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Reforming the dark art of GST forecasting

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Abstract

A decade after its introduction the Goods and Services Tax (GST) and its role in funding the States and Territories in the Australian federation is once again on centre stage of the national political debate. As a precursor to the forthcoming review of the Australian federation, this paper focuses on a technical yet significant aspect of intergovernmental financial reform, namely enhancing the transparency and accuracy of the methods State Governments use to forecast GST revenues. Without a consistent and credible national framework for forecasting GST revenues, State forecasts will continue to deviate significantly from projections published by the Commonwealth. We argue that while the States are justified in abandoning Commonwealth projections, the GST Distribution Review's recommendations to address the problem do not go far enough. There is need to develop a transparent national approach to forecasting GST distributions administered by the Commonwealth Grants Commission as part of the broader debate about reforming the governance of the Australian Federation. Such an approach would yield credible forecasts and is less dependent on State cooperation and information sharing than the model recommended by the GST Distribution Review.

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1. INTRODUCTION

Australia is on the verge of a national debate concerning the nature and financial foundations of its federation. As the Commonwealth's Commission of Audit makes clear, a central plank of this agenda will be establishing a simpler and more efficient model of intergovernmental financial relations which will promote State sovereignty and financial accountability within the federation (NCA 2014, 142–150). It is inevitable that part of the broader debate will consider whether the Goods and Services Tax (GST) is likely to provide the States and Territories with sufficient revenue to meet their future expenditure needs, and whether the current GST 'pool' is being distributed to the States in an equitable and sustainable manner. One of the persistent criticisms concerning the process used to distribute the GST is the lack of transparency and predictability in the methods State Governments use to forecast future GST revenues. As there is no nationally accepted framework for forecasting GST relativities, State governments have been forced to develop their own forecasting methodologies which deviate substantially from projections published by the Commonwealth.

This debate about reforming GST forecasting comes at a time of intensifying intergovernmental conflict surrounding fiscal federalism in Australia. This conflict, and the need to adopt new forecasting methodologies, has arisen in the wake of lower rates of GST revenue growth in the aftermath of the 'Financial Crisis' and amid disputes concerning the distribution of resource revenues in the Australian federation (Daley, Walsh and Keen 2013; Swan 2013). Within this political and financial context there is a clear case to develop and adopt a consistent, transparent national approach for forecasting GST distributions.

Debate concerning the reform of intergovernmental financial relations in Australia came to the fore in the *GST Distribution Review* (2012). *The Review* made a number of key findings including the need to develop a new mining revenue assessment regime; that the Commonwealth should underwrite the GST pool; and a number of other procedural reforms. One of the procedural reforms of *The Review* was that the current State and Commonwealth relativities forecasting and projections regime is misleading and in need of reform. We agree with this assessment, but argue that *The Review's* belief that increased intergovernmental cooperation between the States will result in more credible relativity forecasts does not reflect the reality of political relations in the Australian federation and the decline in intergovernmental cooperation in relation to financial issues.

The paper begins with an overview of Australia's Horizontal Fiscal Equalisation (HFE) regime and its implications for determining and forecasting GST distributions to the States. Having provided this historical context we present a critique of the current GST forecasting regime in the context of increasing revenue volatility in the aftermath of the Financial Crisis and Resources Boom. Section 3 presents original data assessing the extent of variation between Commonwealth projections of GST distributions to the States relative to their own forecasts. While the data does not support the hypothesis that States systematically over-estimate future GST revenues, significant State-specific variations (over 17% in the case of Western Australia and Tasmania) between Commonwealth GST projections and forecasts prepared by State Treasuries over the forward estimates highlights the need for developing a consistent national approach to GST forecasting.

The paper concludes by considering options for reforming the GST forecasting regime. After considering the recommendations of the 2012 *GST Distribution Review* we argue that a consistent national approach to GST distribution forecasting should be

administered by the Commonwealth Grants Commission (CGC) in order to enhance the accuracy and credibility of State budgeting without compromising their financial independence from the Commonwealth. Such an approach would enhance the political legitimacy of State budget processes, reduce the incentives for States to over or underestimate their relativity, and help restore credibility to State public finances. The States in turn would have greater accountability as they would have to attempt to budget within the confines of CGC forecasts.

