Queensland Government

Deputy Premier
Treasurer
Minister for Aboriginal and Torres Strait Islander Partnerships

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24 OCT 2018

Mr Alan Raine
A/g Committee Secretary
Senate Economics Legislation Committee
Parliament House
CANBERRA ACT 2600

Dear Committee Secretary

I attach the Queensland Government submission regarding the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018*.

The Queensland Government has consistently supported the current system of distributing GST revenue and the changes proposed by this Bill are of great concern to me. While I welcome the recent addition of a guarantee that ensures no state will be worse off under the updated system, I must also acknowledge that the Australian Government is making a unilateral decision to amend legislation for the benefit of one state.

The Queensland Government's submission outlines our outstanding concerns with the Bill and provides additional and alternative recommendations for the Committee to consider.

Thank you for providing the opportunity to be consulted on this important matter and I hope that this information is of assistance to you.

If you require any further information, please contact Dr Peter Power, Senior Economic Advisor in my office on [redacted]

Yours sincerely

[redacted]

JACKIE TRAD MP
DEPUTY PREMIER
Treasurer and
Minister for Aboriginal and Torres Strait Islander Partnerships

Queensland Government

Queensland Government Submission to the Senate Standing Committee on Economics

Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018

October 2018

Queensland Government Submission to the Senate Standing Committee

Contact:

Dr Peter Power

Senior Economic Advisor

Office of the Hon. Jackie Trad MP

Deputy Premier, Treasurer

and Minister for Aboriginal and Torres Strait Islander Partnerships

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1.0 Executive Summary

The Palaszczuk Government is a strong supporter of the current system of horizontal fiscal equalisation. The current system of HFE ensures that Queenslanders, no matter where they live, can receive a similar level of services whether they live in Cooktown or Canberra. As the state with the most decentralised population Queensland is uniquely exposed to arbitrary changes to the GST system which abandon the principle of full HFE. This system has meant that Queensland has received less than its population share of GST revenue in some years and more than its share depending on the economic circumstances.

The Queensland Government will receive approximately $14.8 billion in Goods and Services Tax (GST) revenue in 2018-19. This represents about one quarter of the State's total revenue. **Any changes to the collection and distribution of GST revenue could have a significant impact on the S**tate's ability to deliver critical services to Queenslanders.

Therefore, the Productivity Commission's Final Inquiry Report into Horizontal Fiscal Equalisation and the Australian Government's Interim Response, which recommended **changing the system for distributing GST, were received with great concern.**

Despite promises of consultation and opposition from states to proposed changes, the Morrison Government introduced the Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018 on 18 October 2018. The Bill will permanently change the system of distributing GST revenue and enshrine in legislation Australian Government powers.

The Palaszczuk Government acknowledges that the Australian Government has taken a unilateral decision to amend legislation to change the distribution of GST. Queensland welcomes the recent additions to the Bill, namely the 'no state will be worse off' guarantee and **a legislated Productivity Commission inquiry into the effectiveness of the changes. However, there are many outstanding concerns regarding the guarantee, the impact on other payments to states, and status of the additional financial assistance.**

The Queensland Government recommends the Australian Senate Committee on Economics amend the Bill and/ or the Explanatory Memorandum to:

1. **ensure that no state is worse off in a single year, as opposed to over the course of the transition period, when comparing the current system to the updated system**
2. **strengthen the assurance that states will receive additional financial assistance based on** the Minister's satisfaction (rather than Minister's opinion) **with the objective advice from the Commonwealth Grants Commission and consultation with states**
3. **ensure that additional financial assistance is considered as other GST payments—in other words, untied by additional conditions and excluded from the Commonwealth** Grants Commission's revenue assessment
4. **in its inquiry in 2026-27, require the Productivity Commission to consider the future impact of the updated system, including if the pool top-up is sufficient to ensure that no state will be worse off in perpetuity**
5. **strengthen the assurance that neither the pool top-up or additional financial assistance will be to the detriment of other payments to states, including National Partnership payments and other government assistance**

6. **regarding administration of the Productivity Commission inquiry, require the Australian Government to:**
    - **consult all states and territories in developing the terms of reference for the Productivity Commission inquiry, and**
    - **upon completion in December 2026, immediately release the Productivity Commission Final Inquiry Report to the Council on Federal Financial Relations**
7. **if requested by states and territories, after consideration of the Productivity Commission Final Inquiry Report, negotiate amendments in good faith to legislation and the Intergovernmental Agreement on Federal Financial Relations so that no state is worse off under the updated system in perpetuity.**

2.0 Recommendations

1. ensure that no state is worse off in a single year, as opposed to over the course of the transition period, when comparing the current system to the updated system

The guarantee, as proposed in this legislation, will only ensure that no state is worse off over the course of the entire transition period. This means that a state could still be worse off in a single year—potentially causing great uncertainty in its budget.

