submission I propose an alternative HFE framework based on federal public goods – nationally defined priorities in areas of state responsibility – which would express contemporary national values and be responsive to changes in those values, and at the same time systemically resistant to capture by political cherrypicking.

It's unlikely there are many voters in Queensland who care whether South Australia spends state funds on a busway, a tramway, or replenishing beach sand as it drifts north. However, in the unlikely event that South Australian state schools ran out of capacity and started turning children away, voters both within and without South Australia would be likely to show some concern, because universal school education is a staple of Australian national aspirations. If voters in one state heard of this happening in another state which they were subsidizing, they would have fair cause for questioning the level of federal accountability for that subsidy.

HFE does not prevent this happening – not only for the obvious reason that it doesn't use tied grants, but more importantly because it does not assert any nationwide standards for any state service. HFE also does not compensate state communities for bearing heavier loads of shared national responsibilities. It's not designed to do either of these things. HFE is designed to make variations in state government capacities for public services a non-issue for persons deciding where to live, so that individuals won't have a fiscally induced bias for taking less productive jobs in states with higher average incomes.

The gap between what Australia mistakenly relies on HFE for and what it actually does, was illustrated in a 2008 Senate inquiry into claims that the Northern Territory government had been diverting funds "intended" for remote Aboriginal communities (Senate, 2008). Some tied grants are provided to governments for the care of these communities, but because of unusually high costs in the Northern Territory outback, most of the funding for its services to Aboriginals comes from HFE transfers of state GST revenue.

The inquiry found that the terms of reference with which the Senate had raised it had misconstrued the way the Commonwealth Grants Commission (CGC) funded states and territories. There is no "intended service recipient" for HFE grants. There is no "funding formula" for determining how much money should be spent or what outcomes should be achieved. The terms of reference implied that these did exist. The CGC explained to the inquiry that it estimates empirically how much states and territories have been spending on average to provide the services that they do, then taking into account revenue capacities and regional cost variations, rebalances their budgets so that all jurisdictions can potentially provide the same levels of average services. For one jurisdiction or another to "underspend" on a service is simply to fall below average state spending for that service. This may be due to different democratic preferences for public services in that jurisdiction. It may even be a result of providing average or above average levels of service with better than average spending efficiency.

Perhaps the most surprising revelation of the inquiry was that members of the Senate who had raised it – representatives of their states in the house originally designed for protecting state interests – did not know these basic facts about how their constituencies were being funded.

Perhaps the least surprising revelation was that the system had failed the nation's indigenous population. The Northern Territory is in the special situation of having a disadvantaged political minority which occupies the greatest part of its financial resources. The government is therefore not accountable to voters in that minority, nor is it held accountable by the commonwealth government which empowers it.

Because of the large proportion of the nation's indigenous persons under its care, the standard of services that the Territory chose democratically to provide to its dependents became a very large component of the weighted average of services provided to Aboriginal and Torres Strait Islanders throughout the federation. Empirical estimations of these services, and of the unusually high costs of labour and remoteness in the Territory, became the basis for HFE predictions of how much each jurisdiction would need to maintain the same average, and thus the biggest component of the Northern Territory's budget. So the tail came to wag the dog. But because the amounts transferred by HFE were large, and the system so arcane, the public assumed that some national standard of decency was being expressed through the HFE system, and left it on autopilot.

The Northern Territory is a special case for several reasons, and there are probably simpler ways of fixing its funding arrangements than by remodelling the entire fiscal federal system to accommodate it. But the 2008 Senate inquiry showed the extent to which we rely on the HFE system for things which it is not designed for, as well as the lack of understanding, even at Senate level, of how it works. A system which is designed neither to reward state economic performance, nor to articulate any national expression of shared values. A system which merely rebalances averages in state service capacities.

