

Report

Referral

1.1 On 19 April 2016, the Senate referred the following matter to the Finance and Public Administration References Committee (committee) for inquiry and report by 4 May 2016.

(a) The outcomes of the 42nd meeting of the Council of Australian Governments held on 1 April 2016, with particular reference to:

- (i) schools funding;
- (ii) hospitals funding; and
- (iii) taxation; and

(b) That the Senate directs the responsible ministers to ensure that relevant officials of the Department of the Prime Minister and Cabinet and the Treasury appear before the committee to answer questions.¹

Conduct of the inquiry

1.2 Details of the inquiry were placed on the committee's website at www.aph.gov.au/senate/fpa.

1.3 The committee directly contacted a number of relevant organisations and individuals to notify them of the inquiry and invite submissions by midday 26 April 2016. Submissions received by the committee are listed at Appendix 1.

1.4 The committee held a public hearing in Canberra on 27 April 2016. A list of witnesses who appeared at that hearing is set out in Appendix 2.

1.5 The committee thanks those who assisted by providing submissions and appearing at the hearing.

Prime Minister's announcement of 30 March 2016 and 'Statement on Federation'

1.6 On 30 March 2016, at a media event at the Penrith Panther's academy, the Prime Minister, the Hon Malcolm Turnbull MP, foreshadowed discussions to take place at the upcoming Council of Australian Governments (COAG) meeting on 1 April 2016:

There is also a very big fundamental reform to federalism, to the reform to our Federation that I'll be raising with the chief ministers later this week. And we have, as you know, we've raised it with them in advance, we thought it would be more important to let them know about our plans for reform in advance rather than just reading about it in the press.

This is the big challenge. We are a federation in Australia, some people say we shouldn't be but we are and we always will be in my judgement. The

1 *Journals of the Senate*, No. 150 — 19 April 2016, pp 4128-4129.

Federation must work better and right at the heart of the problems in the Federation is the fact that the states do not raise enough of the revenue that they spend. In other words they're not accountable enough in the way a government should be. This is often described as vertical fiscal imbalance, which is a dreadful bit of jargon but it basically means the states do not raise enough money and so they, as we know, every year and often several times a year, they go cap in hand in Canberra, to Canberra and complain that the Federal Government is not giving them enough money.²

1.7 The Prime Minister continued, announcing:

What we are proposing to the states is that we should work together on this basis: that we, the Federal Government, will reduce our income tax by an agreed percentage and allow state governments to levy an income tax equal to that amount that we have withdrawn from.

So there would be no increase in income tax from a taxpayers' point of view, he or she would pay the same amount of income tax. But the states would be raising the money themselves.³

1.8 The Prime Minister gave the following explanation of how such a scheme would operate:

We [the Federal Government] would obviously administer it and collect it for them, so again there'd be no compliance costs.

But what this will do is give the states access to their – an additional source of revenue so that they will have a tax base that includes personal income tax, this obviously would not apply to companies but personal income tax can be dealt with on a state by state basis.

At the same time, we would then, with agreement with the states, withdraw from a number of the grants programs we have, so that from the Federal Budget's point of view, the outcome would be, would net off, so that we would not be, we would be making fewer grants to the states but we would be receiving less income tax ourselves, the states would be receiving the income tax to cover those responsibilities.⁴

1.9 The Prime Minister contended:

It will give the states real financial autonomy. It will mean that instead of the marginal dollar for the states always coming from the Federal Government and so you're always having to have this depressing blame game where no-one really knows who's responsible for what. We will clearly identify the areas of responsibility for the state and for the Federal Government and the state will have access to the source of income tax,

2 Prime Minister, the Hon Malcolm Turnbull MP, Doorstop Interview, Penrith, 30 March 2016, available at: www.pm.gov.au/media/2016-03-30/doorstop-penrith.

3 Prime Minister, the Hon Malcolm Turnbull MP, Doorstop Interview, Penrith, 30 March 2016.

4 Prime Minister, the Hon Malcolm Turnbull MP, Doorstop Interview, Penrith, 30 March 2016.

personal income tax, to enable them to raise that money, to fund that expenditure.⁵

1.10 The Prime Minister suggested that such a change to the tax system would be a 'once in a generation reform'.⁶

1.11 The Prime Minister also indicated that the Commonwealth, states and territories would be seeking to reach agreement on new hospital funding arrangements which:

[W]ill be designed to ensure that we have the right level of federal support and the right level of improvement in the effectiveness of the delivery of health care and we're having very good discussions with the premiers and the chief ministers and their senior officials in the lead-up to that.⁷

1.12 The Prime Minister's announcement on 30 March 2016 was accompanied by a 'Statement on Federation', which also spoke in broad terms about the proposal for a state income tax levy.⁸ In part, the Statement on Federation stated:

Currently, Canberra collects taxes and provides the states and territories almost \$50 billion a year in tied grants each year to fund services and build infrastructure. This results in ongoing arguments, negotiations and duplication in administration.

In many areas responsibility is far from clear and the only thing in ample supply is finger pointing and blame.

We're all sick of it.

A way to solve this problem would be to give the states and territories a proportion of personal income tax - rather than demanding money from Canberra they would be raising money themselves and be accountable to their own voters.

The focus of governments should be about delivering better services – not arguing over funding.

The key principles will be that this is not about increasing the total tax take - any income tax surrendered by the Commonwealth to the States would be offset by a reduction in Commonwealth grants to the states.⁹

1.13 On 31 March 2016, the Prime Minister gave an interview to ABC Radio in which he stated:

[Education] funding is committed through to end of 2016-2017. We believe that the future of that funding of post 2017 should be bound up with these

5 Prime Minister, the Hon Malcolm Turnbull MP, Doorstop Interview, Penrith, 30 March 2016.

6 Prime Minister, the Hon Malcolm Turnbull MP, Doorstop Interview, Penrith, 30 March 2016.

7 Prime Minister, the Hon Malcolm Turnbull MP, Doorstop Interview, Penrith, 30 March 2016.

8 See Prime Minister, the Hon Malcolm Turnbull MP, Statement on Federation, 30 March 2016, available at: www.pm.gov.au/media/2016-03-30/statement-federation.

9 Prime Minister, the Hon Malcolm Turnbull MP, Statement on Federation, 30 March 2016.

discussions about revenue sharing, that is because for example the Federal Government provides money to state government schools, you could make a very powerful case for example, that if there was revenue sharing, if the states had access to a portion of income tax that they would have the resources and the money and bear in mind income tax grows at a faster rate than either GST or grants, they would then have the responsibility for states schools which are the schools that they manage...¹⁰

Outcomes of the 42nd Council of Australian Government meeting

1.14 The Communiqué of the 42nd Council of Australian Governments' (COAG) meeting on 1 April 2016 (Communiqué) is attached to this report as Appendix 3.

Taxation

1.15 The proposal for a state income tax levy, as announced by the Prime Minister on 30 March 2016, was rejected by COAG. The Communiqué contained the following comments in relation to taxation:

There was not a consensus among states and territories (states) to support further consideration of the proposal to levy income tax on their own behalf.

Leaders agreed to consider proposals to share personal income tax revenue with the states to:

- provide them access to a broad revenue base that grows in line with the economy;
- reduce the number of tied Commonwealth grants to the states, providing them with greater autonomy and reducing administrative burden; and
- create flexibility for states to meet their ongoing expenditure needs.¹¹

1.16 The Communiqué continued:

COAG further agreed to continue pursuing initiatives that will enhance transparency by providing Australian citizens with a greater level of real time data on how government money is spent and on the outcomes and performance of government initiatives.

