Borrowing Spree Under Fire

State debt blows out 40 per cent

NSW and Queensland are slipping behind in tax competitiveness as they also spearhead a borrowing spree that will see state debt blow out more than 40 per cent by end-2015.

An analysis by the The Australian of mid-year budget updates finds state and territory net debt is forecast to surge by more than 40 per cent from $129 billion at June this year to $183.7 billion in 2015 to fund infrastructure upgrades and spending on health, education and other services, while their net financial liabilities — which also include liabilities from superannuation schemes for public servants — are forecast to rise from $302bn to $352bn over this time.

Queensland was the last mainland state to release its mid-year budget update on Friday, and now faces a backlash over its plans to impose new charges on mining companies and defer the abolition of stamp duties on the transfer of core business.

It comes as a new business tax report to be released today by the Institute of Public Affairs, obtained by The Australian, finds Queensland is continuing to lose its historical low-tax mantle to states such as Victoria and urges NSW to make across-the-board state tax reductions to improve the performance of the nation’s largest state economy.

The IPA report finds that moves by NSW to cut the rate of its “concessional” payroll tax “will not materially affect NSW’s position as the high employment tax state” and that Australia could promote private-sector growth amid international turmoil if inefficient state taxes were slashed across the nation.

South Australia remains the No.1 taxing state. Western Australia is the lowest-taxed of the states, but it pipped at the post by the Northern Territory for having the most competitive business tax regime.

Yesterday, the report’s author, IPA research fellow Julie Novak, said states and territories could lessen the debt burden without imposing any new taxation on businesses. This could be done through privatisation, she said, pointing to the potential sale of electricity assets and the franchising of public transport.

Future Fund chairman David Murray warned that as Australia’s net foreign liabilities were already high and productivity was weak, “open government indebtedness needs to be constrained or even reduced.”

The federal government revised its general government net debt levels for 2011-12 up by $25.8bn in its mid-year update to $138bn.

Mr Murray added: “The states need to be accountable for the powers that they have under the Constitution, and they should be able to fund the related activities.

“The best form of federalism is one where the states can tax and that we have a competitive federalism so people want to live and work in the states that are run the best.”

Business Council of Australia acting chief executive Maria Tartar backed the comments, saying the states were too reliant on inefficient and “productivity-damaging” taxes such as stamp duties and insurance taxes.

“There are major problems with the way the finances are organised between the states and the commonwealth, where the states have accountability for delivering high-demand services, but have little of their own revenue,” Ms Tartar said.

“The commitment by the governments of NSW and Victoria to state tax reform plans was a welcome development from last year’s tax forum.

“But it is difficult to see how they can do this, given their future budget pressures, can fully fund removal of inefficient taxes without other sources of revenue and an examination of roles and responsibilities.”

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This thing is really killing me

I’ve heard about it

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Tell me about it

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Inefficient taxes here to stay without incentives to premiers

Judith Sloan

There was agreement at the Tax Forum held last October that something must be done about the plethora of inefficient state taxes.

The real problem was that no solutions were made about how the revenue hole would be filled, if the inefficient taxes were abolished.

The truth is that unless the federal government co-operates with the states, the plan for the abolition of inefficient state taxes will remain just that—paper.

But any possible progress on this issue was effectively killed by the late insertion in the terms of reference of the Greiner Review, looking into the distribution of the GST between the states, that "state tax reform will not be financed by the Australian government". Federal Treasurer Wayne Swan had insisted on this addition.

Of course, it is important to define what is meant by inefficient. High compliance costs relative to the revenue collected is one consideration. Inducing unwanted and detrimental behaviour is another. Taxes on taxes would qualify as inefficient. Taxes that produce volatile and unpredictable revenue are also not particularly helpful to state governments.

One of the most common business complaints relates to payroll tax, which raises relatively large sums for the states. There is an irony here that payroll tax had been a federal tax, but was transferred to the states by Prime Minister Billy McAlmon in the early 1970s. In theory, payroll tax can be an efficient form of taxation, equivalent to a consumption tax.

In the hands of state governments, however, payroll tax has become distorted by the exemptions that have been granted to small businesses, meaning only those businesses with payroll above a certain amount pay the tax. Land tax can also be an efficient form of tax, but state governments have been reluctant to apply it to owner-occupied dwellings. To be sure, there are some equity issues for those with valuable homes and low incomes, but there are ways to address them.

Stamp duty on the purchase of properties discourages turnover and potentially restricts mobility. The option of moving states to cash in on job opportunities, for instance, can be stifled by the stamp duty on the transfer of properties.

There are a number of smaller state taxes that affect mainly business and are both inefficient and raise relatively small amounts of money. None of the states, however, want to forgo any revenue without some compensation from the federal government.

The figures on levels of state debt point to a marked weakening in their financial positions. And looking forward, debt levels look certain to increase significantly. It is easy to be complacent as Europe flounders. But one of the stories of Europe is just how quickly the public finances of some of these countries deteriorated. It could happen here.

Where once the GST was described as a miracle growth tax, the sluggish growth of consumption since 2008 has meant that the growth of GST receipts has not kept pace with the growth of disposable income. As Reserve Bank governor Glenn Stevens has noted, we have been living in an age of "the cautious consumer".

The Gillard government will be concentrating all its efforts on "returning the federal budget to surplus in 2012-13 as promised - no ifs, no buts. This means there will be little sympathy for helping out the states even if, from an economy-wide viewpoint, what really matters is the combined budget positions of all levels of government. Expect no progress on these inefficient state taxes.

Bank strategist David Plank said the Standard & Poor's downgrade of nine European countries over the weekend would "inject a note of caution and uncertainty and could drive spreads wider in the short term".

The analysis of the state net debt and net financial liabilities was based on the non-financial public sector, which includes both state-owned businesses such as electricity and core government, and is used by rating agencies.

About two-thirds of state bonds are issued by Queensland and NSW, and the analysis found that in dollar terms, the growth in their net debt was highest.

The survey of the mid-year updates found some states had lower net debt forecasts for some years, but when protected with their budget-time forecasts. Queensland's net debt is lower for each year to June 2015, while NSW is lower only for June 2012.

In Queensland, net debt for the core government is forecast at negative $3.2 billion in June 2012, but this is set for a sharp turnaround in future years. By mid-2015, it is forecasting a net debt of $10.4bn for the general government sector, while net debt for the wider non-financial public sector will rise from $24.9bn to $43.8bn.

State treasurers have defended their debt levels and tax systems, arguing existing federal-state financial arrangements could not be sustained.

"History tells you the future cannot sustain indefinitely the fiscal imbalance in our federation," Queensland Treasurer Andrew Fraser said.

NSW Treasurer Mike Baird said investor demand for NSW triple-A rated bonds had been strong. "Those who don't have the triple-A are struggling to raise debt because the cost of borrowing is that much higher. This is not as a result of why protecting our triple-A credit rating is paramount," he said.

After being topped by NT and WA, the IPA's league table ranks Victoria third, Queensland fourth, while NSW is at six.

The IPA finds a hypothetical "reference business" pays an extra 17.9 per cent of its federal corporate income tax liabilities in state and territory taxes each year.