INSURANCE COUNCIL OF AUSTRALIA

Submission to the 2014/15 Tasmanian Budget

October 2013

INTRODUCTION

The Insurance Council of Australia is pleased to be able to lodge this submission as part of the Tasmanian government's 2014/15 Budget consultations.

This ICA submission has been prepared against a backdrop of three significant policy and natural events that have occurred in Tasmania over recent periods. The first of these occurrences was the announcement by the Tasmanian government in the 2012/13 Budget of its plan to increase stamp duties on insurance from 8% of premium payable to 10% with the objective to increase revenue (an additional $9.4 million in 2012/13 and an additional $13.1 million in a full year of operation). Regrettably, the stamp duty announcement followed on from the decision of the State Tax Review Panel in November 2011 to abandon the State tax review process which offered stakeholders a path to fundamental tax reform in Tasmania. Lastly, the bushfires of January 2013 which occurred in the Tasmanian peninsular and resulted in total insurance claims of 1,800 at a total value of just under $90 million, reinforced the ongoing natural risks faced by Tasmanians and the role of private insurance in assisting recovery and rehabilitation of communities, businesses and households.

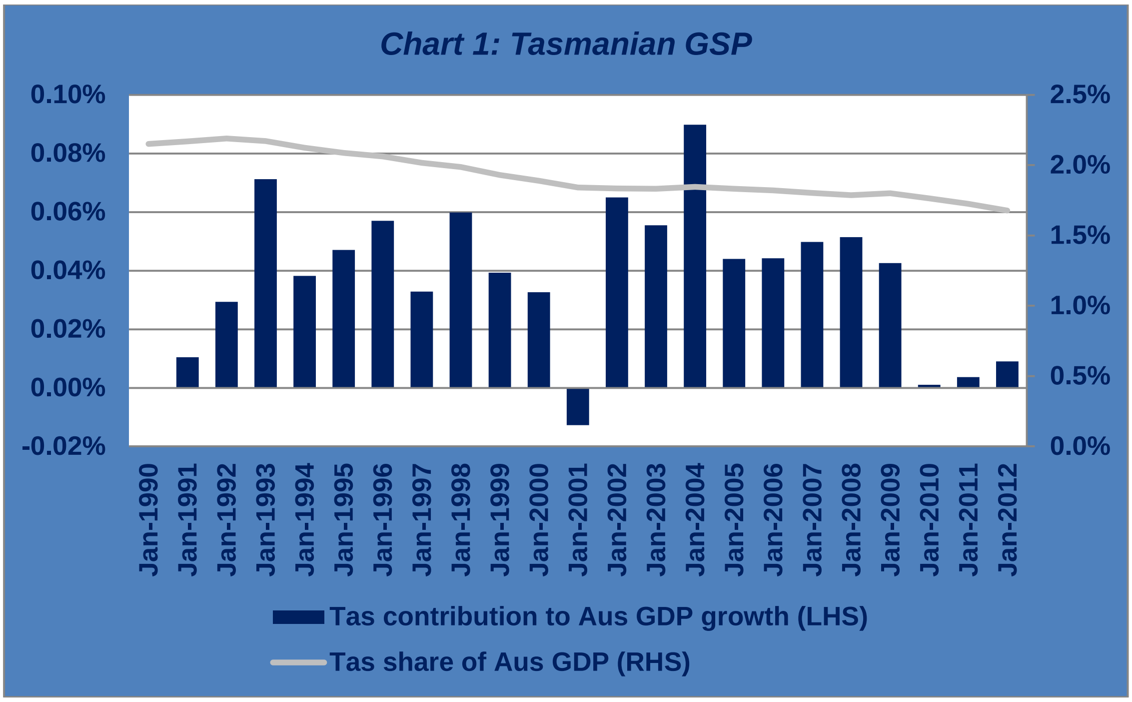
The Insurance Council of Australia submits that the above events and occurrences serve to highlight the inherent ambiguities that bedevil Tasmanian policymakers. One the one hand, Tasmania faces critical fiscal, economic and social challenges which are unique to the State. On the other hand, these same economic and social challenges require a supportive revenue framework that promotes growth and productivity enhancement. In short, Tasmania policy makers face a formidable task – arresting the State's economic and social challenges at the same time as re-engineering the revenue arrangements. The ICA contends that this twin challenge can only be met through support for fundamental tax reform.

