

# Australia's Future Tax and Transfer Policy Conference

Speaking Notes for Final Panel Session

Don Challen  
Secretary, Department of Treasury and Finance, Tasmania

Melbourne Business School  
Friday 19 June 2009

My job as part of this final panel session is to draw out some of the main themes that have emerged at the conference. In organising my thoughts, I had to predict what the two preceding speakers might have to say. Happily, I seem to have made a reasonable fist of that!

I am here this afternoon as a practitioner. I have been working in the area for an extended period and have a high level of interest in reform – particularly of State (wherever I use the term State, I mean the Australian States and Territories collectively) taxation. Indeed, I have been involved in quite a bit of tax reform over the years.

A conference like this is something of a smorgasbord – there is a tendency in all of us to pick up things we hear that we like the look of and to leave the remainder on the table.

One of the things I heard and picked up was best summarised by Peter Whiteford:

“The broad architecture of the Australian tax system has considerable strength, so that in looking at reform options we should consider refurbishment and modernisation, not demolition and rebuilding”.

However, Peter and others that were expressing that view were focussing on our tax system at the **national** level.

When we look at things at a State level, the consensus is rather different.

Richard Bird commented that:

“If Australia wants (or needs) to be a real federation, then it should assign some serious tax bases to the states”.

He and others helped the Conference to what seems to be a strong consensus that the current crop of State taxes are “not very good”, that the States’ relatively heavy reliance on transaction taxes on property is undesirable and that the design of those taxes is far from optimal.

Richard came up with the quote of the conference when he went so far as to describe the States’ conveyance duty as “an absolute piece of garbage”!

Richard – delighted as I am to see you in Australia, I have to tell you that we didn’t need to bring you all this way to have you tell us that. We knew it!

The bigger question is what can we do about it?

Three main options appear to have emerged in the conference discussion. They are to abolish conveyance duty and replace it:

- by broadening and perhaps personalising the payroll tax base;
- by broadening the land tax base;

- by piggy-backing on the Commonwealth Personal Income Tax base or perhaps the PAYG base;
- or presumably some combination of these.

The last option needs to be refined a bit – the PAYG isn't a tax or a tax base and I doubt that it could be used for the purpose.

However, the idea of giving the States access to the Commonwealth Personal Income Tax has been thought about before and, politics aside, appears to be a perfectly viable option.

We heard quite a few interesting proposals for reform in other areas of taxation but the earlier speakers on this panel have covered that ground thoroughly, so I won't detain you further on the specifics.

The interesting question that arises from all this and is of special interest to me, is how do we get there?

While I think this issue is highly important whichever reform element we are talking about, I plan to focus attention on the area of particular interest to me – namely the abolition of the States' conveyance duty if that was to proceed.

A good place to start is to remind ourselves that:

- while the average taxpayer no doubt responds to the incentives embedded in the tax system;
- the average voter is abysmally ignorant of tax theory; and
- the average Member of Parliament is magnificently incentivised to respond to the views of the average voter.

A couple of speakers have noted the difficulty of starting with a clean sheet of paper. It is another way of putting the same thought that I have when I remind people, as I often do, that we are all captives of our initial conditions. It's the same as the problem of path dependency that Richard Vann noted in his presentation earlier today.

Any reform, but most particularly tax reform, requires leadership. Significant tax reform requires a delicate political alignment of the right political leaders and the right circumstances.

Looking at abolition, two forms of reforms have been canvassed at the conference.

The **first** internalises the reform challenge at the State level – by swapping conveyance duty for a broader payroll tax or a broader land tax.

In Australia, conveyance duty is levied by each of 6 States and 2 Territories. Each of them has their own legislation and their own collection and compliance administration.

Implementation of this type of reform would require 8 lots of political commitment and 8 lots of legislation and whatever 8<sup>3</sup> is of opportunities for it to come undone.

That path is doomed to failure.

As David Smith observed in his commentary yesterday, Australia's great recent tax reform was around the introduction of the GST when we not only introduced a new tax but also achieved the abolition a whole collection of taxes at both national and state levels.

It is interesting that, at the time, there was a high degree of consensus between Treasuries about the ranking of State taxes by "goodness" (though the list went from worst to best!). Indeed, the Heads of Treasuries agreed a ranking that was used as the basis for the State taxes to be abolished from the GST revenue yield in the original reform package. When the package was modified, following the changes to the base made as part of negotiating the support of the Senate for the necessary legislation, the same ranking was used but the cut-off "line" was simply moved higher up the list to reflect the somewhat lower revenue yield from the narrower GST base. What this shows is that it is possible to get a workable consensus on the ranking of taxes which are the subject of reform.

Some would say that a lot more could have been achieved through the reform of the tax system around the introduction of the GST. I share that view but let's not be churlish, a major reform was indeed pulled off.

The other very significant reform we have seen in Australia in the past couple of decades was the suite of microeconomic reforms under the umbrella of the Council of Australian Governments (COAG) reform agenda of the mid 1990s. Far reaching shifts in policy positions with very significant benefits in efficiency, consumer choice, GDP and the operation of a wide range of markets was achieved through this process.

The feature of the GST-related tax reforms and the COAG microeconomic reforms is that both were **national** reforms – the States and the Commonwealth came together with a joint objective and a unified approach to overcome what were politically very difficult challenges – and they put the reforms in place.

There is a major lesson in that which suggests that the **second** of the forms of reform of conveyance duty is much more likely to be realised.

In this approach, the Commonwealth and the States would jointly promote a tax reform in which conveyance duty would be abolished and in return the States would be given access to say the national Personal Income Tax base using the piggy back method. Each State would surcharge the Commonwealth Personal Income Tax base for residents of the particular State.

No one, as far as I can see, is suggesting other than that this swap would be done on a budget neutral basis. While there may well be good arguments for expanding the States' tax base, that does not form part of the proposal that has emerged at this conference for abolition of the States' conveyance duty.

In my view, this approach not only has a good chance of success, it is probably the only approach that will succeed.

Some of you will find this unsatisfying because you will be looking for a more basic consideration of the assignment of expenditure responsibilities to the levels of Government and a more clean sheet approach to considering what revenue needs are required to meet those expenditure responsibilities.

I have a couple of observations on that.

There is little likelihood that anything like the current collection of State taxes, albeit broadened, will meet the longer-term funding requirements for areas of State responsibility like health in which costs are rising at multiples of the CPI.

This provides the basis for another argument for providing the States with access to a new tax base.

And I find the “financing follows function” debate all very interesting but rather sterile. It’s that “initial conditions” problem again.

A country only gets one chance at the expenditure responsibilities assignment – Australia got it in the decade before federation in 1901 when our Constitution was negotiated.

There is a lot of simultaneity between expenditure responsibilities and tax assignments, so once the die is cast, it is impossible to achieve change except at the margin – and it is evident that even that is very difficult.

Thank you.