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Title:

Article for The Australian Book Review (on Commonwealth/State funding arrangements)

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ARTICLE FOR THE AUSTRALIAN BOOK REVIEW.

BY DON DUNSTAN.

It seems that as far as State Treasurers and Premiers are concerned a solution has at last been found - State-Commonwealth financial wrangling is to be resolved on a tax-sharing basis Canada introduced in 1962. The Commonwealth hasn't exactly agreed yet, and may not, but the Premiers have left their Adelaide meetings obviously pleased with themselves as their staffs handed out optimistic press releases. In the absence of dynamism, it was a matter of looking dependable and in control.

It must be nice sitting over there in the Canberra dress-circle watching the rowdy mob in the stalls, where the seats are clearly not comfortable and some are even hot. The Commonwealth is really doing quite nicely, thank you, financing its expanded defence programme and other items, and paying off its loan burden, all at the expense of the States. The present Commonwealth-State Financial Agreement has simply meant that over the last twenty years or so the States have not had maintained to them their previously existing growth-rate revenues, particularly in income tax. Canberra has made a profit.

But the blame cannot entirely be placed at the feet of Capital Hill. The continual meetings of State officers and the constant public demands by State Premiers could have led one to believe that the necessary work had been done to achieve a well founded and agreed programme for rewriting the Financial Agreement. The Adelaide meeting in December was supposed to have completed this process. Jovial photographs of well satisfied leaders may even have encouraged many people

to think that something had actually happened. But the result announced was simply that a further study of the problem was to be made, this time with the object of adapting the Canadian tax-sharing system to Australian conditions. It was, I suppose, one kind of solution - it amounts to replacing a problem with a problem.

What is in fact being investigated by the Premiers can most clearly be seen by contrasting the present system with the Canadian model. In Australia financial assistance grants to the States are provided from Commonwealth revenues on the condition that the States refrain from collecting income tax. The formula gives some weighting to the disabilities of Western Australia, Tasmania and South Australia and provides for increases in the grants once individual State wage levels and/or populations change. On the recommendation of the Grants Commission, Tasmania also gets a special disability grant designed to provide it with a level of State services comparable with the standards shown from an examination of the Victorian and New South Wales budgets. And then, under Section 96 of the Constitution, special grants and specific purpose grants are made from time to time.

By contrast, in Canada prior to 1962 the Provinces 'rented' their income taxes to the Federal Government which both imposed and collected the tax. It paid to the provinces, 'tax rentals' which gave them 10 per cent of the provincial yield of Federal and individual income tax, 9 per cent of the taxable income of corporations, and 50 per cent of the yield in Federal succession duties. Tax equalization payments were made where the overall payments were below the weighted average per capita yield in Ontario and British Columbia.

Unfortunately, this Canadian agreement led to just as much dissatisfaction there as our present arrangement between

the Commonwealth and States has here. In fact, the whole history of Federal and Provincial Canadian tax arrangements has been unhappy. In 1962, a new arrangement was entered into where instead of the Federal Government paying a 'tax rental' to the provinces, it agreed to reduce the amounts of its individual and corporate income tax by the respective 10 and 9 percentages in order that the Provincial governments could impose their own taxes. The Federal Government offered to collect these taxes provided that the Provinces would define taxable income identically with the definitions of Federal taxable income. Then, with the Provinces able to levy their own set of taxes, taxpayers could take their provincial tax payments as abatements of their Federal tax liability. Which brings us to the present, where the system has been found in many areas to be a new distinction that provides very little actual difference. Provinces like Manitoba and Saskatchewan tax individuals at rates in excess of the allowed abatements, and those two Provinces together with Ontario, Quebec and Newfoundland tax corporations at rates in excess of the allowed abatements. In the matter of equalization rates, which are designed to ensure a consistent standard of development and services throughout the country, there is a complicated arrangement under which the tax base and relative fiscal capacity of the Provinces is reckoned on a comprehensive index. The average of the actual Provincial tax rates is reckoned, a calculation is made of the potential revenue of each Provincial Government by applying the average rates to the calculated tax base, and if the potential revenue per head is less than the average per head, the difference is multiplied by the relevant Provincial population and this determines the equalization grant.

