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SELECT COMMITTEE ON THE SCRUTINY OF NEW TAXES

Reference: Mining taxes

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SENATE SELECT COMMITTEE ON

SCRUTINY OF NEW TAXES

Thursday, 9 December 2010

Members: Senator Cormann (Chair), Senator Hutchins (Deputy Chair) and Senators Bushby, Cameron, Fifield and Williams

Senators in attendance: Senators Cameron and Cormann

Participating members: Senators Abetz, Adams, Back, Barnett, Bernardi, Bilyk, Birmingham, Mark Bishop, Boswell, Boyce, Brandis, Carol Brown, Cash, Colbeck, Coonan, Crossin, Eggleston, Faulkner, Ferguson, Fielding, Fierravanti-Wells, Fisher, Forshaw, Furner, Heffernan, Humphries, Hurley, Johnston, Joyce, Ian Macdonald, McEwen, McGauran, Marshall, Mason, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Pratt, Ronaldson, Ryan, Scullion, Stephens, Sterle, Troeth and Wortley

Terms of reference for the inquiry:

To inquire into and report on:

(a) new taxes proposed for Australia, including:

- (i) the minerals resource rent tax and expanded petroleum resource rent tax,
- (ii) a carbon tax, or any other mechanism to put a price on carbon, and
- (iii) any other new taxes proposed by Government, including significant changes to existing tax arrangements;

(b) the short and long term impact of those new taxes on the economy, industry, trade, jobs, investment, the cost of living, electricity prices and the Federation;

(c) estimated revenue from those new taxes and any related spending commitments;

(d) the likely effectiveness of these taxes and related policies in achieving their stated policy objectives;

(e) any administrative implementation issues at a Commonwealth, state and territory level;

(f) an international comparison of relevant taxation arrangements;

(g) alternatives to any proposed new taxes, including direct action alternatives; and

(h) any other related matter.

WITNESSES

Committee met at 10.44 am

CARLTON, Mr Tim, Director, Commonwealth Grants Commission

SPASOJEVIC, Mr John, Secretary, Commonwealth Grants Commission

CHAIR (Senator Cormann)—Welcome. I declare open this sixth hearing of the Senate Select Committee on the Scrutiny of New Taxes inquiry into a national mining tax. These are public proceedings although the committee may hear certain evidence in camera. Proceedings are governed by rules set by the Senate copies of which have been given to the witnesses. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee and such action may be treated by the Senate as a contempt. I remind members of the committee that the Senate has resolved that public servants shall not be asked to give opinions on matters of policy. I now invite our witnesses to make a brief opening statement.

Mr Spasojevic—We have no opening statement to make at this point.

CHAIR—Is implementation of the MRRT and expanded PRRT going to have an effect on horizontal fiscal equalisation?

Mr Spasojevic—If by that you mean the introduction of a Commonwealth tax on mining profits, the answer is no.

CHAIR—Why that qualification?

Mr Spasojevic—I am just trying to qualify what you mean by that statement.

CHAIR—Let me go back to your 2010 methodology review, where on page 13 you say that Western Australia has the highest assessed fiscal capacity due to its very high revenue raising capacity. What are the main factors that cause this highest assessed fiscal capacity?

Mr Spasojevic—They have got a lot of iron ore.

CHAIR—So it is fair to say that state government tax revenues from mining states like Western Australia and Queensland through your processes are then shared with other states.

Mr Spasojevic—They are.

CHAIR—Through the processes of horizontal fiscal equalisation.

Mr Spasojevic—Correct; the revenue that they collect from royalties are redistributed, effectively, by the GST.

CHAIR—Can you talk us through how that works.

Mr Spasojevic—Certainly. It may be some easier to have a very simple kind of model to aid understanding. If I imagine I have one state which has a very high value of mining production and one which has a very low value in per capita terms, they would have an unequal capacity to raise revenue from mining royalties. That unequal capacity to raise revenue from mining royalties then would feed through, all other things being equal, into requiring less per capita in the GST in the state which has an above-average capacity to raise mining royalties. So there is a balancing process.

CHAIR—The WA Treasury has made a submission to this committee which suggests that about 65 per cent of the mining tax, the MRRT, would be raised from projects in Western Australia. In a broad sense those proportions have been confirmed by BHP and Rio Tinto yesterday, on the basis of 97 per cent of iron ore production taking place in Western Australia and that most of the tax would come from iron ore. Will that affect the fiscal capacity of Western Australia to raise revenue into the future?

Mr Spasojevic—I cannot answer that question. I do not know what impact it is going to have on their fiscal capacity in the future.

CHAIR—But you make those regular assessments, don’t you?

