This time, the Productivity Commission gets it right

The Productivity Commission has today released its Interim Report on the changes to the system for distributing the revenue from the Federal Government's GST among the states and territories instituted by the Morrison Government, with the support of the then Labor Opposition, in 2018, and extended by the Albanese Government in 2023.

The Report was tasked – as required by the 2018 legislation – with ascertaining whether the changes instituted in 2018 "are operating efficiently, effectively and as intended".

To this question the Productivity Commission has answered with an unequivocal "no".

"The 2018 reforms have largely not met their intent and have introduced a range of undesirable features into Australia's horizontal fiscal equalization system".

Specifically, the PC says the 2018 changes have:

- reduced the level of horizontal fiscal equalization achieved in Australia
- introduced perverse outcomes to the GST distribution system
- come at a significantly higher cost to the Australian Government than expected
- had mixed impacts on states' fiscal positions – with Western Australia being better off, and other states no worse off – while creating additional fiscal uncertainty for governments, and
- increased the complexity of the GST distribution system, making it less transparent.

The PC notes that the $6.4 billion which the 2018 changes cost the Federal Government in 2024-25 could instead have paid for a $450 tax cut for each Australian taxpayer, or (alternatively) an increase in JobSeeker payments to 90% of the age pension.

Additionally, it notes that the 2018 changes have done nothing to reduce the year-on-year volatility in the shares of GST revenue received by individual states and territories – other than Western Australia. It repudiates the assertions repeatedly made by Western Australia that the pre-2018 system acted as a disincentive for states and territories to pursue productivity-enhancing reforms, or to seek to increase revenues from their own sources.

The PC's report also usefully dispels a number of myths about the GST distribution which have been promulgated by, in particular, successive Western Australian Governments in their pursuit of a larger share of GST revenue than they objectively 'need' in order to provide their population with a similar standard of public services whilst levying on them a similar burden of state taxes and charges to the average of all states and territories (which is – or was before the 2018 changes were instituted – the objective of 'horizontal fiscal equalization').

The Report points out that:

- it is not possible to calculate the amount of GST paid in each state with any level of confidence
- there is no way of verifying assertions that a state pays its exact population share of GST or that states are only 'getting back a certain percentage of the GST paid by their population
- the argument that states are 'not getting back' their population share does not align with attitudes towards other key federal taxes – for example there is no public expectation that income tax paid by an individual is returned to the state or postcode in which they live.

The PC presents the Government with three options for 'fixing' the problems caused by the changes instituted in 2018:

- the 'first best option' is to transition back to the pre-2018 system, but with a direction from the Federal Treasurer to the Grants Commission to deal with so-called 'dominant state effects' (where one state's actions can materially shift the average for all states and territories) where they arise (most obviously in the case of mineral royalty revenues)
- the 'second best option' would be to return to the pre-2018 system, but with the Federal Government making direct and transparent payments to states it considers to be materially affected by 'dominant-state effects' (which is, in effect, what the Morrison Government did between 2018-19 and 2020-21);
- or, if the Federal Government is "only minded to make minimal and critical changes to the current system" (as may well be the case), to remove the requirement that no state can have a lower 'relativity' than New South Wales, and to retain the 'No Worse Off' guarantee (to the 'eastern' states and territories) in perpetuity (this would be the most costly option for the Federal Government).

The PC's Interim Report is a refreshing change from the Report which the Commission undertook in 2018. That Report was governed by terms of reference which more or less guaranteed that it would come up with recommendations designed to assuage Western Australia's greed. And for that and (possibly) other reasons, the inquiry which produced it was conducted with scant regard for the evidence presented to it. Indeed, there was considerable dissatisfaction among the staff who worked on it with the way in which it was conducted, prompting one of those staff to resign in disgust.

So it is quite wrong for Western Australian Treasurer Rita Saffioti to assert, as she has done today, that for the PC to repudiate its 2018 findings would "irretrievably damage its credibility". On the contrary, the PC has restored and elevated its credibility with today's report.

The PC will present its final report and recommendations to the Federal Treasurer before the end of this year.

And the Federal Government's response to those recommendations will constitute an important test of its commitment to the notion of 'equity', and of its claims to be a prudent manager of the Federal Budget.

I cannot understand how a Labor Government can think handing $60 billion over 11 years to the richest state in the country, a state which is richer than the rest of Australia by a bigger margin than any other state has ever been, so that it can run budget surpluses whilst every other government in the country (including the Federal Government) runs persistent deficits, and so that the residents of the richest state in the country can enjoy better public services whilst paying lower state taxes than other Australians, can be consider 'fair'. Nor do I understand how that can be considered consistent with 'prudent management' of the nation's finances.

Equally, I don't understand how the Coalition parties can be taken seriously as wanting to reduce government spending and the Federal Budget deficit, if they aren't willing to support the first or second of the PC's recommendations.

Both sides of Federal politics should put the national interest – in ensuring that no matter which state or territory they live in, all Australians can have access to similar standards of education, health care, community and environmental protection and other services – above their narrow partisan interest in retaining or regaining House of Representatives seats from Western Australia. In other words, the opposite of what they both did in 2018.

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