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# THE WORST PUBLIC POLICY DECISION OF THE 21ST CENTURY (THUS FAR) – THE CHANGES TO THE DISTRIBUTION OF GST REVENUES MADE BY THE MORRISON GOVERNMENT (WITH THE SUPPORT OF THE THEN LABOR OPPOSITION) AT THE BEHEST OF WESTERN AUSTRALIA IN 2018

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by

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It's highly appropriate to be talking about the distribution of the revenue from the GST among the states and territories in the week before the federal Budget, because it is the largest single expenditure item in the Federal Budget. According to Table 6.3.1 in last year's Budget Paper No 1, it will amount to $92.5bn in the current 2023-24 financial year, compared with $59.2bn for the second largest program, 'support for seniors', and $41.9bn for the third biggest, the NDIS.

Historically, revenue from the GST was – and, prior to the introduction of the GST in 2000, 'general purpose' or 'financial assistance' grants to the states and territories were – distributed in accordance with a principle known as 'horizontal fiscal equalization', the objective of which was to ensure that each state and territory had the same 'fiscal capacity' to provide public services of a similar quality and standard whilst levying similar burdens of state taxation.

That is one of the things that makes Australia a better country than other federations, in particular the United States. Which state you happen to live in matters far less for the quality of the schooling that your children get, or the quality of the health care that you, your parents and your children get, in Australia than it does in the United States, or Canada, or even Germany.

The objective of 'horizontal fiscal equalization' was originally promulgated in the aftermath of the 1933 'Wexit' referendum in which Western Australians voted by a margin of 2 to 1 secede from the Commonwealth – something which the British Parliament subsequently ruled wasn't possible under the Constitution (and in those days, that was that). But in response, the Lyons Government established the Commonwealth Grants Commission to recommend how grants from the Commonwealth should be distributed among the states.

And for almost seventy years after that, Western Australia got a larger share of Commonwealth 'general purpose' grants to the states than it would have obtained had those grants been distributed on a per capita basis – or, to put it in the terms that Western Australia now uses, it got "more than 100 cents in the dollar" of those grants – in recognition of the facts that it cost relatively more per capita to provide services to Western Australia's small and widely dispersed population, whilst with the prices of WA's principal commodity exports being very low its capacity to raise revenue was limited.

Indeed Western Australia got more "cents in the dollar" – that is, a larger share than its share of Australia's total population – than Tasmania between 1945 and 1962, more than South Australia between 1945 and 1985, and more than Queensland between 1945 and 2000.

But then, beginning in the early 2000s, Western Australia got, to adapt a Keatingism, "kissed on the nether regions by a Chinese rainbow". China's appetite for the mineral and energy resources with which nature had so richly endowed Western Australia led to a surge in both the prices of those resources and, subsequently, in the volume of their production. Not just iron ore, but LNG, gold, copper, and most recently lithium ores.

All of which led to Western Australia becoming richer – as measured by per capita gross product – than the rest of Australia, by a bigger margin (more than 60% in the past three years) than any other state had ever been, in Australia's history.

It's perhaps worth emphasizing that this wealth didn't come about because of any unusual effort on the part of Western Australian State Governments.

Yes, successive WA state governments, beginning with those led by Sir David Brand and Sir Charles Court, assiduously courted investment in WA's resources sector.

But they didn't put the minerals under the ground, or the seas surrounding WA's shores.

They didn't push the prices of those minerals into the stratosphere.

And neither they, nor Western Australian citizens or businesses, put up the bulk of the capital required to fund the expansion in the production capacity of WA's mines and gas fields (that came from shareholders located primarily in the 'eastern states' or overseas).

That private sector capital also funded most of the infrastructure used by WA resources producers – in contrast to NSW or Queensland where the railway and port infrastructure used by coal miners has predominantly been funded and provided by state government authorities.

And a good deal of the labour required for that additional production also came from the 'eastern states' or overseas, either by people moving to WA or as 'fly-in, flyout workers.

Reflecting the fact that most state taxes and charges are levied on businesses, not individuals or households, the enormous increase in WA's per capita GSP relative to the rest of Australia implied an enormous increase in its revenue-raising capacity – to, on average over the past decade, about 50% above the average for all states and territories, according to assessments by the Grants Commission.

Never before had one state's capacity to raise revenue from its own resources exceeded that of the other states and territories by as much as Western Australia's has done since the turn of the century. In recent years, WA has been raking in more than $10bn per annum in mineral royalties, compared with around $1bn per annum 20 years ago.

And so, under exactly the same principles that saw WA getting more than "100 cents in the dollar" from Commonwealth grants to the states and territories for the best part of seven decades, WA's share of GST revenues, relative to its share of Australia's population, began to fall to unprecedentedly low levels.

But rather than accepting that this new-found wealth meant that WA should be 'putting into the pot' from which it had so happily drawn for 70 years, it instead threw a giant tantrum, equating 'unprecedented' with 'unfair', complaining that it was only getting "30 cents in the dollar" of "its" GST "back" – even though no-one, least of all the ATO, knows how much GST is collected in, or paid by the residents of, each state and territory.