The second biggest recipient per capita of HFE transfers is currently Tasmania. In the 1980s, preservation of native wilderness went from being a state conservationist matter to a national concern across Australia, which led to a federal battle over the Franklin Dam. Intergovernmental forestry agreements and woodchip export caps until 1998 placed a proportionally higher burden on the Tasmanian economy than any other state. I haven't found any estimates of the cost to Tasmanians of federal interest in forest conservation. Could a climate of regulatory risk have contributed to broader effects on investment and competition? In 1980 despite chronic economic problems, Tasmania's per capita disposable income was 90 per cent of the national average, but this declined to 77 per cent of the national average in 2002 (Eslake, 2005).

What we can say is that HFE does not compensate Tasmanians for economic losses caused by complying with federal pressure to conserve forests and the Franklin River. HFE equalizes only the capacity for public goods, hiding the fiscal effects of lower private incomes without replacing the foregone private component.

One way to address this would be to make additional National Partnership Payment (NPP, under the 2008 IGA) incentive grants which take private incomes into account. But other states have borne varying loads of opportunity cost from the same federal conservation initiatives, either in forest harvesting or land clearing for agriculture. How to divide it up fairly between the states? The 2008 Intergovernmental Agreement (IGA) made a commendable effort to be fair by distributing national SPP grants on a per capita formula for purposes that are relatively evenly spread across the states, such as education and hospitals. HFE smooths out most of the interstate cost variations. Other purposes are very unevenly spread such as Indigenous services; these are addressed by NPP incentive grants most of which are outside the HFE assessment terms so that the incentives are not diluted away.

But then how can something as complex as a fair price for the Murray Darling Basin Plan be worked out for different states affected by it, without tempting some states (especially those least in need of the grant) to hold out for higher incentive payments at the cost of more agreeable states?

SPP grants have been one of the most controversial elements of Australian fiscal federalism, particularly since the 1970s (see Bennett and Webb, 2008). Using them to secure intergovernmental agreement on shared federal priorities can give rise to political failure in three main ways.

1. How does the public know the amounts and conditions are negotiated to fair value, not just strategically cherry-picking votes in swing seats, or providing a fiscal boost to preferred parties in state politics?

2. Where federal grant purposes overlap with what state governments would have done for their own reasons, what's to stop state governments withholding cooperation to gain higher federal grants?

3. If state governments are so dependent on the federal grants that they cannot refuse any substantial offer, what's to prevent the commonwealth government using its fiscal leverage to annex state powers opportunistically?

The solution to the first two problems is to mediate the grants through an independent and impartial distribution authority.

To illustrate, consider two offers of special grants for state local goods which were made on either side of the 2010 federal election. During the election campaign, the government committed to $2 billion in funding for a railway link in southwest Sydney. (Whether the grant would have been subject to dilution by HFE was not made clear.) During negotiations to form minority government after the election, the opposition was reported to have offered $1 billion to Tasmanian independent Andrew Wilkie for a hospital in Tasmania.

This can give rise to inefficiency because voters in the larger jurisdiction (the commonwealth) who effectively authorize an expenditure, are less able than voters in the smaller jurisdiction (the state) to weigh up the benefits of a local project against its costs and trade-offs.

But the real damage can be deeper and more subtle than a bit of inefficient spending. State governments can claim a free lunch for state voters simply by negotiating for commonwealth taxpayers to fund something which the state public would have been willing to fund. Commonwealth governments can pick low-hanging fruit for votes in swing seats, sidestepping the need to serve broader national interests, and without any need to concern themselves with the more mundane and thankless tasks of state government such as traffic enforcement and public sanitation. This can lead to state and commonwealth communities electing different governments than they would have elected if political responsibilities were more robustly defined, causing government to become less accountable and allowing the quality of governance to stagnate.

