From: Secretary@CGC
Sent: Tuesday, 12 June 2018 10:09 AM
To: secretary@putwesternaustraliafirst.com.au
Subject: FW: FOI Request [SEC=UNCLASSIFIED]

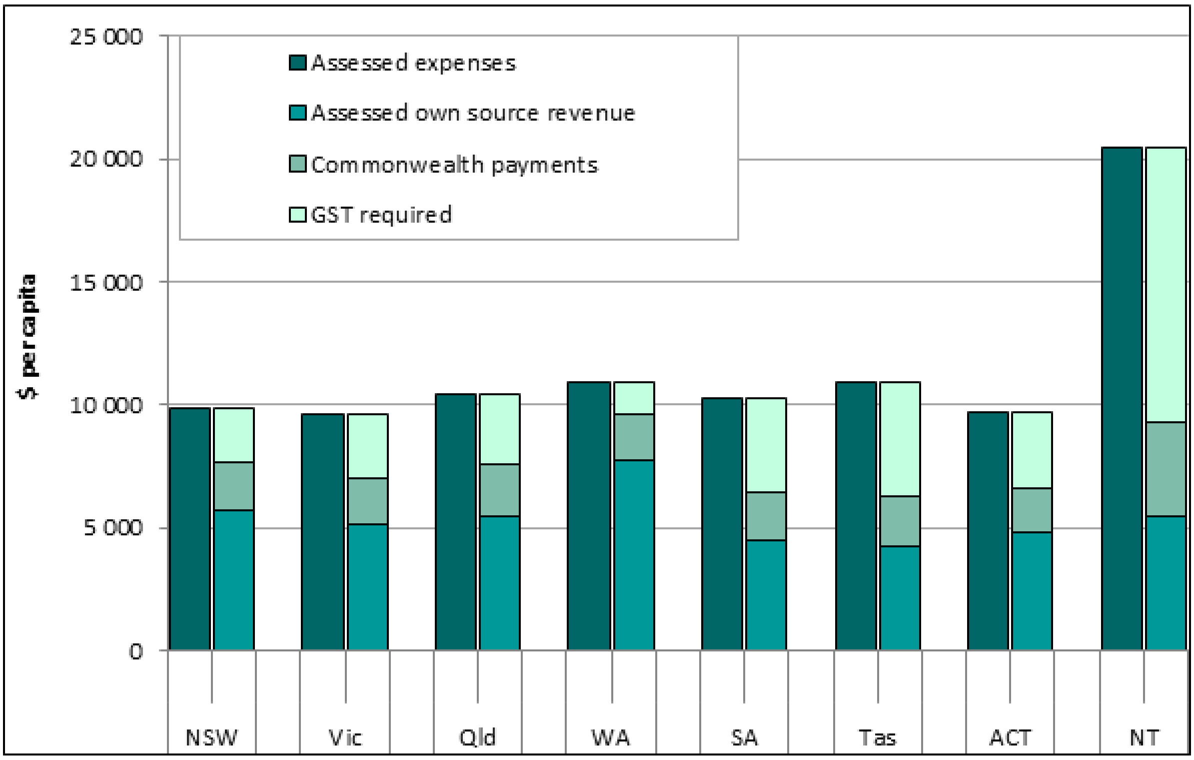
Dear Mr Leigh

Further to your follow-up email of 28 May, I make the following observations on how the Commission implements HFE.

The Commission's approach to HFE is to equalise States to have the same fiscal capacity to provide the average level of services. In contrast, the Productivity Commission's draft report proposal is focused on raising fiscally weaker States to the average fiscal capacity (with the remaining GST apportioned to all States on an equal per capita — EPC — basis). These two approaches are subtly but significantly different in that, as explained further below, they are based on different interpretations of the term 'average'.

