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Tax White Paper Task Force
The Treasury
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PARKES ACT 2600

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Dear Sir or Madam

Vertical Fiscal Imbalance

The taxation arrangements between the Commonwealth and State governments are a mess. The States raise about 45% of their own revenue. The remaining 55% comes from the Commonwealth in the form of grants. This has the rather unfortunate description of “vertical fiscal imbalance”. Originally, these grants could be used by the States as they saw fit. Over more recent decades the trend has been for grants to be for specific purposes with the Commonwealth requiring specific outcomes. The level of 45% represents one of the worst cases of vertical fiscal imbalance of Federations around the world.

The arrangement has led to an inexorable encroachment by the Commonwealth into areas like education and health which, constitutionally, are matters for the States.

As a direct consequence, many services provided by the States are now duplicated by the Commonwealth. For example, the Commonwealth employs thousands of public servants in the Departments of Health and Education despite the fact that it does not run a school and only runs one hospital.

The arrangements do not encourage accountability and lead to blame shifting between the levels of government.

Prior to 1942 the States raised their own income tax. They ceded this power to the Commonwealth as part of the war effort.

The way forward

The way forward is to allocate a share of income tax revenue to the States. At the same time the Commonwealth would reduce grants to the States by an equivalent amount. For administrative simplicity the Commonwealth would collect the States’ share for them.

The Commonwealth would then dismantle the arrangements that duplicate functions which are the responsibility of the States. The savings would be substantial, amounting to billions of dollars. The emphasis should be on simplifying the present costly system and not on increasing the G.S.T.

For a more detailed discussion of the subject see “A State income tax for Australia?” by Robert Carling of the Centre for Independent Studies¹, and also the Centre for Independent Studies’ 2014 submission to the Commonwealth Government’s Commission of Audit.

Sincerely

R C Campbell

¹ This paper was presented at the Personal Income Tax Reform Symposium organised by the Australian School of Taxation, UNSW, April 2007 and is published in the Australian Tax Forum.