

The Senate

Economics
Legislation Committee

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

November 2018

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ISBN 978-1-76010-857-1

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Printed by the Senate Printing Unit, Parliament House, Canberra.

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Chapter 1

Introduction

1.1 On 18 October 2018, the Senate referred the provisions of the Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018 to the Economics Legislation Committee for inquiry and report by 8 November 2018.¹

Overview of the bill

1.2 The bill amends the *Commonwealth Grants Commission Act 1973* and the *Federal Financial Relations Act 2009* to give effect to key elements of the government's interim response to the Productivity Commission's Inquiry Report, *Horizontal Fiscal Equalisation*.²

1.3 The key elements of the government's interim response include:

- transitioning the horizontal fiscal equalisation system from full equalisation (equalised to the strongest state or territory) to reasonable equalisation (equalised to the stronger of New South Wales and Victoria);
- introducing a minimum Goods and Services Tax (GST) revenue sharing relativity (GST relativity floor) that may be determined by the Treasurer for any individual State or Territory; and
- permanently boosting the GST revenue pool with additional Commonwealth financial assistance.³

1.4 The following elements of the government's interim response are given effect under existing laws:

- providing short-term transition payments to any state or territory with a GST revenue sharing relativity below a relativity factor of 0.7; and
- providing short-term transition payments to the Northern Territory if its GST revenue sharing relativity falls below its determined relativity factor for 2017–18.⁴

1.5 The bill introduces a guarantee that each state and territory will get the better of the current distribution system or the updated distribution system during the transition period.⁵

1 *Journals of the Senate*, No. 125, 18 October 2018, p. 3994.

2 Explanatory Memorandum, p. 3.

3 Explanatory Memorandum, p. 3.

4 Explanatory Memorandum, p. 3.

5 Explanatory Memorandum, p. 3.

1.6 In addition, the Productivity Commission will be required to conduct an inquiry at the end of the transition period to assess whether the updated system is operating efficiently, effectively and as intended.⁶

1.7 The additional funding, to be contributed by the Commonwealth to support the states and territories to transition to the new benchmark, is nearly \$9 billion over ten years.⁷

Conduct of the inquiry

1.8 The committee advertised the inquiry on its website. It also wrote to relevant stakeholders and interested parties inviting submissions by 24 October 2018. The committee received 13 submissions, which are listed at Appendix 1.

1.9 The committee held a public hearing in Canberra on 26 October 2018. The witnesses who appeared at the hearing are listed at Appendix 2.

1.10 The committee appreciates the efforts of all stakeholders who contributed to the inquiry.

Background

1.11 Since the GST was introduced in 2000, GST revenue has been distributed to the states and territories according to a system of horizontal fiscal equalisation (HFE). This GST distribution system worked in a relatively stable and predictable way in its early years, but the economic shocks of the last decade have resulted in a level of volatility that could not have reasonably been foreseen when the system was introduced. This volatility has reduced community confidence in Australia's HFE system and resulted in the government asking the Productivity Commission (PC) to undertake a thorough review of the strengths and weaknesses of the existing GST distribution arrangements.⁸

1.12 The PC concluded that the HFE system had deficiencies in the following areas:

- the system is not policy neutral which can deter states from improving the efficiency of their tax mixes or expanding their tax bases;
- too little weight is afforded to the importance of fairly rewarding states and territories for their policy efforts; and
- lack of transparency and accountability can lead to misinformation and undermine accountability for decisions and public confidence in the system.⁹

1.13 The PC recommended that, among other things, the objective of the HFE system should be refocused to provide the states and territories with the fiscal capacity

6 Explanatory Memorandum, p. 3.

7 Explanatory Memorandum, p. 7.

8 Explanatory Memorandum, pp. 6–7.

9 Productivity Commission, *Horizontal Fiscal Equalisation*, Inquiry Report No. 88, 15 May 2018, p. 18.

to provide services and associated infrastructure of a reasonable standard. The PC also examined a range of alternative equalisation benchmarks and noted none of these benchmarks is unambiguously superior and there is no 'right' balance before concluding that the HFE system should transition towards equalisation of the average (pre-GST) fiscal capacity of all states and territories, with the remaining GST revenue distributed on a per capita basis.¹⁰

1.14 The government's interim response proposed a plan to update the way the GST is distributed:

The Government's plan involves transitioning to a new HFE system over eight years from 2019–20 in a way that is fair, reasonable and sustainable and that would ensure all States [and Territories] are better off.¹¹

1.15 The plan announced by the government has three steps:

- short-term transition payments;
- phasing in a new HFE system; and
- completing the transition to a new, more stable equalisation standard.¹²

1.16 The bill under investigation enacts the government's transition plan.

Detailed explanation of the bill

Amendments to the Commonwealth Grants Commission Act 1973

1.17 The bill amends the *Commonwealth Grants Commission Act 1973* to require the Treasurer, when framing the terms of reference for a Commonwealth Grants Commission (CGC) inquiry, to pursue the objective of ensuring the states and territories each have the fiscal capacity to provide services at the same standard as the higher of New South Wales and Victoria—that is, the Treasurer is to set the equalisation standard to the stronger of New South Wales and Victoria.¹³

1.18 For the 2021–22 financial year and later financial years, the Treasurer must set the equalisation standard to the stronger of New South Wales' and Victoria's respective fiscal capacities when setting the terms of reference for the CGC's inquiry and report. The CGC will be required to set this as the standard when it makes its assessments using the HFE methodology.¹⁴

1.19 The bill transitions Australia's HFE system over a number of years in a fair, reasonable and sustainable way that would leave no state or territory worse off. To

10 Productivity Commission, *Horizontal Fiscal Equalisation*, Inquiry Report No. 88, 15 May 2018, pp. 18–32.

11 Australian Government, *Productivity Commission inquiry into horizontal fiscal equalisation: Government interim response*, July 2018, p. 16.

12 Australian Government, *Productivity Commission inquiry into horizontal fiscal equalisation: Government interim response*, July 2018, pp. 20–22.

