

Treasurer Scott Morrison has acceded to pressure from his Western Australian colleagues in announcing another review of the way GST is divided up among the states and territories. But the current system shouldn't be tossed aside just because the WA government was unable to control its spending.

Australia has long gone much further than other federations in seeking to "equalise" the way state and territory governments provide public services to their citizens. That's one of the principal reasons why the disparity in living standards between Tasmania (Australia's poorest state) and WA (our richest), is a lot less than that between, say, Mississippi and Massachusetts in the United States or even Mecklenburg-Vorpommern and Bavaria in Germany.

The [Grants Commission was established](#) in 1933, this is the body that decides how much GST revenue the states get in our current system. Since its establishment right up until the year 2000, WA has been the main beneficiary of ["horizontal fiscal equalisation"\(HFE\)](#)

That's the principle that GST is assigned by. It assumes each state and territory should be making an equal effort to raise revenue from its own sources and by being equally efficient in its spending, to provide the same range and quality of public services as every other state or territory.

However, since the early 2000s, WA has become Australia's richest state. This is the result not of any particular effort on the part of successive WA state governments, but rather of China's almost insatiable appetite for the iron ore with which WA has been uncommonly endowed.

Over the five years to 2014-15, WA's per capita gross product (what it produced) averaged almost [50% above that of Australia as a whole](#) . This is a margin without precedent in Australia's history.

This enabled WA to raise far more revenue per head of population than it, or any other part of Australia, had been able to in the past. This is also why in recent years WA's share of the

revenue from the GST has fallen to such a low level, relative to its share of Australia's population.

Between 2005-06 and 2015-16, WA's [share of the revenue from the GST fell](#) by about A\$2 billion, from A\$3.8 billion to A\$1.8 billion. But its revenue from mineral royalties rose by almost A\$3 billion over the same period, from A\$1.2 billion to A\$4.1 billion.

Despite the sharp decline in its share of GST revenues, the [WA government's total revenue per head of population](#) in 2015-16 was just A\$67 (or 0.7%) below the average for all states and territories. By contrast, by 2015-16 the WA government was spending over A\$1,000 (or 10.5%) more per head of population on "operating expenses", than the average of all states and territories.

WA's present fiscal woes are the result not of a flawed system of distributing revenue from the GST among the states and territories, but rather of its inability to control its own spending.

Although an equal per capita distribution of GST revenues has become commonly used as a benchmark by government for assessing redistribution, it's never been generally accepted that GST revenues should be distributed on an equal per capita basis.

Neither the federal government, nor the states and territories, allocate their spending programs on an equal per capita basis. Nor do they collect revenue in that way. There is no reason why an equal per capita distribution of GST revenues should be regarded as some kind of desirable norm.

As you can see in the chart below, if you did allocate GST in equal per capita, according to my calculations Queensland, the North Territory, South Australia and Tasmania would lose millions. But it would give Victoria, NSW and WA more of the GST revenue.

It would be akin to reducing the top rate of personal income tax, paid by those earning more than \$180,000 per annum and raising the bottom rate, paid by those earning less than \$37,000 per annum, to the same figure.

Allocating GST per capita like this is not based on need or any policy and is quite arbitrary.

The questions in the terms of reference, that the Treasurer has given to the Productivity Commission, were answered almost [five years ago by a similar inquiry](#) . This was conducted by former NSW Premier Nick Greiner and former Victorian Premier John Brumby, together with Adelaide businessman Bruce Carter.

Even though these state premiers had voiced the same concerns as the current government about the way GST is distributed, their inquiry recommended against any radical changes. They found many of concerns about the current system turned out to be overstated.

And, contrary to the Treasurer's [insinuation](#) that "the current approach of horizontal fiscal equalisation creates disincentives for reform", the previous inquiry concluded there was not enough evidence of efficiency losses in the economy.

I doubt that the Productivity Commission will find differently. There is room, to be sure, to make the Grants Commission's procedures less complex and more transparent. But the principle which has underpinned the Grants Commission's recommendations for more than 80 years has served Australia well, and shouldn't be tossed aside merely to salve the self-inflicted wounds of Australia's richest state.

Saul Eslake does not work for, consult, own shares in or receive funding from any company or organisation that would benefit from this article, and has disclosed no relevant affiliations beyond the academic appointment above.

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