COAG agreed that this work, along with the work on broader opportunities for tax reform, including state tax reform, will be progressed by the Council on Federal Financial Relations, with a progress report to COAG at its next meeting.¹²

10 Prime Minister the Hon Malcolm Turnbull MP, Interview with Fran Kelly, ABC RN Breakfast, 31 March 2016, available at: <http://www.pm.gov.au/media/2016-03-31/interview-fran-kelly-abc-rn-breakfast>.

11 COAG Communiqué, 1 April 2016, pp 1-2.

12 COAG Communiqué, 1 April 2016, p. 2.

Hospitals funding

1.17 The Communiqué notes 'COAG reaffirmed that providing universal health care for all Australians is a shared priority'.¹³

1.18 The Communiqué continues, outlining an agreement on future funding arrangements:

Leaders agreed a Heads of Agreement for public hospitals funding from 1 July 2017 to 30 June 2020 ahead of consideration of longer-term arrangements. This will see the Commonwealth providing an estimated additional \$2.9 billion in funding for public hospital services, with growth in Commonwealth funding capped at 6.5 per cent a year.

This Agreement preserves important parts of the existing system, including activity based funding and the national efficient price, and focuses on improving patient safety and the quality of services, and reducing unnecessary hospitalisations.¹⁴

1.19 The Communiqué points out:

As part of this Agreement, all jurisdictions agreed to take action to improve the quality of care in hospitals and reduce the number of avoidable admissions, by:

- reducing demand for hospital services through better coordinated care for people with complex and chronic disease – the current system does not always provide the care the chronically ill need – this means they are hospitalised more than is necessary;
- improving hospital pricing mechanisms to reflect the safety and quality of hospital services by reducing funding for unnecessary or unsafe care – reducing hospital-acquired complications will improve patient safety; and
- reducing the number of avoidable hospital readmissions – too many patients are readmitted to hospitals as a result of complications arising from the management of their original condition.¹⁵

1.20 The section of the Communiqué dealing with hospital funding and health reform concludes:

The Commonwealth will continue its focus on reforms in primary care that are designed to improve patient outcomes and reduce avoidable hospital admissions.¹⁶

13 COAG Communiqué, 1 April 2016, p. 1.

14 COAG Communiqué, 1 April 2016, p. 1.

15 COAG Communiqué, 1 April 2016, p. 1.

16 COAG Communiqué, 1 April 2016, p. 1.

School funding

1.21 In relation to schools, the Communiqué states:

COAG recognised the positive contribution high quality schooling makes to both individuals and the economy. It noted that the Commonwealth's contribution to school education is funded through to the end of 2017, and agreed that discussions on new funding arrangements should be concluded by early 2017.¹⁷

State income tax levy proposal

1.22 The committee was interested in the timeline, consultation and processes underlying the development of the 'state income tax levy proposal', which was announced by the Prime Minister on 30 March 2016.

History of the idea

1.23 Mr Luke Yeaman, First Assistant Secretary, Economic Division, Department of the Prime Minister and Cabinet (PM&C), noted that 'there has been a long history' around the issue of state income tax.¹⁸ Mr Yeaman referred to the issue being raised by the National Commission of Audit in 2014 and by various state premiers. Mr Yeaman noted that NSW Premier Mike Baird had specifically raised a state income tax levy in March 2015.¹⁹

1.24 Mr Paul Drum, Head of Policy, CPA Australia, noted that although the idea had a long history it had not been previously viewed as a serious policy proposal:

I have been a member of CPA Australia for over 37 years. I have been involved in every tax review – not the draft white paper in 1985, but every review since then. There is often discussion about the states sharing, but to me it is an academic discussion that is included for completeness to show that we are thinking of all the options rather than something that is being put forward as a silver bullet idea, as a great moment in tax reform. This is not something that had been put out there as something that anyone was seriously contemplating as a silver bullet moment or a eureka moment for tax reform, in my opinion.²⁰

1.25 Officers from PM&C stated that they had been looking at the 'broad issues' involved with sharing income tax with the states as part of the federation and taxation white paper processes.²¹ However, officers from PM&C confirmed that a state income tax levy proposal was not considered at the COAG meeting in December 2015.²²

17 COAG Communiqué, 1 April 2016, p. 1.

18 *Proof Committee Hansard*, 27 April 2016, p. 13.

19 *Proof Committee Hansard*, 27 April 2016, p. 13.

20 *Proof Committee Hansard*, 27 April 2016, p. 4.

21 Mr Luke Yeaman, First Assistant Secretary, Economic Division, Department of the Prime Minister and Cabinet (PM&C), *Proof Committee Hansard*, 27 April 2016, p. 13.

22 See Ms Alison Larkins, Acting Deputy Secretary, Social Policy, PM&C and Mr Luke Yeaman, PM&C, *Proof Committee Hansard*, 27 April 2016, p. 11.

Mr Michael Brennan, Deputy Secretary, Fiscal Group, Department of the Treasury (Treasury), also confirmed that the state income tax levy proposal was not discussed at the CFFR meeting on 14 December 2015.²³

1.26 Officers confirmed that they first began work on the specific policy proposal in January of 2016, as part of the process of preparing for the April 2016 COAG meeting.²⁴

Preparation for the April COAG meeting

1.27 Work on the state income tax levy proposal discussed at the April COAG meeting was 'led by PM&C in consultation with other central agencies'.²⁵

Briefings to the Prime Minister and Treasurer

1.28 Work commenced on the state income tax levy proposal in January 2016. There were three rounds of briefings provided by PM&C and Treasury to the Prime Minister and Treasurer before COAG. During this period there were 'a variety of tax options' worked on and that the state income tax levy proposal was not the only option.²⁶ Officers from PM&C and Treasury did not know whether the same sets of options were set out in the briefings to the Prime Minister and the Treasurer.²⁷

1.29 PM&C provided the Prime Minister with a general briefing on 'a range of options in the revenue-sharing space' on 22 January 2016. That briefing included discussion of the state income tax levy proposal.²⁸ Treasury was not consulted on the specifics of this briefing, only the issues and implications raised.²⁹

1.30 Mr Roger Brake, Acting Deputy Secretary, Revenue Group, Treasury, indicated that the Treasurer was separately briefed generally on the state income tax level proposal 'around about the same time' as the Prime Minister.³⁰

1.31 Mr Brennan, Treasury, confirmed that the briefing to the Treasurer was general in nature:

I think it is fair to say, without going to the content of the advice, that I do not think it was an outcome of that advice that the field got particularly narrowed to a smaller range of options. [PM&C and Treasury] did not share the letter of our respective briefs [of January 2016]. I know in our case, without going to the content of the advice that we provided, the brief that

23 *Proof Committee Hansard*, 27 April 2016, p. 18.

24 Mr Luke Yeaman, PM&C, *Proof Committee Hansard*, 27 April 2016, p. 13.

25 See Ms Alison Larkins, PM&C, *Proof Committee Hansard*, 27 April 2016, p. 13.

26 *Proof Committee Hansard*, 27 April 2016, pp 14-15.

