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Western Australia and the Goods and Services Tax

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If you are following the politics in Western Australia, the conference of the West Australian branch of the Labor Party is in town today, and Bill Shorten, the federal leader, has had his Eureka moment. He has come down from the mountain with his tablets and said: "I have solved the GST [goods and services tax] issue." Actually, all he has done is to perpetuate the problem that we have had for decades. That is, because of the problems with the interpretations of our constitutional structures, he has promised either to borrow $1.6bn or, more probably, tax more and use those proceeds to soak a paper over an issue in Western Australia. It is an illustration of the problem and not an illustration of a solution.

What I propose in this address is to discuss with the learned people of The Samuel Griffith Society an issue or proposal that I want to pursue because this Society is the right group to begin the discussion.

I am not a lawyer: I am a politician now, and an economist before. I have spent a great deal of my life looking at federal fiscal issues. My first task with the Institute of Public Affairs was with the States Policy Unit, where I went around and commented on federalism and the States' budgets for quite a few years, with John Stone, Des Moore and other learned people who have been participating in The Samuel Griffith Society for a long time.

One of the issues that The Samuel Griffith Society, and I, and others, have talked over and over about is the misinterpretation of the Australian Constitution.

Under the Constitution, Australia was meant to be a federation of States with enumerated powers between the States and Canberra. It was based to some extent on American experience and also Swiss experience but, actually, it has become "Washminster"; it was interpreted increasingly from the perspective of Westminster rather than Washington, with an increasing accretion of power to the Commonwealth.

What I plan to do is come up with a proposal that, in one sense, can figuratively be a hand grenade into the fiscal federalism of Australia, but what I would call, more positively, a rebooting of the system. The proposal involves looking to a constitutional challenge to the validity of the Grants Commission process.

Alfred Deakin very famously wrote:

> [The States were left] legally free, but financially bound by the chariot wheels of the Central Government. Their need will be its opportunity. The less popular States will succumb first; those smitten by drought or similar misfortune will follow; and finally even the great and most prosperous will, however reluctantly, be brought to heel. Our Constitution may remain unaltered, but a vital change will have taken place in the relations between the States and the Commonwealth. The Commonwealth will have acquired a general control over the States, while every

extension of political power will be made by its means and go to increase its relative superiority.

We have a huge imbalance between the revenue-raising and spending capacity of the Commonwealth, and the States. The Commonwealth has accreted to itself the lion's share of spending power.

But, as any politician knows, politics is all local. I get involved in local government a lot. The Commonwealth gets involved, increasingly, in State and local government, and has the capacity to do so very extensively. There is an imbalance. That allows the Commonwealth, and allows the States to go to the Commonwealth, to solve its problems. Joh Bjelke-Petersen used to say, the best tax is a Commonwealth tax, because the Commonwealth levies the tax, it gets the umbrage from that tax, and the States get crumbs from it to spend. A problem!

I am not going to try to solve vertical fiscal imbalance in this address. What I want to consider is using the Constitution to bring into question the constitutionality of the Grants Commission process. I know this will probably precipitate a questioning of the whole grants system, not only to the States, tied and general, but also to local government.

We have evolved (in Australia) the Grants Commission process slowly and steadily since the 1930s; and then, in the 1950s and 1960s, it was more formulated, basically along lines of horizontal fiscal equalisation. It is a very complex system but, when boiled down, it involves overriding the States to have a unitary type allocation of resources around the country and it allows – which is actually a socialist agenda – a tax according to those who have the ability, and payment to those who have the need. It essentially redistributes all identified revenue to the States throughout the nation according to what the bureaucrats in the Grants Commission perceive to be the needs of the States, so that every State has the same capacity – no matter what it does – to provide the same basket of services as every other State. The basket of services has been widened over a period of time.

If you have unity amongst the States, it is not a big issue. It does not lead to too much difference, as the States do not have a huge difference in their taxes. But it is a big issue if you have a shock to the system, that is, one State does something different to the rest. And Western Australia did it: we had a very open, progressive, bipartisan policy for development of our resources sector.

The Fraser Institute, a very fine think-tank in Vancouver, Canada, does a review of resources policy around the world and, year after year, Western Australia has been in either the top five states, if not the most open state, to developing resources in the world.

And it has paid off. We have invested heavily over a long period of time in infrastructure, such that when the Chinese decided they wanted to build their economy and needed massive amounts of iron ore, oil and gas, where did they come? They came to Western Australia. We have had $600bn worth of infrastructure invested in Western Australia – in iron ore, oil and LNG and a whole raft of other things – over the last 10 years. Massive infrastructure.

