2 The contrast between models of *equalisation*

2.1 The challenge for the Panel

The Terms of Reference state that HFE has served Australia well and should continue, but ask the Panel to consider the appropriate *form* of HFE.[1] Without taking into account the history and development of HFE, particularly in Australia, it can be hard to understand what that task really means. If, under the strict interpretation of the modern theory, equalisation represents a particular and definite outcome, how can there be different *forms* of it? In that case, by definition, anything different is not strictly 'HFE', although it may be referred to as 'equalisation' in a broader sense.

The Panel has interpreted that aspect of our Terms of Reference to mean that we should inquire as to whether the modern HFE model (with the goal of comprehensively providing States with the capacity to deliver interpersonal horizontal equity) is the right form of equalisation to determine the level of assistance to fiscally weaker States, or whether a less comprehensive approach, or one that took a slightly broader view of equity, would be better in current circumstances. The comparison to be made should take into account whether any possible changes would be simpler, more transparent, easier for States to predict for budget purposes, maintain confidence in the Federation and be as efficient, or more efficient, than the current system.[2]

Chapter 1 shows the essential difference between the modern equalisation model based on interpersonal equity and locational efficiency and systems with earlier motivations, such as ensuring the continued viability of all States, supporting a minimum standard of services, or compensating for any losses in revenue associated with joining the federation. The modern model has some important consequences for implementation, as can be seen by some of the changes in equalisation practice in Australia since federation. Without seeking to be exhaustive, several differences in the implementation mechanisms for the models are important for the purposes of the current Review.

The current system provides each State with a GST share such that, after allowing for material factors affecting revenues and expenditures, it would have the capacity to provide services and associated infrastructure to its citizens at the same standard, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency. The goal of providing States with the capacity to deliver 'materially-the-same' assessed average standard of service, for the 'same' assessed revenue raising effort describes the difference between the modern HFE concept and other forms. This point of 'sameness' is, in effect, the average capacity of the States, having corrected for their relative revenue raising and expenditure capacities and effort, disregarding minor, immaterial factors. For convenience — and without disregarding or diminishing the importance of these qualifications — the goal of the modern model will be referred to hereafter as providing them with the 'same capacity'.

1 See *GST Distribution Review Terms of Reference*, Objectives and Scope, paragraph 4.
2 See *GST Distribution Review Terms of Reference*, paragraphs 4 and 5.

Providing States with the same capacity needs to be distinguished from other forms of equalisation that might tend towards that direction, but not arrive in the same place. In the Panel's earlier reports we referred (as a convenient 'shorthand') to comparisons between models that deliver the *same* capacities or *comparable* capacities, and between the application of *full, comprehensive* HFE compared with a *partial, less comprehensive* form of equalisation.

The basis for 'full' equalisation has solid support amongst academics. Put very simply, the reasoning goes as follows: just as, in the absence of States, a unitary government would naturally want to treat citizens the same way unless there were specific policy decisions made to distinguish amongst them, so too, in a federation, providing States with the capacity to treat their citizens equally is critical. In 1950, in what is regarded by many as a seminal paper, James Buchanan showed that HFE payments are necessary to achieve the capacity for horizontal interpersonal equity across a federation.[3]

Whatever terminology is used, the motivations, outcomes and consequences of the 'full' modern model need to be distinguished from other models that seek to give fiscally weaker States some assistance, say via a minimum 'safety net', but do not prescribe the point to which all are brought. The current system brings all States to the same capacity — that of the strongest State — rather than simply bringing weaker States up to another arbitrary point. The point to which the States are equalised is determined by 'what States do' on average. This approach is consistent with modern HFE theory, although not always explicitly based on it.

Further, under the modern model the same capacity is not designed to set an external 'efficient' standard (however determined) — it is an internal average standard. Nor is the system designed to make judgements about how much should be spent by looking at the standard that is actually chosen by say the most frugal or efficient State.