27 See Mr Luke Yeaman, PM&C, and Mr Roger Brake, Acting Deputy Secretary, Revenue Group, Department of the Treasury (Treasury), *Proof Committee Hansard*, 27 April 2016, p. 16.

28 See Mr Luke Yeaman, PM&C, *Proof Committee Hansard*, 27 April 2016, p. 13.

29 Answer to question on notice number 1 from 27 April 2016 hearing, received from Treasury on 29 April 2016.

30 *Proof Committee Hansard*, 27 April 2016, p. 15.

we provided [to the Treasurer] would have gone to fairly general propositions rather than specific, concrete models...I think the raising of the issue of a state income tax levy would have been done in fairly broad terms.³¹

1.32 The second round of briefings occurred in February. Mr Yeaman provided the following information on further briefings to the Prime Minister on the state income tax levy proposal:

There was a further briefing provided on 26 February to the Prime Minister and a briefing was provided in a minimal way ahead of the COAG meeting itself as part of the COAG briefing papers [a week or so before the meeting].³²

1.33 Mr Brennan stated that his recollection was that the Treasurer would have been briefed again 'in early February' and that briefing would again only 'have gone to the broad range of options' around taxation.³³

1.34 A final briefing was provided before the Prime Minister's announcement on 30 March 2016.³⁴

Analysis and modelling

1.35 Officers confirmed that no modelling of the state income tax levy proposal was undertaken.

1.36 In terms of the extent of the work underpinning the briefings provided to the Prime Minister and Treasurer, Mr Yeaman stated:

We provided analysis and data information around the proposal. Modelling is one of those terms that is difficult to define. There was not a large-scale modelling exercise attached to it, but we provided a series of analysis and data.³⁵

1.37 Mr Yeaman advised that PM&C carried out the analysis and Treasury provided the dataset and general advice.³⁶

1.38 The committee pressed officers from Treasury on whether modelling had been done on the state income tax level proposal and how that would look at different rates. Mr Brennan stated:

I would not describe it as modelling, no.

...

We have done quantitative analysis, yes.³⁷

31 *Proof Committee Hansard*, 27 April 2016, pp 16-17.

32 *Proof Committee Hansard*, 27 April 2016, p. 16.

33 *Proof Committee Hansard*, 27 April 2016, p. 17.

34 See Mr Luke Yeaman, PM&C, *Proof Committee Hansard*, 27 April 2016, p. 16.

35 *Proof Committee Hansard*, 27 April 2016, p. 16.

36 *Proof Committee Hansard*, 27 April 2016, p. 16.

1.39 Mr Jonathan Rollings, Division Head, Commonwealth-State Relations Division, Treasury, informed the committee that the quantitative analysis was limited:

Because the proposal was at its early stage and broad concept, the extent of the quantitative we were doing was around the dimensions and impact of the Commonwealth reducing its tax rates to make room for a state levy and broad observations on the quantum of state payments that are currently made.³⁸

1.40 There was no analysis about how the state income tax levy proposal would interact with the principle of horizontal fiscal equalisation (HFE). Mr Rollings stated:

Broad commentary on the fact that HFE impacts would have to be a consideration that would be part of further work if this were to be progressed.³⁹

The Commonwealth's negotiating position

1.41 The Commonwealth's negotiating position for the April 2016 COAG meeting, including the proposition of a state income tax levy, went to Cabinet on 22 March 2016.⁴⁰

1.42 Both the announcement and the Statement on Federation on 30 April 2016 indicated that, from the point of view of the taxpayer, the overall level of income tax would not increase, because the 'income tax surrendered by the Commonwealth to the States would be offset by a reduction in Commonwealth grants to the states'.⁴¹

1.43 However, on 30 March 2016, the Prime Minister was subsequently questioned about the possibility that states and territories may raise taxes to increase their revenue. The Prime Minister responded:

[T]he way I believe this would work, just to expand a little bit on your question, the way it would work is that we would envisage it working, is we would withdraw from a certain amount of income tax that would be available to the states and we would agree that that would be the maximum they would levy for a period. But in future, of course, on the longer term, a state should be free to lower that amount or indeed raise it and then they are accountable to their own voters.⁴²

37 *Proof Committee Hansard*, 27 April 2016, p. 19.

38 *Proof Committee Hansard*, 27 April 2016, p. 19.

39 *Proof Committee Hansard*, 27 April 2016, p. 19.

40 See Mr Luke Yeaman, PM&C, *Proof Committee Hansard*, 27 April 2016, p. 17.

41 Prime Minister, the Hon Malcolm Turnbull MP, Statement on Federation, 30 March 2016. See also Prime Minister, the Hon Malcolm Turnbull MP, Doorstop Interview, Penrith, 30 March 2016, where the Prime Minister stated: 'there would be no increase in income tax from a taxpayers' point of view, he or she would pay the same amount of income tax...from the Federal Budget's point of view, the outcome would be, would net off, so that we would not be, we would be making fewer grants to the states but we would be receiving less income tax ourselves, the states would be receiving the income tax to cover those responsibilities'.

42 Prime Minister, the Hon Malcolm Turnbull MP, Doorstop Interview, Penrith, 30 March 2016.

1.44 The committee asked officers from PM&C if, at the time of the Prime Minister's announcement on 30 March 2016, the Commonwealth was contemplating a proposition for discussion at COAG that any arrangements would permit a state to lift taxes beyond an agreed amount. Mr Yeaman answered:

As I understand the comments, the proposal was that in the short term there would be no additional increase in taxation. So the Commonwealth would vacate a certain share, a space, and the states would be allowed to fill that. That would be a period of transition and then at some point in the future it was possible, subject to further discussions and negotiations with the states, that they may have the capacity to then vary income tax rates as they can with land tax, payroll tax, stamp duty et cetera.⁴³

1.45 The committee pressed officers from PM&C as to whether there was an agreed position, as a result of a cabinet decision or other Prime Ministerial decision which contemplated different rates of income tax across the Federation and the possibility that a state or territory could raise taxes beyond the agreed amount. Mr Yeaman set out his understanding of the government's position:

As I understand the government decision, it was an agreement to approach the states with a proposal to offer them the capacity to levy their own income tax under the parameters discussed. The details of that was a matter for discussion and subject to the states' interest. So I think those broader parameters were things that still needed to be settled, but the broad concept and the idea was what was going to be raised with the premiers at COAG.⁴⁴

1.46 In terms of the length of transition period being contemplated before states could raise their tax rate beyond the amount the Commonwealth had reduced its rate, Mr Yeaman indicated that these were matters to be settled in discussion with the states.⁴⁵

1.47 Mr Yeaman stated that the contemplation of a ceiling rate to which states could raise their income tax rates was also a matter to be settled in discussion.⁴⁶

1.48 When asked when officers from Treasury became aware that the Commonwealth's position included a proposal that, after a transition period, the states would be able to raise income tax levels beyond the level reduced by the Commonwealth, Mr Brennan responded:

As unsatisfactory as this may be, the way I would characterise it is that we were aware of the proposition that was being put, as per the press release of 30 March. We were also aware that the Prime Minister and the Treasurer's view was likely to be that they wanted to initiate a discussion and there was a degree of openness about where that discussion might go.⁴⁷

43 *Proof Committee Hansard*, 27 April 2016, p. 24.

44 *Proof Committee Hansard*, 27 April 2016, p. 24.