Mr Spasojevic—No, what we do is say how much do states actually raise. We do not say how much they could raise, should raise, would raise; we just say how much royalties they do raise.

CHAIR—I am quoting from your methodology review on page 13, where you say Western Australia has the highest assessed fiscal capacity due to its very high revenue raising capacity. Why is that then relevant?

Mr Spasojevic—Because we look at the shares of the value of production. It is not an absolute statement. If the states tomorrow were to cut royalties to zero, that would be their decision. But, if they were to cut them significantly, WA would still have the highest fiscal capacity. It is a relative statement, not an absolute statement.

CHAIR—So if WA were to cut—

Mr Spasojevic—No, if the states were to cut.

CHAIR—Okay. Let us focus for a moment on Western Australia, because this is what the statement relates to here and because a significant proportion of the mining tax is to come from Western Australia. If WA were to significantly cut its royalties on iron ore, what would be the effect, if any, on horizontal fiscal equalisation?

Mr Spasojevic—The average royalty collected across the country would fall. So differences in mining production would have a lesser impact on the distribution of GST.

CHAIR—And what would that mean for the proportion of GST raised in Western Australia that would go back to Western Australia?

Mr Spasojevic—I have no idea what that means because I do not know how much GST is raised in Western Australia.

CHAIR—You would be well aware of the arguments that have been put forward by the Premier of Western Australia that an ever-decreasing share of the GST raised in WA finds its way back into WA, and that is because of the processes of horizontal fiscal equalisation.

Mr Spasojevic—No, I do not think he has ever said that, actually.

CHAIR—What he says is that it is going to be about 68c in the dollar this year and it is on track to go down to 42c in the dollar.

Mr Spasojevic—Sorry, you misunderstand me. It is absolutely true that the proportion of GST per capita going to WA has fallen. What is not true is that that is in any way related to how much GST is collected in Western Australia.

CHAIR—Yes, that is not what I was trying to say either. I guess the question I am asking is: how is that dynamic, which you have just agreed is there, going to be influenced if Western Australia reduces or increases its royalties?

Mr Spasojevic—If Western Australia and other states were to cut royalties then WA would get more GST revenue as a result and its relativity would rise.

CHAIR—And I am not asking about 'WA and other states'. If WA—

Mr Spasojevic—Or if WA were to do it—

CHAIR—So, if WA reduced royalties, it would get more of its GST back?

Mr Spasojevic—Correct.

CHAIR—Is it a zero-sum game?

Mr Spasojevic—No. WA would be worse off.

CHAIR—So there is still a benefit for WA having higher royalties than no royalties.

Mr Spasojevic—Absolutely.

CHAIR—That is good to hear. So the assessed revenue raising capacity is completely irrelevant to your decisions or your methodology around determining shares of GST?

Mr Spasojevic—No, it is absolutely vital. But I think you are trying to interpret assessed revenue raising capacity in the wrong way.

CHAIR—I am trying to understand it. I am quite happy to concede the Commonwealth Grants Commission processes are a mystery to me. Assume I know nothing. I am trying to understand it. I am trying to get on top of it, which is why we have you here before us, so please explain it to me in very simply terms.

Mr Spasojevic—The assessed revenue raising capacity for Western Australia and other states is a relative concept; it is not an absolute. We do not sit here in Canberra and say, 'How much royalty revenue could Western Australia raise?' The average state might raise, say, $100 per capita in mining royalties. Imagine that is the world. Currently they raise, on average, 100 and our question is: can Western Australia raise more or less than 100 if it were to follow the average policy on royalties of all the states?

CHAIR—If it can raise more, what is the effect of that?

Mr Spasojevic—Then it would get a proportionate reduction in its GST. So the way we do this—imagine we have this world where we have $100 of mining royalties raised per person—is we say, 'Compared to the average value of production of mining in the country, across all the states, is Western Australia above or below average?' If Western Australia had 20 per cent more mining production than the average, we would basically say it could raise 20 per cent more royalties.

CHAIR—Okay, we are getting somewhere now. If Western Australia essentially does not raise as much revenue as it could, or not more than the average, then that is going to impact on its share of GST under the general pool. Is that differential going to be impacted by the imposition of a national minerals resource rent tax or not?

Mr Spasojevic—The national minerals resource rent tax, if you leave state royalties unchanged, will have absolutely no impact on the GST distribution.

CHAIR—That is good to know. What you are effectively saying is this is going to be an imposition on the top up and, to the extent that the states are not going to vary the proportionality of their royalties vis-a-vis each other, it is not going to have an impact. Is that what you are saying?

