NSW Review of Federal Financial Relations

Discussion Paper

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Summary

The Discussion Paper (the Paper) paints a picture of an exciting technological and "lower carbon" (dioxide) future. However this vision is marred by the calls on Government for health, education, infrastructure and services for which there is growth in expenditures that rapidly exceeds projected revenues. The Paper says this is unsustainable without incurring even more debt. It canvasses and critiques the various taxes the State levies, and the various grants from the Commonwealth. But there is no discussion of costs and how to contain them. A problem that all levels of Government talk about but do little to fix.

The prevailing issue according to the Paper is to create a "sustainable but substantially increased tax revenue base" for the States. But in a way that "enhances economic productivity" and outcomes for "citizens". Essentially the Paper proposes taxing the economy more in order to make it more productive, and to pay for higher expenditure and infrastructure.

Overall Thoughts and Responses

The Paper is disappointing. It exposes why voters on all sides of politics are wary of the words "tax reform". They know that it means "higher taxes". The Paper takes an unquestioning view of rising expenditure which is termed the "new" normal. While the Paper canvasses changing demographics and a failing GST as reasons for this gap, the reality is that Chart 1 shows real (or nominal) revenue sitting quite steady in the future.

But expenditure is rising at a faster rate. Undoubtedly health costs rising at 2 or 3 times CPI are a factor that needs addressing. Recently the American Enterprise Institute in the US charted rising costs (Link https://www.aei.org/carpe-diem/chart-of-the-day-or-century-2/). Interestingly it showed the costs of everything touched by Government growing at an accelerated rate. I would suggest the chart would look similar here.

In terms of taxes it is fair to say that all State taxes are inefficient, and weighted against productivity. Sustainably collecting taxes is ever hampered by economic cycles and human behaviour. Better design will not change this.

Main Observations

My responses to the Paper will concentrate on critical observations and suggestions. The main aim, in my view, is to have a State tax system that is efficient, causes less economic disruption and is less costly to the economy and to administer. Taxes need to be effective, in line with State productivity goals and be reasonably sustainable.

- The benefit of Land Tax is that it is immobile and therefore difficult to avoid. Exemptions aside. The Paper is silent on the hundreds of thousands of dollars in levies, taxes and fees that are incurred before a block of land is even sold.
- GST is regarded as less sustainable and falling because fresh food, education and health are excluded. Inflation is too low to push up prices and ergo GST.
- But if the exemptions were removed, there would be immediate consequences.
    - For instance children would be removed from the private school system and placed in state schools.
    - Many would forego private health cover and go onto waiting lists for operations in the public system. They would attempt to avoid private operations and health services.
    - Raising the GST or expanding it would incur costs against the tax raised, and would require many levels of welfare recipients and low income earners to receive compensation.
- Stamp Duty is inefficient but how do you move to a larger Land Tax? Who would be the winners and the losers? Would a Land Tax raise the same annual revenue? Would Stamp Duty be entirely abolished?
- Motor Vehicle Tax is interesting. The cost of roads has increased through bad planning, delays, and ridiculously high construction costs. Tolls are not mentioned. User pays is a euphemism that never actually works. For example Medicare doesn't pay for all health. All collections go into consolidated revenue. If you want user pays, then apply that principle to public transport as a first step.
- Chart 1 shows Revenue steady between circa 12% and 13.5% of GSP. At a Commonwealth level this is circa 25% of GDP. So real tax raised at two levels of Government is effectively about 39%. But the Expenditure the State is incurring, on apparently a real basis is over 14% rising to 16%. And yet this is occurring while we are seeing low growth in wages…..except in the public service. We have **low inflation but with high and increasing cost of living**. As noted above much of the increase in cost of living seems to be Government induced.
- Changing demographics are blamed, yet the real revenue stays within the 12-13.5% band over the next 30 years. In other words the question can be asked, is it a revenue problem or an expenditure problem?
- Chart 4 shows comparable GST coverage, with Australia at just under the average. NZ is shown as having the highest coverage. But NZ has no Capital Gains Tax, it has lower Income Tax rates and has no Medicare Levy. Every country is different and a real comparison would be total tax revenue as a percentage of GDP or GSP.

