

# NSW Review of Federal Financial Relations

Working together  
for a better future



Consultation Findings

February 2020

# Introduction

In October 2019, the NSW Review of Federal Financial Relations (the Review) released its first major publication, a Discussion Paper titled *Working Together For A Better Future*.

The paper sought to drive a national conversation about how state governments, in a time of great change, can sustainably fund and deliver the frontline services and infrastructure that citizens expect and need. It welcomed your thinking on a roadmap for a federation where innovative policy thrives, and funding arrangements provide the necessary revenue, flexibility and productivity growth to support future living standards.

Since October, the Panel and I have heard from many voices across the country, through written submissions and face-to-face discussions.

We heard how a number of state and territory (state) taxes are unfair, complicated, and weigh too heavily on citizens' decision making. There is duplication and bureaucratic waste within our federation, and a number of services shared by governments, particularly health and schooling, could be vastly improved. There were also fundamental questions about whether the size of government and the current responsibilities of each level of government are appropriate.

Many creative solutions were proposed to address these issues. They suggest that while the roles of the Commonwealth and the states may be irreversibly mixed, there are many opportunities to work better together. In parallel, there appear to be many actions the states can, and should, take to support a stronger economy and put themselves on a more sustainable footing.

## In total:

- **33 written submissions were made in response to the Discussion Paper**
- **extensive consultations nationally across governments, industry, think tanks and academia**
- **more than 100 unique reform ideas were raised**
- **all state and territory Governments were consulted along with the Commonwealth**

This report contains a snapshot of the key themes that you raised, while giving consideration to the Review's terms of reference. Published submissions can be found on the Review's website: [www.treasury.nsw.gov.au/federal-financial-relations-review](http://www.treasury.nsw.gov.au/federal-financial-relations-review). Your contributions will play an important part in shaping the Review's findings and recommendations in 2020.

While this Review was launched by the NSW Government, this is a national conversation about our collective future. We welcome everyone's voice in building a stronger federation.

## David Thodey AO

Chair



## We asked...

### Question 1:

Which state taxes impact the choices of citizens and business the most?

### Question 2:

How can the tax system work better for citizens and businesses and improve the economy for future generations, keeping in mind the changing environment and the increasing volatility to state tax revenue bases?

### Question 3:

Is there a better way that the Commonwealth Government can ensure its revenue sources remain sustainable in a changing environment?

### Question 4:

How can the states reduce their dependence on the Commonwealth?

### Question 5:

How can Commonwealth - state relations encourage states to innovate and reform?

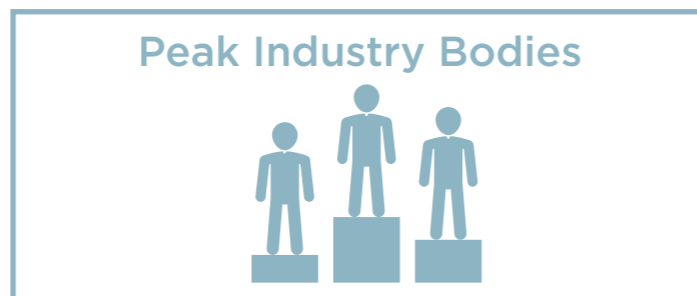
### Question 6:

How can agreements between the Commonwealth and states ensure accountability for how the money is spent but allow flexibility to deliver the best outcomes for citizens?