2. HORIZONTAL FISCAL EQUALISATION AND ITS IMPLICATION FOR GST DISTRIBUTION

The introduction of the GST in July 2000 by the Howard Coalition Government had the aim of putting State finances on a secure footing. At that time Treasurer Peter Costello claimed “[t]he GST will provide the States and Territories with a secure source of revenue that grows as the economy grows to secure funding for essential services, such as schools, hospitals and roads” (as quoted in Hamill 2006, 126). Prior to the onset of the Financial Crisis, the GST largely lived up to the Howard Government’s claims, with revenues distributed to the States rising by an average of 8.9 per cent per annum in nominal terms between 2000–07 (GST Distribution Review 2012, 154; Eccleston 2008, 39). This increase in general purpose payments to the States was widely lauded although more recently Australia’s unique approach to distributing these grants through a system of comprehensive horizontal fiscal equalisation (HFE) has been subject to criticism (Williams 2012; Warren 2012a; Garnaut 2013).

From the early 20th century there has been broad political support for equalisation in the Australian federation (see Mathews and Grewal 1997; CGC 2008). This goal of equalisation was formally adopted in 1933 with the creation of the CGC as an independent body designed to ensure adequate funding for the States (CGC 2008, 1, 25–28). Until the 1970s Australia’s equalisation regime was limited to transfers to poorer claimant States, but the Fraser Government’s ‘New Federalism’ gave rise to a comprehensive approach where the revenue capacities and costs associated with service provision of all States (and later Territories) were assessed and used to allocate Commonwealth transfers (CGC 2008, 28; 32). This gradual shift from ‘partial equalisation’ under which the CGC recommended Commonwealth assistance to claimant States, to a system of ‘comprehensive horizontal equalisation’ whereby the capacity of all States were assessed and compared to a national average has had numerous consequences (Williams 2012, 148–150). Specifically, under the current regime the overall amount of GST raised in one State or Territory is pooled rather than being retained in the jurisdiction in which it was raised. Each State’s share of the GST pool is determined by the CGC, an independent statutory body which is at arms-length from the Commonwealth.

The CGC achieves HFE through providing a recommendation to the Commonwealth for each State’s funding relativity, which is used to determine their share of the GST pool. The CGC (2013, 144) describes a State’s funding relativity as “[a] per capita weight assessed by the Commission for use by Treasury in calculating the share of the GST revenue a State requires to achieve horizontal fiscal equalisation”. The per capita benchmark is presented in projections and forecasts as outlined in Table 1 (below). The relativities themselves are determined by a formula designed to ensure each State has the fiscal capacity to deliver services of a similar standard across the federation after taking account of State-specific cost and revenue raising factors (CGC 2013, 71–73). Variations in a State’s relativity have a major impact on a State’s budget position, especially when a jurisdiction depends on GST revenues for a significant portion of their funding. For example, the decline in GST growth rates have been hard felt in small non-resource jurisdictions like the Northern Territory and

Tasmania where their GST allocation represented 58.9 per cent and 35.5 per cent respectively of total revenue for 2012–2013 (GST Distribution Review 2012, 77).

Table 1. Commonwealth Projected Relativities 2012–16

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Average (per capita)
2012-13	0.95312	0.92106	0.98477	0.55105	1.28472	1.58088	1.19757	5.52818	1.0000
2013-14	0.96576	0.90398	1.05624	0.44581	1.26167	1.61454	1.22083	5.31414	1.0000
2014-15	0.97500	0.88282	1.07876	0.37627	1.28803	1.63485	1.23600	5.66061	1.0000
2015-16	0.96513	0.88240	1.09328	0.36355	1.29491	1.71346	1.23444	5.70038	1.0000
2016-17	0.94732	0.87560	1.13192	0.34988	1.33452	1.68279	1.21322	5.67391	1.0000
2017-18	0.95023	0.88592	1.12472	0.36364	1.32193	1.65697	1.19896	5.50247	1.0000

Source: Commonwealth Government 2012a, 123

After the onset of the Financial Crisis the stream of GST revenues distributed to the States has become increasingly volatile. Not only has the rate of growth of the GST pool slowed considerably due to lower consumer spending, but the divergent fiscal fortunes of States and Territories in the federation as a consequence of the resources boom has led to significant variations in funding relativities calculated by the CGC to determine specific State's shares of the GST pool (Commonwealth 2010, 5–8). The *GST Distribution Review* (2012, 153–154) notes that after increasing at over eight per cent per annum prior to 2007, since 2008–09 GST revenue growth has averaged only 2.2 per cent — it is expected to rebound to five per cent in future years but is unlikely to recover to pre-crisis rates. Given this volatility in both the size of the GST pool and its distribution there have been growing calls to improve the accuracy of GST forecasts.