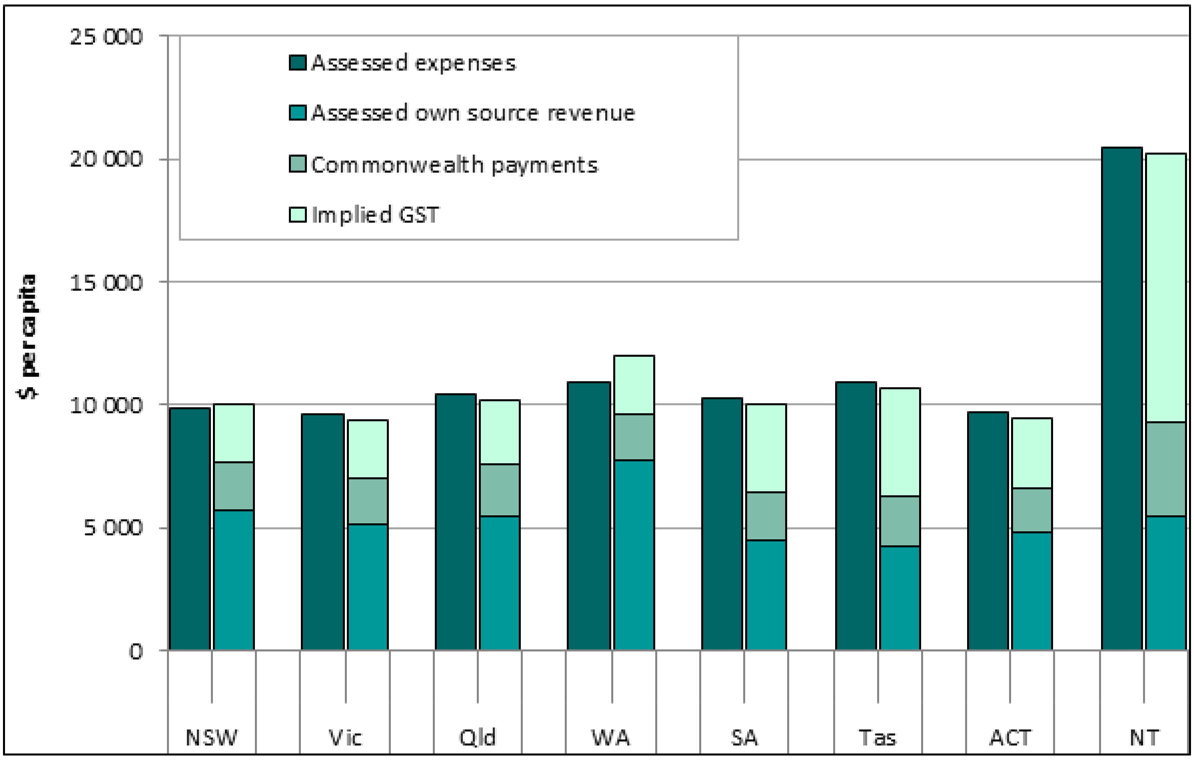
The Commission recommends a distribution of GST revenue among the States designed to give each State the fiscal capacity to deliver services and the associated infrastructure at the same (average) standard, if each made the average effort to raise revenue from its own sources and operated at the average level of efficiency. This approach is illustrated in Figure 1 below. It shows that each State is recommended to receive GST revenue such that, combined with own source revenue and other payments from the Commonwealth for specific purposes, each State will be able to meet its assessed spending requirement to provide the same (average) level of services and associated infrastructure. Spending requirements to deliver the average services differ across the States because of factors such as population characteristics (age, Indigenous status, socio-economic status), population dispersion across more remote areas and underlying wage costs. Similarly, own source revenue raising capability differs across States due to factors such as size and structure of their private sector workforces, property values and the existence of mineral deposits. Despite having the second highest assessed spending needs, Western Australia is assessed to require the least GST revenue per capita due to its much higher than average capacity to raise own source revenues. This is largely due to its high level of mining royalties per capita.

Figure 1: GST requirement, 2018-19



In contrast, the results of an approach along the lines proposed in the PC's draft report – of raising fiscally weaker States to the average fiscal capacity (and please note this critical point – as applied by the PC, this is average fiscal capacity BEFORE the GST is distributed) and distributing the remainder of the GST to all States on an EPC basis – is illustrated in Figure 2 below. You can see that, under this approach, some States will be fiscally stronger (that is, they will have more than the capacity required to meet their assessed spending needs to provide the average level of services and associated infrastructure) while the most other States will be fiscally weaker (that is, they will have less than the capacity required to meet their assessed spending needs to provide the average level of services and associated infrastructure). The fiscally stronger States will therefore be able to provide higher than average service levels, and/or have lower than average taxes. This approach does not result in achieving HFE as the Commission has been asked to do through its terms of reference.

Figure 2: Implied GST revenue after equalising fiscally weaker States to the average, 2018-19



In its terms of reference for the 1999 Methodology Review, the Commission was directed in Clause 2(a) that its assessments should '… enable each State to provide the average standard of State-type public services assuming it does so at an average level of operational efficiency and makes the average effort to raise revenue from its own sources.' As the average standard of services would be the same for all States, the Commission considered that a clearer way of expressing this requirement was to adopt the following definition:

'State governments should receive funding from the Commonwealth such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standard.'

The Commission believes that its adoption of this definition was consistent with its terms of reference and rejects arguments to the contrary. The 1999 Review definition of HFE was the definition in force at the time all governments signed the 2001 Intergovernmental Agreement on Federal Financial Relations, following the introduction of GST revenue as the pool of general revenue assistance available to States. Successive terms of reference issued to the Commission for annual updates to its relativities since the Commission's adoption of that definition have been based on the definition.

I have attached to this email a copy of relevant chapters from Volume 1 of the Commission's 1999 Review Report which may be of assistance.

Regards

FOI Coordinator
Commonwealth Grants Commission