It is for this reason that the Insurance Council laments the missed opportunity of the State Tax Review process and urges its reinvigoration. As the ICA argued in its submission to the Review (copy attached), there exists considerable scope within the bounds of the Tasmanian tax/budget framework to undertake reforms of a lasting nature that support both growth *and* provide revenue certainty. The ICA contends that as part of the 2014/15 Budget the Tasmanian State government resuscitate the Tax Review process or, in the absence of such a process, look to independently introduce taxation reform measures consistent with the directions set out in the Henry Tax Review and the Tasmanian State Tax Review. Furthermore, the ICA contends that, at the very least, the Tasmanian State government looks not avoid the error of the insurance tax announcement and further disturb the tax reform task through the introduction of revenue/budgetary measures that are fundamentally inconsistent with the goals of the Henry Tax Review.

TASMANIA'S ECONOMIC AND SOCIAL CHALLENGES

A Declining Share of Australia's national output & the impact on living standards

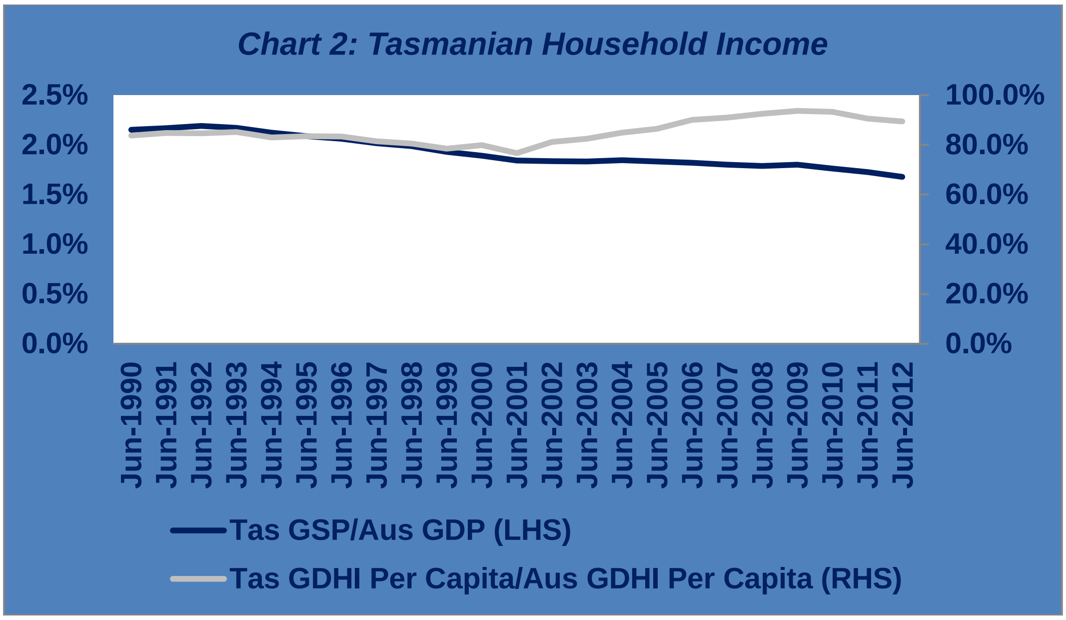
Over the last decade, the Tasmanian economy has increased in real terms by 20% compared with growth in the national economy of 31%. As Chart 1 demonstrates, the Tasmanian economy occupies a declining share of the nation's output .Over the last five years for example, the Tasmanian economy has contributed, on average, just 0.02 percentage points[1] to the nation's total economic growth.



Source: Australian Bureau of Statistics

Tasmania's marginal economic growth constrains living standards in the State. In effect, the absence of endogenous growth results in Tasmanian households having to maintain nationally comparable living standards through direct transfers from the Commonwealth. The extent of Commonwealth transfers to the State will be outlined further in this submission however, the chart below demonstrates the extent of the support. Prior to the introduction of the GST in 2000, Tasmanian living standard (as measured by Gross Disposable Household Income) closely tracked the State's economic performance. However, as Tasmania's economic performance deteriorated vis a vis the remainder of the nation (measured as Tasmania's share of Australian GDP), Tasmanian living standards followed suit. With the introduction of the GST in 2000, Tasmanian household living standards relative to the Australian population improved reflecting the support provided by these transfers to Tasmanian households.