13 Explanatory Memorandum, p. 13.

14 Explanatory Memorandum, p. 14.

give effect to the transition period for the adoption of the updated equalisation standard, the Treasurer is to frame the terms of reference for a financial year that occurs during the period 2021–22 to 2025–26, so as to require the CGC, to make necessary adjustments to its principles, categories and methods of assessment to make an appropriate and even transition from the old equalisation standard to the new equalisation standard.¹⁵

1.20 During the period 2021–22 to 2025–26, the terms of reference are to involve the CGC applying a methodology that uses both the old and updated HFE systems to recommend a new set of relativities that combine the results of both systems in the way set out in Table 1.¹⁶

Table 1: Methodology to transition to an updated HFE system

<i>Financial year</i>	<i>Transitional methodology</i>
2020-21	<i>old factor</i>
2021-22	$transition\ factor = \left(\frac{5}{6} \times old\ factor\right) + \left(\frac{1}{6} \times new\ factor\right)$
2022-23	$transition\ factor = \left(\frac{4}{6} \times old\ factor\right) + \left(\frac{2}{6} \times new\ factor\right)$
2023-24	$transition\ factor = \left(\frac{3}{6} \times old\ factor\right) + \left(\frac{3}{6} \times new\ factor\right)$
2024-25	$transition\ factor = \left(\frac{2}{6} \times old\ factor\right) + \left(\frac{4}{6} \times new\ factor\right)$
2025-26	$transition\ factor = \left(\frac{1}{6} \times old\ factor\right) + \left(\frac{5}{6} \times new\ factor\right)$
2026-27	<i>new factor</i>

Where: *old factor* means the relativity derived from the old HFE system; and *new factor* means the relativity derived from updated HFE system

Amendments to the Federal Financial Relations Act 2009

1.21 The bill amends the *Federal Financial Relations Act 2009* to introduce a 'minimum' or 'floor' in relation to the Treasurer's power to determine the GST revenue sharing relativity factor for particular states or territories for a financial year. The floor would initially be set at a relativity of 0.7, before moving up to 0.75. These floors are intended to be an additional safety net and, as such, are scheduled to come into effect at a time when the relativities of all states and territories are projected to be, and projected to remain, above these relativities.¹⁷

15 Explanatory Memorandum, p. 15.

16 Explanatory Memorandum, p. 16.

17 Explanatory Memorandum, p. 17.

1.22 In addition, the size of the annual funding pool from which GST grants are made will increase by incorporating into the annual pool amount calculation a 'pool top-up' which will be sourced from Commonwealth revenues not related to GST.¹⁸

1.23 An additional \$600 million will be placed in the GST distribution pool from 2021–22, the first years of transition to the new equalisation standard. This additional contribution will be indexed at the rate of growth of GST collections; that is, the expanded GST pool would continue to grow at the same rate as GST collections each year.¹⁹

1.24 In 2024–25, a further \$250 million will be added to the GST distribution pool and future Commonwealth contributions to the GST distribution pool will be indexed to grow in line with GST collections on a permanent basis.²⁰

1.25 In calculating indexation for a particular year, the amount of indexation cannot be less than zero and cannot be less than the amount of indexation included in the pool top-up from the immediately preceding year.²¹

1.26 The bill introduces a guarantee that each state and territory will get funding at least equal to the better of the current distribution system or the updated distribution system during the transition period. This is achieved by providing additional financial assistance if a state or territory's cumulative grant entitlements under the updated distribution system, calculated from the beginning of the transition period, is less than the entitlements they would have received under the current distribution system.²²

Review of the operation of the bill after enactment

1.27 The bill contains a requirement for the Treasurer to refer to the PC for inquiry, a review into the operation of the bill which would assess whether the updated distribution system is operating efficiently, effectively and as intended. In undertaking the inquiry, the PC would be required to focus on the fiscal implications for each state and territory arising from the updated HFE system and related reforms to the *Federal Financial Relations Act 2009*. The PC must complete its inquiry and provide its report to the Treasurer by 31 December 2026.²³

Compatibility with human rights

1.28 The bill is compatible with human rights as it does not raise any human rights issues.²⁴

18 Explanatory Memorandum, p. 17.

19 Explanatory Memorandum, pp. 17–18.

20 Explanatory Memorandum, p. 18.

21 Explanatory Memorandum, p. 18.

22 Explanatory Memorandum, p. 19.

23 Explanatory Memorandum, p. 20.

24 Explanatory Memorandum, p. 24.

Chapter 2

Views on the bill

General views on the bill

2.1 There was enthusiastic support for the proposed changes to the horizontal fiscal equalisation (HFE) system from the Western Australian Government.

The Western Australian Government strongly supports the passage of the Bill. The current GST distribution system is broken and needs to change.

...

While the Bill is expected to give Western Australia lower funding than the changes recommended by the Productivity Commission, Western Australia accepts the reforms as a reasonable and pragmatic response.¹

2.2 The Hon. Mark McGowan, Premier of Western Australia, provided a personal endorsement of the proposed changes:

...I do think that the outcome that has been reached, which is by necessity a compromise, is a good compromise and a reasonable compromise and ensures that no state is worse off. It does largely resolve the issues confronting Western Australia.²

2.3 Various bodies representing the business community also supported the proposed changes to the HFE system.³ For example, the Chamber of Commerce and Industry Western Australia (CCIWA) outlined some of the benefits from the proposed HFE system update:

Reforming the distribution formula of the GST is in the national interest and can stimulate national economic growth by strengthening development incentives for all states.

...

The proposed legislative change to equalise to the higher of New South Wales or Victoria will minimise the adverse effects of outlier outcomes, such as a mining boom, from the equalisation task. It will also restore Western Australia's incentive to develop its own economy.⁴

2.4 Mr Rick Newnham from CCIWA provided an interesting perspective:

There are really good reasons why we don't equalise everyone's personal income in Australia to the same point, because again, it removes the

1 Western Australian Government, *Submission 3*, pp. 1, 3.

2 The Hon. Mark McGowan, Premier of Western Australia, *Committee Hansard*, 26 October 2018, p. 20.

3 See also The Chamber of Minerals and Energy of Western Australia, *Submission 12*.

4 Chamber of Commerce and Industry Western Australia, *Submission 1*, [p. 2].

incentives for people to get out and have a go. For the same reasons, states shouldn't necessarily be equalised to exactly the same point...⁵

2.5 Similarly, the Minerals Council of Australia welcomed:

...the Federal Government's initiative to reform the GST distribution which has for some time not delivered an equitable share of funding to states that promoted economic growth through the development of their natural resources.⁶

