Occasional Paper: New GST distribution arrangements - alternative scenarios

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Department of Treasury and Finance

Tasmanian Government

Summary

On 27 September 2021, the Tasmanian Department of Treasury and Finance (Treasury) published the *Occasional Paper: New GST distribution arrangements* which is available at https://www.treasury.tas.gov.au/gst-distribution-to-tasmania/publications.

This Paper complements the September 2021 Occasional Paper by expanding on the modelling in that Paper to demonstrate the impact of the new arrangements on Tasmania's GST revenue under a range of alternative scenarios.

The September Occasional Paper noted that, when the Australian Government implemented the new GST distribution arrangements in 2018, it argued, based on a single scenario, that all States and Territories (States) would be better off financially under the new GST distribution arrangements.

However, the Tasmanian Government has consistently argued that the assumptions and modelling upon which the Australian Government based the new arrangements were flawed and failed to take into account a number of more realistic alternative scenarios.

The scenarios modelled by Treasury in both Papers indicate that Western Australia will be by far the main beneficiary of the new arrangements, and that Tasmania and the majority of other States will be worse off.

The alternative scenarios presented in this Paper indicate that by 2031-32, Tasmania could receive between \$190 million and \$755 million less than it would have under the previous GST distribution arrangements. In comparison, over the same period, Western Australia could be up to \$57.5 billion better off.

Tasmania could be up to \$100 million worse off in 2031-32 alone, which represents up to 1 000 teachers, nurses or police officers unfunded as a result of the new GST distribution arrangements.

The scenarios demonstrate that there is a range of potential outcomes that could eventuate for Tasmania, reinforcing the significant risks inherent in the new GST distribution arrangements.

All alternative scenarios indicate that the new GST distribution arrangements will provide Western Australia with a permanent and growing advantage over the other States. This advantage will allow Western Australia to deliver a higher standard of services or lower taxes to its residents compared to all other States, and will entrench inequality between Western Australia and all other States.

The Tasmanian Government has consistently argued that the new arrangements will embed inequality between Western Australia and all other States, including Tasmania. As such, the Tasmanian Government has committed to advocate for a permanent no-worse off guarantee, or alternatively, a return to the previous GST distribution arrangements.

Introduction

On 27 September 2021, Treasury published the *Occasional Paper: New GST distribution arrangements* which is available at https://www.treasury.tas.gov.au/gst-distribution-to-tasmania/publications. The September Paper considers the importance of Horizontal Fiscal Equalisation (HFE) for Tasmania, the 2017-18 Productivity Commission (PC) Inquiry into HFE and the Australian Government's response to the Inquiry. The paper also includes indicative modelling of the impact of the new GST distribution arrangements.

This Paper complements Treasury's September Occasional Paper by outlining the impact of the new arrangements on Tasmania's GST revenue under a range of alternative scenarios.

This Paper considers:

- the scenario relied upon by the Australian Government in its response to the PC's Inquiry into HFE;
- the alternative scenarios modelled by Treasury in 2018; and
- the impact of the new GST distribution arrangements on Tasmania under a range of additional scenarios.

The Australian Government's scenario

As noted in the September Occasional Paper, the Australian Government presented one modelled scenario to support the transition to the new HFE system. Based on this scenario, the Australian Government considered that every State would be better off financially under the arrangements (with Western Australia substantially better off).

The outcome from the Australian Government's scenario is detailed in Table 1. At the time, the Australian Government estimated that the total cost of the new arrangements to the Australian Government would be around $4.6 billion from 2019-20 to 2024-25.

Table 1: State by State impact compared to previous HFE system - Australian Government scenario using PC relativities

	NSW $m	Vic $m	Qld $m	WA $m	SA $m	Tas $m	ACT $m	NT $m
Total (to 2026-27)	351	425	518	4 702	257	112	46	258

The Australian Government's single scenario was based on the GST relativities for each State as forecast by the PC in the *HFE - PC Inquiry Report.*

At the time, most States, including Tasmania, argued that the assumptions and modelling upon which the Australian Government built its new arrangements and arguments were flawed and failed to take into account a number of more realistic alternative scenarios.