45 *Proof Committee Hansard*, 27 April 2016, p. 25.

46 *Proof Committee Hansard*, 27 April 2016, p. 25.

47 *Proof Committee Hansard*, 27 April 2016, p. 26.

1.49 The committee noted statements by the Treasurer on 30 March 2016, following the Prime Minister's announcement to the effect that the Commonwealth had 'no appetite' for states to be able to increase taxes. Mr Brennan indicated that the officers from Treasury had nothing to add to the Treasurer's statement in terms of explaining its apparent inconsistency with the Prime Minister's statement.⁴⁸

Consultation with states and territories

1.50 In terms of the consultation with states and territories on the state income tax levy proposal, Ms Alison Larkins, Acting Deputy Secretary, Social Policy, PM&C stated that PM&C led these consultations.⁴⁹ Mr Yeaman indicated that subsequent to the Cabinet meeting on 22 March 2016, PM&C were not tasked with consulting with the states and territories.⁵⁰ However, Mr Yeaman stated that the Secretary of PM&C, Dr Martin Parkinson PSM, 'may have had some informal discussions with his counterparts in the lead-up to the COAG meeting' on 1 April 2016.⁵¹ Mr Yeaman's understanding is that those discussions took place over the weekend prior to the COAG meeting and were only 'broad discussions covering the whole agenda'.⁵²

1.51 Mr Brennan indicated that there was no formal consultation between Treasury officials and their state counterparts:

Senator WONG: ... Did Treasury officials consult with any state or territory officials ahead of the COAG in relation to the proposition of a state income tax levy?

Mr Brennan: We did not have a formal structured consultation process, no.

Senator WONG: And heads of treasury did not meet?

Mr Brennan: No, as I said the most recent heads of treasury meeting was in March.

1.52 Mr Brennan indicated that he 'would have had some informal conversations with some of [his] counterparts in the days leading up to COAG' about the state income tax levy proposal.⁵³ Mr Brennan clarified that these included 'private conversations', and that the income tax levy proposal would have 'popped up' as part of a 'broader conversation'.⁵⁴

1.53 Mr Brennan confirmed that 'we did not provide any documentation to our [state and territory] counterparts'.⁵⁵

48 *Proof Committee Hansard*, 27 April 2016, p. 30.

49 *Proof Committee Hansard*, 27 April 2016, p. 17.

50 *Proof Committee Hansard*, 27 April 2016, pp 21-22.

51 *Proof Committee Hansard*, 27 August 2016, p. 22.

52 *Proof Committee Hansard*, 27 August 2016, p. 22 – 23.

53 *Proof Committee Hansard*, 27 April 2016, p. 18.

54 *Proof Committee Hansard*, 27 April 2016, p. 18.

55 *Proof Committee Hansard*, 27 April 2016, p. 23.

Preparation of agenda papers

1.54 Ms Larkins outlined the preparation of the agenda papers for the April COAG meeting:

We were working on papers straight after the December COAG. We worked through January on various papers that were being prepared.⁵⁶

1.55 Ms Larkins agreed that this work is done in partnership with the states. For example, in relation to the health and hospitals issue under consideration:

Primarily PM&C do that engagement with the premiers' departments. At various points we might bring in the Department of Health and the premiers might bring in their health departments.⁵⁷

1.56 The product of this work is, ultimately, the agenda papers and supporting papers to the agenda.⁵⁸

1.57 Ms Larkins informed the committee that no agenda paper was prepared for COAG which included the state income tax levy proposal.⁵⁹ Mr Yeaman confirmed that the formal papers for COAG did not incorporate the state income tax proposal:

There were papers prepared in the context of the discussion around state tax reform more generally for the COAG meeting and around other economic matters, but it did not encompass the state tax-sharing proposal.⁶⁰

1.58 Mr Yeaman attempted to clarify the Prime Minister's intentions as to the course of action in relation to the state income tax levy proposal:

I think that, drawing on the Prime Minister's comments, he indicated that he wanted to have a discussion with the state premiers on this issue, on the concept of this idea, and that, if they were agreeable, a series of further work would occur after that point on the details of the proposal.⁶¹

Preparation of the Statement of Federation and the announcement on 30 March 2016

1.59 Both Ms Larkins and Mr Brennan indicated that they became aware of the 'Statement on Federation' '[w]hen it was released'.⁶² Their respective departments were only aware that the state income tax levy proposal was going to be a 'topic of conversation' at the 1 April 2016 COAG meeting.⁶³ Ms Larkins stated that PM&C

56 *Proof Committee Hansard*, 27 April 2016, p. 12.

57 *Proof Committee Hansard*, 27 April 2016, p. 12.

58 See Ms Alison Larkins, PM&C, *Proof Committee Hansard*, 27 April 2016, p. 13.

59 *Proof Committee Hansard*, 27 April 2016, p. 15.

60 *Proof Committee Hansard*, 27 April 2016, p. 15.

61 *Proof Committee Hansard*, 27 April 2016, p. 15.

62 *Proof Committee Hansard*, 27 April 2016, p. 23.

63 *Proof Committee Hansard*, 27 April 2016, p. 17.

were not aware that the Prime Minister was going to make a public announcement about the state income tax levy proposal prior to the announcement being made.⁶⁴

1.60 In relation to the 'Statement of Federation' released on 30 March 2016, Mr Yeaman advised that PM&C had not been involved in the preparation of the 'Statement on Federation'.⁶⁵ When questioned as to who prepared the 'Statement on Federation', Mr Yeaman stated:

I presume it was in the Prime Minister's office.⁶⁶

No support for state income tax levy proposal

1.61 The state income tax proposal was not agreed to by the Premiers and Chief Ministers.⁶⁷

1.62 Mr Paul Drum, Head of Policy, CPA Australia, noted his concerns about the approach to tax reform:

CPA Australia and I think the community at large would say there has been a bit of a squib on tax reform, and it is at every level. We really need to wait to see the outcome in the federal budget next week, but we were promised a white paper and we were promised packages, and now it seems as though, in a decreasing spiral, we have gone from a root and branch review to items being slowly taken off the table one by one and the states walking away, in absolute terms, from looking at embracing greater taxes on consumption.⁶⁸

1.63 Mr Drum suggested that the Prime Minister's announcement of state-levied income taxes was a 'curve ball':

That skewed the whole debate before the meeting happened two days later. Again, from the outside, it did not do much to imbue community confidence in where our governments—our leaders—are taking that particular discussion.⁶⁹

1.64 Mr Drum noted the lack of consultation which had occurred on the state-levied income tax proposal:

We were not engaged in any discussion on the reintroduction of income taxes at the state level, so that is not something that we have been privy to any discussion on. That is why I think, to us, this was like curve ball—something out of the blue—because it was not something that had been part

64 *Proof Committee Hansard*, 27 April 2016, p. 17.

65 *Proof Committee Hansard*, 27 April 2016, p. 23.

66 *Proof Committee Hansard*, 27 April 2016, p. 23.

67 COAG Communiqué, 1 April 2016, p. 1. See also, Dan Conifer, 'Tasmania, South Australia reject Turnbull's plan for state-set income taxes', ABC News, 31 March 2016.

68 *Proof Committee Hansard*, 27 April 2016, p. 1.