2.6 Rio Tinto submitted that:

The legislation provides a more stable and predictable source of revenue for all States and Territories and helps ensure states that develop their natural resources are able to retain a greater share of the benefits.⁷

2.7 But less enthusiasm was forthcoming from other states for a change in GST distribution arrangements.

Tasmanian Government

The Tasmanian Government remains of the view that the current system of HFE is not 'broken' and that the PC did not make a convincing case that it needs changing.⁸

Northern Territory Government

The Northern Territory Government is a strong supporter of the current definition of Horizontal Fiscal Equalisation (HFE) and strongly rejects the view that the current system is broken.⁹

Victorian Government

Victoria considers the Commonwealth's proposal to be inequitable, as it moves away from the principle of giving each State the potential to fund government services to the same standard.¹⁰

Queensland Government

The Palaszczuk Government is a strong supporter of the current system of horizontal fiscal equalisation.¹¹

5 Mr Rick Newnham, Chamber of Commerce and Industry Western Australia, *Committee Hansard*, 26 October 2018, p. 32.

6 Minerals Council of Australia, *Submission 6*, [p. 1].

7 Rio Tinto, *Submission 11*, [p. 1].

8 Tasmanian Government, *Submission 2*, p. 2.

9 Northern Territory Government, *Submission 4*, [pp. 1–2].

10 Victorian Government, *Submission 5*, p. 3.

11 Queensland Government, *Submission 7*, p. 1.

Australian Capital Territory Government

The claim that the current equalisation system is broken has been made by a variety of commentators and political leaders. This view is not shared by the ACT Government.¹²

New South Wales Government

New South Wales has always played a key role in supporting the smaller states, however it is not responsible for funding states that receive revenue windfalls from its resources and then fail to plan for the future.¹³

South Australian Government

The South Australian Government has been a long standing supporter of the current objective of horizontal fiscal equalisation (HFE), which is to provide states and territories with the capacity to provide services and the associated infrastructure at the same standard...

In line with these views the South Australian Government's preferred position is that the current GST distribution arrangements are retained.¹⁴

2.8 Ms Kate Phipps from the Treasury drew attention to the fact that an extensive and independent review had been undertaken by the Productivity Commission (PC), which did find that while there was support for the principle of HFE there were advantages to moving to a new standard of equalisation, consistent with that contained in this bill:

As you would be aware, the Productivity Commission undertook a review of horizontal fiscal equalisation. The PC found that there was unanimous support for the principle of HFE across all jurisdictions and all states and territories, but the PC also recommended that there were advantages in moving to a standard of reasonable equalisation rather than full equalisation, and the changes that are implemented through this bill represent that change.¹⁵

2.9 One submission argued for a complete overhaul of the GST distribution system. The Institute of Public Affairs believed that equalisation should be abandoned as a policy objective:

In its place, the principles of decentralization and competitive federalism should be adopted. To unlock the benefits of competitive federalism, the states would require the power to set the rate of GST that applies in their respective jurisdictions, with an associated entitlement to claim the proportion of the GST that is attributable to that particular state.¹⁶

12 Australian Capital Territory Government, *Submission 8*, p. 2.

13 New South Wales Government, *Submission 9*, [p. 5].

14 South Australian Government, *Submission 10*, [p. 1].

15 Ms Kate Phipps, Treasury, *Committee Hansard*, 26 October 2018, p. 46.

16 Institute of Public Affairs, *Submission 13*, [p. 2].

Specific comments on the bill

Concerns about forecasts and alternative scenarios

2.10 Many state and territory governments raised how GST relativities are forecast. Mr David Martine from the Victorian Department of Treasury and Finance noted that:

It is important to understand that neither the Commonwealth nor the states forecast relativities past two years. Beyond that, forecasters formulate projections which generally assume a return to long-term trends...¹⁷

2.11 The Tasmanian Government provided its interpretation of the methodology adopted by the PC:

...the PC failed to take into account that relativities are generally very volatile. For this reason States generally do not forecast relativities beyond the Budget and Forward Estimates period and if they do, they are heavily caveated...

The PC has also assumed the States' relativities trend to their long term average at the end of the Forward Estimates period.¹⁸

...while projecting an increase in Western Australia's relativity, the PC has not projected a corresponding decline in other States' relativities. This outcome is not possible under the GST distribution methodology and the assumption would appear to distort the 'zero sum' outcome of the GST methodology where any financial distribution to one State must be offset by a redistribution away from other States.¹⁹

2.12 However, Mr Simon Atkinson from the Treasury confirmed the forecasts are based on ten year Budget projections, using relativities from the PC:

...our modelling of the government's proposal is outlined on page 21 of the government's interim response, and that's based on the PC's modelling, which is based on our central projection that underpins the Commonwealth budget and the 10-year forecasts as well.²⁰

2.13 A number of state governments noted that there are various feasible alternative scenarios, based on different assumptions, which would appear to indicate that the proposed changes to the GST distribution may be detrimental, rather than beneficial, to the fiscal position of some states.

2.14 Modelling undertaken by the Victorian Government illustrated that:

...most States could get less GST in future years compared to the current distribution method based on several scenarios. Therefore, the use of

17 Mr David Martine, Victorian Department of Treasury and Finance, *Committee Hansard*, 26 October 2018, p. 13.

18 Tasmanian Government, *Submission 2*, p. 3.

19 Tasmanian Government, *Submission 2*, p. 3.

20 Mr Simon Atkinson, Treasury, *Committee Hansard*, 26 October 2018, p. 46.

forecasts to determine the compensation required for States may still result in a negative financial outcome for an individual State.²¹

2.15 Similarly, the South Australian Government noted that:

Modelling undertaken by the states and territories shows that under different assumptions jurisdictions could be worse off as a result of the new arrangements with an overall reduction in GST revenue compared to what would have been delivered under the current arrangements.²²

2.16 While acknowledging that the relativities presented in the Australian Government's policy response to the PC report were not fixed, Mr Simon Atkinson from Treasury noted that:

...if you fundamentally change the relativities you actually need to understand what economic circumstances would have driven those and calculate through the other side of the equation.²³

2.17 Hence, in relation to the alternative scenarios modelled by the states:

The challenge with those scenarios is that they just deal with relativities. They don't model the full range of economic parameters that would need to shift to create those relativities and the flow-through that that would mean to the GST pool, which is fairly fundamental in the calculation to how much funding each state gets.²⁴