Treasury raised significant concerns with the approach taken by the PC to forecast the GST relativities used as part of the Australian Government modelling, including that:

- the PC assumed that States' relativities would trend to their long term average, which does not take into account the large amount of variability that has been historically seen in relativities;
- the PC assumed that Western Australia's relativities would continue to increase, which could only occur if Western Australia's mining royalties were to decline over this period. This was inconsistent with Western Australia's 2018-19 Budget, which forecast that the State's royalty income would remain stable at high levels; and
- the PC did not project a corresponding decline in other States' relativities. This outcome is not possible under the "zero sum" nature of GST distribution. For one State's share of the GST to increase, another State's share must decrease.

A number of States, including Tasmania, also raised concerns with the Australian Government's intention to legislate the new arrangements.

Notwithstanding these concerns, the Australian Government proceeded to legislate, introducing the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018* (the Bill) into Parliament on 18 October 2018. To address the concerns raised by Tasmania and most other States at the time, a guarantee that each State would be no worse off in total during the transition period to 2026-27 was included in the Bill.

The Bill was referred to the Senate Standing Committee on Economics on 18 October 2018. A copy of the Tasmanian Government's submission to the Committee is available at https://www.treasury.tas.gov.au/gst-distribution-to-tasmania/publications. States were not provided with any other opportunity to influence the content of the Bill and it was passed by both Houses of the Australian Parliament on 14 November 2018.

It is becoming increasingly apparent that the simplistic scenario modelled by the Australian Government portrayed a "best case" for the States and significantly understated the benefits to Western Australia and the costs to other States.

In its latest 2021-22 Budget, the Australian Government has forecast that all States, except Western Australia and the Northern Territory, will be worse off under the new arrangements across the Forward Estimates.

The Australian Government has also forecast that the cost of the new arrangements (including top up payments, pool boosts, and guarantee payments to the States) has increased to $15.6 billion over six years from 2019-20 to 2024-25. This significantly exceeds the $4.6 billion, as estimated by the Australian Government just three years ago.

This is largely attributable to the rapid growth in Western Australia's revenue from mining royalties, which has increased from $6.7 billion in 2018-19 to an estimated $12.1 billion in 2020-21, an increase of 81 per cent over three years. While Western Australia forecast in 2018 that royalty revenue would remain stable at high levels, this was not reflected in the Australian Government's scenario.

Treasury's 2018 scenario analysis

In response to the Australian Government's proposal, the Tasmanian Government modelled alternative scenarios to demonstrate the risks to Tasmania of the new GST distribution arrangements. The Tasmanian Government's alternative scenarios modelled in 2018 can be found at https://www.treasury.tas.gov.au/gst-distribution-to-tasmania/publications and are summarised in Table 2.

The alternative scenarios demonstrated that there was a range of feasible scenarios, based on different assumptions and more realistic relativities, which could eventuate and would result in some States being worse off, compared to the previous GST distribution arrangements.

Table 2: Treasury's 2018 alternative scenarios (2019-20 to 2026-27)

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	$m	$m	$m	$m	$m	$m	$m	$m
Australian Government scenario	351	425	518	4 702	257	112	46	258
Tasmanian Government 2018 alternative scenarios								
Rapid growth in mining royalties	-5 462	-4 580	-3 199	25 132	-965	-248	-267	232
Return to 10-year average relativities[1]	-3 316	-2 744	-1 914	18 086	-528	-125	-150	404
Stable relativities from 2021-22[2]	-32	146	231	4 689	219	90	28	787

