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TWIN CRISES BUILD CASE FOR FEDERATION REFORM

Report backs National Cabinet, land tax switch, abolition of stamp duties, GST reform

The catastrophic challenges faced by Australians in the past six months – the summer of bushfires followed by the COVID-19 pandemic – have dramatically increased the urgency to reshape the Federation and the tax system that underpins it, according to the Draft Report of the NSW Government's Federal Financial Relations Review.

The Draft Report, released today by the independent, expert Review panel appointed last year by NSW Treasurer Dominic Perrottet, sets out a roadmap to realign financial relations between the Commonwealth and the states to help the economy recover and ensure future governments can continue funding the essential services and infrastructure citizens expect.

The Report – *Supporting the road to recovery* – says federalism has served Australia well and remains one of the most economically efficient forms of government. However, it warns the benefits are being undermined in Australia by duplication, bureaucracy and creeping centralisation, which has given too much financial power to the Commonwealth and fostered “a learned financial dependency amongst the states”.

The Report advocates changing Australia's tax mix to make taxes as simple as possible and to limit the impact they have on citizens' lives, such as the decision about when to move house and whether to take out insurance.

This would involve the replacement of inefficient, unfair or shrinking taxes, such as stamp duties on property transfers and insurance taxes, with broad-based or fairer taxes, such as land tax. These would have the effect of making state revenues more stable and sustainable and, along with allowing the states to access a share of personal income tax already paid by citizens, give them more control over revenue raising and spending on essential services such as health and transport.

The Report makes clear that genuine reform cannot be achieved by simply raising the total tax take but “will involve changing the tax mix in a way that is neutral to the overall burden on the taxpayer, while extracting the best value”.

The Report concurs with the view of the Prime Minister that the Council of Australian Governments (COAG) is no longer the best vehicle to deliver such a major reform agenda and supports its replacement by the National Federation Reform Council, with the National Cabinet at its centre. The National Cabinet was created by the Prime Minister to manage the greatest economic, financial and social shock since the Second World War.

“State and territory governments confront a significant decline in their tax revenues at the same time as they inject all of their fiscal firepower into the economy to avoid serious economic collapse,” the Report says. “They now face an era of higher debt, challenging their ability to sustainably

deliver essential services and infrastructure. With economic recovery now a priority, the question facing the Review is how state governments can provide taxpayers with reliable, quality government services, while ensuring they pay the lowest amount of taxes possible.”

Among the Report’s 15 recommendations are:

- To **establish the National Cabinet** as the permanent decision-making body to guide the federation. It should be an inter-governmental body of equals with an independent national secretariat;
- To **review and reform all Commonwealth-State** funding agreements to reduce waste and duplication and shift the basis of funding towards outcomes;
- For the state treasurers, in consultation with the Commonwealth, to assess and agree options for **lifting and/or expanding the base of the GST**, with some of any revenue gained transferred to lower-income households to maintain fairness;
- To **replace stamp duties on property with a broad-based land tax**, with an appropriate transition process that recognises the impact on property owners. The Report notes that there were various transition models, each with significant trade-offs that need to be explored further;
- For NSW to work with the Commonwealth on the **development of personal income tax-sharing model**, potentially involving a small pilot. This would involve substituting a small set of tied grants for an untied share of the personal income tax currently raised from NSW citizens. There would be no impact on the amount of tax paid by individuals;
- To **replace all specific taxes on insurance policies** with broad-based taxes, such as a land tax, to improve insurance affordability and uptake;
- For the state treasurers to agree a **national approach to payroll tax reform** to address the hollowing out of the tax base and the complexity this imposes on taxpayers;
- For the state treasurers to design a **national road user charging scheme for electric and other zero-emission vehicles**; and
- For NSW to commence **the trial of a ‘congestion cordon’ around the Sydney CBD** involving charges for drivers entering the zone.

The Panel’s Interim Report says that if Australia could reform its federal system to match the decentralisation in other leading OECD federal countries, per capita income could increase by more than \$4500 per Australian – a long-term pay-off of \$116 billion (in 2020 dollars) in GDP.

“To achieve this payoff and meet the challenges before us, the federation must evolve. The crises of the summer’s bushfires and COVID-19 have put in plain sight how the status quo is no longer fit for purpose,” the Report says.

The Chair of the Review Panel, David Thodey AO, said: “Over months of consultation, we have found a consensus that our federation has served the nation well and, properly calibrated, can remain one of the most economically efficient forms of national government. However, we have also found clear areas where it can – and must be – be improved for our long-term prosperity.

“The summer bushfires and the COVID-19 pandemic have exposed the best and worst of the federation and have only added to the urgency to undertake significant reform. The status quo will only exacerbate the challenge faced by the states in funding the essential services their citizens expect and deserve.”

Consultation is ongoing to ensure that the Review's recommendations are fully informed by the community. The Review welcomes comments by 31 July to inform its Final Report to Government. The Draft Report and more details about the Review panel and process can be found at <https://www.treasury.nsw.gov.au/draft-report>

The Panel's final report is expected to be delivered in September 2020.