30 June 2017

Commissioners Karen Chester (Deputy Chair) and Jonathan Coppel
Productivity Commission
Level 12, 530 Collins Street
MELBOURNE VIC 3000

Business SA
Chamber of Commerce and Industry South Australia

ABN 000 14 725 309 328
Level 1, 136 Greenhill Road
Unley South Australia 5061
T: +61 8 8300 0000

Working for your business.
Working for South Australia

Dear Commissioners

I write in response to your request submissions addressing the issues and questions raised by the terms of reference for the Inquiry into Horizontal Fiscal Equalisation (HFE).

Executive Summary

- Business SA recognises that the lagged impact of GST revenues makes it difficult for mining dependent States like Western Australia and the Commission's focus in this review should be on ensuring States can better plan for GST revenues and receive distributions at the times needed while maintaining the existing principles of HFE which has served our nation well for over a century.
- Since the early 2000s Western Australia has experienced an unprecedented mining boom enabling 14 consecutive Budget surpluses up until 2014/15 and resulting in a ten-fold increase in mining royalty revenue which the Commission needs to consider in the context of why it would recommend any permanent changes to the current HFE system.
- Australia relies on a strong and stable system of Federation where capital and labour can easily migrate and it is in all States' interests for one another to have the capacity to deliver a comparable level of services.
- If there is to be future reform of the GST, including changes to the rate and base, then all States including Western Australia must come on board and the existing system of GST distribution needs ensure fair outcomes.
- The South Australian Government has shown it is willing to implement tax reform, including abolishing commercial property stamp duty, under the existing system of HFE and is also pro-development of energy and resources, including being open to both uranium mining and unconventional gas extraction.

Should you require any further information or have questions, please contact
Andrew McKenna, Senior Policy Adviser, on (08) 8300 0000 or andrewm@business-sa.com.

Yours sincerely,

Anthony Penney

Why this matter is important to South Australian businesses

As South Australia's Chamber of Commerce and Industry, Business SA is the peak business membership organisation in the State. Our members are affected by this matter in the following ways:

- GST is the largest single source of revenue for the South Australian State Government and to enable future tax reform, including the reduction and eventual abolition of payroll tax, it is important that the integrity of the current GST HFE system is maintained.
- The GST has uniformity across the nation and it is important for the business community that tax revenues are raised in a manner which promotes efficiency and does not detract from companies expanding interstate, which is particularly important for South Australian businesses operating in an environment of weak local demand.
- South Australia already has high costs of doing business on a range of metrics compared to other States and local businesses cannot afford additional indirect tax imposts through unjustified changes to the current system of HFE.

Key Policy Points

1. Business SA's *2014 Charter for a More Prosperous South Australia*, released ahead of the last State election, recommended the State Government ensure it maintains its share of GST revenue, Special Purpose Grants and other Federal funding in accordance with the principles of HFE[1]. At the time, we argued that HFE was important to ensure that each State and Territory has equal fiscal capacity to deliver services and infrastructure to an equivalent level such that no Australians are disadvantaged by living in one jurisdiction over another.

   The fiscal capacity of each State and Territory differs due to a number of factors, including but not limited to demographics, urban density and distribution of population. In terms of raising tax revenues, unfortunately South Australia is most disadvantaged by its ageing population which manifests in a much lower workforce participation rate of 62.1 percent compared with the national average of 64.8 precent[2]. For Western Australia, this figure is currently 67.7 percent and even 20 years ago was still averaging around 66 percent while at that stage, South Australia was averaging around 61 percent, only just below its current rate.[3] This suggests such indicators are more dependent on structural differences between States rather than relative economic performance at any given point, including through commodity cycles.

2. The historical roots of HFE can be traced to pre-federation when the colonies combined to form a political model, fundamentally underpinned by equal distribution of power and resources. The new federation introduced a national aged pension in 1909 and established the Commonwealth Grants Commission (CGC) in 1933 to assess claims by the States for financial assistance. In 1976 the Federal and State Governments agreed that the fiscal capacities of States and Territories should be made equal and the CGC was given responsibility to make recommendations for how general revenue could be distributed accordingly.

[1] Business SA, 2014 Charter for a More Prosperous South Australia, P 11, https://business-sa.com

[2] ABS, Labour Force (April 2017), www.abs.gov.au

[3] ABS, Labour Force (April 2017) – rates from mid 1997, www.abs.gov.au

Prior to the introduction of the GST in 2000, all States agreed with the current system whereby GST distributions provide each State with the capacity to provide its citizens with a comparable level of government services. Again in 2008, under the Inter-Governmental Agreement of Federal Financial Relations, the Federal, State and Territory Governments reaffirmed that GST distributions should achieve HFE.