No worse off guarantee

2.18 With such a significant proposed change to the GST distribution system, Mr David Martine outlined the position of those states and territories that would not be unambiguously better off under the updated HFE system:

...the challenge for most states and territories has been to ensure that we receive at least as much GST going forward under the proposed new methodology as we would under the current system.²⁵

2.19 While welcoming the insertion of the 'no worse off' guarantee into the bill, the Victorian, Tasmanian, Australian Capital Territory and Northern Territory Governments advocated for the extension of the guarantee in perpetuity.²⁶

2.20 The Victorian Department of Treasury and Finance undertook analysis of the proposed update to the HFE system and concluded that:

21 Victorian Government, *Submission 5*, p. 3.

22 South Australian Government, *Submission 10*, [pp. 1–2].

23 Mr Simon Atkinson, Treasury, *Committee Hansard*, 26 October 2018, p. 46.

24 Mr Simon Atkinson, Treasury, *Committee Hansard*, 26 October 2018, p. 46.

25 Mr David Martine, Victorian Department of Treasury and Finance, *Committee Hansard*, 26 October 2018, p. 13.

26 Tasmanian Government, *Submission 2*, p. 5; Northern Territory Government, *Submission 4*, p. 8; Victorian Government, *Submission 5*, p. 4; ACT Government, *Submission 8*, p. 3.

...without a guarantee that is enforced in perpetuity, as a result of enacting the Bill most States may be financially worse off beyond the transition period, possibly substantially so.²⁷

2.21 Noting the Australian Government's reluctance to provide a guarantee beyond 2026–27, Mr Martine argued that:

...part of the policy rationale by the Commonwealth in making this change...is that they make the statement that the original architects of the GST distribution system could not have envisaged GST relativities changing so much over a period of time...In that world, it is a bit hard to accept a proposition that the architects of the new system can be so certain that the GST relativities can be projected for the next eight years, 10 years, and even 20 years. That's why the ongoing guarantee is important.

...

If the Commonwealth wants to make this change and say it is not going to affect anyone, then the guarantee should be in perpetuity.²⁸

2.22 Concerns were also raised about the cumulative nature of the guarantee. The Northern Territory and Queensland advocated for the guarantee to be applied to single years, rather than over the entire transition period as outlined in the bill.²⁹

2.23 The New South Wales Government submitted that transparency of the operation of the guarantee would be welcome:

This could include publication by the CGC [Commonwealth Grants Commission] of the old and new relativities directly after they have produced them rather than waiting for the Commonwealth Treasurer's permission for those to be released.³⁰

2.24 Mr Martine echoed these sentiments on behalf of the Victorian Government:

Our view would be that transparency and visibility are really important. There's nothing in the legislation that actually says that the CGC's calculations of the old system would be made available to the states, or even made public. So, transparency is very important, along with a stronger role for the CGC to be determining what additional amounts would be to honour the guarantee commitment in the legislation.³¹

2.25 In response to the concerns about transparency, Mr Chris Leggett from Treasury noted that:

27 Victorian Government, *Submission 5*, p. 4.

28 Mr David Martine, Victorian Department of Treasury and Finance, *Committee Hansard*, 26 October 2018, p. 15.

29 Northern Territory Government, *Submission 4*, p. 8.

30 Mrs Natalie Horvat, New South Wales Treasury, *Committee Hansard*, 26 October 2018, p. 8.

31 Mr David Martine, Victorian Department of Treasury and Finance, *Committee Hansard*, 26 October 2018, p. 17.

Section 25 of the Commonwealth Grants Commission Act, requires Commonwealth Grants Commission reports to be tabled in both houses of Parliament and, at that point, they all become publicly available.³²

2.26 However, not all stakeholders considered that a 'no worse off' guarantee was required. For example, CCIWA did not believe that the guarantee was necessary and could be a costly drain on the federal budget:

The proposed legislative guarantee could prove to be an expensive liability for the Commonwealth Government. In effect, it transfers the risk of a diminished GST share away from the leading state other than New South Wales and Victoria (currently Western Australia) to the Commonwealth Government in the instance of an outlier event, such as another mining royalty boom for Western Australia.³³

Discretion afforded to the Treasurer

2.27 A number of states, including New South Wales, raised concerns about the scope of ministerial discretion in decision making.³⁴

2.28 The Victorian Government noted that the proposed legislation:

...gives the Treasurer significant discretion in determining whether a State is to receive a payment under the no worse off guarantee. In particular:

- an assessment of the GST that a State would have otherwise been entitled to if the Bill had not been enacted, is based on 'the Minister's opinion'; and
- in forming this opinion, the Minister must only 'have regard to any report of the Commonwealth Grants Commission that the Minister considers relevant'.³⁵

2.29 Similarly, the Queensland Government was concerned that the discretion afforded to the Minister's opinion was too subjective in its application and should be replaced by a more objective test where the Minister is 'reasonably satisfied'.³⁶

2.30 However, the Australian Capital Territory Government viewed the approach taken by the bill 'as a sound and practical way of implementing the Commonwealth's 'no worse off' commitment'.³⁷

2.31 Mr Chris Leggett from the Treasury gave a comprehensive response to allay the concerns raised by the states:

I think we would say it's perhaps incorrect to characterise the description 'in the minister's opinion' as giving the minister a discretion. It's consistent with the drafting of the bill and its current framework in the Federal Financial Relations Act, which gives the Treasurer the sole responsibility

32 Mr Chris Leggett, Treasury, *Committee Hansard*, 26 October 2018, p. 52.

33 Chamber of Commerce and Industry Western Australia, *Submission 1*, [p. 2].

34 New South Wales Government, *Submission 9*, [p. 6].

35 Victorian Government, *Submission 5*, pp. 4–5.

36 Queensland Government, *Submission 7*, p. 4.

37 Australian Capital Territory Government, *Submission 8*, p. 4.

for making decisions and determining entitlements under the act. The wording that we've chosen, which is 'in the minister's opinion', is a very common drafting technique at the Commonwealth level—for example, one of the income tax assessment acts uses the term over 150 times to describe actions by the Commissioner of Taxation.