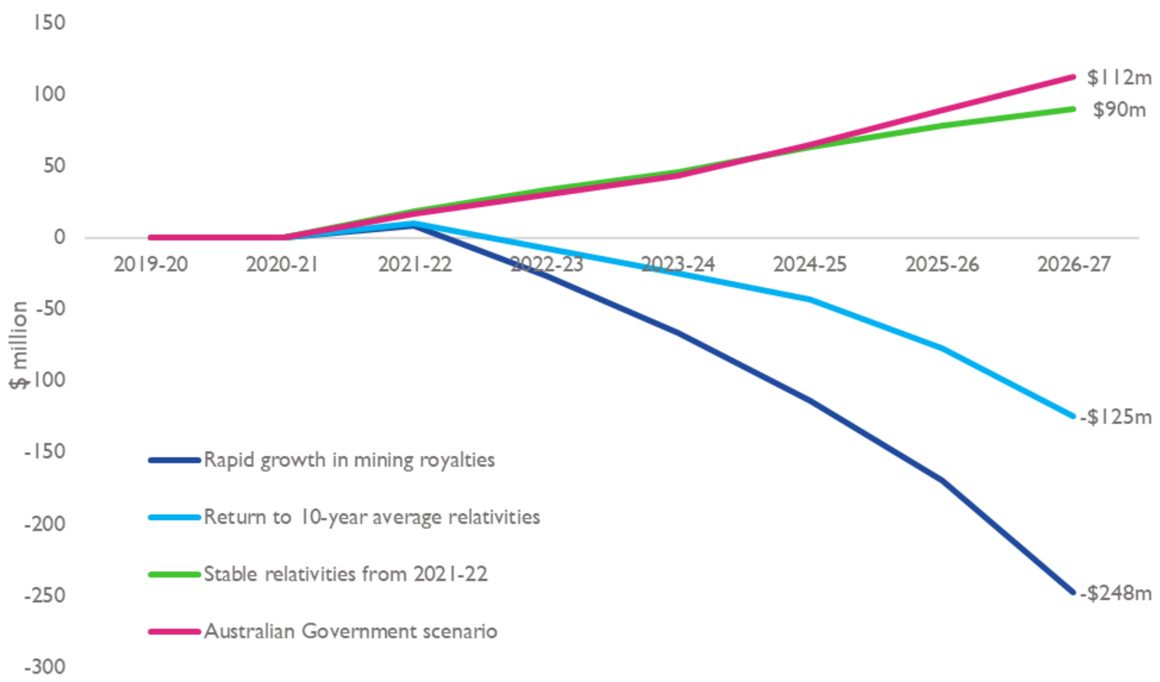
[1] 10-year average relativities uses relativities of 2009-10 to 2018-19

[2] Stable relativities holds the 2021-22 relativities constant to 2026-27

These alternative scenarios formed the basis of the Tasmanian Government's submission to the Senate Standing Committee on Economics and demonstrated that under all scenarios Western Australia was the main beneficiary of the new GST distribution arrangements and that the new arrangements could be detrimental to Tasmania's fiscal position.

Chart 1 shows Tasmania's cumulative change in GST revenue to 2026-27 under each of the Tasmanian Government's 2018 alternative scenarios.

Chart 1: Tasmania's cumulative change in GST revenue to 2026-27



Impact of the new arrangements - alternative scenarios

To expand on modelling previously undertaken, Treasury has modelled a number of alternative relativity scenarios using current data to illustrate the range of outcomes that could result from the new GST distribution arrangements.

These scenarios replicate historical situations to test the impact on Tasmania from 2019-20 if they occurred again by 2031-32. Treasury has modelled the following scenarios:

1. stable relativities from 2023-24 (included in Treasury's September Occasional Paper);
2. gradual return to 10-year average relativities by 2031-32;
3. a short term modest decrease in Western Australia's mining revenue; and
4. a gradual return to New South Wales being the strongest State by 2031-32.

The scenarios are purely indicative to demonstrate a range of potential outcomes and are not an expectation of future outcomes.

Scenario 1: Stable relativities from 2023-24

Treasury's September Occasional Paper provided indicative modelling to illustrate the impact on Tasmania of the new GST distribution arrangements. The Occasional Paper modelled a relatively simple scenario that held States' relative fiscal capacities constant from 2023-24 to 2031-32. The modelling demonstrated that Tasmania could be up to $755 million worse off by 2031-32, with only around 40 per cent or $302 million of this covered by the current guarantee arrangements (shown in Table 3).