Mr Spasojevic—I am not sure whether that is what I am saying. I am trying to think whether that is what I am saying. I think what I am saying is: if the Commonwealth were to introduce a tax on top of royalties in whatever shape or form and it did not change state royalties, then it would not change the GST distribution.

CHAIR—I am not focused on whether it is going to change state royalties; what I am asking is whether it is going to have an impact on revenue-raising capacity and to the extent that the revenue-raising capacity is relevant to your decisions on how you allocate GST revenue.

Mr Spasojevic—It would if it changed the value of production.

CHAIR—If the national mineral resources rent tax were to have an impact on production up and down that is when—

Mr Spasojevic—That is when there might be an effect, because that is the only thing we take into account in assessing WA's relative revenue-raising capacity.

CHAIR—So the volume of production is—

Mr Spasojevic—Value.

CHAIR—The value of production.

Mr Spasojevic—Yes. Royalties are raised on value.

CHAIR—Sure, the value of production. The value of production is not determined by what levels of taxes are paid on profits. Essentially, you are taking the value of iron ore as a commodity price value, and that is the basis that you use. You take production—

Mr Spasojevic—We ask the state: what is the value of production in your state? They give us the number.

CHAIR—So that is volume and commodity price, and that gives you a total number.

Mr Spasojevic—That is it.

CHAIR—If a new iron ore field is discovered and/or developed that adds to capacity so that then leads to a variation in the payment of GST.

Mr Spasojevic—That is right.

CHAIR—If there is more production in Western Australia or Queensland, more capacity to raise revenue and they do not increase royalties that leads to reduction in GST revenue into that state.

Mr Spasojevic—Correct.

CHAIR—The more production in an individual state, the less GST is going to go back into that state.

Mr Spasojevic—Correct.

CHAIR—Will the MRRT and expanded MRRT have any effect on the Commonwealth Grants Commission process at all?

Mr Spasojevic—No.

CHAIR—Why not?

Mr Spasojevic—Because it is a Commonwealth tax.

CHAIR—GST is a Commonwealth tax.

Mr Spasojevic—That is right, and the GST has no impact on what we do either because we are only asked to share it out.

CHAIR—You just distribute it. I think you are taking a very technical view on whether it is going to have an impact on you. If your argument is that the GST does not have an impact on the Commonwealth Grants Commission, I do not know that any ordinary person looking at what you do would come to that conclusion.

Mr Spasojevic—That may be correct.

CHAIR—At the committee's hearing in Melbourne Professor Garnaut told the committee that horizontal fiscal equalisation provides a disincentive for the states to establish efficient taxation arrangements of their own. Under horizontal fiscal equalisation, if they took the big effort that was necessary they would lose most of the revenue anyway. He cited Western Australia as an example. Would you care to respond to that?

Mr Spasojevic—No.

CHAIR—That is very clear. You are very concise in your answers. You do not have a response to the suggestion that the Commonwealth Grants Commission processes can be distortional.

Mr Spasojevic—Sorry, Senator, I was being a bit glib. The objective of horizontal fiscal equalisation is an agreed objective of the Commonwealth and states. If you want a response to Professor Garnaut's concern that that objective leads to inappropriate outcomes, then you should speak to the people who made that agreement, and that is not the Commonwealth Grants Commissions.

CHAIR—Sure. Has the shortening of the Commonwealth Grants Commission evaluation period from five years to three years—a methodology change that was reflected in GST allocations amongst states for 2010-11—intensified in effect the sharing of Western Australia's mining revenues among all states?

Mr Spasojevic—If I understand what you are trying to get at in the question, the answer would be yes.

CHAIR—How do you understand what I am trying to get at in the question?

Mr Spasojevic—I think what you are trying to say is: does the move from five to three make the GST distribution more closely reflect the conditions in the year in which the money is actually going to be allocated? And it looks like, in the year the money is going to be allocated, Western Australia will have a much higher share of the ability to raise revenues than it would have had with a five-year averaging period.

CHAIR—It makes it more volatile and a little less predictable for those states in terms of their revenue expectations and budget planning, doesn't it?

Mr Spasojevic—Some states have contended that it does do that. Some states have contended that it does not do that—that it actually smoothes their overall revenue rather than just looking at one or two components. They contend that it actually improves the overall stability of state revenue.

CHAIR—Are state mining royalties considered, for your purposes, as a tax or payment for use or sale of assets?**Mr Spasojevic**—It is considered as a revenue source to the states.

CHAIR—So you do not make any distinction at all. We have talked about Western Australia for a bit but New South Wales and Victoria obviously have a different profile, although there is a lot of mining in New South Wales as well. When you assess revenue-raising on a state-by-state basis would you apply similar principles to the value of mining production to other industries that are predominant in other states?