### Question 7:

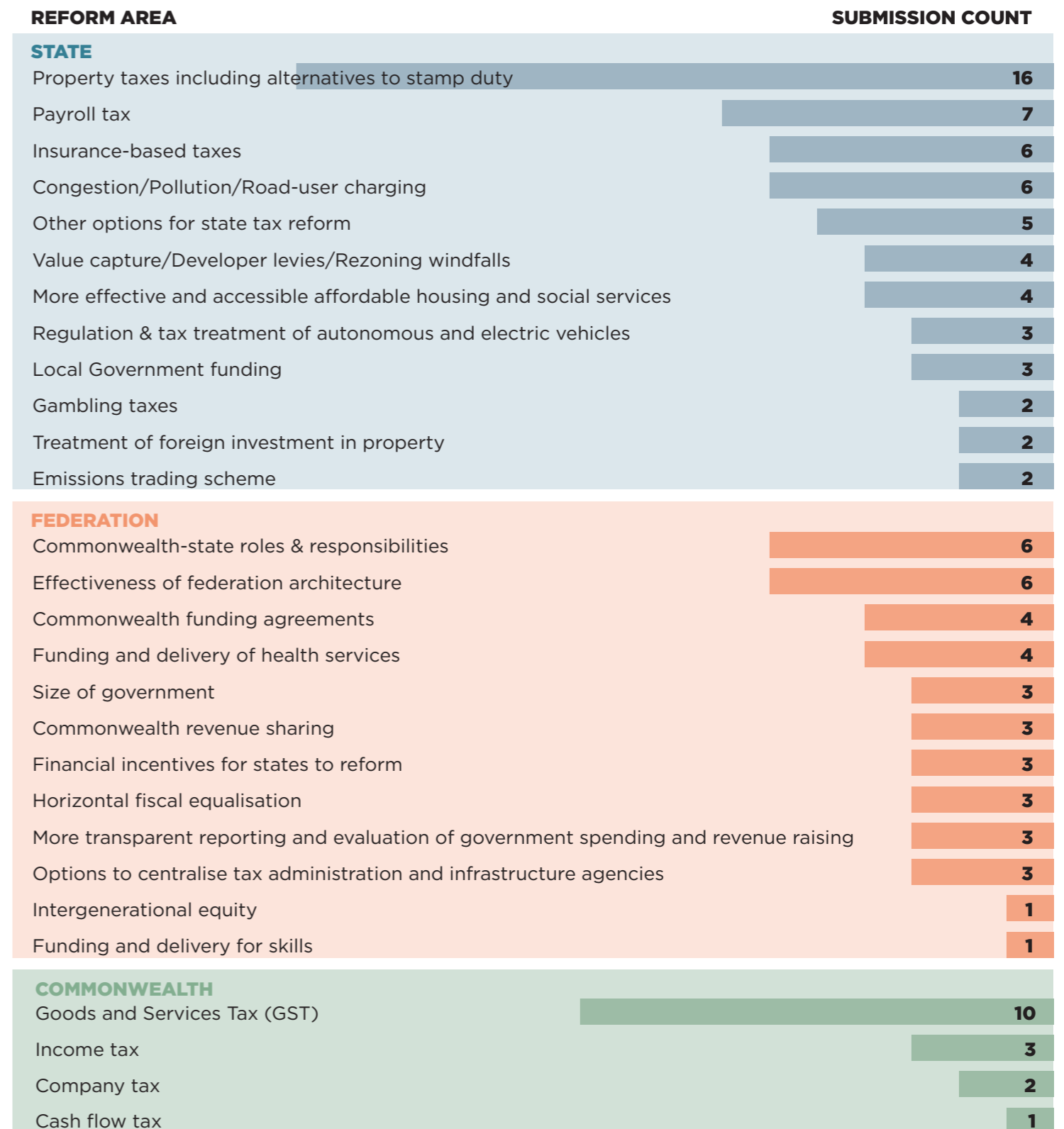
How can governments work better together and learn from each other, putting citizens at the centre of decision making?

# Who joined the conversation...



# What you said are the important issues to investigate...

In raising these issues across submissions, you both advocated **for** and **against** reform in the following areas:



# You said this on...

## Which state taxes impact the choices of citizens and business the most...

The state taxes that received the most mentions across submissions and consultations were transfer duty (stamp duty), payroll tax and insurance-based taxes.

