

Government response to the Parliamentary Inquiry into Commonwealth Support for Victoria

Introduction

The Parliament of Victoria's Economy and Infrastructure Committee (Committee) *Inquiry into Commonwealth support for Victoria* (Inquiry) has highlighted the inequity of the new GST distribution arrangements and other Commonwealth funding for the state.

The Victorian Government has continually advocated for a fair share of GST and other sources of Commonwealth funding for Victoria. This Inquiry adds to the growing body of evidence that the new GST equalisation arrangements are detrimental to Victoria.

The Victorian Government would like to acknowledge the work of the Committee, and those who contributed submissions and presented at hearings for the Inquiry. These contributions are valuable to ensure a broad and robust consideration of cross-jurisdictional arrangements.

Overview of current situation

The Committee's report details how the GST distribution reforms legislated by the Commonwealth Government in 2018 harm Victoria, and how the Commonwealth could better support Victoria through this and other mechanisms.

GST is a vital source of revenue for Victoria, and its distribution between states and territories (states) is consequential to the level of services state governments can provide.

Victoria has long supported the principle of horizontal fiscal equalisation (HFE), that residents of all states should be able to access broadly equal levels of government services under similar tax burdens. Victoria recognises its role as a fiscally stronger state, subsidising fiscally weaker states through the GST distribution system.

However, changes to long established equalisation approaches legislated by the Commonwealth Government in 2018 have compromised the underlying intent of the GST distribution system and seriously undermined its operation. The system no longer achieves HFE and does not address the key concerns that motivated the changes.

The system is now costing the Commonwealth Government billions of dollars annually, costs that will be borne by states once the no-worse-off guarantee ends in 2026-27. These costs are likely to fall to all states except Western Australia (WA).

Despite the Commonwealth originally stating in 2018 that all states would be better off, modelling presented in Victoria's submission to the Inquiry showed that, under a wide range of scenarios, the end of the no-worse-off guarantee will financially disadvantage most states for the benefit of WA.

If the no-worse-off guarantee ends, states will be fully exposed to the operation of the new system, impacting state budget forward estimates from 2024-25. This impedes not only states' ability to invest in vital services for their citizens now, such as education, health, and mental health – but also their ability to plan effectively into the future.

Most jurisdictions will be disadvantaged once the guarantee expires, when compared with the former system, in order to cross-subsidise WA – the fiscally strongest state. If the no-worse-off guarantee ends as currently legislated, Victoria will face an entrenched and ongoing loss of GST revenue.

Overview of Government actions

On 5 July 2018, the Commonwealth released its interim response to the Productivity Commission's Horizontal Fiscal Equalisation Inquiry Report, which detailed the new equalisation arrangements.

Since this time, the Victorian Government has worked to preserve the integrity of the equalisation system and secure assurance that change would not leave Victorians disadvantaged – including working with other states and making formal representations to the Commonwealth Treasurer, the Council on Federal Financial Relations, and an associated Commonwealth Senate Inquiry.

In response to such advocacy, the Commonwealth committed to ensuring that no state would be worse off because of the changes to the GST distribution system, until the transition is complete in 2026-27.

Since the implementation of the new arrangements, new evidence has emerged demonstrating that Victoria is worse off under the new system and will be significantly impacted once the no-worse-off guarantee ends in 2026-27.

The Commonwealth's 2022-23 Budget estimated it will pay \$14.8 billion in no-worse off payments to states over the budget and forward estimates, including \$4.4 billion to Victoria alone.

The Victorian Government has advocated in the first instance for the new equalisation arrangements to be reversed.

If the Commonwealth is unwilling to revert to the previous equalisation arrangements, the no-worse-off guarantee should be continued, and a review of the GST system accelerated.

The Victorian Government will continue to advocate for Victoria's fair share of GST and other Commonwealth support.

Response to Recommendations

Table 1: Guide to response

| | |
|----------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Support in full | All elements of the recommendation are supported |
| Support in part | Some elements of the recommendation are supported |
| Support in principle | The Victorian Government generally supports the intent or merit of the policy underlining the recommendation, but does not necessarily support the method for achieving the policy |
| Under review | Further analysis is required for the Victorian Government to determine its position (when possible, estimated expected timeframes for the review and/or implementation should be included in the response) |
| Not support | The Victorian Government does not support the recommendation |

Table 2: Government response to the inquiry recommendations

| Number | Recommendation | Response | Detail |
|--------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1 | That the Victorian Government work with other adversely affected states and territories to advocate that the Australian Government revert to the former equalisation arrangements for GST revenue distribution. | Support in full | <p>When the new equalisation arrangements were brought in, the Victorian Government articulated its shortcomings and disagreed with the changes. Since their introduction, the Victorian Government has advocated for the system of GST to revert to the former equalisation arrangements, or at a minimum for the no-worse-off guarantee to be extended indefinitely.</p> <p>In response to repeated requests from Victoria and other states, former Commonwealth Treasurer Frydenberg and former Prime Minister Morrison publicly ruled out further changes to the GST distribution.</p> <p>With a new Commonwealth Government, new advocacy efforts are underway to ensure that Victoria receives its fair share of Commonwealth support.</p> |