Table 3: State by State impact compared to previous HFE system - stable relativities

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	$m	$m	$m	$m	$m	$m	$m	$m
Total (to 2026-27)	-6 054	-5 139	-3 759	26 611	-1 164	- 302	- 304	220
Total (to 2031-32)	-14 887	-12 909	-9 330	57 460	-2 855	- 755	- 748	184

Scenario 2: Return to 10-year average relativities

Another scenario modelled is a gradual return to 10-year average relativities (2012-13 to 2021-22) by 2031-32. Under this scenario, Tasmania could be up to $692 million worse off by 2031-32, with $296 million covered by the guarantee (shown in Table 4).

Table 4: State by State impact compared to previous HFE system - return to 10-year average relativities

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	$m	$m	$m	$m	$m	$m	$m	$m
Total (to 2026-27)	-5 945	-5 042	-3 693	26 298	-1 141	- 296	- 298	223
Total (to 2031-32)	-13 611	-11 753	-8 536	53 704	-2 591	- 692	- 677	221

Scenario 3: A decrease in Western Australia's mining revenue

A more conservative scenario modelled is a short term modest decrease in Western Australia's mining royalties. This is consistent with Western Australia's 2021-22 Budget which has forecast a 42 per cent decline in royalty income in 2022-23. The scenario replicates the relativities that occurred in 2019-20, following the peak of Western Australia's mining boom in 2014-15.

Under this scenario, Tasmania could be up to $445 million worse off by 2031-32, with $261 million covered by the guarantee (shown in Table 5).

Table 5: State by State impact compared to previous HFE system - a decrease in Western Australia's mining revenue

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	$m	$m	$m	$m	$m	$m	$m	$m
Total (to 2026-27)	-5 394	-4 539	-3 334	24 681	-1 013	- 261	- 267	233
Total (to 2031-32)	-9 826	-8 238	-6 037	42 510	-1 721	- 445	- 464	286

Scenario 4: A return to NSW as the strongest State

Lastly, Treasury has modelled a scenario that reflects a gradual return to New South Wales being the strongest State by 2031-32. In order for this scenario to eventuate Western Australia's mining revenue would need to significantly decline. Treasury considers that this is a highly unlikely scenario given New South Wales has not been the strongest state since 2007-08 as a result of the series of mining booms in Western Australia from around 2003.

While an unlikely scenario, this is the only scenario modelled that results in a gradual return to Tasmania being better off under the new arrangements by 2029-30. However, the scenario still indicates that the new arrangements are expected to be detrimental to Tasmania's GST revenue over the full 13-year period.

Table 6: State by State impact compared to previous HFE system - a return to New South Wales as the strongest State by 2031-32