More than half of all submissions raised transfer duty, with the majority of people calling for the tax to be replaced, while others suggested the tax rate be reduced or thresholds increased. Throughout the consultation period, we consistently heard how transfer duty is a costly tax that impacts citizens' freedom to move throughout the seasons of life. We also heard how it can often have the worst impact on first home buyers and seniors. By hindering mobility, we heard stories of people living in housing that doesn't meet their current needs.

Payroll tax came up as a key concern for businesses, particularly in regard to compliance and the burden associated with different definitions across the states. Payroll tax thresholds received mixed comments - some of you called for higher thresholds to minimise administration costs, while others argued that lowering thresholds would limit the distortionary impact on business decisions and stop the tax base being 'hollowed out'.

You were also concerned that by adding to the price of insurance, taxes on insurance (including insurance duty, the emergency services levy contribution and health insurance levy) encourage underinsurance and non-insurance. This can create long-term risks, particularly if the likelihood of emergencies, natural disasters, or accidents grow. Insurance duties were also considered to be inequitable as they disproportionately affect poorer households.

On a broader note, several submissions suggested that the interdependencies between all state and commonwealth taxes as well as government transfers, need to be considered holistically instead of looking at one tax in isolation. Any tax reforms should take into account how to make the entire tax system better.

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"In 2016, it was calculated that there were **over half a million homes in NSW** with at least two or more empty bedrooms, equating to **roughly 20 years of housing** supply that could potentially be unlocked for first home buyers and young families. Stamp duty acts as a major financial disincentive for retirees seeking to downsize." — *Committee for Sydney*



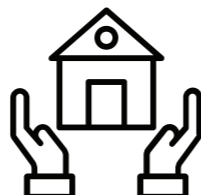
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"**Generally, payroll tax with a wide base is a highly efficient tax.** It is less so where the tax base is not comprehensive or where it is not harmonised. This is our present circumstance." — *KPMG*



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"**The take-up of home and contents insurance is consistently lowest in NSW,** the jurisdiction with the highest rate of insurance duties and levies." — *Insurance Council of Australia*



## How the tax system can work better in a changing environment with increased volatility of state revenues...

Many of you recognised the importance of predictable revenues to enable governments to plan and deliver services and infrastructure successfully, but that the current tax settings were not enabling this. We heard a range of views about replacing transfer duty with a more efficient tax. Land tax was offered as an alternative tax base as it has fewer impacts on the choices people make. Many of you also acknowledged that land tax is currently applied with too many exemptions. Submissions also suggested that the reduction or abolition of insurance-based taxes could be funded through reforms that involve broadening the taxation of land.

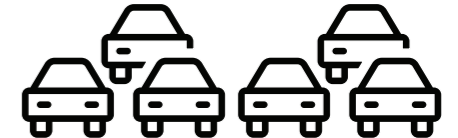
Noting businesses' administrative difficulties associated with compliance, payroll tax was cited as an option for joint Commonwealth-state reform, where its collection could be centrally administrated through the pay as you go (PAYG) system. Simplifying contractor and employee definitions across states was also raised to ease some of the burden on businesses operating in more than one state.

Submissions noted a growing inequity arising in who pays for wear and tear, congestion and pollution resulting from road use. While electric vehicles produce less pollution, they travel on some of our busiest roads and do not contribute as much to road maintenance as internal combustion engine vehicles. It was proposed that high emitting vehicles should be charged more while electric vehicles should also pay their fair share to use our roads. The challenge here will be to determine how this can be done without discouraging the uptake of more fuel-efficient transport options.

We heard differing views on how foreign investment in the property market should be treated, including ways to increase investment demand while not pricing-out our first home buyers. The treatment of gambling taxation was also questioned, along with the tax exemptions given to certain gambling sectors. Some of you presented options to take advantage of the indirect benefits of government investment in infrastructure or planning changes, such as those from higher land values and economic activity.