Over the five years to 2012, Australian output grew by 2.7% on average. A 0.02 percentage point contribution to growth suggests that Tasmanian output contributed 0.8% to national output, despite the Tasmanian economy being 1.8% the size of the national economy. This suggests that over the 5 years to June 2012, the Tasmanian economy performance was significantly weaker than the national average



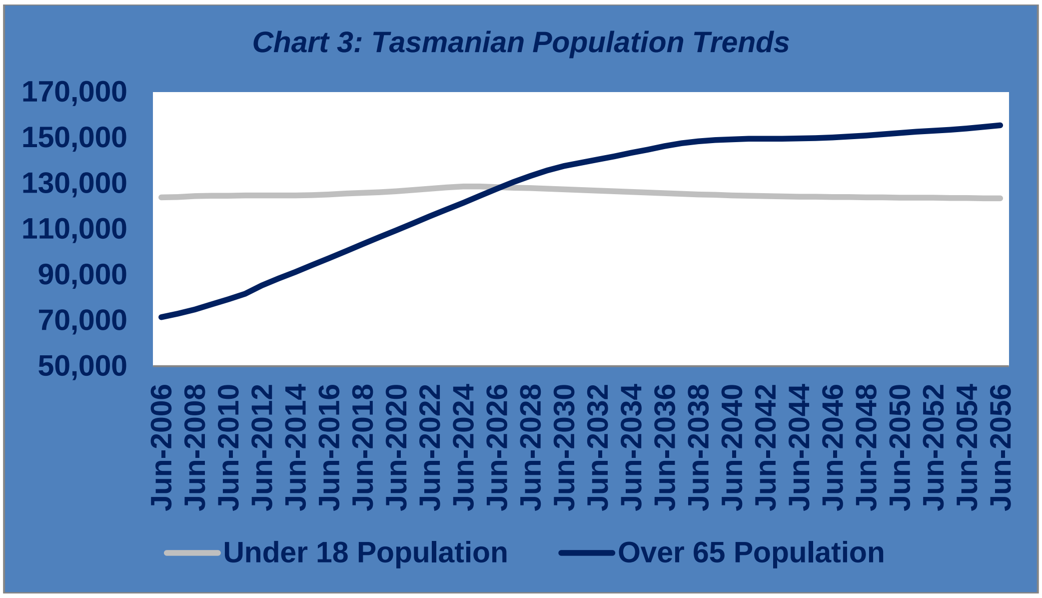
Source: Australian Bureau of Statistics

The reliance on Commonwealth transfers has several implications for Tasmania's policy arrangements. In the first instance, the support provided by Commonwealth transfers suggests that policy makers face a considerable challenge in lifting economic growth to the extent needed to substitute such Commonwealth transfers. Secondly, to the extent that Tasmania is highly reliant on Commonwealth transfers for its current living standards, this circumstance may be at risk in the event that such transfers are compromised or reviewed due to changes in Commonwealth priorities. Finally, and as the abandonment of the Tax Review process suggests, the expediency of Commonwealth transfers may be adversely impacting Tasmania's policy creativity and sovereignty through fostering dependence on Commonwealth transfers in contrast to the active promotion of a strong domestic reform agenda.