State governments clearly need accurate forecasts of GST relativities in order to budget effectively. This concern prompted the *GST Distribution Review* (2012, 151–164) to recommend measures to reduce the volatility of the GST pool and enhance the accuracy of budget forecasts concerning GST distributions. On the announcement of the Review Prime Minister Gillard stated “[I]nstead of States facing penalties for economic growth and rewards for economic underperformance, the GST distribution process should encourage economic reform and better delivery of services, and provide States with certainty” (Gillard in Warren 2012b, 6).

3. THE LIMITS OF THE GST FORECASTING REGIME

GST revenue forecasts used by the States for budgeting purposes are the combined result of the total GST revenue for a given year, each State's share of Australian population and each State's relativity calculated by the CGC to meet HFE goals (GST Distribution Review 2012, 79). Using the best available information the Commonwealth forecasts both the total of GST revenue and the populations of each State. While GST pool and population forecasts may, like any estimation, be inaccurate, the real concern is the process used to forecast future GST relativities, or the relative share of the GST pool being allocated to a particular State in a given year of the forward estimates.

The problem arises because under the current regime the CGC only produces an accurate forecast for the current financial year. Given this limitation estimated GST collections are reported in the Commonwealth budget papers as forecasts for the first year, and ‘projections’ for the remaining three years of the forward estimates period. The distinction is that forecasts are attempts to estimate future relativities as accurately as possible using all available data, whereas projections apply to current year relativities to predict future GST distributions. Projections ultimately exclude predictable factors that may change the future relativities across the forward estimates and therefore are not as accurate as forecasts (GST Distribution Review 2012, 78). While the use of such projections may have been defensible during the period of relative economic stability prior to the Financial Crisis, this clearly is no longer the case.

As the *GST Distribution Review* points out, these simplified projections ‘make no allowance for fiscal capacity changes’ of States, as the Commonwealth assumes the latest assessed relativity for the year remains constant for the further three “out years” (GST Distribution Review 2012, 78–79). This approach models the total forecast of the GST revenue pool and anticipated population changes in each jurisdiction, while excluding other predictable factors which will influence future relativities. This methodology has compromised the accuracy of GST projections published in Commonwealth Budget Papers. In the words of the Commonwealth Treasury (Commonwealth Government 2012a, 123):

The Commonwealth's projections of GST relativities for 2013-14 to 2015-16 assume that the States' fiscal capacities will be broadly consistent with the assessment of their relative fiscal assessed differences in the Commission's *2012 Update*. The projections only include adjustments to account for estimated changes in the size of the GST pool, State population shares and the distribution of the National SPPs.

The Commonwealth’s method excludes expected changes in relativities because the Commonwealth’s primary concern is with the size of the GST pool and the Treasury accepts advice from the CGC in terms of how State-specific factors impact on its distribution (CGC 2012a, 112–113). As outlined above, the CGC only publishes its annual update of relativities in the year which they are applied and does not forecast future movements in relativities. For example, the relativities for the 2014–15 fiscal year were published by the CGC in February 2014 based on its analysis of average State circumstances for 2010–11 to 2012–13 (CGC 2012b, 2). The three assessment years which will inform the relativity for each year across the current forward estimates are listed below (Table 2).

Table 2. Commonwealth Projection Method

Application year	Commonwealth’s Calculation method	Assessment years required
2011-12	CGC calculated	2007-08, 2008-09, 2009-10
2012-13	CGC calculated	2008-09, 2009-10, 2010-11
2013-14	Commonwealth projections	2009-10, 2010-11, 2011-12
2014-15	Commonwealth projections	2010-11, 2011-12, 2012-13
2015-16	Commonwealth projections	2011-12, 2012-13, 2013-14

Source: GST Distribution Review 2012, 79

In its forward estimates the Commonwealth projections assume each States' fiscal capacity in the future years will remain the same as the current assessed year (GST Distribution Review 2012, 79). Major structural economic changes, such as those associated with the resources boom and its subsequent decline, render this simplistic approach unrealistic. There is now broad-based acceptance that predictable changes in GST relativities over the course of the Commonwealth forward estimates will compromise the accuracy of the projected GST revenues published in the Commonwealth's Budget Paper Number 3. This known inaccuracy has prompted State Treasuries to adopt their own methods of forecasting relativities beyond the inaccurate Commonwealth projections (GST Distribution Review 2012, 79–80).