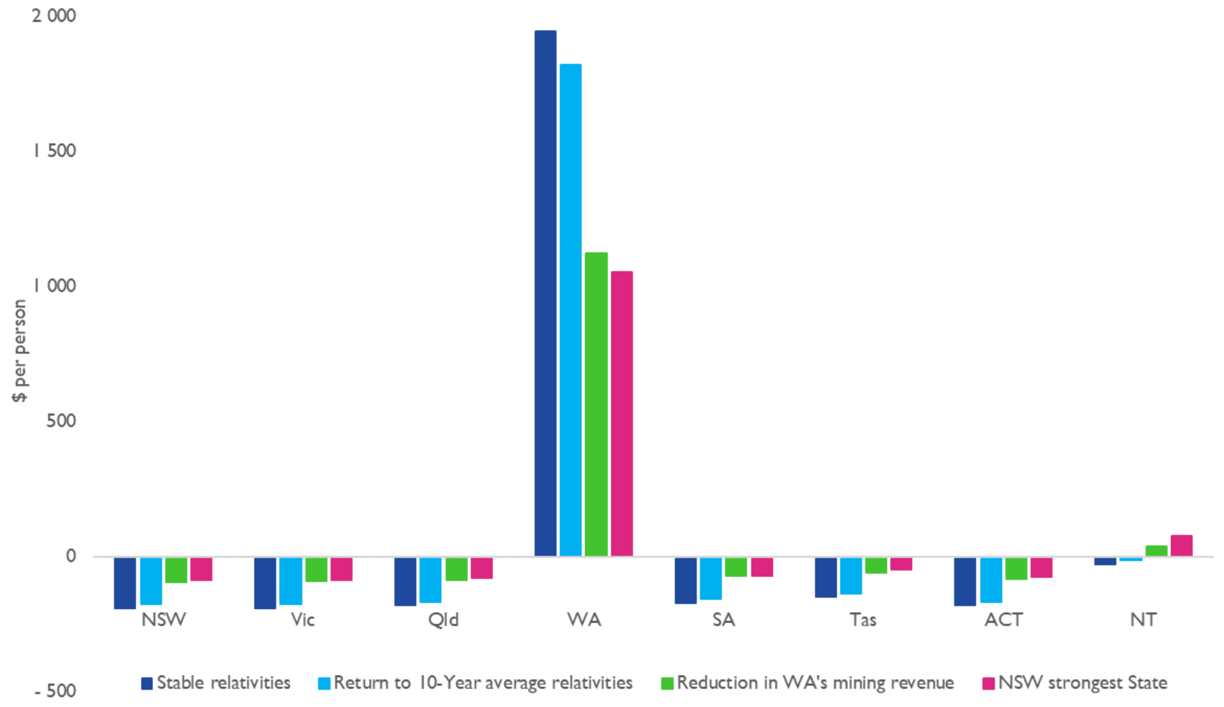
	NSW $m	Vic $m	Qld $m	WA $m	SA $m	Tas $m	ACT $m	NT $m
Total (to 2026-27)	-5 266	-4 461	-3 250	24 350	- 997	- 251	- 261	243
Total (to 2031-32)	-5 971	-5 047	-3 506	31 595	- 993	- 190	- 266	443

Impact on Tasmania of each scenario

Each scenario modelled by Treasury indicates that Western Australia is consistently the main beneficiary of the new arrangements and that Tasmania (and the majority of other States) will be worse off under the new arrangements.

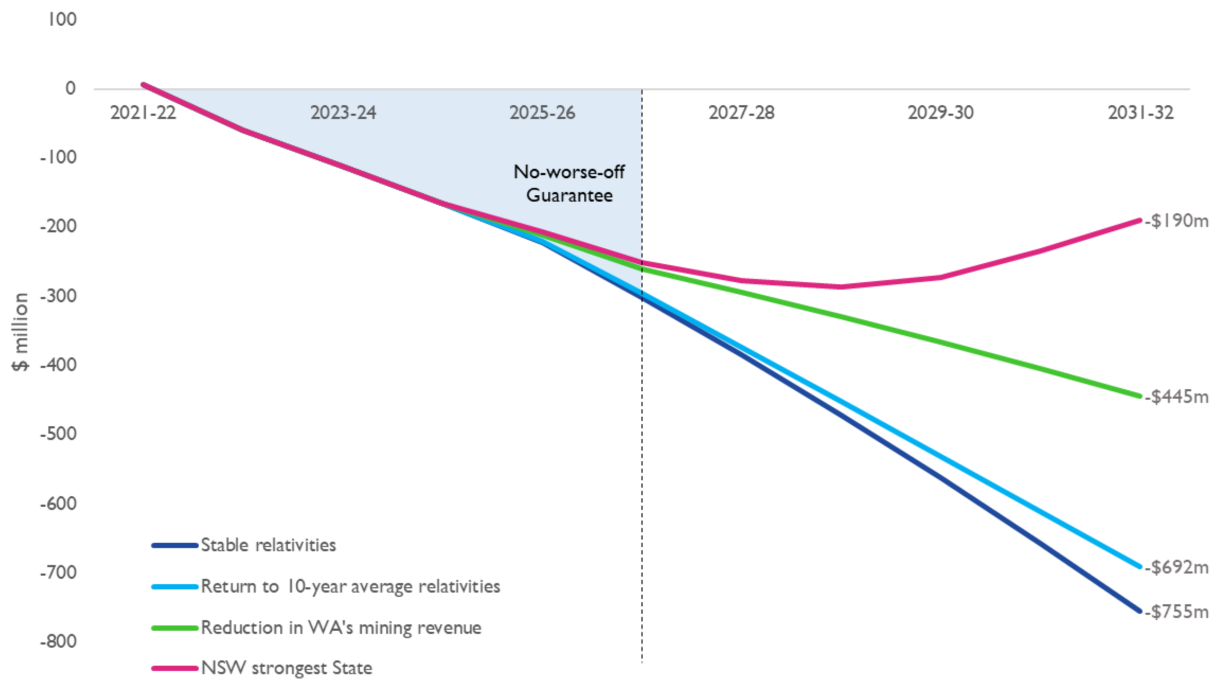
The four scenarios demonstrate that when the guarantee ends in 2026-27, Tasmania's GST revenue could reduce by a range of $27 million to $83 million in 2027-28 under the new arrangements or by $47 to $147 per person. In comparison, Western Australia is expected to be between $3.0 billion and $5.6 billion better off, or $1 056 to $1 945 per person. Chart 2 shows the States' estimated per person change in GST revenue in 2027-28 after the guarantee ends for each scenario.