We now account for 50 percent of exports, pushing towards 60 percent. When LNG goes up, then, depending on the value, it will be larger. So we have done it and we have had to go out there and provide the infrastructure for it.

When this happened, we ran out of people. 500 000 people, the population equivalent of Tasmania, moved to Western Australia. Not from interstate, because they were paid to stay put. When our unemployment was 2.5 percent or less, the unemployment rate in north-western Tasmania, a beautiful place with hard-working people, was 8 percent. They did not come over. We brought them from everywhere around the world. We ran out of people. We had the equivalent of Dutch disease. We had to pay people excessively. But it paid off.

People in New South Wales think their wealth is driven by building apartments, when in truth it is built from wealth in Western Australia and in Queensland.

But, what has happened? The GST does this: when a single State gets a great big whop of money, in a unique form, such as iron ore royalties, they redistribute it; 90 percent, with a lag of three years.

In 2002, we were getting about 25 percent of our income from the goods and services tax. Stable, predictable, controlled. Now we get about four percent or five percent, maybe seven percent, depending on the price of iron ore. At the same time, more than 20 percent of the income of Western Australia comes from iron ore.

There are a number of problems with this.

First, it takes the proceeds from investment in the State of Western Australia and redistributes it elsewhere. There is a disincentive there.

Second, it is forcing the State of Western Australia to be highly dependent on some of the most volatile prices in the world. Let us face it, the iron ore market world-wide – prices are now spot-market, not contract as they used to be – is a gambling den. It varies 50 percent within a year. How is a government supposed to provide services for education, health, police, on a long-term stable basis, on the basis of a price that varies 50 percent within a year? Already this year it has gone from $94 to $55; it is now up to $76. Unpredictable. Ask the majors what the iron ore price will be and they say: "we gave up trying to predict that a long time ago; we are just focusing on costs."

So we have had a very large increasing reliance on iron ore prices.

Traditionally, the share of tax revenue has been very stable. The lowest share before us was in about 1942, to Victoria, which got down to about 71 percent. Western Australia has dipped down to 29.9 percent. In fact, when I first came into the West Australian Government, in 2013-14, the prediction we had on the forecast of iron ore prices, at that time, was that we were going to get zero share of GST back in four years' time.

Why would Western Australia be a part of the Australian federation? We like Tasmania and South Australia, but why would we do that? It is simply unfair.

When I showed the figures to John Howard, one of Australia's most astute politicians, he looked at it and said: "not fair". It does not pass the smell test.

Based on population, this amounts to a huge redistribution that goes off the charts. And to put this in context, this is not the only form of redistribution. We have income tax, company tax, payroll tax. In 2015-16, the last time we have estimated, the total net distribution from Western Australia to the other States, via Canberra, was $20bn, of which only $4bn was GST. This is like a colony.

People in Victoria, Tasmania and South Australia say: "But you do not need the money. We need it more than you". But it is not only about redistribution of money. In terms of per capita income, we have quite a bit. The problem is that it stops people from moving around and investing.

We hear often that back in the 1970s and 1980s, when the tariff walls were high, Western Australia was a claimant State. This is true. But if you take the total receipts, put it into 2013 dollars, and find out what the net present value is, it turns out to be negative, because the drop in recent years has been so profound that it wipes out decades of being a claimant State.

This is, simply, politically and economically unsustainable, and the argument we have is that this is discrimination.

This is not just about a fair deal for Western Australia. It is also about the systems that redistribute money from high-yield, high-gain areas to consumption in other areas.

We have had large amounts of money pulled from infrastructure and developments that underpin the fastest growing areas of our economy – whether that be iron ore, or LNG, or agriculture – to pure consumption in other States.

It is a dynamic inefficiency because the Grants Commission takes the pool of money and pays people to stay put. It pays people not to move around in response to higher yields, better lifestyle, or whatever motivates them.

It is “sit-down money” on a wide, national scale, on an inter-generational basis.

That is inefficient. It is an attack on our future. The biggest challenge we have, as Australians, is: where is our productivity growth going to come from now that the mining boom has subsided?

Also, one of the biggest issues with the process is that there is an asymmetry between revenue, which they can measure pretty well, and costs. A whole range of costs associated with the grants process are not treated adequately.

Take regional development. The Grants Commission will set per capita income on a national basis. Back in 2012-13, Victoria and New South Wales had very little regional development. Nothing was going on because they had stopped their mining sector to a large extent.