The GST Distribution Review found two fundamental problems with the current State and Commonwealth regime in relation to GST revenue forecasts and projections. It made the blunt assessment that “there is confusion around the purpose and intended accuracy of the Commonwealth projections and secondly, that all GST projections (both Commonwealth and State) are not as accurate as they could be, or should be” (GST Distribution Review 2012, 79). Given such concerns a primary objective of this paper is to establish the extent to which State GST forecasts vary from Commonwealth GST projection over the period until 2015–16 (the period for which there is complete data), and whether there is a systematic bias in the variance and options for reform.

4. VARIATION IN GST FORECASTING — THE EVIDENCE AND ITS CONSEQUENCES

The analysis of State, Territory and Commonwealth Budgets for 2012–2016 presented below (Table 3) highlights variations between the Commonwealth Projections and the State and Territory forecasts which in turn have led to confusion and uncertainty in relation to the final GST allocation each jurisdiction is likely to receive. Table 4 focuses on the extent of the variation between State forecasts and Commonwealth Projections for 2015–16 and reports these variations as a percentage of total GST revenues to highlight the relative significance of the discrepancy for the jurisdiction concerned. To gauge the political significance of this variation Table 4 also reports whether the State forecast used in a given jurisdiction has a decisive impact on the overall operating balance of the budget concerned.¹

The data presented in Table 4 clearly demonstrates variation between Commonwealth GST projections and State-based forecasts. The fact that this variation is most significant among smaller jurisdictions and the resource-based economies such as Western Australia and Queensland is consistent with the claim that these States are the most vulnerable to changes in GST relativities. While the impact on New South Wales and Victoria is modest, with the revised State-based GST forecasts within three percent of the original Commonwealth projection, this is not true for the other States and has had significant political implications.

The dramatic decline in Western Australia's GST relativity, as evident in both the projections and forecasts in Tables 3 and 4, has resulted in a situation where the Western Australian government is predicting it will receive 17.5 per cent less GST revenue than projected by the Commonwealth in 2015–16, a finding which has sparked an intense political backlash (Franklin 2011). The current and potential future disparities in GST distributions have led commentators and politicians, including the Western Australian Premier Colin Barnett, to suggest that the smaller States of South Australia, Tasmania and the Northern Territory are mendicant, relying on “federal

¹ We would like to thank a reviewer for suggesting this analysis.

Table 3. Variations between Commonwealth Projections and State and Territory Forecasts of GST Revenues 2012–13 to 2015–16 (AUD Millions)

State or Territory	Method to determine Relativity (Own or Cth)	Cth 2012–2013 (forecast)	States 2012–2013	Difference 2012–2013	Cth 2013–2014 (projection)	States 2013–2014	Difference 2013–2014	Cth 2014–2015 (projection)	States 2014–2015	Difference 2014–2015	Cth 2015–2016 (projection)	States 2015–2016	Difference 2015–2016	Total difference
NSW	Own	14,796	14,796	0	15,816	15,685	131	16,680	16,399	281	17,452	17,023	430	842
VIC	Own	11,073	11,041	31.6	11,376	11,592	-216	11,812	12,144	-332	12,435	12,997	-562	-1,078
QLD	Own	9,667	9,667	0	11,194	10,951	243	12,274	11,782	491.7	12,872	12,105	766.8	1501.5
WA	Own	2,797	2,792	5.3	2,109	2,139	-30.3	1,667	1,663	3.9	1,843	1,520	323.5	302.4
SA	Own	4,512	4,512	0	4,782	4,642	140.40	5,104	5,126	-21.70	5,306	5,579	-273	-155
TAS	Own	1,704	1,700	4.4	1,720	1,849	-128.5	1,771	2,059	-287.8	1,832	2,147	-315	-727
ACT	Own	938	938	0	989	994	-4.7	1,069	1,047	22.5	1,120	1,101	19	37
NT	Own	2,714	2,704	9.7	2,911	2,867	44.8	3,123	3,040	82.7	3,214	3,223	-9	128
Cth (Totals)	Cth	48,200	48,150	50	50,900	50,719	181	53,500	53,260	240	56,075	55,695	380	851