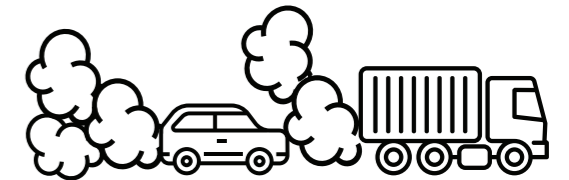
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"Road congestion and public transport crowding are estimated to have cost the Australian economy **\$19.0 billion in 2016**, and without action, this figure could grow to **\$39.6 billion by 2031**." — *Infrastructure Australia*



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"**Transport sector is the second largest emitter of Co2 in Australia.** Passenger cars account for the vast majority of emissions, but heavy vehicles and aviation are projected to drive growth in emissions in the next ten years." — *Infrastructure Australia*



# You said this on...

## How the Commonwealth could ensure its revenues remain sustainable in the changing environment...

Some of you noted that the Commonwealth tax system, to the extent that it provides funding support for the states, should in principle tax income and capital less, and consumption and wealth more. This, it was argued, would support a stronger economy. It was also noted that the Commonwealth's revenue base, like the states', can be highly volatile in response to fluctuations in the economy.

In a world where vehicles are more fuel efficient, fuel excise was commonly seen as unsustainable as revenues do not keep up with road wear and tear. A national approach to charging road users based on the distance travelled and incorporating electric and autonomous vehicles, was seen to be a more sustainable alternative that better reflects the social and financial costs of road use. It was noted, however, that this may be challenging to implement in Sydney given the number of toll roads and the uncertain impact on toll road operators.

Slowing growth in GST revenues was seen to be a direct financial risk for the states, however there were mixed views on how to address the issue. On the one hand, it was suggested that more goods and services could be subject to GST or that the rate could be increased to provide more sustainable revenues for the states to use as they see fit. This was sometimes presented as one component of a broader package of reforms with the states, such as abolishing payroll tax. However, some of you indicated that these options would unfairly impact low income households and that the amount of compensation required to offset this would consume any additional revenue and would leave these households worse off over time.

Others suggested that the Review should not focus on the GST, as there are significant improvements that could instead be made to productivity and service delivery by reducing overlap and duplication through clearer roles and responsibilities between states and the Commonwealth.

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"Australia's GST coverage is narrow by international standards. It applies to about **47 per cent** of consumption, below the **OECD average of 55 per cent**, and well below New Zealand where the GST covers 96 per cent of all goods and services consumed." — *Grattan Institute*



## Reducing states' dependence on the Commonwealth...

Interestingly, many submissions disagreed with the commentary in the Discussion Paper about how states have limited revenue raising capabilities. The states are seen to have at their disposal, but are yet access, a sustainable and predictable revenue base to fund the growing demands for delivery of services and infrastructure in a way that does not damage economic growth. This included extending the application and base of existing land taxes, raising their own income tax and removing exemptions to payroll tax.

Some of you noted that Commonwealth funding has been used to creep into areas of state responsibility, however views on how to address this varied. On the one hand, it was suggested roles or responsibilities could be reallocated in a way that improves outcomes for citizens (such as better grouping education responsibilities for children and adults to also acknowledge the importance of lifelong learning with a growing population and longer lifespans). Alternatively, the Commonwealth could withdraw from areas in which the states are traditionally responsible. Some of you however, suggested that many roles are irrevocably mixed and would be difficult to untangle.

## How Commonwealth-state relations can encourage innovation and reform...

Some of you noted that a one-size-fits-all approach across the federation to both government policy and how services are funded does not work. Each state is unique, as are the needs of its citizens. Therefore, what works in one state to address a particular issue will not necessarily work in another.

We heard that governments need to find ways to better measure the performance of, and risks to, government revenue raising and expenditure across service areas. For example, there is no national measurement of the states' long run revenue and expenditure pressures, making it difficult to develop lasting and impactful reform initiatives across service delivery areas.