| | | | |
|---|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2 | <p>That the Victorian Government work with other adversely affected states and territories to advocate that the Australian Government extend the no-worse-off guarantee beyond 2026–27 until the inequity created by the new equalisation arrangements is addressed.</p> | Support in full | <p>The cessation of the no-worse-off guarantee could have severe fiscal impacts for Victoria. The Commonwealth’s 2022-23 Budget estimates over \$3.8 billion to be paid to states in no-worse-off payments in 2022-23 alone, which demonstrates the potential financial impacts to states of the new system without the guarantee in place.</p> <p>The Victorian Government has consistently advocated for the continuation of the no-worse-off guarantee in response to mounting evidence that it, and most other states, face significant fiscal risks if it is allowed to end. This case was made, for example, in its <i>2022-23 Budget</i> papers.</p> <p>Should the Commonwealth not revert to the former equalisation system, the Victorian Government will continue to seek for it to make the no-worse off-guarantee permanent.</p> |
| 3 | <p>That the Victorian Government work with other adversely affected states and territories to advocate that the legislated Productivity Commission review, or another independent review, of the new equalisation arrangements be conducted as soon as possible with input from the states on the review’s terms of reference.</p> | Support in full | <p>In addition to reverting to the former equalisation arrangements or continuing the no-worse-off guarantee, the Victorian Government has requested that the Commonwealth Government bring forward the Productivity Commission review or hold an independent review of the new equalisation arrangements.</p> <p>In December 2021 the South Australian Government engaged PwC to conduct an independent review of the GST system, supported by the Victorian Government. The report’s base-case modelling showed that, without the no-worse-off guarantee in 2026-27, Victoria faced losing \$1 billion – while Western Australia would gain \$4.2 billion.</p> |
| 4 | <p>That the Victorian Government drive collaboration between itself, the Australian Government, Infrastructure Victoria and Infrastructure Australia to develop common priorities for infrastructure investment in Victoria based on evidence indicating which projects will deliver the highest net public benefits.</p> | Support in principle | <p>Increased collaboration between the relevant Commonwealth and state infrastructure advisory and planning bodies on project identification and design will help to ensure infrastructure investment delivers value for money and net public benefits.</p> <p>It is important for the responsible state, in this case Victoria, to retain final project decision-making autonomy to ensure the project meets the needs of the local community and that project risk sits with the responsible government.</p> |

| | | | |
|---|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 5 | That the Victorian Government continue to pursue greater Commonwealth investment in regional infrastructure development, especially projects that will improve digital connectivity, transport networks and skills shortages. | Support in full | <p>More Commonwealth funding for Victoria is required to achieve a fairer share of national infrastructure funding. Economic growth and improved well-being are becoming increasingly tied to digital connectivity, higher skills and efficient transport connections, including in the regions.</p> <p>The Victorian Government is already delivering key transport projects in partnership with the Commonwealth in the regional areas, such as the Regional Rail Revival program and tranches of road upgrades through the Commonwealth Roads of Strategic Importance program. The Victorian Government is delivering joint planning for future regional rail upgrades via the National Faster Rail Agency, a business case for the Geelong Fast Rail and other rail network planning proposals that will inform future joint investment options via the Western Rail Plan and Northern Rail Plan.</p> <p>The need for greater Commonwealth investment in regional infrastructure development is evidenced by the higher rate of population growth in regional Victoria.</p> <p>State and local governments have substantially less financial capacity than the Commonwealth to respond to regional infrastructure challenges. Regional infrastructure investment is an important role of the Commonwealth to support and stimulate regional areas.</p> <p>In relation to digital connectivity, and as noted in the Victorian Government's submission to the 2021 Regional Telecommunications Independent Review, the Commonwealth Government has primary responsibility for telecommunications. In parallel with delivering the Connecting Victoria program over coming years, the Victorian Government will continue to advocate for the Commonwealth to partner with State programs to maximise benefits to regional users, address connectivity gaps to drive regional growth and inclusion and support more resilient critical communications.</p> |
| 6 | That the Victorian Government advocate that a greater proportion of Commonwealth revenue be allocated to Financial Assistance Grants for local government. | Support in full | <p>Commonwealth general purpose funding is an important revenue source for local governments in Victoria, especially for small rural councils. The Commonwealth Government's three-year indexation freeze on the size of the Financial Assistance Grants pool starting in 2014-15 has reduced the amount of funding available to Victorian Councils by approximately \$60 million per year. An increase in the funding pool size would help restore this funding shortfall. This would be especially beneficial to small rural councils in Victoria who rely more heavily on Commonwealth funding grants.</p> <p>In addition, the Victorian Government considers that any steps to improve financial assistance grants to rural councils should also prioritise addressing constraints in the legislation and national distribution principles. The most significant constraint is a requirement imposed by the Commonwealth that there be a minimum general-purpose grant to councils (which currently is \$21 per capita). This effectively redistributes funds away from councils most in need. A reduction or removal of this requirement would increase the financial assistance grants to small rural councils.</p> |

7

That the Victorian Government continue to advocate that the Australian Government provide additional support to address the significant and ongoing negative impacts of the COVID-19 pandemic on Victoria's businesses, social service organisations and vulnerable populations as well as on the wellbeing of all Victorians

Support in full

While the Victorian and Commonwealth governments co-funded several significant time-limited business support programs over 2021-22, the key current priority is alleviating workforce and skills shortages impacting some sectors of the Victorian economy, supported by the reopening of Australia's international borders by the Commonwealth Government in early 2022.

The Victorian Government also recently advocated to the Fair Work Commission for an increase to minimum wages to counterbalance increases in income inequality due to the COVID-19 pandemic, provide opportunities for those from marginalised cohorts to increase their economic participation, be more economically secure when reaching retirement age and to have the possibility of building or rebuilding their savings.

The Victorian Government will continue to advocate for a more equitable distribution of GST revenues to further enable the State to support vulnerable cohorts through service delivery.