Sources: State, Territory and Commonwealth Budgets for 2012-2013

Table 4. Percentage discrepancy between Commonwealth projection and State Forecasts and impact on Net Operating balance for 2015–16

State or Territory	Cth 2015–2016 (projection)	States 2015–2016	Difference 2015–2016	Difference as a % of revenue	Forecast 2015–16 Budget Surplus/ Deficit using C'th projection	Forecast 2015–16 Budget Surplus/ Deficit using State forecast
NSW	17,452	17,023	430	-2.4%	587	157
VIC	12,435	12,997	-562	3.4%	1365	1927
QLD	12,872	12,105	766.8	-6.0%	3954	3188
WA	1,843	1,520	323.5	-17.5%	451.5	128
SA	5,306	5,579	-273	5.1%	102	375
TAS	1,832	2,147	-315	17.2%	-348.9	-33.9
ACT	1,120	1,101	19	-1.7%	48.3	29.3
NT	3,214	3,223	-9	0.1%	-245	-236
Cth (Totals)	56,075	55,695	380	0.7%	-	-

“largesse” (Kenny 2013; Denholm 2011). In these circumstances some States, such as Western Australia, may have a political interest in underestimating their relativity to highlight the extent to which they cross-subsidise poorer jurisdictions.

In contrast, States such as Tasmania conceivably have an interest in over-estimating their relativity to obscure the magnitude of the budgetary challenge they face. These political dynamics were evident in Tasmania during the 2013 Federal Election campaign where there was public concern that its share of GST would be cut (Denholm 2013a). In contrast in Western Australia there was discontent in relation to the perceived injustice of receiving less GST than the Northern Territory despite the Northern Territory having only one-tenth of Western Australia’s population (Greber, Duncleley, Sprague and Ludlow 2013). In addition to triggering interstate conflict over the distribution of the GST this volatility has created budget-forecasting challenges for State governments amid uncertainty about how the \$51 billion GST pool will be distributed.

This volatility was the pretence for the States to generate their own relativity forecasts to improve the accuracy and credibility of their respective budgets. These concerns led the Western Australian Treasury to conduct a *Review of Revenue Forecasting* in 2006 to establish how the States’ changing revenue-raising capacities had contributed to errors in State revenue forecasting. At the time of the 2006 review, all the States had used the Commonwealth GST projections for budget forecasting purposes and the review determined that these projections were a significant factor in State budget

forecasting errors (Government of Western Australia 2006, 20). The review recommended that the States' should prepare their own GST revenue forecasts as an alternative to the Commonwealth projections to provide improved modelling for out-years (Government of Western Australia 2006, 28). In Western Australia and Queensland the claim had been that the Commonwealth's projections systematically overestimated the amount of GST they will receive.

Reflecting these concerns, by the 2012 budget season all State jurisdictions had adopted their own methodologies rather than relying on the Commonwealth's GST projections (Giddings 2013). The then Tasmanian Premier Lara Giddings (2013) justified the move on the basis that State based modelling of forecasts are more in line with CGC estimates because they more accurately take into account the effect of one off project funds on their relativities. As noted above, by 2015–16 the discrepancies between the Treasury projections of GST revenue and State forecasts are in the order of 17 per cent for both Tasmania and Western Australia, while in Queensland the State government expected to receive six per cent of the distribution less than that predicted by the Commonwealth. These are substantial sums that significantly impact on the medium term fiscal strategy of the government in question. In the case of Tasmania, the Treasurer attempted to reassure voters that the recovery in the State Budget is based on "hard work and not smoke and mirrors" (Giddings 2012). In contrast Western Australian forecasts amount to some \$302 million less than the Commonwealth projections by 2015–16 and highlight its declining share of GST. In the case of Queensland the predicted decline in GST revenue was highlighted by the Newman Government's *Commission of Audit* that precipitated 14,000 public sector job losses in order to bring recurrent expenditure in line with future income (Queensland Government 2012a).

The States clearly have an administrative incentive to produce independent forecasts of their likely GST distributions given the known inaccuracy of Commonwealth projections. Moreover, as the above commentary suggests, there may be political incentives to manipulate GST forecasts. One way of assessing such claims using existing data is to establish the extent of any systematic bias in State forecasts by comparing the sum of the individual State forecasts with that of the total Commonwealth pool. In theory this figure should be zero because the relativities are used to distribute a fixed revenue pool — any gains a particular State makes due to an improving relativity must be offset by another's loss.

