THE AUSTRALIAN FINANCIAL REVIEW

Best GST fix is to expand the pool

Revenue share

Instead of fixating on Western Australia, Victorian Treasurer Tim Pallas should focus on the economic policy reforms needed to reverse the decline in the GST to GDP ratio.

Dean Smith

Victorian Treasurer Tim Pallas claims the current system for dividing GST revenues between the states and territories "isn't just unfair" but is "far worse" than first imagined.

This is a tricky attempt to unwind an agreement that enjoyed enthusiastic support from his federal Labor colleagues just 2½ years ago.

When debating the passage of the "making sure every state and territory gets their fair share of GST" legislation, then shadow treasurer Chris Bowen said it was very welcome and the new GST law "would put this issue to bed".

Last week Pallas sought to revive the GST debate with the complaint the Commonwealth Grants Commission's latest report leaves Victoria worse off.

In fact, the *Report on GST Revenue Sharing Relativities – 2021 Update* states that, due to an increase in the size of the GST pool, Victoria's entitlement this financial year would rise by an estimated $344 million and its GST revenue sharing relativity will be 0.923 in 2021-22, resulting in an estimated GST distribution of $16.2 billion – second only to NSW, which will receive a relativity of 0.956, or $20.3 billion.

How conveniently people overlook the original motivation for the most significant reform to the GST in its 20-year history.

In the period from 2006-07 to 2014-15, NSW, Victoria, South Australia and Tasmania all enjoyed an improving GST relativity – 0.87 to 0.95, 0.89 to 0.92, 1.18 to 1.28 and 1.54 to 1.58 respectively.

In contrast, over the same period, Western Australia's relativity fell sharply from 0.94 to 0.37. In 2015, frustrations peaked when the CGC recommended it drop to just 0.30.

Queensland was the only other jurisdiction to slide backwards, from 1.02 to 0.98.

More curiously, Pallas has called on federal Treasurer Josh Frydenberg to do more to support his Victorian brothers and sisters.

Unfortunately for their taxpayers, Pallas and his NSW and South Australian counterparts are blind to the more pressing challenge to the GST.

When then federal treasurer Peter Costello introduced the GST in 1998, he said it "will provide states with a secure and growing source of revenue" and "facilitate a stronger and more productive federal system".

The long-held assumption was that revenue from a tax on consumption expenditure would grow in line with the broader economy.

The evidence now demonstrates that Australia's experience with its broad-based consumption tax has fallen short of this expectation.

The Parliamentary Library has calculated the size of the Australian economy as measured by GDP grew from $996.4 billion to $1.99 trillion in the period between 2005-06 and 2019-20.

In the same period, GST collections increased from $39.06 billion to $65.3 billion – but as a percentage of GDP, fell from 3.9 per cent to 3.3 per cent.

This dire prediction for the future financial independence of the states and territories has been reinforced by the independent Parliamentary Budget Office.

In its publication *Structural Trends in GST*, released last year, it said that total GST revenue had increased by 130 per cent since 2000 and GDP had increased by 180 per cent, concluding that the GST to GDP ratio was "likely to continue to decline further".

It predicted the GST to GDP ratio will be just 3.2 per cent by 2030-31, representing a shortfall of up to $24 billion compared with the earlier years of the GST.

This steady reduction in the GST to GDP ratio has been attributed to changes in household spending, changes in consumer savings behaviour, and the mining boom.

The publication identified the future key trends affecting the GST to GDP ratio as being the unequal price growth shifting from GST-applicable and GST-free goods in household spending; the measurement of household consumption in the national accounts; the impact of demographic trends on spending; and the changing composition of household expenditure, dwelling construction and mining sector growth in the economy.

Pallas' demand that the federal government secure the extension of the "no worse off" guarantee beyond 2026 is the wrong medicine for an ailing GST system.

Instead, he and his fellow state and territory treasurers should redirect their energy to policy reforms that would drive Australia's economic activity, increase the size of the economy and, therefore, the size of the GST pool to be distributed between them.

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