Suppose the commonwealth government were able to determine only amounts and purposes for grants, but not where the grants will go. Then such grants would be offered to the public in this manner or not at all:

> *If elected, we will fund an additional $2 billion for railway projects, somewhere where it's most needed.*

This is an application of James Harrington's cut-and-choose division of power. In his book *The Commonwealth of Oceana* (1656), Harrington wrote that two young girls could reveal how to secure the common good in a republican power structure, in the way they settle the division of a cake:

> *For example, two of them have a cake yet undivided, which was given between them. That each of them therefore may have that which is due, 'Divide', says one unto the other, 'and I will choose; or let me divide, and you shall choose.' If this be but once agreed upon, it is enough; for the divident dividing unequally loses, in regard that the other takes the better half; wherefore she divides equally, and so both have right.*

A common application of this principle is a trust, where a settler insulates himself from disbursement decisions by appointing a trustee. In the case of a federal system of grants, the role equivalent to trustee would be a highly complex one, beyond the capabilities of most federal governments around the world. Whatever flaws there may be in the theory or practice of HFE, it has been instrumental for settling quarrels between subnational governments in Canada and Australia, and in Australia it has led to the Commonwealth Grants Commission (CGC) developing a unique analytical technology for identifying fiscal needs.

SPP grants would be disbursed through a modified HFE system. The role of the CGC would be to advise

> *the distribution of each federal grant to states and territories such that, after allowing for material factors affecting revenues and expenditures, each state and territory would have the fiscal capacity to carry out services consistent with the terms of the grant 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.*

The above wording is based on that used by the CGC to describe HFE at present, with a few differences:

(a) It allows for more than one federal grant in place of a single GST revenue pool. Each single grant would be distributed to the states and territories.

(b) The phrase "consistent with the terms of the grant" is inserted. If a grant is untied with no terms specified, then all state functions which would normally assessed by the CGC would be consistent with the terms of the grant.

(c) Not stated but assumed: one of the material factors affecting revenue would be the distribution of GST funds in proportion to Gross State Product (see section 2).

Consider how this would work in practice. If the commonwealth provided block grants for education and healthcare, as it does now, the CGC would work out how to enable the most consistent provision of schools and hospitals across the states. In other words, the same as it does now, except that if for example education became a higher federal priority, the commonwealth might provide an education grant in excess of the total amount that states have been spending on education. This would increase the weighting of education as a need factor, favouring states with more school age children.

At first glance this appears little different from providing education and healthcare block grants directly, followed by HFE on top to adjust for differences in state capacities and regional costs. The main difference would be that redistribution would apply to the SPP grants, not GST revenue, so the GST state performance signal would remain intact and states with high GST would receive relatively low SPP amounts, making them less accountable to the commonwealth government and more accountable to their own state voters for their spending decisions.

To take a more complex example, suppose the commonwealth provided a single federal SPP grant to states for implementing the Murray Darling Basin Plan (MDBP), to be distributed by the CGC. The process might go something like this.

1. The commonwealth government, after consulting relevant expert bodies and state governments, would come up with a total figure X for compensating all states if they cooperate with the MDBP, including the costs of compensating private individuals in their states.

2. The CGC would be given terms of reference for this year's federal grants to distribute, including the MDBP grant. Each grant would come with a total national amount and any applicable conditions.

3. The CGC, after doing its own consultations and research, would estimate the revenue capacities and cost disabilities of all states, as it does now, but including estimates of the costs and benefits of the MDBP to each state's capacity for services, on the assumption that they all accept the grant and comply with the conditions. In all other respects the HFE formula would be essentially as it is now: in equalizing capacities for average state services, the recommended distributions would tend to favour states with lower projected revenue capacities and higher projected cost disabilities. States in a stronger fiscal position would be expected to shoulder a heavier share of the federal burden under their own steam.

4. Now suppose one state – perhaps the one in the strongest fiscal position and therefore offered the lowest per capita slice of the MDBP grant – took a look at the figures and decided to refuse.

5. The commonwealth government would decide whether to proceed with partial participation, in which case the CGC would need to revise its distribution figures for the new scenario.

6. Alternatively, the commonwealth government could raise its offer – but this too would require a CGC revision, because all affected states would benefit from the raised offer, not just the one

which initially refused. The last state to withhold agreement would be aware that any rise in offer that it manages to negotiate would still be distributed to all affected states, not just the last one to agree, and the increased cost would be borne by all commonwealth taxpayers. This would moderate the incentive for any one state to extort its way to a higher grant.