69 *Proof Committee Hansard*, 27 April 2016, p. 2.

of the narrative. It had not been something that had been promulgated around to capture people's ideas.⁷⁰

1.65 Mr Drum also addressed the concern that the Prime Minister had raised over tax imbalances:

A lot of people lose sleep over horizontal and vertical imbalance, but we lose less sleep over that. As long as the revenue comes in and pays for the services that Australians expect and need, then that is a pretty fair outcome.⁷¹

Health funding

2014 Budget

1.66 In 2014 the then Abbott Government announced significant changes to the funding of health and education.

1.67 The 2014 Budget made the following funding cuts:

In this Budget the Government is adopting sensible indexation arrangements for schools from 2018, and hospitals from 2017-18, and removing funding guarantees for public hospitals. These measures will achieve cumulative savings of over \$80 billion by 2024-2025. [\$50 billion from public health]

The Government will also reduce or terminate some Commonwealth payments that are ineffective or duplicate state responsibilities.

These include National Partnership Agreements on Preventative Health, Improving Public Hospital Services and Certain Concessions for Pensioners and Seniors Card Holders.

The States will be expected to continue contributing to these arrangements at their expense.⁷²

Health cuts

1.68 Budget Paper No. 2 (2014-15) outlined that initial hospital savings during the next four years would be achieved by removing previous funding guarantees as of July 2014 and changing hospital indexation from 1 July 2017.⁷³

1.69 The government's plan in the 2014 Budget was met with apprehension by organisations such as the Australian Medical Association (AMA). Professor Brian Owler, President of the AMA, told the committee:

70 *Proof Committee Hansard*, 27 April 2016, p. 2.

71 *Proof Committee Hansard*, 27 April 2016, p. 2.

72 2014-15 Budget Overview, p. 7, 13 May 2014 available at: http://www.budget.gov.au/2014-15/content/overview/download/Budget_Overview.pdf.

73 2014-15 Budget Paper No. 2, p. 126, available at http://www.budget.gov.au/2014-15/content/bp2/html/bp2_expense-14.htm

So the AMA has been very concerned about the funding formula that was put forward in the 2014 budget—basically, CPI and population as the formula for funding public hospitals.⁷⁴

1.70 Professor Owler expanded on why the AMA was concerned about the 2014 Budget:

What I can state unequivocally is that the arrangements that were put forward for funding from 2017 in the original proposal were going to be grossly inadequate.⁷⁵

Decisions made at 1 April 2016 COAG

1.71 On 30 March 2016, the Prime Minister referred to the upcoming COAG meeting and the consideration which would be given to hospital funding:

[W]e will be seeking to reach agreement on new funding arrangements for hospitals which will be designed to ensure that we have the right level of federal support and the right level of improvement in the effectiveness of the delivery of health care and we're having very good discussions with the premiers and the chief ministers and their senior officials in the lead-up to that.⁷⁶

1.72 Chief Minister Andrew Barr informed the committee that the ACT Government sought to remedy the 2014-15 Federal Budget, where indexation was reduced and funding guarantee payments were abolished, at COAG. The proposals meant the Commonwealth's contribution to the ACT's health sector would be diminished by:

...approximately \$600 million over 10 years- the equivalent of 58,000 elective surgery procedures. By 2026, that funding could have delivered a further 1,200 nurses, or 80 intensive care unit beds, or 340 general inpatient beds in the Territory. Clearly, the Federal Budget cuts meant a severe reduction in health services for Canberrans over the coming decade.⁷⁷

1.73 Dr Kathryn Antioch, Adjunct Senior Lecturer, School of Public Health and Preventative Medicine, Monash University summarised the 1 April 2016 COAG meeting:

COAG considered hospital funding and health reform and reaffirmed that providing universal health care for all Australians is a shared priority at the 1 April 2016 meeting. COAG agreed a Heads of Agreement for public hospitals funding from 1 July 2017 to 30 June 2020 prior to considering longer-term arrangements. The Commonwealth will provide \$2.9 billion in

74 *Proof Committee Hansard*, 27 April 2016, p. 7.

75 *Proof Committee Hansard*, 27 April 2016, p. 7.

76 Prime Minister, the Hon Malcolm Turnbull MP, Doorstop Interview, Penrith, 30 March 2016, available at: www.pm.gov.au/media/2016-03-30/doorstop-penrith.

77 *Submission 2*, p. 1.

additional funding for public hospital services. Growth in Commonwealth funding is capped at 6.5% per annum.⁷⁸

1.74 Chief Minister Barr's submission outlined that securing \$50 million for ACT health funding at the April COAG, while positive:

...only partially ameliorates the cuts by the Federal Government in the 2014 Budget.⁷⁹

1.75 The Australian Healthcare and Hospitals Association (AHHA) supported the additional \$2.9 billion pledged annually between 2017-20 by the Commonwealth at COAG, but emphasised that this is only:

...a partial turnaround from the \$57 billion cuts to health funding imposed in the 2014 budget.⁸⁰

Outcomes of COAG

1.76 Mr Brennan, Treasury, noted that the 'centrepiece' of the COAG deal on hospitals is the continuation of the key parameters which existed under the National Health Reform Agreement (NHRA). Mr Brennan explained that the activity based funding (ABF) and the National Efficient Price (NEP) will 'really drive what the ultimate health spend will be'.⁸¹

1.77 Ms Larkins, PM&C, advised that officers of PM&C were unable to provide the committee with an estimate of the funds that each state and territory would get under the formula in the Heads of Agreement.⁸²

1.78 Mr Brennan informed the committee that the amount each state and territory receives will:

...depend on the activity levels of the individual states going forward as to what share of the \$2.9 billion they each receive. So that is why a state may or may not end up getting its population share, depending on the activity levels[.]⁸³

1.79 Mr Brennan also referred to the 6.5 per cent cap:

[T]here is a 6½ per cent indexation cap put in place in relation to this funding deal, because it is not a block funding deal it is not as simple as saying there is 6½ per cent indexation and we will just divide that up among the states.⁸⁴

1.80 Ms Larkins advised:

78 *Submission 7*, p. 1.

79 *Submission 2*, p. 2.

80 *Submission 1*, p. 2.

81 *Proof Committee Hansard*, 27 April 2016, p. 28.

82 *Proof Committee Hansard*, 27 April 2016, p. 28.

83 *Proof Committee Hansard*, 27 April 2016, p. 28.

84 *Proof Committee Hansard*, 27 April 2016, p. 28.

We are still to work through the details of how the cap will work, but it is a cap on growth of Commonwealth expenditure...⁸⁵

Is the funding sufficient?

1.81 The AMA commented that although states and territories have accepted the additional funding offered at COAG:

...in most cases they have also made very clear that the funding is not enough, arguing for the full amount of education and health reductions in the 2014-15 Budget to be restored. The specific effects of the new agreement for smaller States and Territories in particular is uncertain.

