

Why the government will be sending more GST funding to Western Australia

Written by John Freebairn, Professor, Department of Economics, University of Melbourne

If the Commonwealth government's proposed reforms for the distribution of the GST revenue between the States and Territories is implemented, about a billion dollars a year of additional commonwealth funds will be spent to ensure “[no state will be worse off](#)”. But where the extra funds will come from is left to the imagination.

A key aim of the reform is to reduce the wild swings in how much states receive from GST collected. The Productivity Commission [had recommended](#) GST be apportioned using an average of the states ability to provide services (known as “fiscal capacity”), but the government has decided to use Victoria and New South Wales as the benchmark.

Given both the current allocation and the proposed reform are instruments for meeting equity and efficiency objectives, the unknown loser is who pays for the additional commonwealth funding.

Read more: [***Explainer: COAG and the 'GST carve-up'***](#)

GST is collected by the Commonwealth and then redistributed. The share of the GST given to each state is designed to meet the objective that “each of Australia's States has the same fiscal capacity, under average policies, to provide general government infrastructure and services.”

The government's proposed reform claims not to reduce the revenue provided to each state. However, it will change the relative shares of the larger sum to be allocated to the different states.

Vital state revenue

State and Territory governments depend on transfers from the Commonwealth government for [about half of their revenue](#)

About half of this is special payments for things such as education, health, housing and infrastructure. The other half is the GST, and these funds are free for the states to spend as they desire.

How much each state receives is determined so that if each state applied similar state-based taxes, the revenue from state taxes plus their GST share would fund similar levels of state government services to its citizens - fiscal capacity.

Those states that have a greater ability to raise taxes (say they have a large mining industry) or can provide services more cheaply (due to a smaller remote and elderly population) receive less than an “equal” per capita share of the GST.

Currently, NSW, Victoria and Western Australia receive less than an equal per capita share of GST.

By contrast, states who can raise less revenue, or have a higher cost of providing services, receive more than an equal per capita share.

South Australia, Tasmania and the Northern Territory are all currently net recipients of GST - they receive more than they pay in.

Changing the distribution

Giving some states more and others less than an equal per person share of GST is done for both equity and economic efficiency. For equity, the idea is that citizens in similar incomes, demographic and other circumstances should enjoy similar levels of state government services regardless of where they live.

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For efficiency, the distribution aims to neutralise the need for different state tax rates; if the states are to fund similar levels of services, particularly on mobile labour and capital.

Read more: [*FactCheck: is the GST as efficient but less equitable than income tax?*](#)

Up until the mining boom the current distribution of GST revenue among the states was generally accepted.

But the large increase in mineral royalties, and especially iron ore in WA, resulted in WA shifting from being a net recipient to receiving only a third of a per capita share in 2017-18, many years after the end of the mining boom.

The data used to determine the allocation of GST lags, meaning the 2017-18 allocation is based on average 2012-13 through 2015-16 data.

[Western Australia](#) , and more recently the [Northern Territory](#) , have been vigorous critics of their smaller share, and at the same time South Australia has [vigorously argued they retain at least their current share](#) . After all, resolving these conflicting political claims is a [zero-sum game](#) !

Introducing a benchmark

In order to deal with wild swings, such as that introduced by the mining boom, the Productivity Commission (PC) considered several reform options.

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A key proposal was to replace the current model of bringing all states up to the fiscally strongest state with a more stable benchmark.

The preferred benchmark proposed in the draft report was the second highest state. The final report recommended an average across the states. The commission assumed a larger share for one state would mean a smaller share for other states.

But the federal government's proposal includes additional funds to top up the GST.

The federal government's interim response to the PC final report has a few more differences to the PC's recommendation.

The benchmark for allocation will be the fiscal capacity of NSW or VIC, whichever is the largest. This will provide stability for major structural and cyclical economic shocks, and a high level of fiscal capacity for state government services.

A "floor" will also be established at 0.7 to 0.75 of the benchmark, creating a safety net.

Read more: [WA's economic mismanagement is not a reason to review how the GST is carved up](#)

The recommended reforms for distribution of the GST revenue between the states by both the PC and the commonwealth government seek to reduce volatility of the shares while roughly maintaining previously accepted principles of equity and efficiency.

For the additional revenue cost, the commonwealth government argues no state will be worse

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