Analysis in the Productivity Commission Final Inquiry Report into Horizontal Fiscal Equalisation showed that Queensland could be worse off under the equalisation to the stronger of NSW or Victoria by around $526 million in 2018-19 alone; that is $105 less per person. Looking forward, the scenarios provided by the Victoria Government demonstrate that Queensland could be up to a $1 billion worse off in a single year. While the proposed legislation attempts to address whether a state will be worse off over the period to 2026-2027, it still exposes state to the potential of substantial negative shocks in individual years. As noted, due to vertical fiscal imbalance states have limited ability to deal with such shocks.

For example, if Queensland receives less GST revenue under the updated system than the current system, the Australian Government will give the State additional financial assistance equal to the difference. If Queensland receives more GST revenue under the updated system than the current system, Queensland will keep the difference. However, keeping the difference is considered as 'credit'. If, in subsequent years, Queensland receives less revenue, the credit will be considered part of the additional financial assistance to be provided by the Australian Government. In other words, the guarantee only provides a no worse off guarantee over the whole transition period and not in any single year.

Adapting an example from the Explanatory Memorandum, Queensland will be $100 million worse off in 2023-24 even with the guarantee (refer Table 1 below). The potential losses would be much greater using Queensland's annual GST receipts of around $15 billion.

Table 1: Example of additional financial assistance paid to a state over the transition period

	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	Total
	($m)	($m)	($m)	($m)	($m)	($m)	($m)
Updated system	1100	1000	900	900	1000	1000	5900
Current system	1000	1000	1000	1000	1000	1000	6000
Difference	100	–	-100	-100	–	–	-100
Additional financial assistance	–	–	–	100	–	–	100
Total entitlement	1100	1000	900	1000	1000	1000	6000

Source: Based on October Explanatory Memorandum, Example 1.2

This creates uncertainty in the budget. States will be required to quarantine payments against the possibility that they will have reduced GST revenue in the years following. In the above example, to ensure a smooth transition, Queensland will need to quarantine funds from 2021-22 to make up for a deficit in 2023-24. At that time, it will not be known if a deficit will arise in the future (and therefore where there is a need to quarantine) and, if so, when it will arise or the likely quantum.

The Bill should be amended such that additional financial assistance does not accumulate as a credit. Instead, additional financial assistance should be reconciled on an annual basis. This will simplify payments and provide states with greater budget certainty.

2. strengthen the assurance that states will receive additional financial assistance based on the Minister's satisfaction (rather than Minister's opinion) with the objective advice from the Commonwealth Grants Commission and consultation with states

The Bill proposes a repeal and replacement of section 5 of Federal Financial Relations Act 2009 (Schedule 1, item 3) to provide a guarantee that each State and Territory will receive funding at least equal to the better of the current distribution system or the updated distribution system during the transition period.

As drafted the operation of the guarantee is dependent upon the Australian Treasurer forming an opinion (i.e. 'Minister's opinion') that grant entitlements under the updated system is less than the grant entitlements that would have been paid under the current system (proposed new section 5(3)). It is also noted that in forming the opinion, the Minister must consult with each state and have regard to any report of the Commonwealth Grants Commission that the Minister considers relevant (proposed new section 5(4)).

Notwithstanding proposed new section 5(4), the reference to the Minister's opinion as proposed in new section 5(3) makes the provision too subjective in its' application and could be argued as conferring an overly broad discretion to the Minister. Accordingly, the section should be amended to reflect a more objective test whereby the guarantee becomes operable where the Minister is 'reasonably satisfied' having regard to the matters in section 5(4) that grant entitlements under the updated distribution system is less than the grant entitlements that would have been paid under the current distribution system.'

3. ensure that additional financial assistance provided to implement the guarantee is considered as other GST payments—in other words, untied by additional conditions and excluded from the Commonwealth Grants Commission's revenue assessment

Any additional financial assistance provided to states to address the difference between the updated and current systems should be 'untied' and be excluded from the Commonwealth Grants Commission's considerations. An important feature of the GST revenue shared among states is that it is 'untied'. The untied nature of the GST funding acknowledges that one-size-fits all proscriptive funding from the Australian Government does not all allow the efficient administration of state governments. States may use this revenue however they need to—to build roads, schools, or deliver health or child safety services according to the state's particular needs at the particular time. The untied nature of this funding is critical to addressing the vertical

fiscal imbalance in a way which allows states to pursue its policy objectives and undertake essential reforms.

Similarly, it is important that this additional financial assistance is not considered in the Commonwealth Grants Commission's assessment of revenue, which sees above average **revenue redistributed among other states. If the payments are not treated as other GST payments and excluded from the assessment of revenue, any money provided by the guarantee** would be essentially redistributed away to other states in the subsequent years' GST **calculations. This would undermine the important stabilising impact of the guarantee and mean that states could be worse off under the arrangement compared with the counter-factual where the current legislation was not implemented.**

The Bill should be amended to require the relevant Minister to exclude the additional financial assistance from GST calculations in framing the terms of reference to the CGC.

