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Economics Legislation Committee

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**Submission to the Economics Legislation Committee inquiry into the  
*Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of  
GST) Bill 2018***

Dear Committee,

The IPA welcomes the opportunity to provide the attached document, *Time to End GST Redistribution: 2018 Update*, as a submission to the inquiry into the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018*. The report outlines the theoretical and practical flaws in cross-jurisdictional redistribution of taxation revenue (or horizontal fiscal equalization), and calculates how much GST revenue has been generated in each state since the GST was introduced (rather than what each states' entitlement would be on an equal per capita basis).

Our report argues the principle of horizontal fiscal equalization has no merit. Transferring revenue from states with a higher fiscal capacity to states with a lower fiscal capacity negatively distorts naturally occurring economic incentives, such as interstate migration, and creates incentives for state governments to raise taxes and rely on the Commonwealth and GST revenue redistribution from other states, rather than undertake pro-growth economic policy reform to expand their fiscal capacity. Moreover, equalisation fails to address (indeed, it entrenches) the core issue afflicting federal-state financial relations – the namely the disproportionate centralisation of taxation powers to the Commonwealth relative to the states' spending obligations. This is also known as vertical fiscal imbalance, which in Australia is among the highest in the world.

The *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018* (the Bill) proposes to amend Commonwealth legislation so that:

- GST revenue is equalised between the states to the stronger of New South Wales or Victoria, rather than to the strongest state or territory overall;
- a minimum GST revenue sharing relativity to be introduced that may be determined by the Treasurer for any individual state or territory;
- short-term transition payments to any state or territory with a GST revenue sharing below 0.7 for 2022-23, and 0.75 for 2024-25 and all later years;
- the GST revenue pool is permanently boosted with additional Commonwealth financial assistance;
- Other interim measures.

The reforms from the Bill do provide marginal improvements to the mechanisms of the current GST system. However, it retains the fundamentally flawed horizontal fiscal equalization system at the core of GST revenue distribution.

The Commonwealth government's promise to transfer to the states and territories compensatory payments is based on the promise to ensure each state should not be 'worse off' by any changes to the horizontal fiscal equalization formula. While each state may not be 'worse off', the same cannot be said for taxpayers who will pay these compensatory payments. Moreover, the promise to ensure states such as Tasmania and South Australia receive less than they would under the current system – but still more than they generate in GST revenue – ignores the extent of redistribution to those states that has occurred since the GST was introduced. As the attached report explains, over \$104 billion of GST revenue generated in New South Wales, Victoria, and Western Australia has effectively been transferred to the other states and territories since 2000.

Equalisation should be abandoned as a policy objective. The imposition of a minimum GST revenue sharing relativity is a partial acknowledgement that redistribution has led to problems. However, a minimum relativity of 0.7 or 0.75 is essentially arbitrary: there is no basis for saying that a relativity of 0.69 is wrong but 0.76 is acceptable. The *relativities* are fundamentally flawed.

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.

I thank the Committee for the opportunity to provide this submission. I would be happy to assist further in any way that the Committee considers appropriate as it deliberates on this topic.

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