We use that in situations where the decision-maker is making a decision under an act that has to weigh a number of competing factors; where they have to make assumptions about facts they aren't aware of or can't get information on; or to determine an outcome in a hypothetical scenario. The last particular case is the one here, which is, with the no-worse-off guarantee, the Treasurer, as the decision-maker, has to determine what he would have done in the hypothetical world of not passing this act. Only the Treasurer is in the position to know what he may have done in the hypothetical world of not passing this act. Only really the Treasurer is in a position to know what he may have done in that particular hypothetical world.

That said, the technique doesn't provide discretion in the sense that the states have used it. The Treasurer can't just decide not to provide or to calculate any random number. His actions have to be consistent with parliament's clear intention as set out in the bill and explanatory materials, and he has to do so, having regard to the advice from the Commonwealth Grants Commission, from us and from the states and territories as part of his consultation arrangements. His actions have to be considered reasonable from the court's position.³⁸

Review of the updated HFE system

2.32 Stakeholders generally welcomed the proposed review of the updated system by 2026. The ACT Government supported an independent review of the new system once it is fully operational.³⁹

2.33 Similarly, Rio Tinto believed the review to be:

...the appropriate place to consider any further reforms that may be required to support states in the development of their natural resources and embed incentives in the GST system to encourage economic development.⁴⁰

2.34 However, several state and territory governments expressed reservations about the proposed review of the HFE system by the PC.

2.35 The Victorian Government considered the aims of the proposed PC review to be unclear given that 'intent' is not defined, nor how 'efficiently' and 'effectively' will be measured. Further, it questioned the value of the PC review as no indication was

38 Mr Chris Leggett, Treasury, *Committee Hansard*, 26 October 2018, p. 47.

39 Australian Capital Territory Government, *Submission 8*, p. 4.

40 Rio Tinto, *Submission 11*, [p. 2].

given of how the recommendations of the PC's report would be applied by the Treasurer.⁴¹ Similar concerns were expressed by the New South Wales Government.⁴²

2.36 The Northern Territory Government considered that:

The Commonwealth Government should waive its right to hold the PC inquiry final report for 25 sitting days, instead releasing the report immediately to the states to ensure any future negotiations around the HFE system are conducted in a prompt manner.⁴³

2.37 Likewise, the Queensland Government called for the final inquiry report from the 2026 PC inquiry to be presented to the Council of Federal Financial Relations immediately on its completion.⁴⁴

2.38 The Tasmanian Government provided the most pointed comments on this issue to argue that the PC should not undertake the review at all:

Notwithstanding that the PC was unable to demonstrate that the current system was detrimental to national productivity, efficiency or growth, it recommended a broad ranging suite of reforms that would benefit one State at the expense of all other States.

Given its demonstrated knowledge and evidence-based approach, the Tasmanian Government considers that the CGC is better placed to undertake the review proposed to be undertaken by the PC...⁴⁵

2.39 The Minerals Council of Australia recommended that the PC review be brought forward to align with the Commonwealth Grants Commission's major update of distribution methods that is scheduled for 2025.⁴⁶

Committee view

2.40 Australia's system of horizontal fiscal equalisation provides an important source of revenue to the states and territories. While the HFE system works relatively well, it can deliver perverse outcomes that discourage states and territories from reforming their tax bases and pursuing some policies that could boost economic growth.

2.41 Given the GST distribution system has not been updated since it was introduced in 2000, the committee welcomes the transition to a new GST distribution system as outlined in the bill. The system will continue to provide Australians with access to vital government services no matter where they live, but also provide states and territories with incentives to undertake reform and foster economic growth. The committee notes that the Australian Government will inject an additional \$9 billion in

41 Victorian Government, *Submission 5*, p. 5.

42 New South Wales Government, *Submission 9*, [p. 6].

43 Northern Territory Government, *Submission 4*, p. 9.

44 Queensland Government, *Submission 7*, p. 7.

45 Tasmanian Government, *Submission 2*, p. 5.

46 Minerals Council of Australia, *Submission 6*, [p. 1].

untied funding to the GST pool over the next ten years, and that this will not come at the expense of existing payments to the states.

2.42 The committee acknowledges the concerns raised by the states and territories regarding the implementation of the updated HFE system but considers that the 'no worse off' guarantee provides a safety net during the transition period. Further, the legislated inclusion of a completed Productivity Commission inquiry by December 2026 gives all stakeholders an opportunity to reflect on the updated HFE system and argue for ongoing improvements following the transition period.

Recommendation 1

2.43 The committee recommends that the bill be passed.

Senator Jane Hume
Chair

Additional Comments from Labor Senators

1.1 Labor Senators support the bill and note concerns raised by some State and Territory Governments through the inquiry process.

1.2 Federal Labor has consistently led the way in arguing for GST distribution reforms that address the needs of Western Australia while also preserving much needed funding across the other jurisdictions.

Federal Labor has led the way on this debate

1.3 While the Turnbull and Morrison Governments have been idle on real action on GST, Federal Labor has been on the leading edge. Federal Labor's announcements have been considered, prudent and thoughtful; reflecting a stable party that is ready to govern for all Australians.

1.4 The first origins of this bill go back to August 2016—when former Prime Minister Malcolm Turnbull first floated the idea of a GST floor at the WA State Liberal conference in the lead up to the state election. The announcement was met with widespread concern from both Liberal and Labor State Governments.¹

1.5 Furthermore, it took until April 2017, after the WA State election in March 2017, for former Treasurer Scott Morrison to not announce action, but the start of a Productivity Commission review which would take the best part of a year.²

1.6 While the Turnbull Government was preoccupied with its own instability, Federal Labor led the debate by announcing the *Fair Share for WA Fund*. Federal Labor did not stand by and watch as the WA economy struggled under the weight of years of mismanagement by the former Liberal Barnett State Government, debt blowouts and a constrained investment environment.

1.7 This fund was designed to bring Western Australia up to the equivalent of 70 cents in the GST dollar from 1 July 2019, based on relativities at the time. At the time of the announcement, it was the first time that a Federal Government or Opposition had put forward a tangible policy response to what had been long acknowledged as a problem with WA's share of GST revenue.