An Ageing Demographic

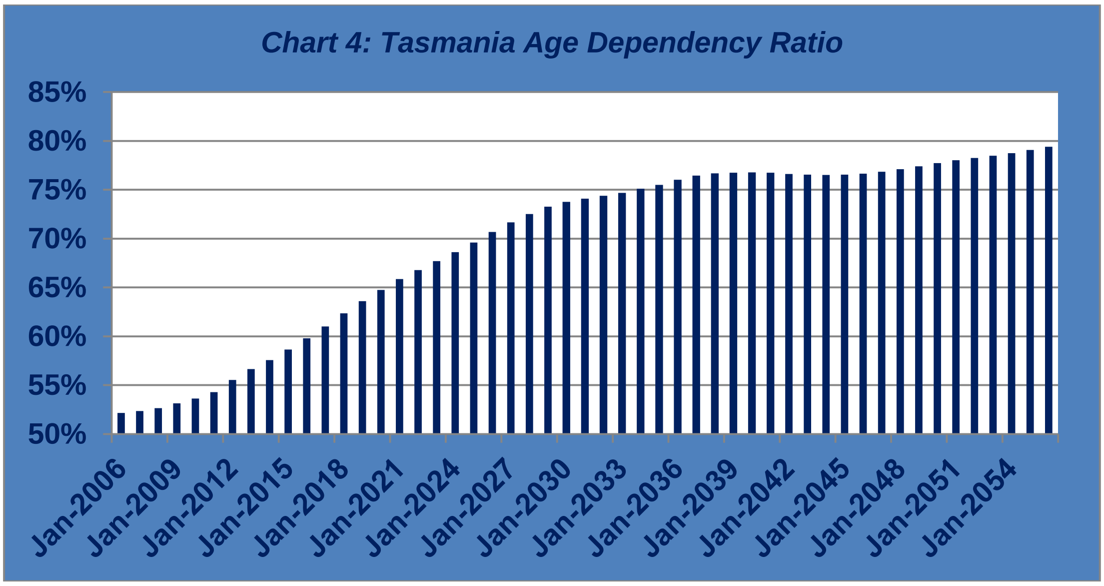
The 2011 Census recorded the population of Tasmania to be 495,354 with a median age of 40 years. Five years prior, the population of Tasmania was recorded to be 476,482 with a median age of 39. Tasmania recorded a growth in population between 2006 and 2011 of just 4% compared to growth in the nation's population of over 8%. The median age of the nation remained unchanged at 37 years over the period 2006 to 2011. The combination of lower population growth and an ageing population will have profound effects on Tasmania's future social settings and growth opportunities.

The charts below map out the extent of the challenge. Chart 3 plots the future profile of the younger population in Tasmania vis a vis the population aged over 65. The demographic cross over point represents the year under which the forecast population aged over 65 will be greater than the expected population of under 18's. In the case of Tasmania, this cross over point is expected to take place relatively soon in 2027, considerably earlier than forecast for the nation as a whole (2043). In the United States, this crossover point is forecast to be 2056.



Source: Australian Bureau of Statistics

The rapidly ageing Tasmanian society will also impact on labour force participation and productivity as can be evidenced from Chart 4. The age dependency ratio for Tasmania – measured as the dependent population (i.e. less than 14 and older than 65 years) as a proportion of the working age population (15 yrs to 64 years) is expected to deteriorate markedly in the future. At present, for every two dependent persons in Tasmania there are approximately four persons of working age. In less than a decade's time, for every two dependent persons in Tasmania, there will be only 3 persons of working age. And by the year 2024, for every three dependent persons in Tasmania, there will be only 4 persons of working age.



Source: Australian Bureau of Statistics

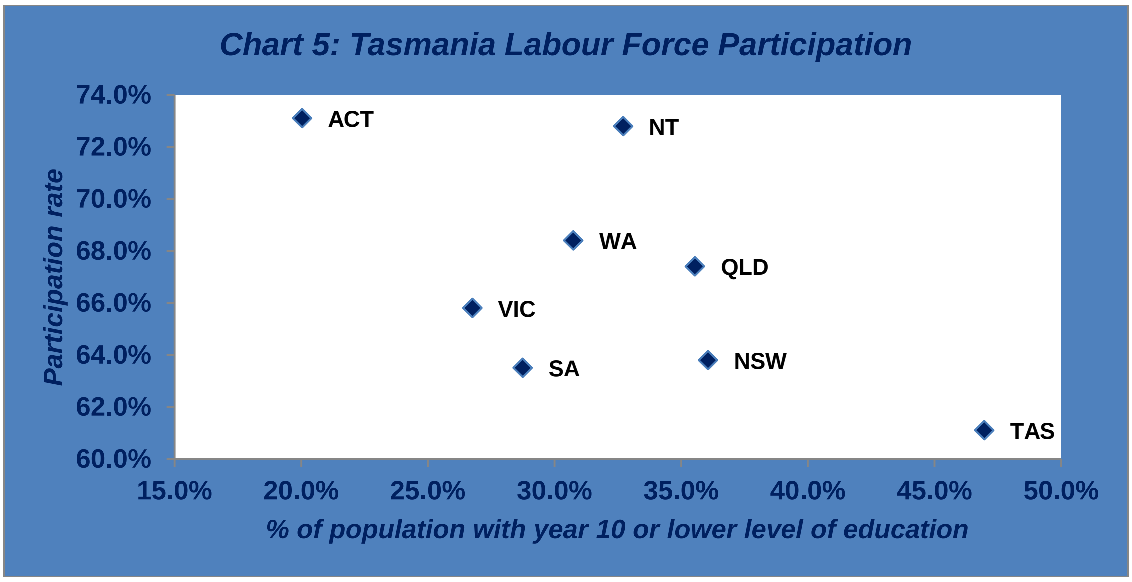
The ageing society is expected to have profound effects on the Tasmanian economy and society. In the first instance, Tasmania is expected to see increased outlays in social services and health in order to cater to an ageing population. Similarly, ageing populations will look to alter housing preferences in search of accommodation more suited to their needs. Declines in the working age population will facilitate changes to labour markets and policy makers will have to examine policy incentives that facilitate additional hours worked. In short, policy makers will be faced with demands to cater for an ageing population and a declining workforce just at the same time as the capacity to draw from existing revenue sources declines. Budget planning and making, both now and into the future, will need to take into account this fundamental shift in Tasmanian society.