Suggestions included developing a national Intergenerational Report covering both Commonwealth and state governments; developing metrics of spending and revenue raising efficiency; and the establishment of a national federation body to guide reform. Other ideas acknowledged that reform is costly, and that financial incentives from the Commonwealth could encourage state-led reform.

While you recognised that fiscal discipline and balanced budgets were important for good government, some of you suggested that more could be done to invest in strategic reforms that would lift economic growth over the longer term. Ideas included an investment approach to building our cities, as well as a focus on making our population healthy through greater investment in prevention.

The way GST is distributed between the states (horizontal fiscal equalisation) was noted as a contentious policy area but one that should be reformed to better encourage policy innovation and productivity-enhancing reform.

# You said this on...

## How funding agreements can ensure accountability and flexibility...

Many of you noted the opportunity to reform the way the Commonwealth provides the states' funding to deliver services and infrastructure for citizens; namely that it needs to be more flexible yet still accountable. Some of you reflected that the original intent of national partnerships and project agreements - namely, to give states the room to test and explore innovative policy reforms and roll these out across the country - has been lost.

Instead of encouraging a 'test and learn' environment, national partnership agreements were seen to be focused on prescribing how funding should be spent, rather than being used as a tool to step back and assess whether the outcomes being delivered are of the highest standard. On this point, the way that governments fund the health system was repeatedly acknowledged as an area too focused on the cost of a service rather than delivering the health outcomes that people value. On the other hand, we heard that historical attempts to implement outcome-based payments were not effective as the states could have done more to deliver on the desired outcomes.

It was clear to many of you that governments could be more productive and cut bureaucratic waste by reducing the number of tied grants and the need to adhere to numerous reporting requirements that divert government resources away from delivering world-class services and infrastructure.

Predictable revenue streams were repeatedly flagged as a key requirement of good government and you pointed to wasted effort in the annual renegotiation of funding agreements for ongoing and essential services.

As an overarching piece of feedback, many submissions spoke to the need for greater alignment of revenue raising and service delivery responsibilities across both levels of government. This would not only help citizens better understand which government is accountable for what, but also ensure that services are delivered by the level of government best placed to do so.

## How governments can work together while putting citizens at the centre...

Some of you noted that both levels of government could work better together and make it easier for tax payers to navigate the system by streamlining and centralising tax administration. You also suggested that state infrastructure assurance agencies could be consolidated within a national body, potentially saving valuable taxpayer dollars by providing a single source of priority infrastructure advice to governments nationally.

In areas where both levels of government share the responsibility for funding and service delivery, some of you urged states and the Commonwealth to work together to better plan infrastructure pipelines, deliver social services in the most effective way, and to look for opportunities to minimise duplication and increase effectiveness. The delivery of health services was again flagged as an area ripe for reform, with suggestions that both levels of government could do more to fund and deliver effective interventions that address preventable health conditions.

We heard that for governments to work effectively together, stronger alignment must be sought between portfolio and central agencies in funding decisions.

Discussions highlighted that while our long standing and respected intergovernmental forums and institutions have previously been the foundation of many reforms, their effectiveness has declined. Suggestions included renewal of the Council of Australian Governments (COAG) to make it more inclusive of the views of all governments around the table. They also highlighted the opportunity to revive the COAG Reform Council to help governments drive a national reform agenda.

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**“A National Federation Commission would provide a mechanism for encouraging and fostering state innovation, and for policy learning and transfer amongst the states to spread the benefits of successful policy innovation.”** — *Griffith Business School*



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**“A clearer and more easily understood method of planning, funding and delivery of infrastructure by federal, state and local government is needed.”** — *Property Council of Australia*



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**“The status-quo of using co-operative models, such as the Council of Australian Governments, to establish national agendas for reform is flawed because the financial power of the Commonwealth necessarily means it will dictate the reform agenda.”** — *Institute of Public Affairs*



