CCIQ SUBMISSION

Horizontal Fiscal Equalisation

Productivity Commission

CHAMBER OF COMMERCE AND INDUSTRY QUEENSLAND

31 January 2018

Introduction

1. The Chamber of Commerce and Industry Queensland (CCIQ) is Queensland's peak industry representative organization for small and medium businesses. We represent over 414,000 Queensland businesses on local, state, and federal issues that matter to them. Our guiding focus is to develop and advocate policies that are in the best interests of Queensland businesses, the Queensland economy, and the Queensland community.

2. CCIQ welcomes the opportunity to comment on the Productivity Commission's draft report into Horizontal Fiscal Equalization (HFE). In its initial submission to the inquiry, CCIQ argued that there should be no change to the existing HFE system for distributing G.S.T. to Australia's States and Territories.

Overview

3. CCIQ remains of the strong view that there need not be changes introduced to the HFE system for distributing GST revenue. The Chamber believes a reduction in GST revenues for Queensland would undoubtedly impact the capacity of the Queensland Government to deliver services to the citizens of Queensland. In the context of a vast and decentralized state, any changes to the current distribution model would force the hand of the Queensland Government to raise taxes on business, thereby undermining the strength and competitiveness of Queensland's economy.

4. We support the Australian Chamber of Commerce and Industry's (ACCI) position, outlined in their initial submission, that there was no evidence of negative impacts to productivity and growth at the state level, and resultingly, no necessary reasons for a fundamental changing of the system. To this end, CCIQ argues that the Productivity Commission should make the case for addressing any changes to the HFE system through broader structural tax reform at the federal level, rather than investigating HFE distribution in isolation.

5. While the Chamber shares some of the Productivity Commission's views and conclusions contained in the draft report, we are strongly opposed to Draft Recommendations 2.1 which states:

> DRAFT RECOMMENDATION 2.1
>
> The Commonwealth Government should clearly articulate the objective of HFE. This objective should aim for reasonable rather than full equalisation (as envisaged in draft finding 2.1).
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> The objective should be established through a process led by the Commonwealth and involving consultation with the States, and should be reflected in the Intergovernmental Agreement on Federal Financial Relations.
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> The objective should also be reflected in the terms of reference which the Commonwealth Government issues for the yearly update and five-yearly methodology review. The *Commonwealth Grants Commission Act 1973* (Cwlth) should also be updated to reflect the adopted objective.

Source: Productivity Commission, Horizontal Fiscal Equalization, Draft Report, October 2017

Chamber of Commerce & Industry Queensland
Industry House, 375 Wickham Terrace, Brisbane, Qld, 4000
T 1300 731 988 F 07 3832 3195 E info@cciq.com.au
EAL 1300 135 822 ABN 55 009 662 060
cciq.com.au

6. The Chamber opposes the suggestion that the objective of the HFE system should be for 'reasonable' rather than full equalization across all States and Territories. The content of the following submission will argue this point, and we refer the Commission to our initial submission for any other matters.

Draft recommendation 2.1

7. Per the Productivity Commission's own findings, there is little evidence to suggest that HFE in its current form has negatively impacted and/or constrained economic growth in Queensland or Australia. The false distinction drawn between 'efficiency' and 'equity' of the system is not underpinned by the evidence required to recommend to government a fundamental re-structure of the existing HFE system. To this end, the Chamber rejects the recommendation that there be a substantial departure from the current arrangement in favour of 'greater efficiency'.

8. We recommend that the Commission retreat from reasonable rather than full equalization and explore alternative mechanisms for greater revenue raising capacity by the States and Territories. This could take the form of broader structural reform of the federal taxation system, thereby leaving room for State and Territory governments to remove inefficient taxes such as payroll tax and stamp duties, while continuing to deliver services to their respective population.

9. To the extent that Draft Recommendation 2.1 attempts to address concerns as contained in the draft report regarding equalization as having gone too far, the Chamber believes the Commission contradicts the reality that each State and Territory has differing fiscal capacity to raise revenues. The existing process for HFE is in place to ensure that each State or Territory has the same fiscal capacity to deliver services and build infrastructure of equal standard across the Federation. This process results in each state receiving the GST contribution required to bring its total revenue to its assessed expenditure needs.

10. Therefore, at the heart of the current HFE system is equity. The proposed goal to aim for less than full equalization violates this principle. The draft report claims the burden of HFE redistribution is onerous and placing the system under strain because the of the extremely low relativity of one state. However, it is our view that the outlier in relativities merely reflects the fact that while WA was a major beneficiary of the mining boom, there were also negative impacts across the rest of the country. Any attempt at policy change to adopt recommendation 2.1 would only benefit the strongest state/s with the weaker states and regions punished twice, thus undermining equity as a key principle of the HFE system.

Impacts

11. The decision to move to partial equalisation would be highly detrimental to Queensland. Under the alternative approaches to HFE canvassed in the Draft Report, Queensland stands to lose anywhere from $729 million to $1.6 billion dollars if the changes were applied to the 2017-18 GST distribution.

