

Not so New Federalism

*John Hyde*

State Governments raise with their own taxes less than half of the revenues they spend. Yet, when the shadow Minister for Finance, Dr John Hewsen, said on television that State Governments should eventually raise their own taxes, he was repudiated by his leader. Hewsen, who said publicly no more than most Federal MPs say privately, may not have been politically astute, but he was correct.

The common-sense belief that a government's power to spend should only accompany the responsibility to tax was once embodied in the Fraser Government's "New Federalism"---but please Dr Hewsen, not in an election year. Although it was no part of his intention, Dr Hewsen demonstrated the inability of political leaders to lead---that is, to win public support for policies which are not immediately popular or which are open to misrepresentation.

Mr Fraser's "New Federalism", enunciated in 1975, allowed the States to raise an income tax. The Premiers had been so loud in their calls for fiscal independence that, at the time, I think Mr Fraser believed them. The policy initially appealed to Federal politicians because it was hoped that State politicians would no longer be able blame them for failure to satisfy interest group demands which always exceed the revenues. Federal MPs get heartily sick of the trouble many of their State colleagues cause for them. In the same mail, I once received two letters from a State MP whose seat was within my Federal electorate. Each was written on behalf of a group of our constituents. One demanded more Federal spending on State schools---an area of responsibility in which the State polly professed to resent Federal interference---and the other complained about high levels of Federal taxation.

Canberra's control of State legislatures denies the whole purpose of the Federal system. But because the Federal Government naturally endeavours to control the taxes which it has incurred the odium of raising, State governments have become clones of each other---so much so that there is not much point in Australians voting with their feet for another State.

Commenting upon the United States, Alexis de Tocqueville observed that a "central power, however enlightened and wise one imagines it to be, can never alone see all the details of the life of a great nation...[S]uch a task exceeds human strength". The inability to see, let alone control, the details from the centre makes decentralised authority---to the States, the local governments, families and individuals in free markets---necessary.

When it came to the crunch, far from being anxious to resume responsibility for their own revenues and expenditures, State politicians opted for glory without power. When Fraser offered income-taxing powers to the States, only the Western Australian Government, under Sir Charles Court, passed the necessary legislation and even he did nothing with it. All of the States claimed that the Commonwealth, by leaving the States no room within the income taxation system to raise a State income-tax, was, in effect, subjecting the public to additional tax---Mr Wran called it "double-taxation". This was a blatant lie but the State politicians got away with the claim.

In the first place, total taxation is, in the end, determined by total expenditure, so the questions of who raises the tax and what transfers take place between governments, have nothing to do with the aggregate. In the second place, clause 32 of the Income Tax (Arrangements with the States) Act 1978 made plain that taxes raised by a participating State would be applied in partial discharge of the taxpayer's liability to the Commonwealth. In the third place, clause 79 of the same Act made plain that taxes levied on incomes would yield to the governments of participating States as much revenue as they each had levied, plus the equalisation assistance awarded to the State by the Commonwealth Grants Commission. The net effect of the Act was to place the States in a position where they could give their citizens a rebate or require them to pay a tax surcharge. The trouble was that the State politicians, who really preferred a quiet life to fiscal responsibility, were given no incentive to take up the opportunity.

Professor Russell Matthews, who at the time was the acknowledged academic authority on Commonwealth-State financial arrangements, had this to say: "From the viewpoint of State fiscal responsibility, the most serious weakness of the new arrangements results from the Commonwealth's failure to make room for the tax surcharges by reducing its own rates and making an equivalent reduction in State tax-sharing entitlements. This would have forced the States to impose surcharges, removing any basis for State arguments about the level of tax-sharing entitlements and for unjustified claims that State surcharges would involve double-taxation, and establish a clear link between State taxing and spending decisions which has been lacking in both the uniform taxation and the new tax-sharing arrangements. It says much about the States' lack of any sense of financial responsibility, and their willingness to leave unpopular decisions to the

Commonwealth, that for their part they have not sought tax room for themselves".

In short, the Premiers did not want responsibility and Mr Fraser was afraid to force it upon them.

I am not sure that returning appropriate incentives to the State governments is properly classified as micro-economic reform, but it is of the same ilk. The reason for doing it is the same as for returning proper incentives to the wharves, the labour market, the motor industry, the airlines and so on. The Australian economy will not recover until the people who make economic decisions face the consequences of their own decisions. And protected State governments are no better than protected industries---indeed they are bigger and worse.

Dr Hawson's passing observation was no more than common sense. It is a great pity that, through fear of resurrection of the "double-taxation" bogey, Mr Howard ruled out what is a very important reform.

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