Weak Labour Force Participation

In addition to meeting the medium term challenge of an ageing community, Tasmanian policy makers are faced with the more immediate task of improving the productivity and participation of the current local labour force. Only through measures that significantly improve the participation and productivity of the existing labour force will Tasmanian policy makers be in a position to enhance living standards for Tasmanians on a sustainable basis.

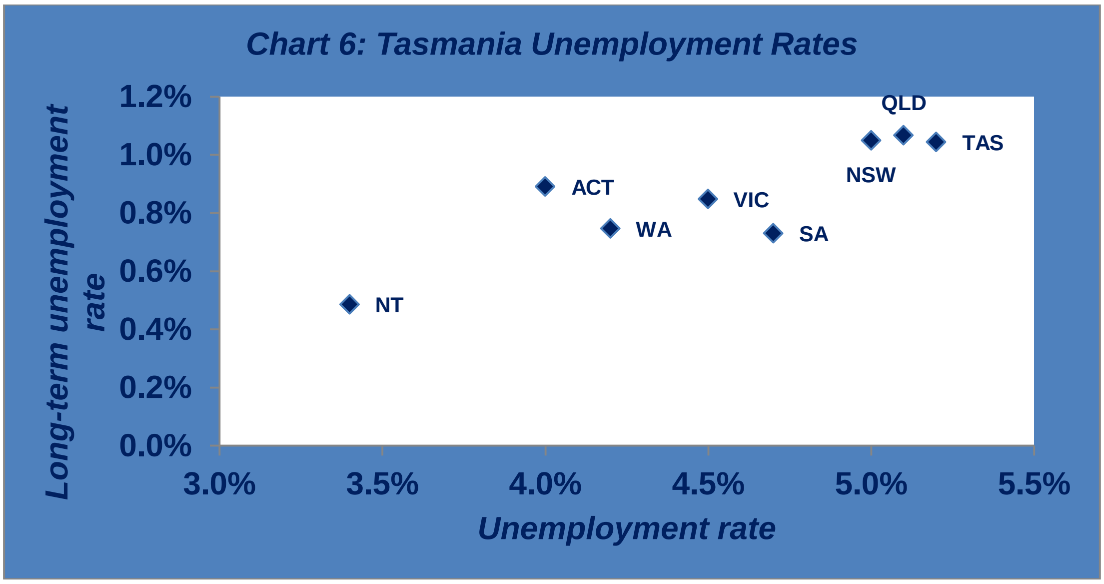
The charts below outline the extent of the challenge by comparing Tasmania to the mainland States in terms of educational attainment and workforce participation.

Chart 5 compares Tasmania to the mainland States by mapping educational attainment (measured as the percentage of the population with year 10 education or below) against labour force participation. As the chart indicates, Tasmania performs well below the rest of Australia across both indicators.



Source: Australian Bureau of Statistics

Meanwhile, Chart 6 compares Tasmania across the nation in terms of the unemployment rate and the extent of long term unemployment (measured as the percentage of unemployed who have been employed for a period of greater than 12 months). Again, this map suggests that Tasmania performs below the remainder of the nation.



