

Victoria thanks the Commission for the opportunity to comment on its illustrative options for advice to the Commonwealth Treasurer on revenue volatility and timeliness of GST relativities.

Victoria restates it is strongly opposed to implementing any of the proposed changes, especially at such a late stage of the assessment process. The proposed changes are inequitable, complex, and are likely to compound volatility in GST shares. In principle, Victoria strongly rejects any ad-hoc methodological changes to GST relativities that are largely designed for the benefit of a single jurisdiction.

The proposed changes would be unfair

As the price of iron ore began to appreciate sharply from 2008-09, Western Australia substantially benefited from the Commission's current three-year averaging methodology, which ensured that state concurrently received significant levels of both GST and mining revenue for a number of years. To change this approach now would represent an unjustifiable windfall gain to Western Australia through them benefitting from the upside of the existing system but changing it to protect them from the downside. It could effectively mean that no iron ore revenue collected at the peak of the iron ore price cycle was subject to equalisation. This outcome would be a highly inequitable departure from the fundamental principles of equalisation, undermining national confidence in the distribution system.

The changes would make the system more complex and less transparent

Taken on their own, each of the proposed options would likely represent one of the single largest methodological changes in the 2015 Review, a process that has extended over two years and included extensive analysis and consultation. Considering these new proposals in the final two months of this process does not allow adequate time to understand and assess their significant implications and runs the risk of significant unintended consequences.

Through no fault of the Commission, the options presented are too underdeveloped to make an informed assessment of how they would operate, or their merits and impact. Victoria considers implementing any of these options to largely be either technically impracticable or require an unacceptable level of judgement. Victoria is concerned that the proposed changes would leave the system of equalisation and the majority of states - including Victoria - worse off in an attempt to support the revenue management issues of one jurisdiction.

To the extent these options require direction from the Commonwealth Treasurer, implementing them has the potential to unduly politicise the GST distribution process and undermine the independence and transparency of equalisation. Victoria is not confident the Commission can satisfactorily resolve these implementation issues prior to finalisation of the Review.

The changes would exacerbate volatility in GST shares

In an effort to manage volatility in one revenue line for a single state, at least two of the Commission's proposals would greatly exacerbate volatility of GST revenue for all jurisdictions, greatly complicating the process of preparing state budgets and the development of reliable revenue forecasts.

To the extent these options rely on forecasts, Victoria considers the Commission's proposals also carry significant risk of gaming of GST shares by some states in preparing their budgets, by enabling states to directly influence their GST shares by varying their revenue forecasting assumptions. In the *2010 Methodology Review*, following extensive analysis and consultation, the Commission concluded that a three year averaging process applied across the entire assessment struck the right balance between minimising volatility, and ensuring that GST shares reasonably reflect states' current fiscal capacities. This view was reaffirmed in the Draft Report of the *2015 Methodology Review*. Victoria agrees with this assessment.

Assessment of options

Victoria strongly opposes implementing any of the proposed adjustments, which are likely to increase uncertainty, GST revenue volatility, and unfairly penalise non-mining jurisdictions such as Victoria. We however appreciate that the Commission is obliged to provide the Commonwealth Treasurer with advice on this issue. Victoria considers that this advice should discuss the complexities and compromises involved, as well as discussing the views of states and territories.

While the Commission has been asked to examine ways to improve contemporaneity associated with volatile revenue streams, this would come at the direct expense of broader volatility in GST shares. In seeking to address these issues, Victoria cannot recommend to the the Commission any option that would result in the exclusion of mining revenue from full equalisation. It is also likely that these approaches would create incentives for gaming.

Regardless of the Commission's final advice to the Commonwealth Treasurer, Victoria requests that relativities advice be provided to states as early as possible, given their significance in preparing the Budget.