1.8 This policy was also designed with other States and Territories in mind. The fund was structured so that other States and Territories would not see any reduction in their GST funding. In terms of funding this policy, Labor was able to make this investment as a result of policy announcements that make our tax system fairer and improve the budget position, including reforms to negative gearing and capital gains

1 AAP, *States angered by Turnbull's pledge to lift Western Australia's GST take*, 15 August 2016, accessed via: <https://www.theguardian.com/australia-news/2016/aug/14/malcolm-turnbull-commits-to-lifting-western-australias-share-of-gst>

2 The Hon Scott Morrison MP, *Productivity Commission to review economic impact of horizontal fiscal equalisation*, 30 April 2017, accessed via: <http://sjm.ministers.treasury.gov.au/media-release/039-2017/>

tax concessions, closing loopholes for multinationals, and limiting tax minimisation through incoming splitting from discretionary trusts.

1.9 While Federal Labor was on the front foot announcing this policy, the former Treasurer's primary response to Labor's announcement was to question how the policy was going to be paid for:

Now, Bill Shorten didn't promise to fix GST relativity, he just promised to spend more money and has no idea where it is going to come from which will mean more taxes for the Australian people but particularly in Western Australia. Labor's \$150 billion and more in higher taxes, if they are ever to occupy the government benches, will hit Western Australians hard.³

1.10 Labor Senators find it curious that the former Treasurer, in announcing the proposed GST package on 5 July 2018, failed to live up to his own standards and provide details on how his policy was going to be paid for. State Governments are also concerned about other funding arrangements being at risk due to this policy change, and this issue will be covered later in these additional comments.

1.11 It took questioning from Labor Senators to confirm that the details of how this policy will be paid for will be released through the MYEFO process later this year:

The government will announce its full economic position and offsetting and the detail of spending that's announced prior to MYEFO, in the MYEFO process.⁴

1.12 With regards to the policy of a legislated floor for GST relativities, Opposition Leader The Hon Bill Shorten MP on 29 August 2018 announced that Federal Labor's position would be to enshrine a floor in legislation:

What Labor will do is that we will support what the Government has said, but what we will also do is we will legislate it within our first hundred days. That's a floor of 70 cents, from 19/20 and we will lift that floor to 75 cents, 2024/25. We will also make sure that this funding is untied. Obviously, we will consult with the Western Australian Government and we'll have a view about things but this is going to be genuinely, a call for Western Australia.⁵

1.13 It took until 1 October 2018 for the Morrison Government to come on board with this proposal⁶, despite the current Prime Minister saying in July 2018 that 'there's no need to do that'.⁷

3 The Hon Scott Morrison MP, *Interview with Sabra Lane, ABC AM*, 28 August 2017, accessed via: <http://sjm.ministers.treasury.gov.au/transcript/162-2017/>

4 Mr Simon Atkinson, *Committee Hansard*, p. 51.

5 The Hon. Bill Shorten MP, *Transcript*, Wednesday 29th August 2018, accessed via: http://www.billshorten.com.au/bill_shorten_transcript_doorstop_perth_wednesday_29_august_2018

6 The Hon. Scott Morrison MP, *Legislating a Fairer Way to Distribute the GST*, 1 October 2018, accessed via <https://www.pm.gov.au/media/legislating-fairer-way-distribute-gst>

7 The Hon. Scott Morrison MP, Press Conference, Canberra, 5 July 2018, accessed via <http://sjm.ministers.treasury.gov.au/transcript/140-2018/>

1.14 Federal Labor has also been on the front foot calling for a 'no State worse off guarantee' in legislation:

Labor's approach on the GST is that West Australia has been unfairly treated, but what we also want to make sure that is that no state is worse off.

Labor has led the debate on improving the GST outcomes for Western Australia and we've also then said that the floor of 75 cents should be legislated. Now the Government's appropriately picked that up, but I just say to the Government, let's not play any silly games here.

I don't want to see Tasmania, Queensland, any of the other states—Northern Territory—disadvantaged because the Government is trying to chase a few votes in Western Australia. We are able to resolve making sure that no state gets unfairly treated in GST distribution but it shouldn't be at the price of any other state.⁸

1.15 The current Treasurer's reply to this was that the public service administrative burden would be too high:

Because what some of the states are wanting us to do is to run two parallel systems. They're wanting us to run an old set of books based on what is the current system and a new set of books, which is based on the new system with the floor and the additional \$9 billion.⁹

1.16 This position only lasted just over a week, where the Government decided to legislate the guarantee on 16 October, after the current Prime Minister and Treasurer united all State and Territory Governments against them by refusing to include an amendment that no State or Territory would be worse off:

From NSW Liberal Treasurer, Dominic Perrottet:

What I don't accept is change in the GST model which will make states worse off. We believe this legislation will do just that.

That's why every treasurer from every state and territory across the country today (is) united in our view that if this legislation is to be passed, there needs to be an amendment to ensure in law that no state or territory will be worse off as a result of this change.¹⁰

1.17 During the inquiry process, Western Australian Premier Mark McGowan endorsed the view that Federal Labor's announcements were game changers in the process:

8 The Hon. Bill Shorten MP, *Doorstop—Melbourne*, 2 October 2018, accessed via: http://www.billshorten.com.au/doorstop_melbourne_tuesday_2_october_2018

9 The Hon. Josh Frydenberg MP, *Interview with David Speers, Speers on Sunday, Sky News*, 7 October 2018, accessed via: <http://jaf.ministers.treasury.gov.au/transcript/035-2018/>

10 The Hon. Chris Bowen MP, *BRAVO: FRYDENBERG'S FIRST FED-STATE FORAY UNITES ALL STATES AND TERRITORIES AGAINST HIM*, 4 October 2018, accessed via: <https://www.chrisbowen.net/media-releases/bravo-frydenberg-s-first-fed-state-foray-unites-all-states-and-territories-against-him/>

Senator KETTER: Thank you very much, Mr McGowan, for appearing before us. You acknowledged, in your opening statement, the significance of the federal opposition in reaching the outcome that we have today. I just want you to reflect on that. How important was it that the opposition put up the Fair Share for WA fund and called for the GST floor to be put in the legislation?

Mr McGowan: Very important. I'd like to thank the federal opposition, Bill Shorten, for understanding the interests of Western Australia and for taking the case up. A few years ago, he put forward the policy of the Fair Share for Western Australia fund, recognising the fact that we were at 30c in the dollar. I think he recognised the deep levels of anger and anguish in Western Australia that perhaps weren't appreciated in the eastern states more broadly. The floor, of course, is the second component of it. They were both important milestones along the way to this significant achievement.

