Slicing The GST Pie

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State government coffers are squeezed by the Commonwealth on one hand and their responsibilities to constituents on the other. For the states to be effective we need a new fiscal deal, writes Ian McAuley.

This year's Commonwealth Budget has been particularly tough on the states. State governments have limited taxation powers. Their own taxes and other funding sources under their control raise only about 55 per cent of their revenue, while the balance comes from Commonwealth grants. In this year's Budget those grants have been cut by six billion dollars.

Commonwealth grants split two ways, into general purpose payments and specific purpose payments. General purpose payments are linked closely to GST collections, while specific purpose payments, as their name implies, are tied to particular services, the main categories being health, education and infrastructure.

GST revenues have taken a hit over recent years. When the Howard Government introduced the GST in 1998, the states were enthusiastic about having access to a tax which would grow as spending grew — such was the economic optimism of the time.

That growth did indeed occur, as we went on a spree of debt-fuelled spending, but as the GFC took hold in 2008, spending slowed markedly. We became more cautious, saving more and spending less. In the last year before the GFC, GST collections were 3.77 per cent of GDP; in the current year (2012-13) they are estimated to be 3.09 per cent of GDP. Had our spending been maintained at the pre-GFC rate, states would have an extra $10 billion in revenue this year.

The fall in revenue has been particularly strong because of the structure of the GST, which exempts certain important items of consumption such as food and health care. When people reduce expenditure they tend to cut back on more discretionary items, which would attract GST.

This coming year is unlikely to see much improvement in GST revenue. Commonwealth general purpose payments to the states, therefore, are estimated to rise by only 6 per cent in nominal terms — in line with general economic growth. The distribution of this revenue is largely formulaic, based on recommendations of the Grants Commission. States with higher revenue-raising capacity, such as Western Australia, get lower allocations than those with low revenue-raising capacity and higher needs, such as Tasmania.

Much of the change in distribution is explained by population growth, which is high in Queensland and the ACT, and low in South Australia and the Northern Territory. In particular there has been a big fall in Western Australia due to the Grants Commission having assessed that their own revenue-raising capacity has risen strongly because of the mining boom.

This small rise in general purpose grants is more than offset by a sharp fall in specific purpose payments. These will be down by 17 per cent in 2012-13, leading to a total fall of 6 per cent, or about 10 per cent after inflation is considered. These changes are shown in the table below.

Change in Commonwealth grants — 2011-12 to 2012-13			
	General purpose	Specific purpose	Total
NSW	5%	-17%	-6%
Vic	8%	-11%	-2%
Qld	12%	-22%	-7%
SA	6%	-26%	-10%
WA	-18%	-10%	-13%
Tas	4%	-19%	-6%
NT	9%	-29%	-4%
ACT	13%	-16%	0%
Total	6%	-17%	-6%

While Commonwealth specific purpose payments for health and education are reasonably steady, the brunt of the cuts is in infrastructure, where Commonwealth payments are budgeted to fall from $7.8 billion this year to $3.7 billion in the coming year. The Commonwealth made much of its promise to complete the Pacific Highway, for example, but even if the New South Wales Government were to come good with matching funds (a condition of the Commonwealth payment), no significant Commonwealth funding would be forthcoming until 2014-15.

Not all states will be hit equally. It appears that Western Australia will be worst off, but of all the states it is the least dependent on Commonwealth revenue, with only about 35 per cent coming from that source. At the other extreme are Tasmania and the Northern Territory; their dependence on Commonwealth grants this year has been about 60 per cent and 80 per cent respectively.

State governments will be left with little flexibility. The Commonwealth can cut defence spending and foreign aid, with little effect on the domestic economy, but such options are not open to the states. Nor do states have much by way of new revenue-raising opportunities. Conveyancing taxes which were high and rising when house prices were rising, have fallen away. On the expenditure side they have little flexibility: health, education and policing, all labour-intensive services with little scope for labour-saving productivity gains, take 60 per cent of their outlays.

It is highly unlikely, therefore, that we will see any more spending on infrastructure backlogs — a backlog estimated by Engineers Australia to be about $700 million, mainly in transport and water supply. Deficiencies in urban public transport are bound to worsen as population grows and more pressure is put on ageing infrastructure. We are still riding off the big public transport expansion in the 1920s.

The Commonwealth's excuse for this cut is that in terms of counter-cyclical management it is appropriate that we should now be withdrawing fiscal stimulus payments. But other, more political, explanations present themselves.

First, Commonwealth outlays for state-owned infrastructure show up as "expenses" on the Commonwealth accounts, and would therefore detract from the Commonwealth's budgetary bottom line. Of course they would show up as assets on the state balance sheets, but, given the political salience of Commonwealth debt, why should the Commonwealth make its own balance sheet look worse and those of the states look better?

Such an accounting anomaly has been long-standing, but it has influenced budgetary decisions only in recent years since Tony Abbott has stood in the pulpit of the Murdoch media to make puerile and misleading statements about debt. (The NBN is an exception, because for now it is Commonwealth-owned, and can appear on the asset side of its balance sheet, thus not contributing to net Commonwealth debt.)

Second, it appears that the Commonwealth is reverting to the Howard-Costello policy of privileging personal cash transfers at the expense of payments for public services and public assets. It has yielded to the "what's in it for me" politics of budgeting. Admittedly its cash handouts are better targeted than the middle-class welfare of the previous Government, but our long-term prosperity is dependent on providing those economic services which the private sector cannot provide efficiently or cannot provide at all, including infrastructure.

Third, with the state political landscape having turned so strongly against the Labor Party (just four years ago there was not a single Coalition Government in office), the Commonwealth has no incentive to do anything that may help the states politically. Federal-state relations have taken on a stronger partisan dimension than has been seen in many years — the newly elected Queensland Government has been particularly truculent. Blame-shifting prevails, a situation not helped by the Commonwealth's opportunistic promises about projects such as Sydney's metro.

We need not only a more mature understanding of debt and public investment, but also a more sensible allocation of Commonwealth and state responsibilities and payments. For transport infrastructure such as urban roads and public transport, it would make sense politically and economically if the Commonwealth were to withdraw, while ensuring that states have a better share of taxation revenue. The Commonwealth could then confine its concerns to national and interstate infrastructure. We badly need a new federal fiscal deal.