In practice, the total revenue forecast by the States does vary from the size of the Commonwealth pool because each of the States employs their own methods. The data presented in Table 3 highlights that over the four years of the forward estimates the States' expect to receive \$851 million less than the total projected by the Commonwealth. This is a relatively minor variation equivalent to .7 per cent of the GST funding pool for 2015–16 and suggests that there is little systematic bias in forecasting methodologies being used by State Treasuries. This conclusion should reassure those who are concerned about politically motivated manipulation and contradicts the public choice orthodoxy on budget politics which suggests that budget agencies face political incentives to systematically overestimate revenue projections to justify higher levels of short-term public spending (see Niskanen 1975; 1994). While it is reassuring that there is little evidence to suggest there has been systematic manipulation of State GST forecasts, the credibility, and perhaps the accuracy, of such

forecasts would be greatly enhanced if they were prepared in a consistent manner at a national level. The final section of the paper evaluates options for establishing a national framework for forecasting GST revenues.

5. OPTIONS FOR REFORMING GST FORECASTS

Budget forecasting will always be an imprecise science, and as *The GST Distribution Review* acknowledges, estimating the GST relativities is particularly difficult given States' fiscal capacities are influenced by significant external factors including exchange rate fluctuation and commodity prices which may disproportionately affect different States (GST Distribution Review 2012, 80). Despite these challenges it is incumbent upon all budget agencies to develop and apply the most appropriate methods available to improve the accuracy and legitimacy of the budget planning process. By this standard the current approach to forecasting future GST relativities in Australia is unacceptable. Given these concerns *The GST Distribution Review* analysed four options for potential reform.

An initial option analysed was whether the Commonwealth Treasury should improve the projections and ultimately create and publish their own forecasts. *The GST Distribution Review* ultimately found that recommending the Commonwealth Treasury to produce accurate forecasts for the forward estimates would be counterproductive. This was because such calculations are largely dependent on data sets provided by the States, which, as *The Review* noted, may or may not want to divulge information concerning their fiscal capacities to the Commonwealth (GST Distribution Review 2012, 80). The other concern of *The GST Distribution Review* was that if the Commonwealth was the body that conducted relativity forecasts, and the CGC subsequently determined the relativity for the current year varied from these forecasts, then the anomaly may undermine the credibility of both agencies (GST Distribution Review 2012, 80). A more practical concern is that tasking the Commonwealth Treasury with preparing GST relativity forecasts would result in unnecessary administrative duplication.

The GST Distribution Review also considered the suggestion that the Commonwealth continue to publish relativity projections while making the limitations of the projections "clear and explicit" (GST Distribution Review 2012, 82). Noting that Budget Paper Number 3 should explain what methods are used in order to reduce the risk of confusing readers. Such an approach may reduce confusion, but begs the question: if such projections are so easily misinterpreted, why should they be published at all?

The ultimate recommendation flagged by the GST Distribution Review was that the States should share their relativity data biannually given that the States are ultimately in the best position to know their likely future fiscal position (GST Distribution Review 2012, 81–82). These include own-source revenue estimates for the next four years in accordance with CGC assessments, any potential impacts from announced policy changes on own-source revenue estimates, and expenditure estimates over the next four years by CGC assessment category (GST Distribution Review 2012, 81–82). The Review similarly acknowledged that as the relativity is a determination of the relative fiscal capacity of each State there is a need for the sharing of information between the States to improve each States projections. The proposal being that the

States should encourage the provision of relevant information to a ‘central point of contact’ either being the Commonwealth or a ‘nominated State’ to calculate a joint forecast of the relativities. Interestingly *The Review* argued that it would be inappropriate for the CGC to assume this coordinating function because of a perceived risk of confusing current year ‘actual relativities’ and forecasts across the forward estimates (GST Distribution Review 2012, 81).

While establishing a regime where State Treasuries share relevant budget data to produce relativity forecasts is administratively feasible we argue that it does not address the political realities of intergovernmental conflict within the Australian federation. Such an approach is impractical given growing evidence of declining intergovernmental financial and fiscal cooperation within the Australian federation. For example, Menzies (2012, 418–419) argues that despite the apparent intergovernmental cooperation of the States in non-financial policy arenas, there is an increasing need for the Commonwealth to invest in strategic mechanisms that focus on a long-term intergovernmental agenda. Intergovernmental cooperation within the federation in relation to State funding is especially problematic due to the ‘zero-sum’ nature of States finances, particularly without effective Commonwealth leadership for reform (Eccleston, Warren and Woolley 2013, 27–28). For example, the Intergovernmental Agreement on Federal Financial Relations setting, extending and defining Special Partnership Payments established by the Rudd Government is now regarded as being dysfunctional and ineffective amid increasing intergovernmental tensions and conflict (Menzies 2012, 418). There is little historical evidence from Australia or abroad to suggest that States who are each vying for an increased share of a limited pool of revenue would openly divulge potential revenue streams to each other (Rodden 2000; 2002).