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12. CCIQ has publicly expressed its concern about Queensland's budgetary position and, in particular, rising debt levels. Removing such a substantial amount from the budget would have to be met through an increase in taxes or through cuts to government spending. Both options are unpalatable.

13. Our members have told us electricity costs are one of the biggest issues holding back their businesses from growing. This reduction in funds will mean the Queensland government will continue to raid government owned corporations for dividends. Currently, the Queensland Government is covering the cost of the Solar Bonus Scheme at an estimated cost of $770 million to the Queensland budget over the next three years. However, the loss of GST funding could result in this cost shifting back onto the electricity bills of residential and commercial users, placing upward pressure on prices.

14. Public infrastructure investment is at decade long lows in Queensland. In the South-East Queensland region, congestion is becoming a major issue, while in the regions, water supply, telecommunications and transport infrastructure is lacking. Infrastructure investment is one of the easiest categories to cut when a government seeks to find quick savings through spending reductions.

15. Additionally, this would jeopardise a number of key welfare and business programs which are relevant to regional communities.

16. The impact would further slow the growth in employment and economic outcomes, particularly in the regions. The Back to Work Jobs Program is a $305 million fund to incentivise employers to hire out of work jobseekers. This has been a popular program among the business community with over 10,000 workers hired under this program. We have grave concerns this program could be scaled back or removed.

17. The State Government relies on a number of inefficient taxes: payroll tax and stamp duties. These taxes would be key targets for the government to recoup any lost GST funding. During the recent election campaign, a key taxation policy was increasing land taxes. Taxes on business are next.

Mining States, Mining Royalty Revenue, and Dutch Disease

18. The Chamber notes Western Australia's reduction in GST share, and concur with the Commission's assessment that this came about as a direct result of the mining boom. With the context of Western Australia's position in mind, CCIQ supports equalizing on 'immobile revenue bases' such as natural resources. If this were not to occur, those States and Territories with a greater proportion of natural resources have greater fiscal revenue raising capacity.

19. As a result, such States and Territories can offer more attractive incentives for business via lower taxes and provide greater government services. Proper equalization of the revenue sources of States and Territories is key to maintaining equity in the system and compensating those States and Territories for factors beyond their control is a key method in such a process.

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20. Output by the mining industry has doubled since 2003/04, with roughly 75 per cent of the increase in activity located in WA. Not only did the state benefit from higher royalty receipts, there was also a surge in employment, wages and property prices boosting payroll tax and stamp duty receipts.

21. While WA benefitted from the mining boom, the corresponding appreciation of the Australian dollar hurt many export-oriented and trade exposed industries. Regions such as Cairns suffered large falls in domestic and international visitor numbers as the tourism industry was priced uncompetitively following the movements in the exchange rate. Employment in the region suffered with sectors such as Accommodation and Food Services with the number of employed workers almost halving, while roughly a third of the Retail Trade workforce was lost.

22. The mining boom created a three-speed economy with the lagging sector (comprised of the trade exposed industries) falling behind in performance to the non-tradeables services sectors and the booming sectors tied to mining. The performance of Queensland's regional economies suffered as the agriculture, tourism and education sectors struggled with the impact of the higher dollar.

23. Changing the HFE system as proposed in the draft report will not improve equity across the nation. It will further skew gains toward those who have directly benefitted from the mining boom and to the detriment of those that were impacted.

Recommendations

24. CCIQ believes the Federal Government has other policy and fiscal levers with which to 'pull' to maintain equity in the GST system, whilst improving fiscal positions for all States and Territories, without resorting to a billion-dollar cut to the Queensland budget. First and foremost, the Productivity Commission should recommend wholistic tax reform.

25. Australia's tax mix has remained relatively unchanged since the 1950's. Australia's tax system faces has been impacted by technological change, an ageing population and increased mobility of investment. Queensland businesses consider the tax system to be outdated and a brake on economic growth. In the CCIQ biannual Red Tape Survey report, dealings with the Australian Taxation Office was cited as the number one regulatory burden for small business. Red tape is predicted to cost the economy up to $100 billion by 2020.

26. GST should not be redistributed but broadened. Raising the GST rate, and removing exemptions to health, education and food, could generate an additional $10 billion in revenue. Increasing the size of the GST pool would result in a greater share of distributions to the States allocated on an equal per capita basis. By creating more efficient broad-based taxes, inefficient state based taxes, such as payroll tax and stamp duty can eventually be abolished. This recommendation was made in the Australia's Future Tax System, commonly known as the Henry Review.[1]

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[1] Henry, K., Harmer, J., Piggott, J., Ridout, H. and Smith, G. 2010a, Australia's Future Tax System — Final Report, Australian Government, Canberra, r. 57, accessed at https://taxreview.treasury.gov.au/Content/Content.aspx?doc=html/home.htm

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