How greed and politics threaten Tasmanian living standards

Saul Eslake – 12th April 2022

Life would be a lot more difficult for a lot of Tasmanians if it weren't for the financial support which the Tasmanian Government receives each year from the Federal Government in Canberra.

In the current (2021-22) financial year, the Tasmanian Government will (according to the most recent Federal Budget Papers) receive a total of $4.8 billion from the Federal Government - $1.8 billion by way of grants for 'specific purposes', such as health, education, roads and social housing, and $3.0 billion from Tasmania's share of the revenue from the GST.

This $4.8 billion represents 62% of the total revenue available to the Tasmanian Government in the current financial year – a higher percentage than for any other state or territory except for the Northern Territory (which this financial year will source almost 80% of its total revenue from Canberra).

Of the remaining $2.6 billion of revenue which the Tasmanian Government will (according to the State Treasury's most recent Revised Estimates Report) have available to it in the current financial year, about $1.5 billion is expected to come from State taxes (such as payroll tax, stamp duties, and land tax), with the remainder coming from GBEs (such as Hydro Tasmania and TasNetworks), fees and charges for government services, fines and other miscellaneous sources.

Tasmania's greater-than-average dependence on the Federal Government for revenue stems from the way in which revenue from the GST (and, prior to the introduction of the GST, 'general purpose grants' which had their origins in the Federal take-over of income taxing powers as a 'temporary' measure during World War II) is distributed among the states and territories on the recommendations of the Commonwealth Grants Commission.

Since its establishment in 1933 – as a response to a referendum in which two out of three Western Australians voted to secede from the Commonwealth (to be told subsequently by the Privy Council, who in those days had the final say on constitutional questions, that they couldn't) – the Grants Commission has recommended that 'untied' grants flowing from the Federal Government to the states (that is, money which they can spend as they see fit, as distinct from 'specific purpose grants' which must be spent on the purpose for which they are provided) should be distributed so as to make it possible for the citizens of each state (and more recently territory) to have access to a similar range and standard of public services without facing vastly different burdens of state taxation.

In order to arrive at its recommendations, the Grants Commission each year undertakes a detailed assessment of each state and territory's capacity to raise revenue from its own sources, and of the demand for and cost of providing, state public services such as education, health, housing and policing. Those states whose 'fiscal capacity' is stronger than average – because they have a greater capacity to raise revenue from state taxes or mineral royalties, or because the demand for particular types of services is lower, or the cost of providing them is less – will receive a smaller share of the revenue from the GST than their share of Australia's total population; while those whose 'fiscal capacity' is weaker than average will receive a larger share of the revenue from the GST than they would have done under an 'equal per capita' distribution of that revenue.

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Of course, whether states choose to use the money which they receive from their shares of GST revenue in order to provide similar standards of public services whilst imposing similar levels of state taxes is a matter for them, and their voters. Successive Queensland State Governments, for example, have long chosen to provide below-average state public services so as to be able to levy lower-than-average state taxes (although that choice has become more difficult to sustain in recent decades as a result of the growing proportion of its population who have moved there from southern states and who have different expectations of state public services from 'native' Queenslanders); while South Australian State Governments have traditionally made the opposite choice.

Tasmania has always received a larger share of revenue from the GST (and, before 2000, from 'general purpose grants) than it would have under a population-share based distribution, because the Grants Commission has always recognized that Tasmania has less capacity to raise revenue from its own resources than other states (as a result of our below-average wages, our below-average property values and below-average resources endowments), and a greater demand for state-type public services (as a result of having, among other things, an older and sicker population than the rest of Australia, and a higher proportion of children attending government schools).

This approach to divvying up federal grants to the states and territories – formally known as 'horizontal fiscal equalization' – is one of the principal reasons why the differences in material living standards among Australia's states and territories are much smaller than those richest and poorest states or provinces of other federations such as the United States of America, Canada, or Germany.

But this long-standing system of ensuring that people living in different parts of Australia can have access to broadly similar standards of state-type public services without facing vastly different levels of state taxes has been undermined by the changes to the GST revenue-sharing arrangements imposed by the Morrison Government in 2018, and which are being 'phased in' over five years from 2021-22 to 2025-26.

These changes were made in response to more than fifteen years of complaints from Western Australia about how that state was being 'unfairly' treated by the long-standing system of 'fiscal equalization'.

As noted earlier, that system was established nearly ninety years ago in response to Western Australia's grievances about the way it had been affected by Federation in 1901. And for about seventy years, Western Australia had been a beneficiary of that system, which recognized that it was very expensive to provide schools, hospitals and other state public services to Western Australia's relatively small population, thinly scattered across one-third of the Australian continent, at a time when Western Australia's mining industry was much smaller and less profitable than it is today.

But, beginning in the early 2000s, China's willingness to pay unprecedently high prices for unprecedently large volumes of the mineral and energy resources with which Western Australia, fortuitously, happens to have been so richly endowed, resulted in Western Australia becoming the richest state in Australia – by a much wider margin than New South Wales or Victoria had ever been during the 20th century, when one or the other of them was the richest state in the country.