Source: Australian Bureau of Statistics

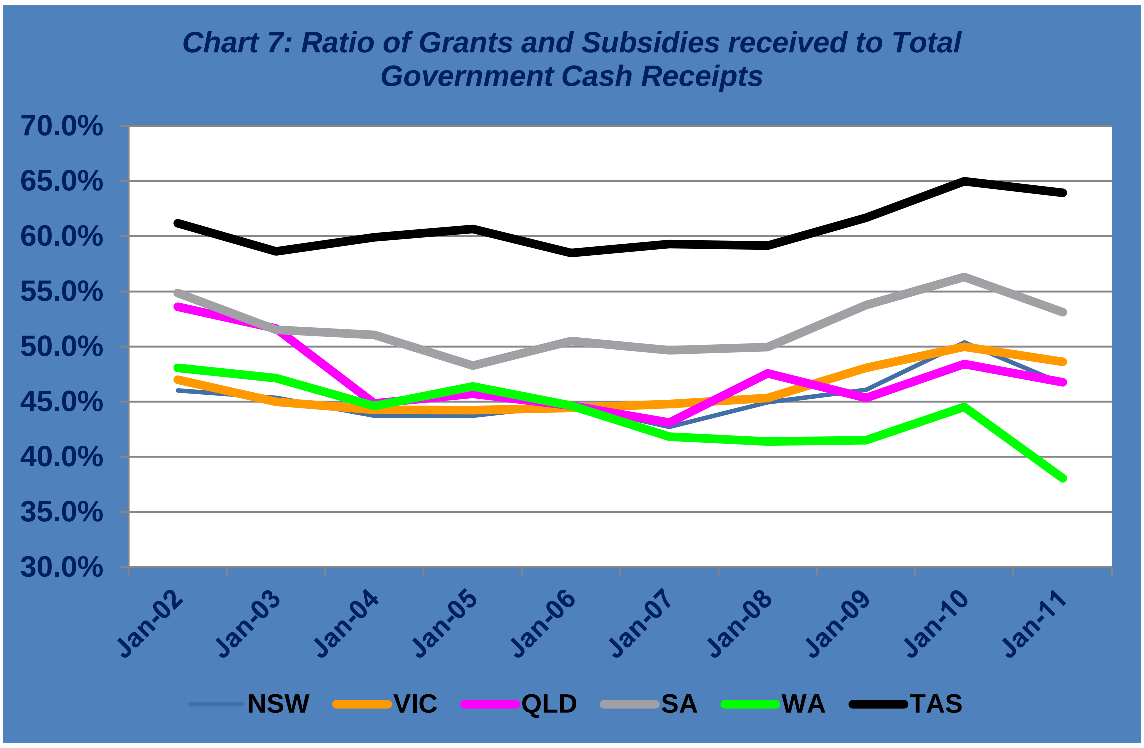
According to the Department of Families, Housing Community Services and Indigenous Affairs (FACHSIA)[2], the number of Tasmanians in receipt of the Disability Services Pension (DSP), Newstart allowance or Parenting Payment single was 56,692 the equivalent of 11% of the Tasmanian population at the time. This compares to an equivalent ratio of 8% across Australia as a whole.

The relatively weak level of labour force participation and educational attainment serves as a drag to the Tasmanian economy, leaving policymakers with the task of developing measures that seek to improve education levels and that also encourage greater labour force participation. Although some of these policies will require Commonwealth support (or indeed will emanate directly from Commonwealth action), Tasmanian policymakers may also need to resource and support such initiatives independent of Federal support. This will serve to provide further strain on Tasmanian budgets and/or result in a redirection of resources and priorities to such policies. Furthermore, to sustain the long term nature of such policy interventions, Tasmanian policy makers will be required to adjust their taxation settings to allow such support in the long term.

Commonwealth Payments Reliance

Largely in response to the conditions highlighted above, it is not surprising to note that Tasmania draws, proportionately, the greatest share of Commonwealth transfers vis a vis the other States. This is outlined in Chart 7 below.

[2] See: Department of Families, Housing, Community Services & Indigenous Affairs *"Income support customers: a statistical overview 2011; Statistical Paper No 10"*