Mr Spasojevic—Not so much industries, but all other tax bases.

CHAIR—For example, New South Wales is much more expert in the financial services industry. Do you look at the financial services industry and capacity for states to raise revenue?

Mr Spasojevic—No. As far as I understand it, there is no state tax on the financial services industry. They may raise revenue indirectly from that industry through payroll tax. That is the only state revenue source which is related to that industry.

CHAIR—Sure.

Mr Spasojevic—So there is no state tax on financial services. If one state has more financial services than another, it does not affect the state's revenue-raising capacity but it does affect their ability to raise payroll tax. Now, we look at the payroll tax base, but not industry by industry.

CHAIR—So if there were no state royalties—none at all—that means essentially that state royalties would become irrelevant in terms of allocating the share of GST revenue.

Mr Spasojevic—Correct. That disability—the difference between the states and their ability to raise royalty revenue—would disappear from the GST allocation and the GST allocation would move closer to equal per capita.

CHAIR—Going back to your 2010 review, which I found quite interesting, on page 7 it says:

Different rates of population growth also impact on State holdings of financial assets per capita and on State capacity to earn income from these assets. We consider the simplest way of accommodating this impact is to equalise States' net financial worth per capita, and assess them to have an equal income earning capacity from these assets.

How close is that sort of assumption to reality?

Mr Spasojevic—The states have quite different holdings of net financial assets per person and we attribute that to their different state policies.

CHAIR—What is the effect of that?

Mr Spasojevic—It has no effect.

CHAIR—Why equalise states' financial asset holdings but not their mineral holdings?

Mr Spasojevic—Sorry, I do not understand that question. Given that we redistribute the mining royalties, then effectively we have.

CHAIR—I am not sure I understand that answer but I will reflect on it.

Mr Spasojevic—I thought quite early on you asked me the explicit question: does the Grants Commission process effectively redistribute mining royalties between the states?

CHAIR—That is revenues.

Mr Spasojevic—I think I answered yes. So we effectively consider that the per capita mining endowment is equally distributed across the country. That is the effect of HFE.

CHAIR—You also said that the Commonwealth Grants Commission does not take into account the incidence of new federal taxes when—

Mr Spasojevic—We do not take into account any federal taxes.

CHAIR—That is right. So for the purposes of determining allocation amongst states does it matter how states choose to finance their expenditure or do you exclusively look at revenue?

Mr Spasojevic—No. States, on aggregate, are borrowing or saving money. That affects their net financial assets per person and—

CHAIR—So if states choose to finance expenditure through taxation or borrowing there is going to be a different effect.

Mr Spasojevic—Sorry, I meant ‘states’ collectively, not ‘a state’.

CHAIR—So what an individual state does does not—

Mr Spasojevic—It does not have any impact on what we do; we only look at the average policy of all the states and we assume that each of them follow that, in turn.

CHAIR—So you look at the average and then you apply the average—

Mr Spasojevic—For example, Western Australia has no gambling tax on poker machines. We assume that they do. We assess that they could raise money from those machines.

CHAIR—So you assume they do, even though there is no revenue coming from them.

Mr Spasojevic—That is their choice.

CHAIR—But if there is no tax—we have had this discussion before—then there is no capacity to raise the revenue.

Mr Spasojevic—We take the total revenue which is collected and allocated amongst the states on the basis of their capacity.

CHAIR—So if Western Australia introduced a tax on the financial services industry, would you then assume that all states could raise—

Mr Spasojevic—That would not be the average policy. Because one state does it, it does not make it the average.

CHAIR—When does it become the average?

Mr Spasojevic—The majority of the population or the majority of the tax base would need to be taxed.

CHAIR—So four states would have to do it?

Mr Spasojevic—It depends which four.

CHAIR—You said ‘or’—the majority of states or the majority of the tax base.

Mr Spasojevic—The majority of the people or the majority of the tax base—population. So the four little states by themselves will not drive the average.

CHAIR—So Western Australia gets a lower share of GST because it does not allow poker machines.

Mr Spasojevic—I am not sure about that. We assess it as having a revenue capacity. Whether it has got an above average or below average revenue-raising capacity, I do not know.

CHAIR—Can you provide that on notice?

Mr Spasojevic—I think you have got it in the report in front of you, volume 3.

CHAIR—I will check that out. Just going back to the question that I actually asked: you take an average of what the states are doing in terms of finance and expenditure through taxation or borrowing; if a state has a different profile, has higher borrowings, how does that impact? If a state has higher borrowings than the average, how does that impact on them?