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And the river of mining royalty revenue which this bonanza generated resulted in Western Australia's 'fiscal capacity' coming to exceed that of the other states and territories by an unprecedented margin – which in turn resulted, as it should have, in Western Australia's share of the revenue from the GST falling to, in some years, less than one-third of what it would notionally have received under an 'equal per capita' distribution.

All of a sudden, then, once Western Australia become so rich, relative to the rest of Australia, that it became required, in effect, to "put into the pot" from which it had been so happy to draw for the previous nearly seventy years, it wanted the rules changed.

And, eventually, it found a Federal Government which was willing to change the rules in order to suit Western Australia – the government in which Scott Morrison was Treasurer, and of which he later became Prime Minister.

Following an 'enquiry' undertaken by the Productivity Commission – which Scott Morrison as Treasurer gave terms of reference which more or less guaranteed that the Productivity Commission would come up with recommendations that acceded to Western Australia's demand – the Morrison Government, via the Orwellian-sounding *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018*, changed the long-standing principles for determining the carve-up of GST revenues among the states and territories in two ways:

- first, from 2021-22 onwards, no state or territory can receive less than 70% (and from 2024-25, 75%) of what it would have received under a notional equal-per-capita distribution of GST revenues; and
- second, instead of recommending a distribution of revenues that would raise the 'fiscal capacity' of each state and territory to that of the fiscally strongest state (which in most of the past two decades has been WA), the Grants Commission is now required to recommend a distribution which raises the 'fiscal capacity' of each state and territory to the stronger of NSW or Victoria.

For Western Australia, this is what Chinese President Xi Jinping would call a "win-win outcome" – whether the iron ore price (the main source of WA's wealth) goes up or down, WA wins. If the iron ore price goes down, WA's share of GST revenues goes up (as it always would have done, under the 'old rules'). But if the iron ore price (and hence its mining royalty revenue) goes up and stays up, WA gets to keep it.

For the other states and territories – including Tasmania – on the other hand, this is a "lose-lose" outcome.

To forestall that – at least until after the forthcoming election – the Morrison Government also provided a 'transitional guarantee' that no state or territory would get less by way of revenue from the GST than it would have done had the 'old rules' not been changed.

In order to give effect to that 'transitional guarantee', the Morrison Government undertook to 'top up' the revenue from the GST with whatever amount was required to ensure that no other state or territory would be worse off. At the time, it estimated that this 'transitional guarantee' would cost federal taxpayers about $4.6 billion over the eight years 2020-21 through 2027-28.

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But because the iron ore price has remained much higher than had been assumed when these initial estimates were made, the cost of the 'transitional guarantee', as revealed in the most recent Federal Budget Papers, has blown out to $18.6 billion (more than four times the original estimate) – and that's only for the years up to 2025-26.

It's scandalous, in my opinion, that at a time when it is already running unprecedently large budget deficits in order to counter the economic carnage wrought by Covid-19, the Federal Government should have to borrow another almost $20 billion, in order to give that amount to the only Government in Australia – and indeed one of very few anywhere in the world – which is currently running, and forecasting, budget surpluses.

This is surely one of the worst policy decisions that any federal government has made in at least the past twenty years.

And it's no less shameful that it has been supported in this by the Labor Party, who have promised to uphold these changes should they form government after the election on 21st May.

For Tasmania, given the importance to it of its share of the revenue from the GST, a particularly worrisome prospect is the expiry of the 'transitional guarantee' at the end of the 2026-27 financial year, after which the cost of pandering to Western Australia's greed will fall to the other states and territories. And because Tasmania relies on its share of revenue from the GST to a greater extent than any other except the Northern Territory, the cost to Tasmania will be proportionately greater than for any other jurisdiction except the Northern Territory.

Tasmania's Treasury has estimated that, after the expiry of this 'transitional guarantee', the cost to Tasmania of the changes to the basis for sharing GST revenues could reach $100 million per annum by 2031-32. It goes on to say that this amount would be equivalent to 1.1 out of every 5 teachers, 1.2 out of every 5 nurses, or 4 out of every 5 police officers – 1,000 teachers, nurses or police officers in total – being 'unfunded'.

That of course doesn't have to be the only outcome. Whoever is in State Government in ten years' time may instead to increase state taxation, or find some other way of absorbing the 'hit' to Tasmania's share of revenue from the GST.

Tasmania's federal political representatives, along with the Tasmanian Government, should be railing furiously against this 'dirty deal' during the current election campaign. They should also be demanding that whoever wins the next election brings forward the review of it currently slated to be conducted by the Productivity Commission in 2026, and that Tasmania (and the other states and territories) have some say in both the terms of reference for that review, and in who conducts it.

But they should also be thinking of how best to reform and improve Tasmania's own tax system, so that we can be more resilient to adverse decisions over which we have little or no control. And that will be the subject of the next article in this series.

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