Western Australia's sustained protest against the GST revenues it is being allocated has paid off in the last month. After directing the Productivity Commission (PC) to complete an inquiry into the dispute, Federal treasurer Scott Morrison ignored their main recommendation while still announcing an alternative compromise. Within the model to be debated at the Council on Federal Financial Relations in September, changes would be made to both the benchmark of service delivery that states and territories (States) are funded towards out of GST revenue (equivalent to the stronger of Victoria or NSW's fiscal capacity), as well as a 'floor' placed on per-capita revenue distributed in comparison to the national average.[1] These two policies explicitly benefit Western Australia for reasons that will be explained below. The Treasurer's model is borne out of politics rather than ideological principles (WA is a strong Liberal state), while the Commission's preferred substantially lower benchmark for services would be deeply unpopular, redirecting money away from struggling States towards those already better off. Neither of these proposals should be undertaken, as WA's case for special treatment is specious.

Australia's taxation system is an outlier among our OECD peers in two directions.[2] Firstly, there is a severe vertical fiscal imbalance (in which federal taxes collected exceed federal commitments, whereas state taxes do not raise enough money to cover state responsibilities) that requires a comprehensive system of redistribution.[2] Secondly, Australia commits to full horizontal fiscal equalisation. HFE is defined in the PC report as, "*[distributing] GST revenues so that each state and territory has the fiscal capacity to provide services and infrastructure to the same standard*".[2] Fiscal capacity is dependent on "*assuming … the average effort to raise revenue and [operate] at the average level of efficiency when differences in revenue streams, demographics, and costs are adjusted for*".[2] States have remarkably different inherent fiscal capacities, which results in an unequal allocation of GST revenue per capita. The benchmark for redistribution is to equalise with the fiscally strongest state (Western Australia since FY10), which is a designation determined almost entirely by WA's capacity to raise mining royalties.[2] Equalisation is the priority of GST revenue allocation – any money left over is distributed solely on a per-capita basis, thus this is the only slice of the pie WA receives. Between 2000-08, approximately 85% of the pool remained for per-capita allocation after equalisation had occurred, however this declined to 30% in FY17, before rising to ~50% in FY19.[2]

WA's quest to gain a higher GST allocation than what would occur under the current HFE system is based on three arguments, each which lose their persuasive power under further scrutiny;

1. **Abuse of 'Relativity' Values**: The process of GST allocation is difficult to concisely explain, which may be the reason the national media uses relativity figures for each state and territory as a shorthand. A relativity figure is "*the ratio of a State's per capita GST allocation to the national average per capita*

GST distributed".[2] Thus, a relativity of 1.0 implies a State received a share of the GST pool precisely equal to its population share. However this definition is continuously misrepresented (including by national media outlets in the reporting of this announcement) as the ratio of every dollar of GST collected in a particular state returned back to that state.[2] It sounds like a small difference; in practice it creates an unfounded set of grievances that a relativity < 1.0 indicates a state is losing what's rightfully theirs. WA's relativity declined to an unprecedented 0.3 in FY16 and it is set to rise only to 0.47 in FY19 from declining iron ore prices.[2] Thus, when the Treasurer discusses his prospective policy of setting a 'floor' of 0.7 in FY23 (rising to 0.75 by FY25)[1], this specifically increases WA's GST share per-capita as no other state looks to be in danger of falling to the 'floor' any time soon.

2. **Budget Repair**: The assessment of relativity values is determined through an averaging process of three fiscal years, with a two year 'data' lag between the determination of a relativity and its realized application.[2] The significant administrative lag has resulted in WA receiving less GST revenue than a contemporaneous assessment would deliver for the last three consecutive years, coinciding with the decline in iron ore prices.[2] A chorus of entities including QLD and the ACT have previously noted the inadvertent procyclical nature of GST revenue, contributing to significant volatility in a state's budget position.[2] However the Commonwealth Grants Commission (the independent body which determines relativities) sharply noted that between FY11-16 WA received almost $7 billion dollars extra than a contemporaneous assessment would have delivered.[2] Furthermore, WA FY12 budget communications explained that the state 'anticipated' that by FY14, a relativity floor of 0.75 would be instituted, and there is some limited evidence that this belief influenced expenditure decisions.[2]

3. **Moving the Goalposts**: In its submission to the Commission, WA stated that "*there is a disincentive… to undertake microeconomic reform…. incentivising states to maintain the status quo and free-ride on stronger States*".[2] This theme of dependence was also echoed by the report's authors, "*HFE reduces the need for smaller States to grow their economies and address their underlying sources of disadvantage*".[2] The Commission explicitly delineated between fiscal equality and 'fairness' - states keeping any extra revenue gained through reform instead of seeing it equalised away – in their most controversial recommendation to set the benchmark at the national average fiscal capacity, rather than the strongest state. It is worth noting on these fronts that WA did not undertake daring fiscal reform to achieve its current status and that the Victorian and NT governments both submitted evidence astutely recognising the revenue HFE provides is solely for service delivery, not intended to reverse underlying disadvantage.[2]

Carving out exceptions to improve WA's fortunes beyond what is already based on the luck of patterns of mineral distribution and state boundary lines is fundamentally at odds with Australia's narrative of itself as an egalitarian society. To be certain, there are disadvantaged groups which would deservedly critique how successfully Australia has lived up to that founding ethos (most notably our Indigenous population). However in a heavily multicultural and technologically disrupted society it is even more important to recognise the benefit of cultural values that are a stabilising influence. Given WA's budget mismanagement and the continued misrepresentation of what relativity measures, the case for receiving special treatment is flawed. The wealth of Australia deserves to be shared equally among its citizens as a continuing communal increase in living standards for as long as the current business cycle allows.

Bibliography

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