For these reasons, the current system requires a consideration of all States' circumstances, rather than only those of States seeking assistance. Despite this, a single very large State or a very strong outlier in one revenue or expenditure category can significantly shift the average and affect the determination of capacity for all. (Previous systems, under which States made claims, looked at the needs or circumstances of the claiming State, rather than the average of all. In those circumstances it was conceivable for a claimant's capacity to be raised higher than that of non-claimants.[4])

As an additional complication, because States are assisted by the Commonwealth in our model (rather than rich States assisting poor ones), all States end up getting significant payments from the Commonwealth from the same funding source, the GST. Thus, the GST is in effect both an equalisation pool and a pool to provide States with general revenue assistance in the light of vertical fiscal imbalance (VFI) within the Federation.

Features of the present system have been criticised, or at least questioned, in various submissions to the Review, but no State denies that an essential ingredient of our federation is the necessity to assist fiscally weaker States, for the ultimate benefit of all.

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3 Buchanan J (1950), Federalism and fiscal equity, American Economic Review 40, pages 583-599.

4 In *Equity in Diversity*, page 145, including all States in the system was estimated to be a benefit of $115m for New South Wales, $55m for Victoria, and $130m for Queensland in 1981 dollars.

2.2 The joint submission of the four largest States

The four largest States have made an argument for a radical change away from the present method of equalisation, but recognise that it could not be implemented in the short term and do not want the small States to be disadvantaged. Essentially, they argue for a system with an equal per capita (or EPC) distribution of GST, with the Commonwealth providing extra assistance to States with lower fiscal capacity, so that no State is financially worse off. Other issues they raise, such as strengthened governance standards, and greater protection for the GST base, are broadly shared by all States.

Despite the seemingly radical approach of the large States in advocating an EPC distribution of the GST pool, they still suggest that the smaller States be assisted, although they argue this should not come from the GST pool. While it is possible that they mean that, in the longer term, the Commonwealth should increase its own taxes (or cut its own expenditure) to provide smaller States with an extra $4-5 billion or so per annum required for them to receive the same as they do under the current system, the Commonwealth Treasurer has made it clear to the Panel that there is no extra Commonwealth revenue available. Even if it were, it is hard to see why or how the Commonwealth would be motivated or inclined to increase States' funding when it already funds the States (via the GST and other grants) at around $100 billion a year. The disinclination of the Commonwealth to raise its taxes to provide extra funding to the States would apply equally any time in the future, not just in the present straitened budget and political circumstances.

Since the Commonwealth provides significant assistance to the States through Special Purpose Payments (SPPs) and the SPPs tend to be allocated on close to an EPC basis, it is conceivable that the Commonwealth could adjust payments to States between SPPs and the GST given time, without actually affecting its own budget in any permanent way. Indeed, until recently, the SPP pool had been intended to become an EPC allocation in order to eliminate tensions with the HFE system[5], so the same outcome could be reached by shifting the GST pool towards EPC and equalising through the SPP pool. However, any such shift would require time to implement as much of the alternative pot of non-GST funds is 'tied' to particular uses by agreements and legislation.

The Panel has taken the view that, although the four largest States have suggested that the Commonwealth should fund the fiscally weaker States, they are not naïve enough to imagine that the Commonwealth would simply choose to increase its overall funding to the States by such a large amount without facing a clear imperative to do so. They must realise that, if the Commonwealth is to 'protect' the small States without putting in extra funds, the revenue must come from somewhere. As there are no additional funds available and budgets are severely constrained, *any* increase in the assistance to the small States would ultimately result in a decrease to the others of roughly the same proportions, at least in the short term.

While perhaps the large States have been laying the groundwork for a future claim and are hoping for *some* extra contribution from the Commonwealth, their motivation seems to come from elsewhere. The large States' individual submissions make it clear

5 See Chapter 5, section 5.4.

that, even if additional Commonwealth funds were available to the States, they would still not want them to continue to be distributed via the current arrangements.