Senator KETTER: Would you say they were game-changers in the process?

Mr McGowan: A game-changer in the process is a great way of putting it. Thank you.¹¹

1.18 The evidence makes it clear that only Federal Labor has been able to provide the stable, thoughtful leadership required to address the fairness of WA's funding arrangements while also ensuring every other State and Territory receives the funding they need to provide services in areas such as education and health.

Concerns raised by State and Territory Governments

1.19 Through this inquiry, State and Territory Governments have raised a number of concerns about how this legislation is constructed. First, the top-up Commonwealth funding is based on a central case forecast that has a high degree of variability. As demonstrated by evidence provided by the Victorian Government, even small changes in assumptions might leave different State and Territory Governments worse off beyond the 2026-27 transition period. Secondly, concerns remain about how the Commonwealth will be funding the top-up payments and whether this top-up funding will be at the expense of other funding arrangements. Remaining issues raised include the transparency in the Commonwealth Grants Commission's work and the details behind the future Productivity Commission review to be held at the end of the transition period.

1.20 Many State and Territory Treasury departments undertook scenario analysis. The Victorian Government took the lead on much of this work and demonstrated that many States could well find themselves worse off after the transition period:

The Victorian Department of Treasury and Finance (DTF) undertook research to demonstrate that forecasts of relativities are likely to vary from actual relativities. The analysis undertaken shows that most States could get less GST in future years compared to the current distribution method based

11 *Committee Hansard*, pp. 22–23.

on several scenarios. Therefore, the use of forecasts to determine the compensation required for States may still result in a negative financial outcome for an individual State.

This work was independently verified by Deloitte Access Economics (Deloitte) who found that alternative scenarios could see some States worse off in dollar terms under the proposed HFE system. The Deloitte report (attached) noted the Commonwealth's modelling is based on comparing the outcomes for each State under a 'central case' set of projections. Under that set of projections, the Commonwealth's proposed system would leave no State 'worse off'. Deloitte observed that this approach does not account for the significant uncertainty surrounding this central case due to that inherent uncertainty in forecasting, which increases over time.¹²

1.21 State and Territory Governments also expressed concern that Commonwealth top-up funding might come at the expense of cuts to other funding arrangements. While a letter from the Federal Treasurer to State and Territory Governments stated that *'any additional financial assistance referred to in the bill will not be offset or partially offset by a decrease in other grant funding to the states'*¹³, States and Territories still had remaining concerns.

1.22 Australian Capital Territory Government Treasury officials stated that:

We have certainly had discussions with the Commonwealth that those top-up funds should not be at the expense of other grants to the states and territories. And I think that's an important principle. It's very difficult to assess that, however, because a budget is a living process and changes are made over time, but the Commonwealth has said that it's their commitment that that would not happen. We accept that commitment.¹⁴

1.23 New South Wales Treasury officials:

Certainly the New South Wales government was concerned that, obviously, it might come from grants paid to states and territories. But the Commonwealth Treasurer has assured us that that won't be the case.¹⁵

1.24 Victorian Treasury officials:

Mr Martine: That has been a concern raised by all of the state and territory treasurers, and assurances have been sought from the Commonwealth Treasurer. At this stage they've been provided in the form of a letter from the Commonwealth Treasurer. I will just quote the letter, 'I wish to confirm that any additional financial assistance referred to in the bill will not be offset or partially offset by a decrease in other grant funding to the states.' The assurances have come in the form of a letter. It's always a very difficult

12 Victoria State Government, *Submission 5*, p. 3.

13 Mr Stuart Hocking, *Committee Hansard*, p. 28.

14 Mr David Nicol, *Committee Hansard*, p. 5.

15 Mrs Natalie Horvat, *Committee Hansard*, p. 10.

thing to verify, of course, because changes can be made for all sorts of different reasons.¹⁶

1.25 South Australian Treasury officials:

The other major issue for us is to ensure that, by virtue of the top-up funding provided by the Commonwealth government, the government doesn't reduce other funding to the states through tied payments, et cetera, and that we receive a commitment to that effect. The federal Treasurer, in his letter to the state Treasurer, made that commitment, and verbally, and our Treasurer has written back to him welcoming that commitment as well as arguing the case for an ongoing no-worse-off guarantee.¹⁷

1.26 Northern Territory Treasury officials:

Mr Graham: Yes, being called back. We share the views of other states in that respect. There have been undertakings made in writing that they would not be offset by reductions in other sources of funding.

Senator KETTER: So the letter from the Treasurer is what you received?

Mr Graham: Yes.

Senator KETTER: Would you like that guarantee to be included in the legislation?

Mr Graham: As a principle, I think so. I understand some of the concerns that have been raised around how you would ensure compliance with that, but I think, as a principle and as a safeguard, it should be enshrined in the legislation.¹⁸

1.27 The Queensland Government stated in its submission that:

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 to the issue.¹⁹

1.28 The nature of the funding supporting the top up payments was also made all the more confusing when, on 1 October, in the lead up to the Council of Federal Financial Relations meeting, the new Treasurer failed to explain how these top up payments would be paid for:

HAMISH MACDONALD, PRESENTER: You're allocating a lot more money. Billions more. Where does the money coming from?

FRYDENBERG: It comes from the Government's budget and we have made an allocation for this increased money, not just for Western Australia

16 Mr David Martine, *Committee Hansard*, p. 16.

17 Mr Stuart Hocking, *Committee Hansard*, p. 26.

18 Mr Craig Graham, *Committee Hansard*, p. 38.

19 Queensland Government, *Submission 7*, p. 6.

but for all of states and territories. All states and territories will be better off as a result of these reforms.

...

MACDONALD: \$9 billion is that the amount that you have to set aside? Where does that actually come from? Where do you cut it from?

FRYDENBERG: We are obviously ensuring that we have fiscal discipline, and as you know, the Australian economy is growing at the fastest rate since the height of the mining boom in 2012

MACDONALD: So the money has to come from somewhere. Can't you give us a simple explanation of where you're getting \$9 billion from?

FRYDENBERG: There has been improvements on both the receipt side and the payments. Receipts because more people are in jobs creating over 1,000 jobs a day. But also, less payments, particularly in the welfare space as more people find jobs and don't need the additional income support.