Meanwhile, Western Australia’s regional development was going off the chart because we had the largest investment in this nation’s history in our regions – namely Karratha and Port Hedland. But they equalised it.

We had much higher income than other States, but it was productive growth. They forget that.

The Grants Commission similarly decided that rural and regional wages are less than metro wages. This is true in most eastern States. That is not the case in Western Australia. We ran out of people in the north. People in Karratha at one time were paying $1 200 to rent a room in Karratha – they were making $200 000 too. Wages differentials were not adequately treated.

So there is a whole range of fundamental problems not only with the basic tenets of horizontal fiscal equalisation but also with the way that it is operated. It fundamentally discriminates against the productive States that decide to provide and allow mining and resource companies to come and drill, frack if they wish, put in railways, and help to resolve native title claims – all those things that go with resource development.

Other States, apart from Queensland, have failed to do it. It is discriminatory.

And it is also discriminatory against everyone because we are the poorer for these policies, which provide a disincentive to be productive and invest.

Tasmania gets about 40 percent or 50 percent of its income – maybe a little more – from GST. We get 20 percent plus on the most highly volatile source of income and when you have a volatile income – what do you do? You have to put something aside. If you are in a volatile industry, you must have large levels of equity or cash sitting around to cope with the volatility in revenue stream. That means – particularly during a boom time – you are taking huge risks.

And that is what happened. We went into deficit.

There is also an issue – this is a technical issue with the GST – where lags in revenue are built into the system. In 2014-15, the GST's assumption was that iron ore prices were $118, when they were actually $37.70, and there was an assumption that we had revenue based on $118, when we had revenue based on about one-third of that, and we went into deficit.

We had revenue streams collapsing because of iron ore, and we also had revenue streams from GST collapsing at the same time.

If that is not discrimination, go heave. I almost did.

So what do we plan to do about it? We have some legal advice and we are going to pursue it.

There was a test case in the High Court in 1926, federal roads case, as to the appropriateness of one of the initial grants from the Commonwealth (*Victoria v Commonwealth* (1926) 38 CLR 399). This policy has underpinned Commonwealth grants to the States ever since. It was a literal interpretation of section 96 of the Constitution at the time, which made it quite clear that the Commonwealth could make grants to the States unfettered.

Since then, there have been a number of interpretations, particularly in 2009, where the High Court said that section 96 has to be interpreted, not by itself, but in the context of all aspects of the Constitution, particularly sections 55 and 99.

My layman's summary is that this essentially allows grants to be provided but there cannot be discrimination on the basis of taxation and other aspects.

In this world, the word, "discrimination", is probably one of the most misused in the English language. But our argument will be that the grants system, as it has evolved, is discriminating against Western Australia and it needs to be re-interpreted.

One challenge is that we need to get access to the High Court. I am confident that there are a number of people in Western Australia who have been hard done by, appropriately, as a result of decisions of the Grants Commission and, therefore, that we can get access, and that the High Court will look at this issue. That is, we are confident that if we can get an appropriate body to make a claim to the High Court, the High Court will entertain the issue. That is what the Court has signalled in recent times.

The task will be to prove discrimination, and that is it.

There is another reason for doing this. There is a real flaw in the solution being proposed by the Turnbull Government and by the Shorten Opposition. Their solution will extenuate the fundamental problem. Their solution is to go out and borrow more money to solve the perceived and, I think, real belief of discrimination in Western Australia.

We do not want the Commonwealth to borrow more; they are already pushing towards half a trillion dollars. We want no more taxation, but fair distribution of existing revenue raised.

Bill Shorten yesterday came out with a promise of $1.6bn for Western Australia. It is not clear where he is going to get the money. But it is either higher taxation or borrowings and, as we know, borrowings are taxation deferred.

We do not want that. We want an appropriate and rigorous allocation of the moneys already raised in Western Australia.

A really important issue is that the States have long hidden behind the Commonwealth in terms of getting the Commonwealth to dole out great big dollops of money that they either could not earn, or justify spending, themselves.

We strongly believe that the best thing going forward is to have States being more fiscally responsible for the money that they raise as well as the money that they spend.

The Grants Commission is stopping people and resources from moving across our nation to the highest value uses. Our challenge is to pull what is one of the major impediments to resource allocation in Western Australia and around the country.

I would welcome any ideas. I would welcome debate on it from The Samuel Griffith Society. We are not yet committed, but it is a path we are going down.