I said above that three main potential problems existed with SPPs. By filtering SPP grants through an HFE process, the framework proposed here would deal with the first two – cherrypicking federal swing seats for local favours, which degrades government accountability to state and commonwealth voters, and the ability of states to withhold cooperation to extract higher grants.

The third problem – vertical fiscal imbalance enabling states to be fiscally subdued rather than cooperating by consent – is not directly addressed by the framework proposed here. But note in the example scenario above that some states would be more susceptible to fiscal coercion than others. States having high GSP and therefore receiving high GST income would be relatively autonomous and relatively indifferent to federal grants. This should offer something of a counterweight to any imperialistic tendencies a commonwealth government might have, especially if it needs submission from all states to get its way.

The flipside of this is that fiscally strong states might not cooperate with genuinely federal priorities for the public good. But this is a strength in the proposed model, not a weakness. The phrase “financial assistance” in section 96 of the Australian Constitution, which was originally intended for emergency rescue from state fiscal crises, implies providing money as unearned largesse. Welfare allowances and food stamps are forms of “financial assistance”; wages and salaries are not. If a self-sufficient state and a self-sufficient commonwealth cannot cooperate without twisting each other’s arm, then something is probably wrong on a level requiring more political subtlety and less fiscal artillery.

To summarize this section, HFE and SPP grants can be combined in such a way as to make the best of both. Several advantages could be realized.

- The best aspects of HFE – the hard-nosed economic impartiality of the CGC – would filter out most of the harmful uses to which SPP powers have been susceptible at times.

- The best aspects of SPPs – the ability for the federal public to articulate standards for shared federal public goods and to share national responsibilities equitably – would enable the system to bridge gaps between what HFE can do and what many Australians, even many Senators, expect it to do, with greater precision and impartiality than is currently the case.

- The framework would be flexible. Instead of a definitive list of federal public goods suitable for equalization, the commonwealth government would be able to identify new priorities, revise old ones, increase or decrease the degree of spending restrictions, and increase or decrease the overall amount of HFE funds for equalization.

- The use of commonwealth funds rather than state GST revenue to carry out HFE would make both the form and the degree of HFE more accountable to the commonwealth public paying the taxes.

In regard to the last point, carrying out HFE using GST revenue is a waste of an almost flat and highly efficient growth signal. GST could be better deployed providing fiscal feedback on state economic performance. This would be of value even under full equalization, because of its visibility showing state voters more clearly where the money comes from. This is the subject of the next section.

3. Goods and Services Tax as state productivity dividends

If GST is no longer required for purposes of redistribution – that purpose being better served by explicitly redistributive taxes, such as federal grants supplied from federal income taxes – then the question of returning GST dollars to states in the proportions that they pay it can be reopened, without fear of impoverishing any states.

GST was originally promoted as a "growth tax" because it would track reasonably closely with economic production.

To implement an exact "state of origin" (SOO) distribution would not be practical, because no mechanism exists for keeping track of the state in which GST dollars are accrued. The Australian Bureau of Statistics uses a variety of data sources to estimate total state consumption.

Even if that were solved, it would be unsatisfactory. GST revenue is very slightly progressive since many consumer staple goods are zero-rated. Another progressive element occurs due to federal taxation which tends to make up a bigger proportion of private goods' prices in high income areas (see section 2, and Albouy, 2009), and the difference is subject to GST taxation on top. So a perfect SOO distribution, even if it were practical, would be regressive. Such a distribution would also discriminate against states with more financial services. There are time lags and spatial gaps between production and consumption, and distributing on the basis of consumption alone could result in a bias against saving in state microeconomic policies.

But this is all unnecessary. The virtue of GST as a "growth tax" derives from it being a reasonably good proxy for gross product, and the virtue of an SOO distribution would in theory be the same – providing states with an efficient revenue stream that truly reflects the conditions of state economies relative to each other.

The Australian Bureau of Statistics reports that in 2006-07 it became sufficiently confident in the robustness of its Gross State Product (GSP) estimates to remove the "experimental" label these indicators had worn since being first published in 1987. The ABS now publishes GSP as the headline figures in its State Accounts. GSP is a state's share of Australia's Gross Domestic Product (GDP), plus taxes paid, minus subsidies received.