Mr Spasojevic—As I say, we do not look at what any individual state does.

CHAIR—I know. You assume that they all do the same.

Mr Spasojevic—Correct.

CHAIR—So what is the practical effect if they do not individually do the same?

Mr Spasojevic—On the GST distribution?

CHAIR—Yes.

Mr Spasojevic—None, because we assume that they do all do the same.

CHAIR—If you assume that they all do the same and it is not the same, there must be an impact.

Mr Spasojevic—Not on their GST distribution. No, there is not. There might be an impact on their state finances, but not through the GST.

CHAIR—So that is not something you take into account.

Mr Spasojevic—Correct.

CHAIR—Have you read the Western Australian Treasury note entitled *Western Australian share of Commonwealth resource rent tax—explanation of calculation*?

Mr Spasojevic—No.

CHAIR—They rely quite extensively on Commonwealth Grants Commission data as a proxy to determine where the mining tax revenue is likely to come from. So you have not read it?

Mr Spasojevic—No.

CHAIR—So you are not able to comment on whether the 60 to 65 per cent share of mining tax revenue to come from WA is accurate or not?

Mr Spasojevic—Not at all.

CHAIR—I will hand over to Senator Cameron for a moment and then come back at the end.

Senator CAMERON—Horizontal fiscal equalisation came in under the Howard government.

Mr Spasojevic—No.

Senator CAMERON—But it changed significantly under the GST—

Mr Spasojevic—I will give you the potted history.

Senator CAMERON—That would be good.

Mr Spasojevic—Horizontal fiscal equalisation came in under the Fraser new federalism in 1976, and that principle has stayed the same ever since. What changed under Howard was the pool of money available to be distributed, with the introduction of the GST. Before the GST, it was a different pool of money.

Senator CAMERON—There have been two inquiries, in 2004 and 2010.

Mr Spasojevic—There usually is a review every five to six years. If you go back in history, there were reviews in 1980-81 and 1985. Let me just assume that they were then every five years, because I was not there. But every five years the methodology is reviewed.

CHAIR—Can I just ask for clarification on this point. I have a briefing note in front of me which says that horizontal fiscal equalisation has been in place since 1936.

Mr Spasojevic—That is wrong.

CHAIR—It has been written by a government.

Mr Spasojevic—It may have been written by a government. The Commonwealth Grants Commission was established in 1933, but there was not horizontal fiscal equalisation at that point, as we know it. What we had was claimant states.

CHAIR—I will quote to you what is written here:

The Commonwealth Grants Commission made the special grants process more systematic by devising a principle of horizontal fiscal equalisation which was originally described as enabling claimant states 'with reasonable effort to put their finances in about as good order as that of the other states'.

So it might have been an earlier version. This is a report from the Commonwealth Grants Commission in 1936. I can read the whole quote if you like, but the essential point is that it has been an evolutionary process, hasn't it, which started with one version and changed. But I think it would not be right to say that horizontal fiscal equalisation only started 30 years ago.

Mr Spasojevic—I disagree. I would say it is absolutely correct and your briefing note is incorrect. What happened at that point in time is that the claimant states were raised up to an average but there was no attempt made to actually equalise all the states. If a state was not a claimant, then there was no impact of HFE. It was not until new federalism and the eighties that all the states were made equal, which is what we currently call horizontal fiscal equalisation. If you go back to the 1933 formation of the Commonwealth Grants Commission, if a state was not a claimant no grants of Commonwealth money would flow to it to equalise its fiscal capacity, and in some years states were not claimants. So HFE was not in practice or in principle adopted at that point in time. Certainly, there was no attempt made for the states which had very high fiscal capacities to reduce their fiscal capacity, so the weaker, where they chose, were raised up to about the stronger. That is not what HFE means in today's language. I am just being absolutely clear.

CHAIR—I grant you that: in today's language—the modern variation of HFE.

Senator CAMERON—That was helpful!

Mr Spasojevic—I am glad!

Senator CAMERON—As I understand it, HFE means that citizens in different states should have access to equal standards of government services—is that correct?

Mr Spasojevic—No, that is also not correct.

Senator CAMERON—We are getting some bad advice on this committee then!

Mr Spasojevic—It is just as well I have come along. What HFE does is give the states the capacity to provide those services. Whether states choose to do that is a matter for their own decision-making processes, and we know that they choose not to necessarily do that.

Senator CAMERON—It says 'should have'; it does not say 'will have'.

Mr Spasojevic—'Could have' is the definition—not 'should', 'could'. 'Could' is very different from 'should'. These are untied grants. The states can spend the money as they see fit. We are giving the states the capacity to deliver the same level of services, but there is no requirement or expectation that they do so.

