Options for improving contemporaneity

2015 Review

Supplementary submission addressing the 20 January 2015 request for comments

Tasmanian Government Submission

January 2015

Tasmania
Explore the possibilities

Introduction

Tasmania appreciates the further consultation that the Commission is undertaking on dealing with volatile revenues and contemporaneity.

Tasmania has comprehensively stated our views on the principles of this issue in our recent submissions. In the context of those principles, we offer the following comments specifically in relation to the illustrative options presented by Commission staff.

Option A: An absorption approach

Tasmania notes that this option proposes that iron ore royalties be removed from the standard assessment methodology, and for the resulting three assessment-year average relativity to be applied to a combined pool of GST revenue and total national iron ore royalties in the application year.

Tasmania sees little merit in this approach. Significantly, it proposes a major shift in the methodological approach of the Commission's assessment without comprehensive consultation or adequate time to fully consider the implications of such a change. It also increases the complexity of the assessment and spreads revenue uncertainty and volatility across all states. We consider that a conceptual case supporting the need for such a change has not been sufficiently demonstrated.

As stated in previous submissions, Tasmania believes that Western Australia has been a clear beneficiary of the current lagged methodology; during the initial stages of the mining boom, they were able to retain the benefits of rapidly increasing iron ore royalty revenues through the lagged impact on the GST distribution. To fundamentally change the methodology for the purpose of ameliorating assessment outcomes at a time where the lagged assessment approach is unfavourable to Western Australia seems reactive and inequitable for other states. This option effectively "socialises" the volatility of a specific revenue source across other states for the clear benefit of one state.

Option B: A lagged five year moving average

Tasmania notes that this option proposes that specific revenue assessments use a lagged five year moving average, whilst other assessments would continue to use a three year moving average.

Tasmania sees some merit in this approach in that the assessments would still be based on actual assessment year data, and would remain relatively consistent with other areas of the Commission's methodology.

However, the use of a five-year moving average would reintroduce the 2009-10 and 2010-11 data years to the assessment. Tasmania contends that previous GST distribution outcomes have already reflected the data of these years when they were part of the assessment years contributing to the three-year average. To return to a five year average will duplicate those benefits by redirecting GST revenue to certain states based solely on the reintroduction of past data.

Similarly, if a revenue assessment settles into a different pattern at a point in future (or a state argues strongly for a more contemporaneous assessment based on new "current circumstances"), it is plausible that the Commission could determine that the assessment should be transitioned back to a three-year average. Depending on the transitioning arrangements and data years involved, it is possible that further duplicate benefits may be delivered to a state at that point also.

Tasmania notes that the iron ore revenues Western Australia receipted in 2009-10 and 2010-11 are lower than those receipted in the three current assessment years. If these data years happened to include higher than average revenues for Western Australia, the option of moving to a five year average would be counterproductive, and would not be under consideration. Therefore, this option is only being considered because it delivers a particular outcome for one state in response to a specific set of circumstances. It is not broad enough to address the general issue of dealing with revenue volatility for any state or territory.

As discussed in our previous submissions, Tasmania notes that the Commission considered the length of the lagged assessment period in detail during the 2010 Review. The decision was made to move from a five year average to a three year average on the basis that it balanced the competing priorities of contemporaneity, and stability, simplicity and practicality. Tasmania reiterates its view that the balance achieved by a three-year average is still appropriate. Further, it is arguable that the move to a five year average for any revenue assessment results in less contemporaneity and increased complexity within the methodology.

Option C: Smoothing through an adjustment to GST outcomes, that would be reversed over subsequent years.

Tasmania notes that this option proposes that the outcomes of the standard HFE-based GST distribution be adjusted to ameliorate the impact of volatile revenues, with the adjustment reversed in later year/s.

Tasmania sees some merit in such an approach in that it does not directly interfere with the Commission's methodology and its delivery of a HFE-based distribution outcome.

Undertaking such an adjustment within the GST distribution system would result in other States in effect "loaning" GST revenue to specific state (or states) for a set period of time. The principle of states being forced to lend their GST revenue to other states is highly questionable, particularly at a time when most Government's face budgetary challenges. It risks the GST distribution system being seen as a temporary loan facility for Government's facing fiscal difficulty. Further, it could lead to a situation where lender states need to borrow funds at market rates to compensate. This, combined with the increased uncertainty, could also negatively affect a state's credit ratings.

On a practical level, Tasmania questions how such an adjustment can be implemented in a way that is equitable for all States and that revenue volatility for one state is not transferred to other states through reduced GST. For instance, how will an appropriate level of adjustment be determined? How will repayments be structured to ensure that the net present value of the loaned revenue is maintained? Will some form of interest repayments be required from recipient states? Determining how this option will be implemented will require considerable judgement on the part of the Commission, on issues that are arguably outside of its remit.

Concluding remarks

Tasmania acknowledges the Commission, at the Federal Treasurer's request, has been tasked with providing advice on options to ameliorate the effect of revenue volatility on the GST distribution. We recognise that the Commission is obligated to provide a response.

However, Tasmania is concerned that endorsing or recommending any specific option for dealing with volatile revenues, particularly given such short timeframes and the inability for states and the Commission to adequately consider all of the issues involved, sets a concerning precedent.

Implementation of any of these options will have a material impact on the distribution of GST between states. Tasmania does not consider it the role of the GST distribution system to do anything other than deliver distribution outcomes based on the principle of HFE.

Tasmania considers options A and B are inappropriate in that they change the methodology to achieve a particular outcome for one state, in a way that reduces the achievement of HFE. While Option C does not change the methodology, Tasmania also considers this option inappropriate in that it proposes that the GST distribution system is used as a "bank" to address particular states' revenue volatility issues.