Chart 2: States' per person change in GST revenue in 2027-28 under each scenario



By 2031-32, Treasury's scenarios illustrate that Tasmania could be up to $755 million worse off (shown in Chart 3). In comparison, over the same period, Treasury has estimated that Western Australia could be up to $57.5 billion better off from 2019-20.

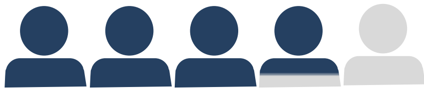
Chart 3: Tasmania's cumulative loss in GST to 2031-32 under each scenario



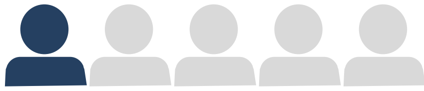
The impact on Tasmania's GST revenue in 2031-32 could range up to negative $100 million, depending on the modelled scenario. In today's terms, a loss of $100 million would result in…

1.1 out of 5 of our teachers unfunded…

or 1.2 out of 5 Tasmanian nurses unfunded…



or 4.0 out of 5 of our police officers unfunded.



This represents up to 1 000 teachers, nurses or police officers unfunded as a result of the new GST distribution arrangements.

The scenarios demonstrate that there is a range of potential outcomes that could eventuate for Tasmania, reinforcing the significant risks inherent in the new GST distribution arrangements. However, the scenarios also demonstrate that it is undeniable that Western Australia is by far the main beneficiary of the new GST distribution arrangements, at the expense of most other States.

Conclusion

The Tasmanian Government has consistently argued that the Australian Government's modelling failed to take into account a number of feasible, alternative scenarios, based on different assumptions, which indicated that the proposed changes to the GST system would be detrimental to Tasmania's fiscal position.

The range of scenarios modelled by Treasury demonstrate that the new arrangements will ensure that Western Australia has a permanent greater and increasing fiscal capacity than any other State. This will enable it to deliver a higher standard of services, or lower taxes to its community, compared to all other States.

The Tasmania Government has indicated that it will continue to advocate for a permanent no-worse-off guarantee, or alternatively, for the HFE system to revert to the previous arrangements.

The PC will review the operation of the new arrangements by December 2026. However, the Tasmanian Government has indicated that it considers a review of the new arrangements to be a national priority. As such, the Tasmanian Government has committed to work together with the South Australian Government on its independent review of the arrangements prior to the PC review.