Senator CAMERON—The 2010 review recommended shorter assessment of periods. Has that been adopted?

Mr Spasojevic—It has.

Senator CAMERON—We had a big debate in parliament this year about New South Wales getting extra funding and Western Australia and Queensland getting less funding. That is not uncommon, is it? Those roles have been reversed in the past, haven't they?

Mr Spasojevic—Absolutely.

Senator CAMERON—I asked the Western Australian Treasury if they had any statistics as to the support that Western Australia had had over the years through horizontal fiscal equalisation. They said that they did not have long-term statistics. Do you have those statistics?

Mr Spasojevic—No, I think I am going to have to say that we also do not collect those numbers or keep them. Basically, we give the eight numbers to the Commonwealth and the states. They then make decisions on how the actual allocations are made and, for our purposes, we do not track long-term series of payments to the states. We rely on the Commonwealth Treasury statistics ourselves.

Senator CAMERON—Would it be accurate to say that over many years Queensland and Western Australia have been beneficiaries of horizontal fiscal equalisation?

Mr Spasojevic—Yes. As soon as a state's relativity is above one—that is, it is giving more than an equal per capita share—the claim is that it is getting assistance. When it falls below one, which is where WA is now, it is said that they are a donor state and contributing.

Senator CAMERON—Is there a time series for above-one states?

Mr Spasojevic—No, there is not a time series for above-one states because, every time the methodology changes, there is a break in the series, so you have to be very careful about interpreting relativities from previous methodologies—they do not translate simply into the relativities that we are getting today.

Other things have changed. For example, I think three years ago the Commonwealth changed the nature of the pool. It took the healthcare grants out of the pool and told us not to allocate those. That, by very definition, changes the relativities. So there is just no comparable series that goes back and a lot of work would need to be done. I suspect going back 10 years it would be almost impossible to reliably build a series of relativities going back.

Senator CAMERON—That is interesting because part of the political argument—and I am asking for a comment from you on the political argument—you are faced with is what you have heard a bit from the chair today, that Western Australia somehow is not getting a fair shake. And, if we do not have historical data, it makes it more difficult, does it not?

Mr Spasojevic—I do not want to comment on that because, as you rightly point out, it is well beyond what the commission would do. The commission is charged with achieving HFE in each year, not over long periods of time. For example, it is probably accurate to say that New South Wales and Victoria have always had an above-average capacity to raise revenue or a below-average capacity on the need to deliver services—that is Victoria's case. So we would not say that fairness is achieved over the long haul; we would say we are trying to achieve fairness in each year by achieving HFE in each year.

Senator CAMERON—And, because Queensland and Western Australia happen, by a quirk of nature, to have the capacity to raise more funding through their iron ore and coal resources, it is appropriate under HFE that they pay a higher—

Mr Spasojevic—They get a smaller share of the GST.

Senator CAMERON—They get a smaller share of the revenue distribution.

Mr Spasojevic—Correct. So the exact analogy is New South Wales has traditionally had an above-average capacity to raise payroll tax and as a result Western Australia has received a higher share of the GST to compensate it for its lower ability to raise payroll tax. If you think across every tax base, some states are up and some states are down. In royalties it is absolutely true that Western Australia is up but in other tax bases it is down. We just add them all up across the spectrum.

Senator CAMERON—Is there an econometric model you use for this?

Mr Spasojevic—It is not an econometric model.

Senator CAMERON—What is it?

Mr Spasojevic—Basically, it says that if I we about an expenditure item, for example, expenditure on schools, if we say states on average spend $1,000 per person on school education we ask: would one state need to spend more or less than the average? The simplest determinant we use is whether states have more or fewer schoolchildren per capita. If you have a very young population, you will tend to have more schoolchildren per capita—I know that is a strange concept, more children in your population—we would say you would need to spend above average on education. If you have a relatively old population—Tasmania, for example—we would expect that you would need to spend less on education. The demographic statistics would then come into play on that.

Senator CAMERON—I do not want to go back to when HFE was introduced and I take your submission this morning on that, but HFE has been a long-established principle across various governments.

Mr Spasojevic—I would say it has been an established principle going back to the Fraser new federalism in its current form, to bring the states into equality.

Senator CAMERON—So, in terms of the coal and resource capacities, the principle stays the same but the revenue capacity of Queensland and Western Australia increases significantly because of the resources boom?

Mr Spasojevic—Correct and the offsetting adjustment is that their share of GST revenue falls.

Senator CAMERON—Is that fair?

Mr Spasojevic—That is a good question. What I will say is that I believe it is HFE.