# We heard you say this...

“Another objective is to sort out the mess of duplication, overlap and constitutional subversion created by the plethora of federal tied grants to the states — which are as large in aggregate as the GST revenue.” — *Centre for Independent Studies*

“Land taxes also present an opportunity to capture a share of increased land values arising from government and community investment, and to return this value to community use. This value-capture mechanism could help resolve large and growing spatial inequalities in NSW — particularly if revenues were invested in social infrastructure such as social housing.” — *St Vincent de Paul Society*

“While the GST base is shrinking due to the exemptions for human services, incorporating those services in the tax base would merely ‘churn’ revenue from households to governments and back via health, education and community service funding programs.” — *ACOSS*

“As a Movement, we are concerned about equity for the next generation. Our generation will have to inherit the consequences of a lack of will by governments to undertake vital tax reform. If nothing changes, our generation will be saddled with higher taxes and more debt. We will be unable to sustainably pay for the public services our society relies on.” — *Young Liberal Movement of Australia (NSW Division)*

“Stamp duty acts as a major financial disincentive for retirees seeking to downsize, and as such, has negative impacts for multi-bedroom dwelling affordability. Stamp duty also acts as a disincentive for people to relocate to be closer to their place of employment, which not only adds to congestion, but which directly undermines the Greater Sydney Commission’s objective of delivering a 30-minute city.” — *Committee for Sydney*

“Introduce additional taxes on car sales in the state that are high emitters (could be tiered to different emission levels) to encourage take up of low emission vehicles.” — *Member of the public*

“Stamp duty distorts business decisions, locks families out of housing choices, worsens housing affordability, suppresses economic activity and leaves governments with highly volatile revenue streams. It is a tax that is a relic from our colonial past, representing a stamp of the state’s authority over property transaction that has absolutely no economic relevance in our modern Australia” — *Property Council of Australia*

“Thought leadership and reform is never easy. We also note there are benefits in making the reform process as broad as possible (by including as many other governments that will come to the party). The idea is to spread the gains and losses from the reform process as widely as possible so that what is lost on one measure is gained on another, so that on balance, people feel no worse off and in fact perceive benefits from efficiency. Here the Federal Government can play an important role by incentivising the States’ promotion of a more rational and streamlined mix of taxation and helping to better balance revenue and spending shares at each level of government” — *Industry Super Australia*

“It is a disservice to the Australian community for the states and territories to be expected to reform in isolation. The most fruitful reform opportunities would necessitate close collaboration between all tiers of government in Australia.” — *NSW Business Chamber*

“The most viable path to real financial autonomy is for states to reach an agreement with the Commonwealth where the responsibility for raising revenue and the responsibility for spending that revenue are more closely aligned.” — *Institute of Public Affairs*

# What happens next....

Based on the nation's feedback, we will now investigate the following ways in which our federation can support a stronger economy, better services and ultimately, better outcomes for all Australians.