- The best practice principles should also include that taxes should not cost the economy more than is collected. GST laws have been changed to remove the $1000 threshold on the value of goods or services purchased overseas that were subject to GST. At the time many economists pointed out that the cost of collection would match the tax raised. What has been the result for NSW?
- Australia has an added problem in that its wages and salaries are amongst the highest in the world. We are quite uncompetitive. Increasing red and green tape exacerbate the competitive failure. Added taxes will not fix this.
- As an observation (stating the obvious) the arrangements with the Commonwealth can be changed at any time. However there is a lack of agreement between the States as to what should change. The "mendicant" states have historically been against any change to the status quo. This is unlikely to change. On top of this it is doubtful that the Commonwealth will stop providing other grants. Politically it is too attractive.
- There is a major issue in how the State wants a Review to proceed. It is difficult to reconcile the statement on P17 that a ***"whole of tax system" assessment*** is seen as necessary, with the Panels view five pages later that the **split up of the GST between the States is better left off the table**. It appears the that this is only about tax and not about competitive federalism
- If a new structure was implemented then we would see greater real competition between the States. Other taxes could be lowered to attract business, and the States would have an incentive to lower their costs or become more efficient in delivery of services to attract people and investment. It would also decentralise the Federation.
- Grants are partially a distribution of Commonwealth revenues and partly political. Doubling the control over Grant Funds is bureaucratic and inefficient.
- Tax and how to increase it seems to be the main concern in the Paper. Costs and controlling them is not mentioned, beyond informing us that costs will rise dramatically. We seem to be in a parallel universe where the Commonwealth could lower taxes but then see the states taking that space. Is this the intention?

Suggested Tax and Revenue Policy ideas

- There is a case for rethinking some State taxes. An Income Tax Levy or State Poll Tax added to an individual Income Tax Return would meet the principles and could be used to replace Land Tax and perhaps Stamp Duty. Even Payroll Tax could be rolled through Company Tax Returns via a tax/levy on wages and salaries. Where the amount of wages paid in that State (over a threshold) would be subject to a Levy. All could be collected by the ATO for transfer to the State. These would be regressive and require consideration for welfare recipients and low income earners. But they would be transparent and effective.
- Grants could be replaced with pro rata Revenue from the Commonwealth that the States controlled themselves. For the sake of efficiency and reducing costs (including compliance) the "rate" of grants can be included in the dispersion of

GST funds. This is being too simplistic, as there are a plethora of various agreements, for projects, expenditure, partnerships or other arrangements. All needing State and Commonwealth bureaucratic “oversight”. A more direct and less complex system is desirable but pits the desire of the States who want to build up their States infrastructure and economies, against the Commonwealth which wants to build the Nation.

- Still, in my view the *States can* reduce their dependence on the Commonwealth, through jettisoning most of the fiscal equalisation which is deadweight, gain powers to levy income tax. This can be achieved more efficiently if they receive a set proportion of Commonwealth revenue depending on population. After a hundred years of federation, Tasmania, South Australia etc. should have been able to adjust their services. The complex calculations of the Grants Commission could be removed. However States who receive Royalties on resources would be asked to share with the other States. We have a Federation and are a Nation. These resources belong to all Australians. Not just those lucky enough to live in Queensland or Western Australia.
- Increasing the scope of the GST to fresh food, education and health will raise little (due to the need for large scale compensation) and cause a lot of changes to peoples behaviours. There will be large cost transfers to State schools and to the public health system.

While the statement that effective tax policy change will require a whole of system assessment from both levels of Government is self-evident. It will also need bi-partisan support and the support of voters. These will be tough conversations. Many voters will rightfully believe that changes to the tax system will not be in their interest. Conversely voters that pay no tax may be in support of changes, subject to their position not changing.

Unless all States and the Commonwealth can agree to a better methodology to share revenue, this over governed, political and bureaucratic hodge podge will persist. And the oversight costs will continue to rise with all other State costs. I fear entrenched interests will not be able to countenance a better, simpler construct for raising and sharing this revenue. But if the purpose is simply to raise more taxes and revenue, then this reaction will be deserved. And even if a new system is put in place, there is nothing to stop the Commonwealth from reinstituting them under the Constitution.

I wish you well in your Review and thank you for the opportunity to comment on the Paper.

John Rutherford