3. Business SA recognises that the 2012 GST Distribution Review was guided by several assumptions, including the following:

   a) That the long standing practice of equalisation between the States has served Australia well; and

   b) That the GST will continue to be distributed to the States on the basis of equalising payments to the States, consistent with the principle that jurisdictions should have equal capacity to provide infrastructure and services to their citizens.

   Furthermore, from the supplementary terms of reference, the Panel was asked to consider possible changes to the form of equalisation to:

   a) Ensure that HFE does not provide a disincentive to State tax reform

   b) Utilise HFE to provide incentives and disincentives to promote future State policy decisions which improve the efficiency of State taxes and mineral royalties; and

   c) Examine the incentives for States to reduce the Minerals Resource Rent Tax (MRRT) or Petroleum Resource Rent Tax (PRRT) revenue through increasing mineral royalties.

   The Panel concluded that there is no evidence that HFE acts as a material disincentive to State tax reform and Business SA acknowledges that since 2012, the South Australia Government has abolished stamp duty on business transfers and is part way through implementing the abolition of stamp duty on commercial property transfers. Given South Australia's move to abolish stamp duty on commercial stamp duty meant it would raise less than its revenue capacity according the HFE, it is hard to see how the current system of HFE has acted as a disincentive to State's progressing tax reforms.

   The Panel also found that the mere fact that the mining part of the HFE system is currently driving a large amount of redistribution was not, in their view, a reason to treat mining differently from other revenue and that States' mining revenue should continue to be equalised through the HFS system, on the same basis as other own-source revenue.

4. Business SA acknowledges the following ‘actual’ State Budget outcomes[4] from Western Australia:

2000/01 - $167.1 million cash surplus and total public sector net debt of $4.381 billion

2001/02 - $197 million cash surplus and net debt of $4.491billion

2002/03 - $254 million cash surplus and net debt of $4.497 billion

2003/04 - $799 million cash surplus and net debt of $4.194 billion

2004/05 - $1.192 billion cash surplus and net debt of $4.001 billion

2005/06 - $2.265 billion cash surplus and net debt of $3.179 billion

2006/07 - $2.254 billion cash surplus and net debt of $2.984 billion

2007/08 - $2.507 billion cash surplus and net debt of $3.634 billion

2008/09 - $318 million cash surplus and net debt of $6.688 billion

2009/10 – $831 million cash surplus and net debt of $9.896 billion

2010/11 – $1.604 billion cash surplus and net debt of $12.03 billion

2011/12 – $649 million cash surplus and net debt of $14.53 billion

2012/13 – $249 million cash surplus and net debt of $18.19 billion

2013/14 – $719 million cash surplus and net debt of $20.75 billion

2014/15 - $431 million cash deficit and net debt of $23.374 billion

2015/16 - $2.037 billion cash deficit and net debt of $27.86 billion

2016/17 - $3.914 billion cash deficit (forecast) and net debt of $33.838 billion (forecast)

Furthermore, total public sector net debt is forecast to increase to $40.193 billion by June 2020. In comparison, South Australia’s total public sector net debt is $20.134 billion and is forecast to increase to $21.760 billion by June 2020.

Over the last 17 years, WA has successfully managed to achieve 14 consecutive budget surpluses and only in the last three years has dipped into deficit territory. There is no underlying fundamental rationale to touch Australia’s HFE system which has served us well for over 100 years because one State jurisdiction, which has managed to turn the country’s longest mining boom into a $40 billion net debt balloon, has for only the last three years recorded budget deficits. In fact, Western Australian mining royalties increased from $685.6 million in 2000/01 to peak at $6 billion in 2013/14 albeit since declining to around $4 billion per annum today after a substantial decline in commodity prices.

[4] ‘Actual’ results taken from subsequent Western Australian State Budgets except for 2015/16 and 2016/17 which are estimates from Budget papers, http://www.ourstatebudget.wa.gov.au/Previous-Budgets/

If Western Australia had adequately managed its $14 billion in budget surpluses over the 14 years preceding 2014/15, it would not be in the situation of having to lobby its perceived unfair treatment in relation to HFE distributions of the GST

5. Business SA recognises the 2012 Panel's comments that '*there is value in exploring options to ensure that the funding pool available to the States is as stable and predictable as possible, in addition to ensuring that the States' shares of the pool are not subject to undue volatility, for a range of reasons including:*

   a) assisting States' budgeting and management of their fiscal position;

   b) ensuring that the GST is an appropriate vehicle for delivering HFR, including that assessment year needs are translated into actual GST shares in a sensible way; and

   c) insulating State governments, with their large service delivery responsibilities, from the fiscal effects of short term macroeconomic fluctuations.'