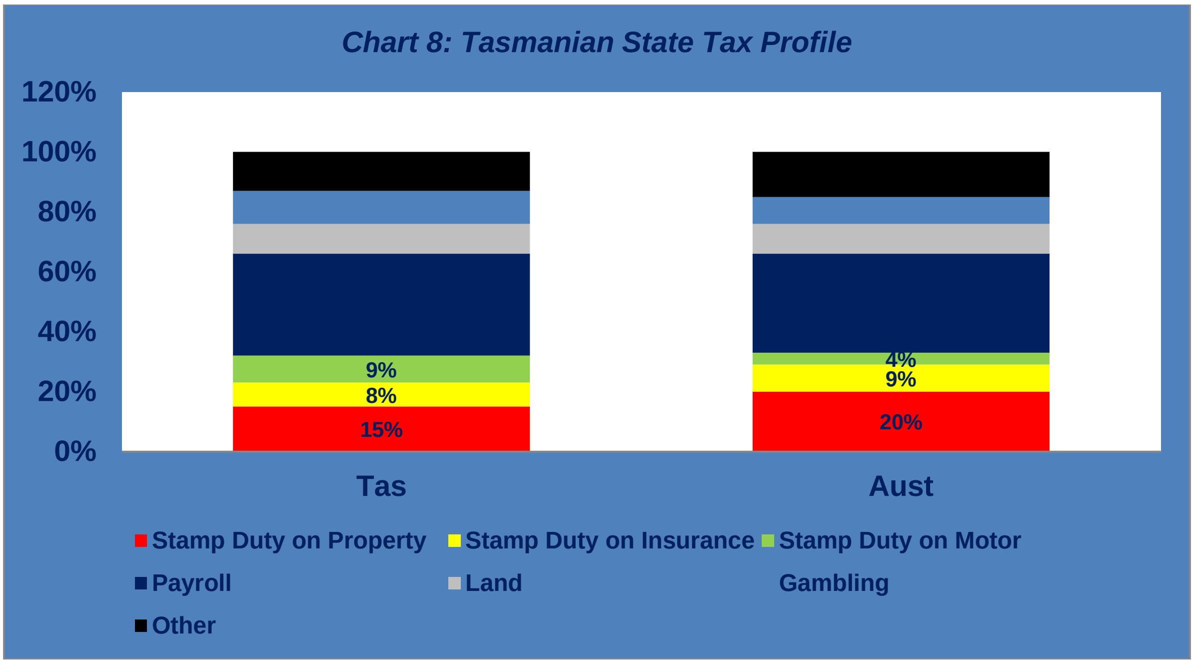
Source: Australian Bureau of Statistics

The extent of Tasmania's vertical fiscal imbalance (i.e. the extent to which Tasmania is dependent on non State revenue) places Tasmania at risk from changes to Commonwealth policy or structural changes to payment sources. For example, dependency from GST payments subjects Tasmanian policy makers to the inherent risks and challenges that emanate from this revenue source, such as distributional quarrels between the States and within the Grants Commission process, as well as structural changes to the GST itself (such as higher savings rates and spending on GST exempt goods and services). Furthermore, a more worrisome concern is the extent to which Tasmanian policy makers have implicitly accepted the VFI state of play and that consequently, policy maker attention is targeted towards the task of protecting Commonwealth State financial settings as opposed to promoting home grown reform. The ICA contends that, regrettably, the decision to abandon the State Tax review process by the Tasmanian government in the absence of Commonwealth support shares elements of this characteristic and as a result, the ICA urges a revisiting of the tax reform process.