The AMA believes the COAG agreement is an inadequate short-term public hospital funding down-payment to appease desperate States and Territories ahead of the Federal election. It is an inadequate agreement that will not be sufficient to meet current and future demand for services which will put lives at risk.⁸⁶

1.82 Chief Minister Barr also emphasised his concerns over longer term funding:

The issue of long-term certainty for health and hospital funding is critical for the jurisdictions, given our service delivery responsibilities. It was therefore disappointing that the health funding offer made by the Prime Minister at the April COAG meeting is a short-term, interim arrangement only.⁸⁷

1.83 Professor Owler commented that the AMA was pleased by COAG's acknowledgement that there should be a better method of funding based on ABF and NEF.⁸⁸ However, the AMA has:

...concerns about the complexity of how the national efficient price is reached. Clearly this method of back casting, where the figures are sort of revised—usually downwards—does create a level of opaqueness to how the national efficient price is calculated. It is clearly a tool that will be used to drive down costs, and there is a danger that if the national efficient price is potentially set too low that we could actually see a budget cut in disguise, if you like, in terms of reducing funding to hospitals, particularly hospitals that might be struggling.⁸⁹

1.84 Professor Owler outlined the AMA's concerns about the adequacy of current and future funding for public hospitals:

Our analysis of the public hospital systems...shows that the system is under enormous pressure and is dealing with an incredible amount of patient

85 *Proof Committee Hansard*, 27 April 2016, p. 28.

86 *Submission 5*, p. 2.

87 *Submission 2*, pp 1-2.

88 *Proof Committee Hansard*, 27 April 2016, p. 7.

89 *Proof Committee Hansard*, 27 April 2016, p. 9.

demand for not only emergency department services but also elective surgery. I think we are a long way from being able to meet that demand.⁹⁰

1.85 Professor Owler further commented on the implications for hospitals without adequate funding:

What often happens is positions go unfilled; they save money by not employing people or replacing people when they retire; and they close outpatient clinics. So often the services offered are reduced.

Other hospitals we have seen extend their closure period, so they shutdown elective surgery for longer periods...The only reason for doing that is to try to save money, or the budget, of the hospital. That is the sort of thing that hospitals do.⁹¹

Education funding

School funding

Arrangements under the previous Government

1.86 In 2010 the federal government initiated a 'collaborative, thorough, and open' review of school funding.⁹² The then Minister for Education, the Hon Julia Gillard MP, explained the need for a review, noting in particular the criticism of the funding arrangements which had been in place for the previous 12 years.⁹³

The SES [socioeconomic status] system uses a particular statistical method to determine funding entitlements for non-government schools that reflects a number of aspects of the communities from which students come.

It provides funding to non-government schools as a percentage of the average cost of educating a child in a government school.

Many critics have attacked this policy decision and criticised the distributional effects.

The most persistent and deeply felt criticism of the system has arisen not because of the way the SES formula distributes funds between non-government schools but because of its perceived injustice to government schools.

In particular, public education advocates believe that because the system uses the average costs of public education as its base, every win for public education flows to non-government schools and public education can never make up ground.⁹⁴

90 *Proof Committee Hansard*, 27 April 2016, p. 7.

91 *Proof Committee Hansard*, 27 April 2016, p. 8.

92 The Hon Julia Gillard MP, Minister for Education, Address to the Sydney Institute, 'A future fair for all – School funding in Australia', 15 April 2010.

93 The Hon Julia Gillard MP, Minister for Education, Address to the Sydney Institute, 'A future fair for all – School funding in Australia', 15 April 2010.

94 The Hon Julia Gillard MP, Minister for Education, Address to the Sydney Institute, 'A future fair for all – School funding in Australia', 15 April 2010.

1.87 The composition of the expert panel to conduct the review was announced on 1 May 2010 and was to be led by Mr David Gonski AC as Chairman. The final terms of reference were released on 9 July 2010. The expert panel's final report was presented to Government in November 2011 and released in February 2012.

1.88 On 3 September 2012 the Gillard Government announced *Better Schools: A National Plan for School Improvement* (NPSI) – a new national school funding model and increased funding in response to the findings of the Gonski Review. The aim of the improvements were to:

Ensure that by 2025 Australia is ranked as a top 5 country in the world for the performance of our students in Reading, Science, Mathematics, and for providing our children with a high-quality and high-equity education system.⁹⁵

1.89 Primary among the proposed changes to existing arrangements was a new school funding model based on the needs of individual students enrolled through a new benchmark for every student. This benchmark would be based on the costs of high achieving schools. A further feature of the new funding system was an additional loading for schools with students who face disadvantage.⁹⁶ Other features included:

- All government schools would continue to be fully publicly funded.
- Special schools (like schools for students with disability) would also receive full public funding.
- Like the current system, the government funding provided to non-government schools would be adjusted based on parents' capacity to contribute.
- Current annual indexation would be replaced by a new measure that reflects the real cost increases across all schools.
- Every school would see its funding rise every year.⁹⁷

1.90 The announcement further noted that funding details would be worked through in discussion with states and territories and that any extra Commonwealth funding would be contingent upon the states signing up to the new arrangements.⁹⁸

95 The Hon Julia Gillard MP, Prime Minister, and The Hon Peter Garrett MP, Minister for School Education, Media Release, 'Better Schools: A national plan for school improvement', 3 September 2012.

96 The Hon Julia Gillard MP, Prime Minister, and The Hon Peter Garrett MP, Minister for School Education, Media Release, 'Better Schools: A national plan for school improvement', 3 September 2012.

97 The Hon Julia Gillard MP, Prime Minister and The Hon Peter Garrett MP, Minister for School Education, Media Release, 'Better Schools: A national plan for school improvement', 3 September 2012.

98 The Hon Julia Gillard MP, Prime Minister and The Hon Peter Garrett MP, Minister for School Education, Media Release, 'Better Schools: A national plan for school improvement', 3 September 2012.

Implementation of the new funding model

1.91 The National Education Reform Agreement (NERA) incorporated funding under the NPSI to apply from 2014-2019:

The NPSI was designed to create a national approach to school funding by adopting a needs-based Schooling Resource Standard...that would apply to all students, irrespective of whether they attend government or non-government schools. The Australian Education Bill 2013 underpinned the provision of Australian Government funding to states and territories, as well as non-government schools. Gaining Royal Assent on 27 June 2013, the *Australian Education Act 2013* provided for states and territories to receive recurrent funding provided that they were party to the National Education Reform Agreement (NERA) and had signed a bilateral agreement with the Australian Government.⁹⁹

1.92 The Gillard Government's 2013-14 Budget included a \$9.8 billion commitment to increase school funding over six years, in addition to better indexation and reforms to lift student achievement.¹⁰⁰ This funding increase included:

The Gillard Government is offering to pay around 65 per cent of the additional investment needed to fund all schools properly and reach our goals – essentially a 2 for 1 offer for all states and territories.

The Gillard Government has also committed to annual growth in school education spending of 4.7 per cent indexation – provided states commit to grow their own school budgets by 3 per cent.

The Government is negotiating with state and territory governments on the Plan, to ensure all schools around Australia can look forward to funding security and increased investment.¹⁰¹

1.93 When fully implemented the NPSI would:

...provide an additional \$14.5 billion over six years in government funding for schools, of which the Australian Government would provide 65.0% (\$9.8 billion) and state and territory governments the remainder.¹⁰²

99 Senate Select Committee on School Funding, *Equity and excellence in Australian Schools*, July 2014, p. 57.

100 The Hon Julia Gillard MP, Prime Minister, The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer, and The Hon Peter Garrett MP, Minister for School Education, Media Release, 'Budget 2013-14: A fairer funding plan for all Australian schools', 14 May 2013.

101 The Hon Julia Gillard MP, Prime Minister, The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer, and The Hon Peter Garrett MP, Minister for School Education, Media Release, 'Budget 2013-14: A fairer funding plan for all Australian schools', 14 May 2013.