   The Commonwealth Grants Commission decided to cut Western Australia's GST share back in 2005 and in the 2005/06 Western Australian State Budget, the Western Australian Government forecast its share of GST revenues to decline over the forward estimates period, due to faster growth than other States in its own source revenue capacity. At the time, the State Government also advised that 'experience shows that the annual change in Western Australia's share can be significant and difficult to predict'. Subsequently in the 2006/07 Western Australian State Budget, the Government advised it 'based its decisions on the budgetary capacity expected to be available over the medium to longer term, rather than the temporary/cyclical nature of the current revenue position'.

   After another reduction in Western Australia's GST share in 2007/08, the Government advised in its State Budget that 'Although the State is expecting a significant penalty ($1.4 billion by 2010-11) from a declining share of national GST revenue as a result of the lagged Commonwealth Grants Commission process, surpluses are expected across the forward estimates period. These surpluses provide the capacity for the Government to continue a substantial level of infrastructure investment, with the Capital Works Program worth a record $21.6 billion over the next four years'. The 2008/09 Western Australian State Budget predicted further declines in the GST share as did the 2009/10 Budget which clearly establishes a trajectory of declining GST relativities in accordance with the long embedded system of GST distribution according to HFE.

   As far back as 2011/12, the Western Australian State Budget forecast WA's GST share to decline to 3.5%, approximately its current share of 3.3% which is scheduled to increase to 3.8% in 2017/18.[5] For 2011/12 and the following two years, the Western Australian Government achieved Budget surpluses of $1.617 billion but by 2014/15, total public sector net debt of $14.53 billion in 2011/12 had increased to $23.374 billion as the State ran its first budget deficit this century. While Business SA acknowledges Western Australia started campaigning strongly for a review of the GST HFE system in 2010, it should have been hedging its bets that changes may not occur given it would take consensus of the Council of Australian Governments.

[5] Commonwealth Grants Commission, Report on GST Revenue Sharing Relativities, 2017 Update

Business SA recognises that in recent years the Western Australian Government may have faced increased difficulty managing its own finances as the mining boom subsided as the lag of GST distributions meant the adjustments for Western Australia were delayed through the existing rules which rely on actual data. Having a GST distribution system which is faster to adapt to changing circumstances such as volatile commodity markets would be more likely to mean resource dependent States are able to adjust their budgets to reflect declining mining royalties and associated State tax revenues. From Business SA's perspective, this is a far more suitable option than changing the underlying system of HFE which is a necessary prerequisite for a functioning federation of States like Australia.

6. The Commission's review will consider whether the current system of HFE impacts upon the willingness or otherwise of States to develop their energy resources. There is no doubt that HFE has not discouraged the South Australian Government from actively pursuing development of an unconventional gas sector which is critical to inducing further supply into the gas market, a substantial issue for Business SA's energy intensive members that have seen their gas costs sky rocket in recent years. South Australia has also been open to uranium mining and in 2015, the State Government took the unprecedented step of instigating a Royal Commission to investigate all options of the nuclear fuel cycle, including nuclear power. No other State or Territory has actively pursued development of its entire suite of energy resources to the degree South Australia has and it would appear inconsistent to change the existing system of HFE to disadvantage Sates such as ours which are very pro-development across a range of energy and mineral resources.

7. Business SA has advocated for a review of the current rate and base of the GST in order to progress tax reform, particularly the eventual abolition of payroll tax. Any such future reform of the GST will require the agreement of COAG and the Commission's review needs to be undertaken in a manner which is fair to all States and Territories to ensure any future changes to the rate or base of the GST have the best opportunity to succeed. While Business SA would not support any changes to impose a floor in GST distributions, or remove any portion of mining royalties from its calculations, we would be open to supporting changes which enable GST distributions to adapt faster for mining dependent States on the wrong side of a commodity cycle. A prosperous Western Australia is also good for South Australia but we are mindful of embedding long term changes to the HFE system which are reactionary to the current commodity cycle. Western Australia too benefits over the longer term from HFE and all States and Territories need to look beyond the existing GST distributions.