Despite the abovementioned concerns outlined in the *GST Distribution Review*, there is a clear case for the CGC, as an independent and expert agency, to prepare and publish accurate forecasts of GST relativities. The CGC should not only publish revised relativities for the upcoming financial year each June, but it should also provide forecast relativities for the forward estimates period. When considering this option *The GST Distribution Review* acknowledged the Commission had ‘necessary expertise’ while noting that the CGC “has been reluctant to engage in projecting relativities in the past” (GST Distribution Review 2012, 81). We agree with *The GST Distribution Review* that our proposal may place pressure on the CGC given that both State and Commonwealth budget forecasts would be shaped by the CGC’s deliberations, but believe that the Commission is well placed to meet and address such political and technical challenges (GST Distribution Review 2012, 81). Indeed the independent nature of the CGC, unlike the politicised equalisation system in Canada, is regarded as a comparative strength of the Australian HFE regime (Lecours and Béland 2010, 570; 2013; Béland and Lecours 2011). The CGC is a superior alternative to either a consortium of States or the Commonwealth forecasting the overall relativities in the forward estimates. The CGC has the expertise and is a politically neutral body which would reduce the risk of manipulating relativities for political advantage. If one national agency publishes credible relativity forecasts on the best available data then it will enhance the accuracy and credibility of budgets at a State level thus averting the uncertainty and controversy that has been associated with State budgets in recent years.

The current system for calculating GST relativities is based on historical data and it is possible to accurately forecast relativities for the first two years in the forward estimates. Indeed this is exactly what State Treasuries have been doing in recent years by using their own methods. For the third and fourth years in the forward estimates it should be possible to provide reasonably accurate forecasts based on data presented in State and Territory budgets. There would then be a process established whereby States provide bi-annual updates concerning 'out years' to the CGC so it can prepare relativities for the four forecast years ahead of the annual preparation of State budgets. This will involve a regular meeting between the CGC and the Standing Council on Federal Financial Relations. States will then have an opportunity to comment on draft relativity forecasts beyond those for the current year as the case is now. Likewise, all States, Territories and the Commonwealth should give an undertaking to use CGC published forecasts in their respective budgets which in turn adds to certainty and legitimacy of the process.

6. CONCLUSION

This paper has argued that there is a clear need to reform the current system for forecasting GST relativities in Australia. This may appear to be a relatively small and technical element within Australia's broad system of federal governance, but we argue that unless the current regime is replaced with a more transparent, consistent and accurate approach to preparing relativity forecasts then the credibility of State budgets and the quality of State budget management will be undermined. This issue was rightly identified by the 2012 *GST Distribution Review*, but we believe that *The Review's* recommendation to improve relativity forecasts by establishing a regime whereby States and territories exchange budget information on a biannual basis is unlikely to succeed based on historical precedent and the parochial tensions which define contemporary Australian federalism.

The paper argues that the CGC should be given a mandate to gather requisite data from the States and Territories and prepare GST relativity forecasts for the States and Territories for the four years of forward estimates published in the Commonwealth budget. The CGC is unique in that it has the necessary expertise to perform this task while being at arms-length from Federal, State and Territory governments. The resulting forecasts will still be subject to the vagaries of ever changing economic conditions and policy settings. However, the fact that they are prepared by an independent agency in a consistent manner will add to their credibility and will counter the lingering concerns that GST forecasts may have been prepared by State governments to further their own political interests. This enhanced credibility should also serve as a more effective fiscal constraint on State governments, placing the onus back on the States to govern within their financial means. Finally, while reforming the GST forecasting is technical in nature and is not as contested as proposals to change the GST distribution formula or rein in special purpose payments to the State, given the fractious nature of intergovernmental financial relations and the looming review of the Australian federation our political leaders might be best served by focusing on technical reforms which should enjoy broad-based support before attempting to tackle more controversial and intractable issues.

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