102 Parliamentary Library, Research Paper No. 3, 2012-13, *Budget Review 2013-14*, School education: the National Plan for School Improvement, Marilyn Harrington, p. 111.

School funding policy under the Abbott Government

1.94 Leading into the 2013 federal election the Coalition policy document for schools *Students First* stated that '[t]here will be no cut to school funding under a Coalition government.'¹⁰³

1.95 Following the change of government in September 2013, there appeared to be a lack of clarity regarding the new Abbott Government's position on school funding policy with a number of inconsistent statements on the policy.¹⁰⁴ On 2 December 2013, the Government stated its commitment to maintain the previous government's school funding model over the next four years.¹⁰⁵

1.96 The Abbott Government subsequently committed to 'matching' the funding allocation for schools funding by the previous government until 2017, but would not match the previous government's funding for years five and six (2018 and 2019) of the NPSI. For jurisdictions not signed up to the NERA (Queensland, Western Australia and the Northern Territory), the Abbott Government announced the restoration of \$1.2 billion in school funding over four years. The Government also indicated that the loading for disadvantaged students would also be delivered over the next four years.¹⁰⁶

Education funding proposal to 1 April 2016 COAG

1.97 As part of the proposed tax reform proposal for the 1 April 2016 COAG meeting Prime Minister Turnbull suggested that the states and territories could directly fund public schools with the federal government divesting itself of this responsibility. Under this proposed reform the Commonwealth would still support non-government schools.¹⁰⁷

1.98 The committee sought details on briefings provided to the Prime Minister prior to his announcement of potential changes to the arrangements on school funding responsibilities for the Commonwealth and states and territories, and was advised by Mr Luke Yeaman from PM&C that there:

...was not an education-specific briefing; it was briefing on the whole range of national partnerships and specific-purpose payments that are currently in play between the Commonwealth and the states.

...

103 *The Coalition's Policy for Schools: Students First*, August 2013. p. 2.

104 Senate Select Committee on School Funding, *Equity and excellence in Australian Schools*, July 2014, p. 88.

105 Senate Select Committee on School Funding, *Equity and excellence in Australian Schools*, July 2014, p. 88.

106 Senate Select Committee on School Funding, *Equity and excellence in Australian Schools*, July 2014, p. 89.

107 See, Treasurer the Hon Scott Morrison MP interview with Leigh Sales, 7.30, 31 March 2016, and Anna Henderson, 'Public school funding: Labor declares Federal Government plan 'outlandish' and divisive', ABC News, 1 April 2016.

There are two streams here essentially. One is that, as you would be aware, there have been ongoing discussions in the context of the Federation white paper around education funding more broadly and education arrangements. Separate to that, there were the proposals around revenue-sharing options including income tax sharing. The material that was in our briefing regarding income tax sharing covered the full sweep of national partnerships and specific-purpose payments in terms of what the Commonwealth currently provides to the states and what that funding is for. It did not go to the detail of specific education arrangements.¹⁰⁸

1.99 The Reform of the Federation Discussion Paper referred to by Mr Yeaman raised a range of concerns about the withdrawal of the Commonwealth from public school funding:

This option could, however, lead to very different funding models being applied across the States and Territories and between the government and non-government sectors, leading to differences in the level of public funding for schools with similar population characteristics.

This is likely to give rise to concerns about fairness, as well as introduce perverse incentives for governments to shift costs within the system.¹⁰⁹

1.100 PM&C officials did not answer the question whether the Prime Minister was briefed about these concerns.¹¹⁰

1.101 PM&C also outlined its consultation processes and confirmed that it did not specifically consult with the Department of Education on this particular proposal in relation to a change in policy of education funding responsibilities. It was also confirmed that there were no discussions with state and territory departments about the proposal in the lead up to the COAG meeting.¹¹¹

1.102 Officials from the PM&C advised that no decision has been taken for the Commonwealth to withdraw from public school funding and that no work is currently being undertaken on that proposal. Mr Yeaman elaborated:

When the Prime Minister used education as an example in the media interview, we took that as him using that as an example of those kinds of choices that would need to be made across all of the areas. But, as Ms Larkins said, no decision had been taken for the government to proceed on that basis in the education space.¹¹²

108 *Proof Committee Hansard*, 27 April 2016, pp 31-32.

109 Draft Reform of the Federation Discussion Paper, p. 62, available at: https://federation.dpmc.gov.au/sites/default/files/publications/reform_of_the_federation_discussion_paper.pdf.

110 *Proof Committee Hansard*, 27 April 2016, pp 31-32.

111 Mr Luke Yeaman and Ms Alison Larkins, PM&C, *Proof Committee Hansard*, 27 April 2016, p. 32.

112 *Proof Committee Hansard*, 27 April 2016, p. 33.

1.103 Given the lack of detail in the COAG Communiqué on future school funding arrangements, the committee asked officials about planned processes for determining arrangements after 2017. Ms Alison Larkins from PM&C advised:

My understanding is that it is not scheduled to come back to the next COAG meeting. It is being taken forward by Minister Birmingham in negotiation with his state and territory colleagues and the non-government schools sector.¹¹³

Tax and Federation White Papers

1.104 Officials from PM&C stated that the Federation green and white paper processes had ceased:

There will not be a green or white paper, and the work on Federation will be taken forward in the context of the work that Treasury is doing arising out of the COAG meeting in April.¹¹⁴

1.105 Officials confirmed that the decision was made by the Prime Minister after COAG.¹¹⁵

1.106 In response to a Question on Notice, PM&C stated that the Federation White Paper process had cost \$4,449,687 to date.¹¹⁶

1.107 Officials from Treasury stated that there would not be a Taxation White Paper:

The white paper sets out the government's proposals. As the government said, these proposals will be set out in next week's budget.¹¹⁷

1.108 In response to a Question on Notice, Treasury states that a total of \$5.4 million has been spent on the Tax Reform Taskforce (formerly Tax White Paper Taskforce) from 2014 to March 2016.¹¹⁸

Committee view

Taxation

1.109 In the words of the Prime Minister on 30 March 2016, at a football academy in Penrith, two days before the COAG meeting on 1 April 2016, the state income tax levy proposal is 'a very big fundamental reform to federalism', and 'a once in a generation reform'.

113 *Proof Committee Hansard*, 27 April 2016, p. 33.

114 Ms Alison Larkins, PM&C, *Proof Committee Hansard*, 27 April 2016, p. 31.

115 Ms Alison Larkins, PM&C, *Proof Committee Hansard*, 27 April 2016, p. 31.

116 Answer to question on notice number 13 from 27 April 2016 hearing, received from PM&C on 29 April 2016 and revised on 4 May 2016.

117 Mr Roger Brake, Treasury, *Proof Committee Hansard*, 27 April 2016, p. 37.

118 Answer to question on notice from 27 April 2016 hearing, received from the Treasury on 29 April 2016.

1.110 The committee examined how this purportedly fundamental reform to federalism was handled by the government. It found that the processes undertaken to raise and consult on this issue with the states and territories and the scant work undertaken within the government did not match the government rhetoric about its importance.

1.111 The committee feels strongly that this inadequate process goes nowhere near matching the claim by the Prime Minister that this proposal is a fundamental reform to federalism. Almost \$10 million has been spent on the abandoned tax and federation white and green paper processes. Given this, it is staggering that there was no proper consultation, analysis, modelling or policy work done.