So the Panel views the four large States as arguing for a change in process as much as outcomes. That means that the fundamental question is: what is so problematic (from the large States' viewpoint) about the current arrangements that swapping the source of funding might change?

2.3 Issues beyond HFE

Part of the answer to the question posed above may lie in the States' current budgetary pressures. All States are having difficulty producing balanced budgets given the investments they wish to make in a range of policies, short and long term. Thus, they appear to incorporate issues that are beyond the strict operation of the HFE system in their GST share concerns. These separate, but related, issues are explained below (and some are so important that we return to explore them in detail in later Chapters).

First, there is an imbalance of taxing powers and spending obligations between the Commonwealth and State governments. By international standards, Australia has a high degree of this VFI. As detailed in the Panel's interim reports, developments since federation have changed the relative revenue raising powers between the two arms of government in favour of the Commonwealth. At the same time as the States' revenue sources were reducing in comparison to the Commonwealth's, the nature of the assistance from Commonwealth to States has morphed from providing limited grants to assist States in special circumstances, through addressing broadly-defined fiscal need and providing general revenue assistance, to the present concept of horizontal (interpersonal) fiscal equalisation. Some submissions to the Review have suggested that nothing short of major reform to the responsibilities of the different arms of government or the arrangements by which they are funded will do to put the Federation on the right path. Others call for significant reform of the nation's taxes as a step to remedying the VFI 'problem'.

Secondly, because the GST replaced several States taxes, the States may well feel a proprietary relationship to it, to the extent that when relativities change in a way negative to any of them, that one sees its revenue stream as being eroded. Under the large States' proposal, even if it ultimately resulted in no additional dollars for them, they would gain control of a larger share of the untied GST pie to count as their revenue, rather than having to rely on the Commonwealth 'granting' additional revenue to them subject to whatever conditions (such as matching State funding for the project) they may desire. For similar reasons all States are sensitive to base erosion, from several directions. They are worried that the incentive is not there for the Commonwealth to act swiftly when the base is threatened by legal challenges or administrative action. They are also conscious that the taxable share of consumption seems to be declining as a proportion of the whole (albeit perhaps not as quickly as might have occurred under the Wholesale Sales Tax and the State taxes repealed).

As highlighted in previous reports and summarised in the *Executive Summary*, a number of other factors have conspired in recent times to make the States shares of GST both unstable and unpredictable. Although these issues are less directly related to the Review's Terms of Reference than the core HFE issues, the Panel has felt it necessary to address most of them in some detail. In particular, Chapter 11 on protecting the GST base deals with some important issues that require more public debate.

Finally, the fact that most Commonwealth payments to States for special purposes (for example, SPPs and NPPs) are formally tied, while GST payments are not, means that the greater the percentage of the former, the less flexible the State's budget. Large States find this perverse in that, the more recipient States are given GST to assist their needs, the *less* of their budget as a proportion is tied to achieving those ends. Conversely, donor States, who have less 'need' for GST, find that *more* of their budget is tied. Victoria's submission suggested that 48 per cent of Commonwealth transfers to donor States are tied, compared to only 36 per cent for recipient States.[6] If States received more untied GST and less tied other grants, they would have greater discretion over a larger proportion of their own budgets. The counterview is that, as the lower untied grants only arise because of an *increase* in untied own source revenue, there is no issue regarding flexibility of budgets.

Which brings us to the question of what advantages — apart from a possible increase in budget flexibility — exist in the large States' model if there are no additional funds?

To find a substantial answer we need to examine the difference in practical impact between the HFE model based on the capacity for producing horizontal equity for individuals and the other models. To do this, we might start simply.

2.4 A simple illustration of the modern equalisation system

Imagine a federation with only two States, A and B, each with just 12 citizens. Each State in this imaginary federation has only one expense policy (the same one), namely that it should provide every citizen with an umbrella. Each State in this federation also has only one tax policy, namely that people earning over $50,000 per year should pay tax necessary to produce a balanced budget.