Senator CAMERON—It is consistent with the principles that have been established?

Mr Spasojevic—It is consistent with the principles that have been established and agreed between the Commonwealth and the states.

Senator CAMERON—Have Western Australia and Queensland argued for different principles in the reviews?

Mr Spasojevic—They have argued for different methodologies, or different ways of doing it, but their governments are signatories to the intergovernmental agreement, which says the GST is to be distributed to achieve HFE. So their officials are constrained by what their governments have committed to.

Senator CAMERON—Right. I might come back to that if we have time. Thank you.

CHAIR—I have a few more questions, if that is okay. Going back to the question Senator Cameron asked earlier about WA being a beneficiary of these equalisation arrangements, when was the last time that WA would have been a beneficiary of these equalisation arrangements overall?

Mr Spasojevic—I think about three years ago.

CHAIR—So it is something that goes up and down and up and down, is it?

Mr Spasojevic—WA has been one of those states that have moved around 1; for a long time it kind of bubbled around 1—and it is a long way away from 1 now.

CHAIR—Where is it now?

Mr Spasojevic—It is 0.68, I think. That is the number that the Premier keeps using.

CHAIR—That is right, and the Premier has started to talk about the fact that it is going to go even lower, to 0.42 or something. That is the number that he has been using over the forward estimates.

Mr Spasojevic—Right.

CHAIR—You are aware of that?

Mr Spasojevic—I have seen that; it is in the state budget papers.

CHAIR—That is right. So you are aware of the figure. Is there any precedent, pre GST or post GST, for a state to get less than 50 per cent of their allocation back?

Mr Spasojevic—The 0.68 is already a historical precedent.

CHAIR—So 0.68 is already the lowest ever?

Mr Spasojevic—Correct, and it is not only the lowest; it has been the fastest movement to 0.68 on record.

CHAIR—So it is the fastest movement to 0.68 on record. Is there any floor at all or is there no limit to how low it can go?

Mr Spasojevic—That is a very good question. We do not think it can go negative.

CHAIR—You mean it cannot get less than zero?

Mr Spasojevic—You cannot get less than zero!

CHAIR—But it could go to zero, conceptually?

Mr Spasojevic—I do not think it could actually ever go to zero. I think there is an asymptote as you get closer to zero.

CHAIR—That is good to hear. Okay—

Mr Spasojevic—You have to ask yourself, Senator: in what kind of a situation would that be? Presumably—

CHAIR—The situation in front of us now is that it is at 0.68, you have said it is the most rapid movement to 0.68 ever and it is on track to go to 0.42. How much further—

Mr Spasojevic—Sorry, I did not say that.

CHAIR—No, it was in the budget in Western Australia—

Mr Spasojevic—They have said that.

CHAIR—They are now working on the assumption that if this rapid trend continues—and, based on the figures that they are aware of, it is going to continue—it will go to 0.42. What would be the bottom?

Mr Spasojevic—There is no floor.

CHAIR—There is no floor? But you said it would slow down at some point because of the way the formula works.

Mr Spasojevic—No, I just find it hard to imagine a world where their royalty revenues grow at a consistent rate. You would need to get a doubling of prices and a continuing rate of expansion of volume for that to happen. I could be wrong, but I just find it hard to imagine that prices will double and double again—

CHAIR—So what has caused the rapid reduction to 0.68, the most rapid fall in living memory?

Mr Spasojevic—The one example I have is that, when we were visiting Western Australia, we were sitting in their state Treasury being briefed and they announced that royalties had gone up by 88 per cent that day. So that provided a huge price impact and a huge increase in their ability to raise revenue, and a huge increase in royalty revenues per se, which is the fundamental driver—plus the fact that it triggered a huge housing boom in Perth and house prices rocketed, and that increased their capacity to raise revenue from stamp duty on conveyancing at the same time as they were experiencing a mining boom.

CHAIR—And all that gets equalised across the nation?

Mr Spasojevic—All of that gets equalised across the nation.

CHAIR—So the suggestion that the nation is not benefiting from these sorts of developments in Western Australia would be wrong?

Mr Spasojevic—As far as state governments are concerned, they have had that mining boom equalised across all state revenues.

CHAIR—And of course those states then provide services to people in their respective states.

Mr Spasojevic—Yes. I just sit back and say what they do with the money is what they do with the money. It is up to them.

CHAIR—Although you make assumptions about how much they need to spend across—

Mr Spasojevic—No.

CHAIR—You said you looked at how much you would expect them to spend on education—

Mr Spasojevic—Compared with the average, they already do.

CHAIR—Okay.