4. in its inquiry, require the Productivity Commission to consider the future impact of the updated system, including if the pool top-up is sufficient to ensure that no state will be worse off in perpetuity

The Bill includes a guarantee that no state will be worse off under the updated system. To achieve this, the Australian Government will provide states with additional financial assistance equal to the difference between the current system and the updated system. However, the guarantee ends in 2026-27 and states could face a fiscal cliff if the guarantee is not continued in perpetuity.

Modelling by the Victorian Government shows that all states other than Western Australia could be significantly worse off under the updated system without significant additional financial assistance. For example, if states return to their 10-year average relativity, Queensland could be about $200 million to $600 million per annum worse off.

Importantly, the worst impacts in most of these models is found in the final year of the transition. According to the modelling, without a continuing guarantee Queensland would face a fiscal cliff of up to around a $1 billion after 2026-27 in some scenarios. This revenue shock is equivalent to around 3,000 teachers, 3,000 nurses, 2,000 police officers and 950 firefighters (based on average salaries in 2018-19). Such a change would be a difficult fiscal pressure for a state to adapt to and makes long term budgeting difficult.

The only states that would benefit are Western Australia and the Northern Territory. The Australian Government will need to provide $4.8 billion in pool top-up and additional financial assistance in 2026-27 alone. This is an increase of $3.7 billion from their current proposal. Without the guarantee, states will have to be prepared to find that amount from within their own budgets from 2027-28.

The Queensland Government acknowledges the challenges inherent in long-term forecasts and that the above scenario may not occur, but this applies equally to the Australian Government's **modelling where all states will be better off.**

The Bill requires the Productivity Commission to conduct an inquiry into updated system by 31 December 2026 to inform the Australian Government and state governments:

- **whether the changes are operating efficiently, effectively and as intended, and**
- **the fiscal implications for each state and territory.**

It is crucial that the inquiry also consider the future impact of the updated system, including if the pool top-up will be sufficient as legislated to ensure that no state will be worse off in perpetuity. To ensure that the inquiry reflects this requirement, the Bill (and the Explanatory Memorandum) should be updated.

5. strengthen the assurance that neither the pool top-up or additional financial assistance will be to the detriment of other payments to states

The Australian Treasurer gave assurances in his letter to the Deputy Premier and during the second reading in Parliament that the updated system will not be to the detriment of other payments to states. However, this is not reflected in the Bill or the Explanatory Memorandum.

Given the possibility of scenarios modelled by states, the Australian Government could be required to contribute billions of dollars to ensure that no state is worse off. This will put noteworthy pressure on the Australian Government's Budget, which may result in pressure on **other financial agreements with states.**

The Bill (and Explanatory Memorandum) should be amended to require that pool top-up and additional financial assistance will not come at the expense of other payments to the states. If this assurance is not provided in legislation other avenues should be explored including a resolution to be agreed with the states and ratified at COAG setting out the federal government's commitment on this issue. This will aid the Productivity Commission in **undertaking its inquiry.**

6. regarding administration of the Productivity Commission inquiry, require the Australian Government to consult all states and territories in developing the terms of reference for the Productivity Commission inquiry, and upon completion in December 2026, immediately release the Productivity Commission Final Inquiry Report to the Council on Federal Financial Relations

7. if requested by states and territories, after consideration of the Productivity Commission Final Inquiry Report, negotiate amendments in good faith to legislation and the Intergovernmental Agreement on Federal Financial Relations so that no state is worse off under the updated system.

As the jurisdictions most impacted by the updated system, states should be consulted in developing the terms of reference. The Bill should set out a number of additional terms of reference for the Productivity Commission inquiry.

These additional terms of reference should include;

- the impact of the current system on state governments' ability to support the provision of **services to indigenous, remote and regional communities**
- **the impact of the current system on enabling states to cater for population growth.**

Further, states relinquished significant revenue raising capabilities in the agreement to implement the GST. Any permanent changes to the system should also be by agreement. While the Bill will introduce changes without agreement, explicit involvement in the inquiry and negotiations and agreement on an updated system in 2026-27 should be embedded in the Bill and Explanatory Memorandum given the long term fiscal implications for states.

The Bill (and Explanatory Memorandum) should be amended to note:

- **the Australian Government will consult all states and territories in developing the terms of reference for the Inquiry**
- **upon completion, the Productivity Commission Final Inquiry Report will immediately be presented to the Council on Federal Financial Relations**
- **if requested by states and territories, the Australian Government will negotiate amendments to legislation and the Intergovernmental Agreement on Federal Financial Relations in good faith to ensure that no state is worse off under the updated system.**