Successive Federal Governments, of both political persuasions, ignored this bleating from Western Australia until after the 2016 election, at which the Coalition Government led by Malcolm Turnbull survived in office by a margin of one seat, primarily due to it retaining 12 of WA's 15 seats in the House of Representatives. The Coalition knew that it had to retain all of those seats if it were to have any chance of remaining in office at the election due in 2019 – and Labor knew that it had to win some of those seats if it were to have any chance of winning office at the election due in 2019.

And Colin Barnett and his successor Mark McGowan knew it too.

Thus, the Turnbull Government, with six Western Australians in its Cabinet, tasked the Productivity Commission with coming up with changes that would give Western Australia what it wanted. That inquiry had terms of reference that read as if they had been drafted by the WA Treasury. It was conducted with unusual haste – something that is perhaps more easily accomplished if you know what you're going to say before you start. It was conducted in a most un-PC like fashion, with scant regard for the evidence presented to it. And that in turn led to considerable unease among the PC staff working on it, with one staffer subsequently resigning in disgust as a result.

What, by the time the PC's Final Report was presented, had become the Morrison Government decided to make two substantial changes to the way in which the GST would be carved up among the states and territories.

First, the distribution would no longer be undertaken with a view to raising the 'fiscal capacity' of all states to that of the strongest state, but rather to the fiscally stronger of New South Wales and Victoria – a change to be 'phased in' between 2022-23 and 2026-27. This meant that if a state other than NSW or Victoria happened to be fiscally stronger than either of those two – and WA was the only state fitting that description – it would remain so.

Second, irrespective of whatever the Grants Commission calculated a state's share of GST revenues relative to its share of Australia's total population should be (based on its assessments of its expenditure needs and revenue-raising ability), no state would get less than, in 2022-23 and 2023-24, 70%, and from 2024-25 onwards, 75% of what it would have obtained under a notional equal per capita distribution of GST revenues.

Again, the only state that this 'floor' under its GST share would apply to was Western Australia.

In order to cajole the other states and territories into agreeing to something that was manifestly obviously to their disadvantage, the Morrison Government agreed to 'top up' the GST pool so that, until 2026-27, no state or territory would get less than it would have done had these changes not been made. This 'no worse off guarantee' was estimated to cost $8.2bn over eight years, on the assumption that the iron ore price would remain at US$55/tonne over that period – in which case, there would be no need for the 'no worse off guarantee' once it expired in 2026-27, because WA's share of GST revenues would have risen 'naturally' anyway.

And so the Orwellianly-titled Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018 was passed by the Federal Parliament with the support of both major parties.

As we know, the iron ore price didn't stay at US$55/tonne, but has instead remained north of US$100/tonne for most of the period since then. That has meant that the 'no worse off guarantee' is now costing the Federal Budget over $4bn a year, as opposed to the $600mn a year originally envisaged.

And in order to get State Treasurers to be willing to talk about assuming responsibility for funding some of the programs currently funded by the NDIS, late last year the Albanese Government agreed to extend the 'no worse off guarantee' to 2029-30.

As a result of these developments, the cost of the changes to the GST revenue sharing arrangements made in 2018 has now blown out to $39.8 billion over eleven years.

That is, as far as I can tell, the biggest blow-out in the cost of any single Federal Government initiative, with the exception of the NDIS, in at least 25 years.

And that estimate assumes that the iron ore price will fall back to US$60/tonne in 2024-25, and stay there thereafter. If it doesn't – if the iron ore price remains at its current level until 2029-30, then the cost to the Federal Budget of assuaging Western Australia's tantrum could be in excess of $50bn.

As it is, by the end of the 2024-25 financial year, Western Australia will have received a total of $21.7bn more by way of the so-called 'transitional payments' the Morrison Government began slinging over the Nullarbor in 2018-19 and additional GST revenues, than it would have done in the absence of those changes.

So far, the main result of that is that Western Australia has or expects to run budget surpluses totalling $20bn over the eight years to 2026-27. That's on the WA Treasury's assumption that the iron ore price falls to US$66/tonne (cif) from 2024-25 onwards: if it doesn't, those surpluses will be even larger.

Indeed, those surpluses would have been even larger had the WA Government not resorted to accounting artifices to make them look smaller. In 2020-21, and again in the current financial year, the WA Government gave its GBEs a 'dividend holiday, worth $1.4bn in 2020-21 and $1.3bn in 2023-24.

Over the longer term, the result of the changes made in 2018 will be that the residents of Australia's richest state will come to enjoy better public services and lower state taxes than other Australians.

I think that is, to use a phrase that I think has been much-abused in other contexts, un-Australian.

The changes made to the long-standing arrangements for distributing revenue from the GST at WA's behest in 2018 were the result of the two major political parties in the Federal Parliament putting their narrow electoral interest above the national interest.

They have corrupted the purpose behind the biggest single spending program in the Federal Budget.

They have resulted in one of the biggest cost blow-outs of any single 'policy decision' in at least 25 years. How many Hunter Class frigates could we have afforded for the difference between the originally estimated cost of those changes and the most recent estimate of them in last December's MYEFO, a total of $31bn?

While I readily concede that there are other contenders for the title, this decision must be the worst public policy decision of the 21st century. And if Australia's major political parties truly did put the national interest above their own narrow partisan interests, they'd reverse it.

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