A useful application of these figures would be as comparative indices for the distribution of GST revenue to the states. GSP is a proxy for SOO distribution which is better than the real thing, because SOO itself would only be an imperfect and slightly distortive proxy for GSP. The total GST revenue pool does not track total GDP perfectly, but at the margin it would be the best dividend incentive for state economic management and microeconomic reform that state governments could possibly have.

The other virtue of GST revenue is that by intergovernmental agreement, no conditions can be imposed on how it is spent. This means any increase in GST revenue caused by improving economic performance would be available for state governments to spend on "sweeteners" – the enticements that are often necessary for getting tough economic reforms accepted by the electorate, and thus giving the government that pushes such reforms an increased chance of being re-elected. At the end of the day, politicians work for votes, not revenue; their own personal incomes are quite secure. Revenue can be converted into votes if the government has full autonomy in how to spend it.

Specific Purpose Payments (SPPs) sometimes serve federal political purposes without necessarily being high priorities for voters in a given state. If the SPPs are assistance money, paid for mainly by other states, then this may be a good thing: federal taxpayers supporting a dependent state should have the option of requiring aid money to be spent on federal priorities, as I discussed in section 3.

This means that even with full equalization using SPP funds, as I described in section 1, the government in a very high income state such as Western Australia that gains most or all of its income from internal revenue, would be in a slightly stronger political position to win elections than a state government receiving most of its income in federal grants with federal conditions.

Even under full HFE with entirely fungible untied grants, or with conditional grants whose purposes align exactly with the wishes of the state anyway, the performance signal would still be meaningful, for two reasons. First, it would be a more secure revenue stream in case of a change of commonwealth government policy. Second, its visibility in the budget would help advertise the GSP headline performance indicator of the state and the economic management of its government.

The potential to free up GST for this "growth dividend", by using federal funds for HFE instead, is the strongest reason for considering the framework I propose in this submission. Even if the suggestions I've made in section 2 about reforming SPP grants are not accepted, it would still be worth finding some other way to fund HFE so that GST can be redeployed as a performance signal for state governments.

5. Conclusion

The GST Distribution Review asks us to consider whether Australia's current HFE system positions the federation to utilize its resources in response to coming challenges, and to maintain public confidence in its fiscal institutions. I have given reasons why it does not. The current practice of HFE actively undermines these things, causing obfuscation of the responsibilities of governments and voters, externalizing any state gains in revenue bases, and diluting the electoral incentives for state governments to take on microeconomic reforms.

These problems can be solved. Existing fiscal instruments can be redeployed in powerful and flexible new combinations. Historically, HFE has played a crucial role in reducing intergovernmental quarrels with impartial institutions for distributing revenue. This has caused the Commonwealth Grants Commission to evolve into an organ ideally suited for distributing Section 96 tied grants.

By entrusting the distribution of tied grants to the CGC, these grants would cease to be useful for purposes which serve governments more than they serve the public. Their only use would then be as instruments for sharing intergovernmental burdens and national aspirations such as education, natural conservation, rehabilitation of Aboriginal and Torres Strait Islander communities, or whatever future challenges the commonwealth electorate may approve treating as federal public goods. Any government making a grant would be at arms length from deciding who receives it.

Each component in this framework offers solutions to problems in other parts of the same framework. By reconnecting these parts in different ways, clearer lines can be drawn between commonwealth and state voters, the tax revenues they provide, the expectations that go with them, and the governments that face them at the polls. Once the right framework is set up, political and fiscal forces can go to work developing and refining its forms.

By designing HFE in this way and funding it from federal taxes, the path can be cleared for GST revenue to act as visible productivity dividends for states, without fear of impoverishing underperforming states. Distribution of the GST revenue would be done in direct proportion to Gross State Product figures, published by the Australian Bureau of Statistics. States receiving more of their income in GST and own-source revenue would have more budgetary autonomy, while states receiving more of their income in Section 96 grants would potentially be subject to tighter spending controls.

I very much look forward to reading the Committee's final report, and hope that my submission may be of some help.

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