Mr Spasojevic—I think it is very important that I am not trying to give the impression that the commission sits down and says how much should be spent on education. What the commission observes is the average a state spends historically. We are only looking at the past, remember. The commission is looking, in this current update, at what was happening in 2009-10, a year that has already passed. So we will ask: against the average of education expenditure in 2009-10—which I do not know yet—would one state need to spend more or less, based on its demographic characteristics? So the commission is not making a judgment about how much should be spent on education, just how much more or less one state needs to spend.

CHAIR—Okay, so it is mainly royalties and the circumstances in Western Australia that are principally driving the quick reduction to 0.68 at this point in time. Is there a point when the proportional impact of royalties on the work you do becomes too high?

Mr Spasojevic—It is a revenue. A dollar of revenue is a dollar of revenue.

CHAIR—I know, but there is a dollar of revenue in other sectors of the economy too.

Mr Spasojevic—Correct, and we take every dollar and we consider it equally, as far as revenue is concerned.

CHAIR—But I go back to the question before. We had 0.68, and the Western Australian government thinks it is on track to go only to 0.42. You said it would never go to zero—and I did not understand the words you used there but you said it was because of some sort of—

Mr Spasojevic—An acento.

CHAIR—I am sorry; say that again.

Mr Spasojevic—I think it is acentos, which is a mathematical term.

CHAIR—But I am not a mathematician, so please explain.

Mr Spasojevic—It becomes somewhat related to percentages. You can never quite get to zero because you are always going to halve the difference to get there.

CHAIR—How close to zero could you get?

Mr Spasojevic—I do not know the answer to that question; I do not think anybody does. But I am happy to say on the record that there is no floor. The paradox is that there is no ceiling, because the floor is the ceiling.

CHAIR—The only way that there could be a floor—and that is not a question I can address to you—is if the people who have set the process up decide to change the legislation, the framework that rules your work and your processes.

Mr Spasojevic—The commissioner can be directed, of course, because we only do what we do in relation to terms of reference.

CHAIR—You could be directed by whom?

Mr Spasojevic—The Treasurer.

CHAIR—A rapid move down to 0.68 is quite reasonable for the great state of Western Australia and going down to 0.42 is reasonable, so you do not need any legislation for that. The Treasurer could say to you that there ought to be a floor of 0.75, below which no state would ever fall.

Mr Spasojevic—The final decision maker is the Treasurer.

CHAIR—Could the Treasurer give you directions to establish a floor—

Mr Spasojevic—Absolutely.

CHAIR—at 0.75 or whatever he chooses?

Mr Spasojevic—Correct—which would also be cap, of course.

CHAIR—Which would be a cap as to how far equalisation goes—

Mr Spasojevic—No, it would restrict how much revenue the losing states would get.

CHAIR—That is right. Essentially, there would be an upward cap in terms of how much above one you could get.

Mr Spasojevic—Correct.

CHAIR—Sure, because there is then less funding to spread around. I guess, in terms of solidarity across states, the question is whether that is reasonable—and that is not a question for you; it is a question for the Treasurer, the government and, I guess, for the processes of government.

Mr Spasojevic—Correct.

CHAIR—The policy question is whether it is appropriate for an individual state to fall so rapidly, as we have experienced, and potentially much further without any floor whatsoever. That is a question for us but I think it is a very good point to conclude on.

Senator CAMERON—I do not want to leave it on the basis of the proposition the chair has put forward, that Western Australia is falling so rapidly.

CHAIR—That is what Mr Spasojevic said.

Mr Spasojevic—It is absolutely true that the state budget of Western Australia has received so much revenue of their own that, with a three-year lag, their GST has experienced the biggest fall we have ever seen, but their overall budgetary situation, of course, is quite well off.

Senator CAMERON—When you talk about the GST income falling, there are compensatory increases elsewhere in terms of Western Australia and Queensland’s budget, aren’t there?

Mr Spasojevic—Absolutely. It is only falling because their own revenue sources are rising so quickly.

Senator CAMERON—So to portray this as some diminution of the state’s capacity to provide services is not correct, is it?

Mr Spasojevic—No. I think the analogy here is: if somebody gets such a rapid expansion of their income that they go onto a higher marginal tax rate, it does not reduce their overall income. It just means they are paying more income tax. Several other states have said to us: ‘If only we were so lucky to be at 0.68.

Senator CAMERON—It is like Twiggy Forrest saying, ‘I’m looking forward to getting my pension,’ isn’t it?

Mr Spasojevic—I do not know what his pension entitlements are.

CHAIR—I think you are asking for an opinion, and I might just close the hearing here.

Committee adjourned at 11.30 am