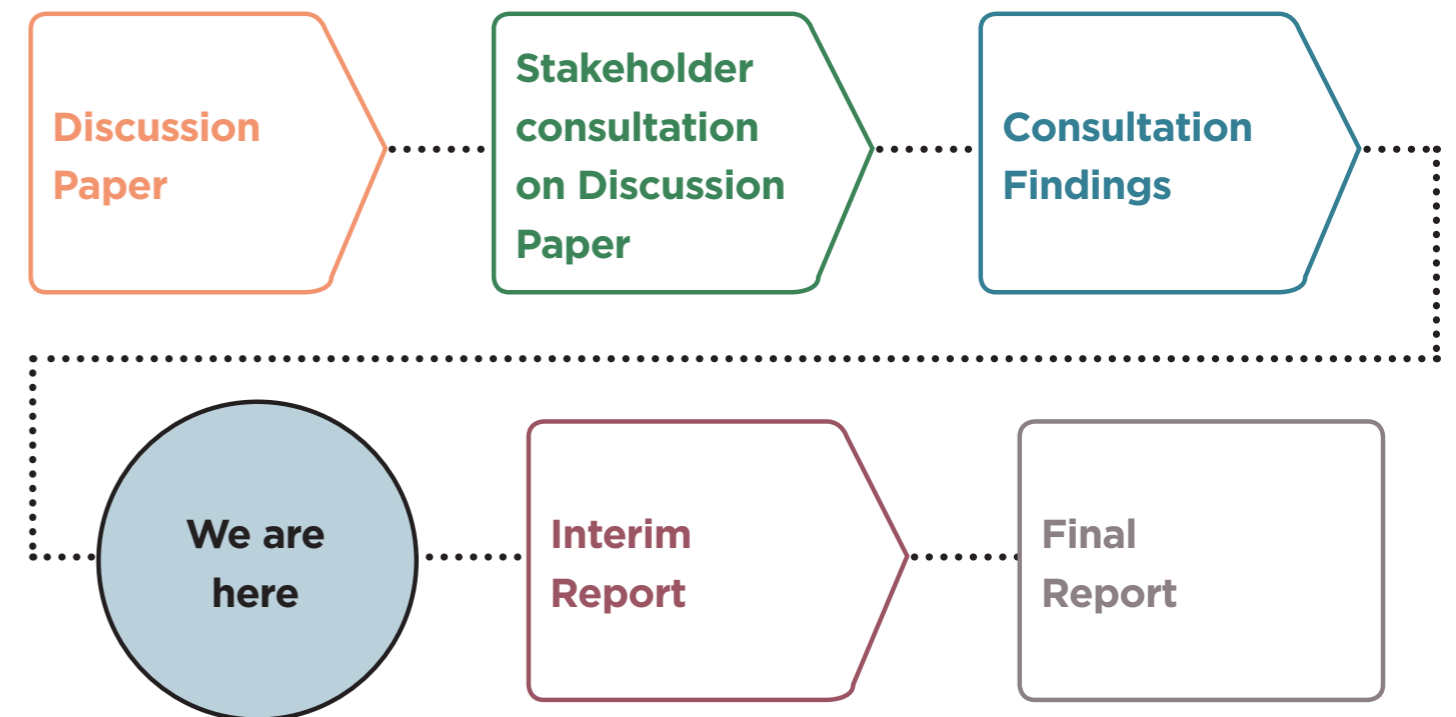
## On funding our future:

- How to support a strong NSW economy and improve the tax mix to be fairer, simpler, more efficient, and sustainable.
- Alternatives to stamp duty on property to make the tax burden fairer and to give people greater flexibility to move house when it suits them.
- Ways to keep the people of New South Wales moving while ensuring road use costs (like maintenance, congestion, and pollution) are priced fairly and sustainably.
- How governments can step out of the way of citizens accessing insurance and create a fairer way to fund Emergency Services.
- Options to address the erosion and volatility in the GST revenue base so that governments can sustainably plan and deliver services and infrastructure into the future.
- Whether payroll tax arrangements can be streamlined to work better for businesses across the country while retaining a sustainable revenue source.

## On our federation:

- Putting people at the centre of policy design and government decision making through effective roles, responsibilities, and institutions.
- Simplifying and setting clear, measurable objectives for Commonwealth-state funding agreements to:
  - remove bureaucratic waste
  - deliver outcomes for citizens, and
  - incentivise innovation and productivity-enhancing reforms.
- Reviving the Intergovernmental Agreement on Federal Financial Relations to deliver on our nation's current aspirations, and improve accountability and cooperative governance across the country.
- The merits of a national Intergenerational Report, covering both the Commonwealth and the states, to build a robust evidence base to inform priority setting and promote transparency in government spending.

Consultations will continue to ensure that your ideas fully inform and guide the Review's recommendations to help shape a brighter future



**Please keep talking to us....**  
**FFRReview@treasury.nsw.gov.au**