The only difference (that affects fiscal capacities) between the two States is the number of citizens earning over $50,000. State A has four of these taxpayers, while State B has eight, so tax rates are the equivalent of three umbrellas per taxpayer in State A (four taxpayers providing twelve umbrellas) and one-and-a-half umbrellas per taxpayer in State B (eight taxpayers providing twelve umbrellas). For convenience, we'll call these tax rates 3U for State A and 1.5U for State B.

Fortunately, umbrellas are cheap, so the taxes paid by both States' citizens are relatively low. A central federal government looking at the two States' circumstances may well conclude that the outcome was satisfactory and that no further assistance to either one (or no *equalisation* in the broad sense) was necessary.

However, the Buchanan model, focussing on the capacity of the States to treat citizens in like circumstances equally, leads to a different view. HFE looks at the fiscal circumstances of the individuals in the States and compares that with the situation that would have applied, but for the State borders. (The reason for doing this is that, central to the Buchanan model is the idea that States' citizens should not be treated differently

6 Victorian submission to the GST Distribution Review, August 2012, page 17.

solely because of State borders. This is not only *unfair*, when compared to what would happen if a single nation applied the same policies to its citizens, it would create an artificial incentive for State A's taxpayers to migrate to State B.)

In this imaginary federation, State A's four taxpayers have a tax rate of 3U and State B's eight taxpayers have a tax rate of 1.5U. However, when the situation is compared with that of a single unitary State that had the same policies, each taxpayer would pay 2U (12 taxpayers providing 24 umbrellas). Looked at in this light, State A taxpayers pay higher taxes than State B simply because of the placement of State borders. If fiscal motivations were the only concern, smart State A taxpayers would migrate to State B.

Buchanan reasoned, therefore, that it was in *everyone's* interests for State B taxpayers to *pay* State A taxpayers (or 'bribe' them as he later put it) to stay where they are. In theory, the subsidy required for State A's citizens not to migrate would be $4U in total, or $0.5U for each of State B's 8 taxpayers, to bring about the capacity for equalisation.

Beyond the theory

At the level of theory, HFE sounds so compelling that one wonders why all States don't enthusiastically endorse it. It is the gap between theory and practice that brings out the different views.

In the real world, the amount that needs to be paid to overcome inefficient fiscally motivated migration is quite hard to calculate and very much harder to see than in this example, and the signals sent by different fiscal capacities are confused by interrelated policies and effects. In Australia, there are eight States to consider, not just two, and there is not one single expenditure policy to evaluate, but over a hundred — each with potentially eight variations — and that's *after* a significant reduction in the number of 'disabilities' following the 2010 CGC Review. Similarly, on the revenue side, there are eight different categories of taxes and other revenue sources, each at least subtly different across jurisdictions.[7] So the chance of a citizen at the border correctly identifying a difference in fiscal capacity that could be gained by migration is slim. The difference would have to be significant, if not extreme, to act as a driver.[8] In addition, the level of confidence that one can have in the calculation of any real incentive is stretched by the number of moving parts. In practice, the CGC is forced to make difficult judgements in the face of (sometimes) poor quality data.

As a further complication, under HFE, the 'payment' to prevent migration, even if made by the stronger State, may never actually be made to the taxpayers of the weaker States to 'prevent' migration, or indeed to achieve the 'equality' outcome goal. This needs some explanation.

Return to our imaginary federation and assume that State B taxpayers understand the problem and decide to pay State A so that its taxpayers will not migrate. The first observation is that the payment goes to the State, not the taxpayer.[9] If State A uses the money to lower tax rates for its taxpayers, everything should work out. However, the

7 See GST Distribution Review, *Interim Report*, March 2012, Section 3.2.

8 Modelling provided to the Review puts the loss if HFE was not pursued at $295 million, or $13 per capita. This calculation has its critics.