So the next question in this the dullest but one of the most important of political issues in a Federation, is if Australia were to change to a system of the Canadian kind, what

would be the effective results to the States? Firstly, Victoria and New South Wales, and particularly Victoria, would be likely to achieve a larger sum in tax revenues. But then if the smaller States wanted access to the revenues that come from growth and expansion, they would have to impose high rates of personal and company tax, despite equalization payments. These are the States which are already at a disability in development, and the consequences would be that they would face even greater disability in providing services to the standards set by New South Wales and Victoria. Moreover, they would be unable to maintain the cost advantages at present used to attract development. Queensland, South Australia and Tasmania would have taxes at a rate industry would find greily disenchanting.

But finally, and overall, in using the Canadian system there is no indication that the amounts to be derived per capita or in percentage of personal income would be significantly greater than under the existing Commonwealth-States Financial Agreement. In fact, taking the years 1965/66 to 1967/68, and the figures supplied by James Maxwell in September's "Economic Record", the effective return to the States as a percentage of personal income in Australia was 5.08 percent while in Canada the combination of grants and tax abatements was 4.35 per cent. In Australia, general revenue grants are \$75.50 per head; in Canada grants plus tax abatements are \$76.52.

So it is not by any means apparent that a change from the present system to the kind suggested is going to solve the problem of the Australian States at all. The problem is that the States are responsible for Education, Health and Hospitals and Development, and in all comparable countries the rate of increase in expenditure per head each year in these areas is greater than the rate of increase each year in population.

What is more, there are development areas, particularly those of urban planning and transport where Federated States of the Australian or North American models have no adequate finance at all but all of the responsibility. To a large degree the planning disasters that have occurred in North America particularly, and could occur in Australia very soon, are directly related to Federated systems that for both historic and political reasons find it increasingly hard to deal in a flexible way with the problems of late twentieth century national government.

But what does appear clear from any examination of the Canadian financial arrangements is that there the Federal Government pays to its Provinces far more by way of specific purpose grants than is done in Australia. The Canadian total per head, \$65.75, is much greater than the Australian \$31.27 and is 3.75 percent of personal income as compared with our 2.11 percent. The Australian Premiers have completely misconceived the way in which our Federation must go. Lamontagne in "Le Fédéralisme Canadien" criticises attempts to lay down absolute principles. He said: "le fédéralisme doit être fonctionnel".

We're stuck with our Federation and we have to make it work, and it's clear that we will not make it work by continued wrangles about which Parliamentary body, the Commonwealth or the States, is to have the right to determine separately the priorities in spending the amounts of revenue available to us. Quite clearly, the Commonwealth will not be prepared to withdraw from responsibility in the spending of the money which it raises, but at the same time it is vital that local representative organisations, particularly the State Parliaments, should have a distinct say in setting priorities. The only functional course is to develop better joint Commonwealth/State areas of administration and to expand the

special grants. This is not, as one Premier put it with muddy shallowness recently "the course of socialism". It is a matter of reasonableness.

The clearly reasonable course is one in which, instead of the Commonwealth's setting the priorities for the grants as, for instance, with its Schools' Assistance Programme which is simply making the States a channel for monies granted under Section 96, what should happen is that Commonwealth and States consult on areas of need and the nature of priorities, jointly determining the patterns of spending and the administration of the schemes. The frustration of this perfectly simple solution has occurred because the Commonwealth has not, under a Liberal Government, been prepared to accept responsibility in traditional State areas, even though First Form arithmetic indicates that the States can't afford major spending in vital areas.

The Department of Housing and Urban Development in the United States and the direct involvement of Federal Governments in both the United States and Canada in urban renewal and planning, is a clear example of what can be done. We also have a model of our own which can do even better. This was the old War Service Land Settlement Scheme in which the States and the Commonwealth jointly determined the course to be followed and jointly administered the monies devoted to the Scheme. The lesson was learnt. It need not be forgotten. And unless Australian Commonwealth Governments accept a widening area of responsibility, and recognise that this responsibility must be discharged jointly in both policy and execution with the States, people will have to be forgiven for seeing only toadstools in the mushroom club.