1.112 The committee attempted to discover when work began on this proposal with limited success. The first work that officials could point to was a briefing was prepared by PM&C, in consultation with Treasury, for the Prime Minister on 22 January 2016 and a brief was provided to the Treasurer by Treasury officials around the same time. Both briefs still contained a range of options but did include the state income tax levy proposal. It does not appear to the committee that either of these briefs resulted in the options being narrowed down to the state income tax levy proposal. Officials told the committee that work continued on a variety of tax options leading up to COAG.

1.113 The committee heard that no modelling of the proposal was done. Officials pointed to quantitative analysis being undertaken but again, because the proposal was at an early conceptual stage, the committee was told the extent of the analysis was limited to the impact of the Commonwealth reducing its tax rates to allow a state levy and broad observations on the quantum of state payments that are currently made.

1.114 The committee contrasts this approach with the reported processes, modelling and costings undertaken by the Commonwealth for the development of a range of GST tax options and Medicare levy changes taken to the December 2015 COAG meeting¹¹⁹ where heads of Treasury were closely involved.

1.115 The committee considers that even to begin considering this proposal there are essential framework issues that would need to form part of the consideration by jurisdictions even at a conceptual level, such as whether the principles of horizontal fiscal equalisation (HFE) would have been regarded as immutable. For example, if the principles of HFE were to be applied unaltered, it would result in different levels of GST allocation.

1.116 Given the significant implications of this proposal, the committee therefore attempted to discover at what point this particular proposal was agreed by the government to take forward. PM&C officials told the committee that further briefing was provided to the Prime Minister on 26 February 2016 and further briefing was provided 'in a minimal way' around one week ahead of the COAG meeting. This did not include modelling but only 'analysis and data information', drawing on

119 Francis Keany, 'Treasurer Scott Morrison says modelled changes to GST 'no secret', done at request of states', ABC News, 9 December 2015.

information from the Treasury and the Department of Finance. Treasury officials confirmed that briefing provided to the Treasurer in February 2016 also still contained a range of options.

1.117 The committee also attempted to discover when consultation began on this proposal with limited success. Despite broad discussions around revenue sharing arrangements, this specific issue was not discussed at the 15 December 2015 COAG meeting. It was not taken to and no modelling was done for the Council on Federal Financial relations (CFFR) meeting the previous day where aspects of that meeting are considered by COAG.

1.118 Officials confirmed to the committee that the state income tax levy was not presented at the 1 April 2016 CFFR meeting prior to COAG either. Oddly no formal meeting was held of the heads of Treasury in jurisdictions. Treasury admitted to some general and informal discussions with state and territory counterparts in the days leading up to COAG but could not confirm whether these discussions contained the proposal.

1.119 Papers for the 1 April 2016 COAG meeting still contained state tax reform generally but not the state income tax levy proposal. Officers tried to convince the committee that it was not unusual to raise an issue at COAG without papers. The committee finds it astounding that a reform of this magnitude would be put to COAG without papers being provided.

1.120 The committee notes that the negotiation position of the Commonwealth for the COAG meeting is taken to Cabinet and this occurred on 22 March 2016. The Prime Minister has confirmed that the proposal was taken to Cabinet for consideration.

1.121 Officials advised that following the Cabinet meeting PM&C officers, although aware that the Prime Minister was likely to raise this issue with premiers in the context of COAG, were not asked to provide formal advice to the jurisdictions or engage with them directly. However, PM&C officers thought that the Secretary of PM&C had some informal discussion with his counterparts leading up to the COAG meeting which may have included the proposal but were probably focussed on the hospital funding agreement. Specifically, these discussions occurred over the long weekend prior to COAG.

1.122 Officers from PM&C confirmed to the committee that they were not aware of the Prime Minister's Statement on Federation before it was released, indicating that it was prepared in the Prime Minister's office as a media statement.

1.123 The committee is astonished that this proposal, cast as 'a very big fundamental reform to federalism' appears to have been raised with the states over a long weekend and put out in a media statement prepared by a political adviser. No modelling or costings were done, there was no discussion at the officials level, no specific papers were prepared and the briefings for the Treasurer contained a range of options on tax reform right up to the Prime Minister's media announcement. The evidence suggests that the Prime Minister may have received a slightly more specific briefing on 26 February 2016 but this was not clear.

1.124 Flow on questions from this proposal appear to have been disregarded in the rush to make the announcement such as, following a transition period, the ability for the states to lift taxes beyond the agreed amount. This important issue also did not seem to have been canvassed at the jurisdictional or Commonwealth officials level. As no ceiling was contemplated, in theory, this could result in separate multiple tax rates across multiple jurisdictions.

1.125 Furthermore, it is clear there was no agreed position between the Prime Minister and the Treasurer on this issue of the states being able to lift the level of tax. The Prime Minister mentioned that states could increase the level of tax in the future.¹²⁰ However, Mr Morrison stated that the Commonwealth had no appetite for states to be able to increase taxes.¹²¹

Health and education funding

1.126 The committee believes that linking the state income tax proposal to the states meeting the costs for health and education into the future was yet another announcement given little detailed consideration.

1.127 The COAG outcomes on health, with an extra \$2.9 billion being put on the table, demonstrate that the government knows more funding is required in this important area after the cuts they inflicted. The draft heads of agreement which was leaked to the media¹²² contained a heading of tax reform which appears to make extra funding from the Commonwealth conditional on signing up to tax reform. The draft agreement also proposed that the Commonwealth government retain \$70 million each year from 2017-18 to 2019-20 from public hospital funding to pay for its own primary health care reforms. This did not end up in the final agreement.

1.128 The committee notes that key parameters that existed under the National Health Reform Agreement negotiated under the previous government are back in place such as activity based funding based on a National Efficient Price. However the funding guarantees are gone.

1.129 The Prime Minister also floated the idea of states assuming funding for state schools under the proposal.¹²³ When raised in a discussion and issues papers in the context of the Reform of Federation process, a number of concerns were pointed out including running the risk of different funding models being applied across the jurisdictions and between the government and non-government sectors, resulting in questions about fairness. Again officials were unable to detail to the committee any

120 The Hon Malcolm Turnbull MP, Transcript of interview with Fran Kelly, ABC RN Breakfast, 31 March 2016.

121 See 730 Report, Transcript of interview with the Hon Scot Morrison MO, Treasurer, 30 March 2016; Anna Henderson and Stephanie Anderson, 'Tax reforms: Turnbull confirms radical proposal to allow states, territories to levy income taxes', ABC News, 30 March 2016.

122 Jane Lee and Julia Medew, 'Hospital funding 'could help fund federal health reforms' – draft COAG agreement', *The Sydney Morning Herald*, 31 March 2016.

123 Ms Larkins, *Proof Committee Hansard*, 27 April 2016, p. 31.

work done or consultations carried out on this proposal for the 1 April 2016 COAG meeting.

1.130 The committee heard that the process in place now to formalise school funding agreements after 2017 is being carried forward by the Hon Simon Birmingham MP, Minister for Education, through the ministerial council and is not scheduled to come back to the next COAG meeting. However the ministerial council due to meet in March 2016 was cancelled and now due in June 2016.

1.131 The committee notes that the gap in health and education funding remains. The government remains committed to policies that deprive these areas of the much needed funds.

Senator Jenny McAllister

Chair