9 In his 2002 paper, Buchanan noted the risk of involving States in the interpersonal equity solution, musing that it would be better to pay the taxpayers directly.

funds are not tied to that purpose and States have autonomy over their own budget decisions. State A could decide that its disadvantaged people need welfare assistance more than the taxpayers need a tax cut. In effect, State B's taxpayers would then be funding a welfare initiative for *State A's* less well off. If that happens, horizontal interpersonal equity between the non-taxpayers of the two States is actually worsened and the incentive to migrate would still be there.

To take the example to extremes, State A might decide that its citizens needed ice cream more than tax cuts or welfare, or that State A's decision-makers need an overseas 'fact finding' trip. Seeing the subsidies 'wasted' (albeit by the democratic choices of another State) would make the taxpayers of State B resent the payment. (Of course, even if State A did something objectively meritorious with the subsidy, that would not necessarily stop State B from *judging* the use of it unfavourably.)

This analysis leaves out further complications including behavioural responses, such as:

- many of State A's taxpayers who were told of a fiscal incentive to migrate wouldn't believe it, or wouldn't want to migrate anyway
- even if they wanted to migrate, there are costs of moving and finding another job, so the full value of the subsidy may not be needed to dissuade them.

This deliberately oversimplified example demonstrates the concerns of the four States who feel they are in the position of State B. For these sorts of reasons they say the system is flawed as it requires them to pay too much, the 'equality point' is very hard to calculate in practice and, unless the weaker States actually use the money for the purpose it was given, the point of the subsidy is defeated.

2.5 Support and criticisms of HFE

Support for the current evolution of the system is evenly split into two camps, albeit with the occupants of each camp disagreeing amongst themselves on certain issues.

Small States say that, because the HFE system currently pursues the 'right' outcomes, the future vision is necessarily an extension or improved version of the present. From this point of view, the challenge is to make the system more rigorous, robust and accurate by improving reliability of assessments through better, more appropriate data and in other ways. Broadly speaking, the smaller States of South Australia, Tasmania, the Northern Territory and the Australian Capital Territory support the maintenance of a robust system of full equalisation, on the grounds that, without it, States would not be given the same capacities, so the system would not be equitable.[10] These four 'supporters' of the system are also the States that receive more than their population share of GST — those with the most to lose directly if the system were removed.

The four remaining States (who receive less than their population share of GST and therefore have the most to gain) argue that equity could be achieved through a much less rigorous pursuit of the capacity for equal outcomes than is presently the case. They would prefer a lesser degree of, or a less precise calculation of, equalisation, for a range

10 The Australian Capital Territory favours a result that reflects the outcome of the current system, even if it would be open to achieving it in other ways.

of reasons. This is not to say that they would seek to treat any State unfairly, just that they see the system as currently equalising for things that are actually within a State's control. Through change they wish to encourage States to do more to help themselves.

While it would be possible to form the view that States simply favour or advocate the method that gives them the best outcome, the Panel is inclined to think the divisions go deeper than that. In our judgement, two States (South Australia and the Northern Territory) are strong supporters of the current system, while three others (New South Wales, Victoria and Western Australia) have little time for it. Queensland seems to support it in principle, but think it's gone too far, while the Australian Capital Territory has a pragmatic view, recognising its special place geographically (as an 'island' surrounded by New South Wales) and its unique status as the national capital. Tasmania has historically been a strong supporter of the system, but has recently accepted quarantined Commonwealth assistance in relation to its health sector. This seems to be a case where the dollars have trumped the principle, as Tasmania would ultimately have retained only its population share — or about two per cent of the payment — if it had not been quarantined.[11]

A sample of the more conceptual and philosophical type of criticism presented to this review includes that HFE:

- fails to ensure equal treatment of people in similar fiscal positions because it focuses on States' capacities rather than outcomes for households or individuals
- fails to produce intergenerational equity because it equalises mining endowments across States instead of over time
- can only ever secure a relatively narrow form of equity, in which differences are allowed provided they arise from democratically supported decisions
- does little to reduce the inequity between rich and poor individuals and families, while the income tax and welfare transfer system is far more effective in moderating the income distribution of individuals and households
- can produce low relativities that are 'manifestly unfair' taking into account the efforts made to raise revenue from their own sources
- takes too narrow a view of States' underlying capacities to raise revenues, and instead equalises for some things that are actually within a States control
- encourages overspending and ineffective service delivery by States, especially since it does not require funds to be spent on the areas assessed as needing funds
- does not provide incentives for labour to flow where it is needed, or worse, provides incentives for labour to flow where it is not needed.

11 While it might be argued that even two per cent of the amount is still a benefit, Tasmania would be obliged to commit the full amount to the stated purpose.

Most of these arguments against the current HFE system can be countered by supporters of the system, or are 'irrelevant' as HFE does not seek to deliver in these areas.[12]

Apart from the conceptual criticisms, some consider that in practice the current process:

- is too unstable and or unpredictable for States to plan their own budgets properly
- is too complex to allow broad debate about the merits and workings of the system
- suffers from false precision (by including calculations that go into a fine level of detail despite resting on assumptions that require significant exercise of judgment)
- has methodological shortcomings of which the most notable relate to the treatment of Commonwealth payments to assist States' capital investment in nationally significant infrastructure and the current mining assessment.

2.6 The search for a model for Australia's future

Against the background of a highly technical topic and hotly contested views, in order to come to a decision on the question of whether an alternative model might be better, it is first necessary to ask whether fairness as between States can be achieved by anything other than full equalisation. In other words, is it possible to consciously choose something less than full equalisation without also actively deciding to discriminate between States and, ultimately, their constituent individuals? If this can be done conceptually, would there be any boundary — that is, where would one stop?

The Panel's first Interim Report quoted extensively from State submissions to show that the answers to questions about fairness are often inherently subjective. At the one extreme some States suggested that the Commonwealth should simply give States the same amount of revenue per citizen (EPC), because this sort of outcome would be 'fair'. At the other end of the spectrum of opinion, some argued that States ought to receive an amount based on an even more precise and comprehensive measurement of their revenue raising capacity and their service delivery costs than at present.

Academics are similarly divided on what a 'fair' distribution would be. Supporters of HFE argue that differing capacities lead to equals being treated unequally and full equalisation is required to remedy this. Others suggest that it is not at all clear that the equity rationale requires full equalisation.

The second question for the Panel is: even if less than full equalisation would be unfair in some way, or to some degree, could that cost be borne to achieve a greater benefit? Currently, other aims (such as the pursuit of simplicity, and predictability and stability of GST revenue) are subsidiary to the paramount objective of equality. But the Panel has been asked to consider what form of HFE is best for Australia overall, having regard to a range of factors and possible future challenges (some of which must be met with higher productivity, efficiency and robust State budgets). We have also been asked to consider

12 For example, criticisms that HFE does not ensure specific outcomes to individuals are met by the response that it doesn't intend or purport to. Concerns that there are better ways to achieve vertical equity, while true, can similarly be met with that response. See also Appendix B.

whether there is room for other goals within the system, such as providing incentives for general economic or State tax reform, or for the efficient provision of services, or to maintain confidence in the Federation.

Some will argue that objectives other than interpersonal equity and locational efficiency are not necessary (because the system is already sufficiently simple and transparent), or that they are not 'worth it' (because the value of greater simplicity is less than the loss to equity), or that they are better pursued through other means (as HFE does not hurt efficiency and, in any case, efficiency is better encouraged through separate payments). Others will argue that the marginal benefit of pursuing equality is minimal, whereas greater simplicity would allow for a broader understanding of the system and greater confidence in federal fiscal relations. Similarly, they would argue that less than full equalisation would ensure that matters within a State's control are not equalised, or would send an important signal about improving efficiency.