MACDONALD: So nothing is being cut from anywhere? Just better receipts?

FRYDENBERG: We have budget rules which we're sticking to...

MACDONALD: So where do the cuts come from? Let's be honest about this?

FRYDENBERG: Hamish, let's be honest. The Australian economy is growing and we've seen improvements on receipts side, but we've also seen lower payments. The last time that the Labor Party delivered a budget surplus, the Berlin Wall was still standing.²⁰

1.29 Federal Labor will hold the Morrison Government to account on its commitment to not cut other funding to States and Territories and will scrutinise the MYEFO budget update to determine how the Morrison Government will be offsetting these top-up payments. Labor Senators are of the view that the letter from the Federal Treasurer to the State and Territory Treasurers should be tabled during the Parliamentary debate so that the Government's commitment to this issue can be strengthened.

1.30 States and Territories also called for greater transparency in how the comparisons of the current HFE model and the proposed HFE model operated:

Transparency of the 'no worse off' guarantee would also be welcome. This could include publication by the CGC of the old and new relativities directly after they have produced them rather than waiting for the Commonwealth Treasurer's permission for those to be released. We would like the bill to strengthen these requirements.²¹

1.31 In response, Treasury officials stated that:

20 The Hon Josh Frydenberg MP, Interview with Hamish Macdonald, News Breakfast, ABC TV, 1 October 2018, accessed via <http://jaf.ministers.treasury.gov.au/transcript/021-2018/>

21 Mrs Natalie Horvat, *Committee Hansard*, p. 8.

I did note this morning that the states and territories said that there should be an obligation in the law for Commonwealth Grants Commission reports to be made publicly available and made to the government. Section 25 of the Commonwealth Grants Commission Act requires Commonwealth Grants Commission reports to be tabled in both houses of parliament and, at that point, they all become made publicly available.²²

1.32 Finally, concerns were raised that there should be greater detail about the nature of the Productivity Commission review to be held. For instance, the Acting Deputy Under Treasurer for the Queensland Government stated that:

In terms of the Productivity Commission inquiry, we also want some clarity around them actually looking at what happens beyond 2026—that needs to be clearly identified; the states to be consulted on the terms of reference and the findings; and the states and territories to work with the Australian government to agree any consequential decisions that are made out of that PC inquiry. The Queensland government's submission articulates those particular issues in more detail and the proposals that we have in terms of addressing those particular concerns.²³

1.33 Labor Senators share the concerns of the States and Territories about the lack of detail provided about how the Commonwealth will be paying for the top-up funding. Labor Senators note the remaining concerns and will take these into account through the remaining legislative process.

Conclusion

1.34 Federal Labor has led the way in the GST debate. It is clear that Federal Labor's calls for a GST floor, for this floor to be legislated and that the 'no state worse off' guarantee be legislated have had a very material impact on the Government's actions and this legislation.

Recommendation 1

1.35 That the letter from the Federal Treasurer to the State and Territory Treasurers stating that 'any additional financial assistance referred to in the bill will not be offset or partially offset by a decrease in other grant funding to the states' be tabled during the Parliamentary debate.

Senator Chris Ketter
Deputy Chair

Senator Jenny McAllister
Senator for New South Wales

22 Mr Chris Leggett, *Committee Hansard*, p. 46.

23 Ms Maryanne Kelly, *Committee Hansard*, p. 40.

Appendix 1

Submissions and additional documents

Submissions

1. Chamber of Commerce and Industry WA (CCIWA)
2. TAS Government
3. WA Government
4. NT Government
5. VIC Government
6. Minerals Council of Australia
7. QLD Government
8. ACT Government
9. NSW Government
10. SA Government
11. Rio Tinto
12. The Chamber of Minerals and Energy of Western Australia
13. Institute of Public Affairs

Answers to questions on notice

1. VIC Government: Answers to questions taken on notice at a public hearing in Canberra on 26 October 2018 (received on 29 October 2018).
2. QLD Government: Answers to questions taken on notice at a public hearing in Canberra on 26 October 2018 (received on 31 October 2018).
3. SA Government: Answers to questions taken on notice at a public hearing in Canberra on 26 October 2018 (received on 31 October 2018).
4. Department of Treasury: Answers to questions taken on notice at a public hearing in Canberra on 26 October 2018 (received on 6 November 2018).

Appendix 2

Public hearings

Canberra, 26 October 2018

Members in attendance: Senators Abetz, Bushby, Hume, Ketter, Lines, and Dean Smith.

ATKINSON, Mr Simon, Deputy Secretary, Fiscal Group, The Treasury

BARNES, Mr Michael, Under Treasurer, Department of Treasury, Western Australia

BRAINER-MEAD, Mr David, Deputy Under Treasurer, Department of Treasury and Finance, Northern Territory

FARRER, Mr Roger, Senior Analyst, Department of Treasury and Finance, Victoria

GRAHAM, Mr Craig, Under Treasurer, Department of Treasury and Finance, Northern Territory

GRANT, Mrs Georgina, Director, Intergovernmental Relations, Department of Treasury and Finance, Victoria

HOCKING, Mr Stuart, Deputy Chief Executive, Department of Treasury and Finance, South Australian Government

HORVAT, Ms Natalie, Acting Deputy Secretary, Economic and Financial Management Group, Treasury, New South Wales

KELLY, Ms Maryanne, Acting Deputy Under Treasurer, Queensland Treasury

LEGGETT, Mr Chris, Principal Adviser, Law Design Office, The Treasury

MARTINE, Mr David, Secretary, Department of Treasury and Finance, Victoria

McGOWAN, the Hon. Mark, Premier, Western Australian Parliament

MINERS, Mr Stephen, Deputy Under Treasurer, Treasury, Australian Capital Territory

NEWNHAM, Mr Rick, Chief Economist, Chamber of Commerce and Industry WA

NICOL, Mr David, Under Treasurer, Treasury, Australian Capital Territory

PHIPPS, Ms Kate, Division Head, Commonwealth-State Relations Division, Fiscal Group, The Treasury

RAYMOND, Mr Greg, Director, Revenue and Intergovernmental Relations, Department of Treasury and Finance, South Australian Government

WHEELER, Ms Andree, Director, Director, Intergovernmental Relations, Treasury, New South Wales