Finally, apart from considering these 'radical' changes, the Panel needs to consider the practical operation of the system. While we will understandably stop short of making detailed recommendations on methodology — that is quite properly a matter for the CGC — there may be some key issues on which the Panel's guidance as to the direction of a methodological change will be productive.

Whatever changes to GST shares are ultimately indicated through these inquiries, there are also important questions as to future governance that need to be addressed.

None of these are matters in relation to which the CGC can be expected to act without clear direction from governments. On many occasions in the past, the CGC has made it clear that it is willing to modify its practices and goals in relation to HFE, but need to be told how and by how much.

2.7 The Panel's findings on the 'right' model of equalisation

While the Panel has not found it necessary to decide every aspect of every argument put to us in submissions about which model is to be preferred, we have thought it potentially beneficial to reach findings on particular matters that have influenced us in reaching our final position.

In recognition of the large States' concerns, the Panel has been keen to search for changes that might improve the transparency, simplicity, efficiency or stability of the system, even if such changes might come at a small cost to the theoretically equal outcome. In Chapter 3 the Panel has therefore exhaustively examined the large States' alternatives for less equalisation, or for a less 'falsely precise' way to calculate it, in order to establish whether any of them are viable approaches in the medium term.

Findings on factors affecting the choice between models of equalisation:

2.1. *Experience shows that a politically indifferent, rules-based, system of allocating finances to States has advantages over the ad hoc negotiation of special deals, especially, but not only, when governments of opposite persuasions are involved. An independent system even arguably has advantages for the 'donors', as New South Wales and Victoria might recall from their experience in the 1980s, when they began to do better from the first full equalisation process than they had under the previous process of considering the claims of individual States.*

2.2. *The purpose of a federation is to bring disparate constituent parts together and so the concept of bringing the weak up to the capacity of the strong has much to be said for it. However, the zeal with which an exact calculation of equalising all States' fiscal capacities must be pursued, the precision with which the target can be determined and the effect it will have are disputed. While there is no reason to argue against providing States with the capacity for horizontal interpersonal equity (i.e. equality) amongst their citizens, inequality is tolerated in many features of government if there are identifiable benefits to be gained.*

2.3. *The current HFE system — requiring material equality and being guided by internally referenced principles and pillars, standards and capacities — is well established and internally consistent. It works satisfactorily if the goal and definition of equalisation as currently set out is accepted and one accepts (as we do) that the CGC does a good job of making its judgements and producing its numbers in the circumstances. However, by recognising that the CGC is often obliged to make decisions that turn on fine judgements and occasionally reverse direction, one is obliged to accept that there is a margin for error in the outcome. Despite the 'conservative bias' arguably applied by the CGC in its judgements, the margin for error could result in over-equalisation, or equalising for things that are effectively within a State's control.*

2.4. *Outside of a small core group, very few people, politicians included, have a good understanding of the background to, or the features of, the current system. This lack of understanding, compounded by the 'zero sum' nature of the exercise and the capacity of all to view the arguments through the lens of a geographic perspective, means that debate about the system can be frustrating if not futile. If a simpler system allowed the democratic processes to operate in a better informed environment, that would be beneficial to transparency and good government. Decision-makers should not be captive to the advice of a very narrow pool of experts, especially when the objectives of the system are contested amongst those experts and, because of the relative nature of the calculations, its effects are hard to predict and sometimes counter-intuitive.*

2.5. *Apart from HFE itself, there are closely connected issues that aggravate the concerns of some States. Concerns about the size of GST shares because the GST has not 'kept pace' with the State taxes it replaced, has not grown at the expected rate, or is shrinking as a proportion of consumption, compound and conflate concerns about HFE. When HFE issues intersect with questions of tax reform and State and Commonwealth rights, the aggravation becomes extreme.*