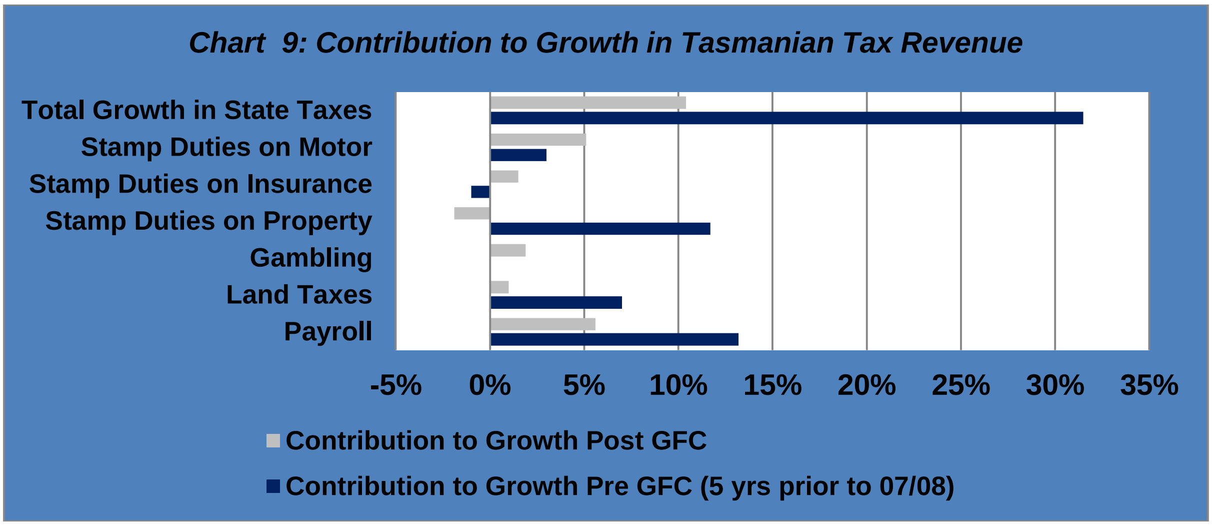
Tasmanian State Taxation Structure

As the ICA argued in its 2011submission to the Tasmanian State Tax Review[3], Tasmania does not depart too widely from the mainland States in terms of its State tax structure. However, like all States, a large component of Tasmania State taxes derives from taxes on transactions, whether on property conveyances, stamp duties on insurance or stamp duties on motor vehicle registrations. As Chart 8 indicates, almost one third of all Tasmanian State taxes emanates from taxes on transactions. The Henry Tax Review reports that taxes on transactions represent the most inefficient of all taxes and should be targeted for abolition in favour of more efficient tax bases.

[3] See Insurance Council of Australia (February, 2011) "*op cit*"



Source: Australian Bureau of Statistics



Source: Australian Bureau of Statistics

A further weakness of transaction taxes rest with their volatility and uncertainty which render them ill equipped to deal with the challenges (such as an ageing population) mentioned above. The permanency and planning needed to manage an ageing society and promote educational attainment will require Tasmanian policy makers to secure stable and secure revenue sources. Further, in the post GFC environment, where existing revenue bases (such as consumption, company and transaction taxes) are under strain, (see Chart 8) the ICA contends that greater efforts should be made by Tasmanian policymakers to engineer tax reform such that both the States and Commonwealth move to more immobile tax bases. The ICA presented in its State Tax review submission the value of improving State payroll and land taxes by broadening the bases under which these taxes operate.

The ICA contends that, today, State governments have two efficient and immobile tax bases – land and payroll – which can be improved upon through changes in exemption regimes. For example, under current payroll tax arrangements, Tasmania exempts 60% of payroll tax revenue through its existing threshold and exemption regime. Moreover, if Tasmania had retained the equivalent payroll tax base and rate it secured upon the Commonwealth transferring payroll tax to the States in 1971 (that is, a payroll tax rate of 2.5% on *all* payrolls) then Tasmania would be, today, no worse off in revenue terms today than it was in 1971. In other words, the historical policy to relieve Tasmanian businesses of payroll tax obligations has resulted in no improvement to revenue and/or Tasmanian overall employment levels. This confirms the orthodox understanding of payroll tax as enunciated in the Henry Tax Review that payroll tax is an efficient tax on labour and that the tax is fundamentally distorted through exemption measures.

The ICA contends that both payroll and land tax bases, with further improvement, are the preferred bases for the States in which to secure their revenues in so far as they allow for a switch away from transaction taxes, promote revenue stability and are highly efficient vis a vis the alternatives. Furthermore, by retaining and improving these bases, as opposed to seeking greater reliance on Commonwealth taxation, the States retain their fiscal sovereignty and reduce their vertical fiscal imbalances. The ICA contends that Tasmania can follow the lead of the ACT in this regard by moving to abandon transaction taxes (stamp duties on insurance and property) and the lead shown by the Victorian government in removing fire levies on insurance and replacing them with a tax on property.

TAX REFORM – RESUSCITATE THE TAX REVIEW PROCESS

The ICA contends that the 2014/15 Budget process provides the opportunity for the Tasmanian State government to resuscitate its own State tax review process. In particular, the ICA contends that the recommendations for reform suggested in its submission to the Tasmanian x Review are relevant and indeed, given the two years that have elapsed since the Review's commencement, remain even more appropriate and should be advanced by the Tasmanian government. In brief, the proposals outlined in the ICA submission to the tax review and which should be adopted by Tasmanian policy makers today include

1. Abandon fire levies on insurance policies with replacement revenue drawn from adjusting the municipal fire charge.

2. Engineer a tax mix switch which replaces the revenue from stamp duties on insurance with replacement revenue drawn from "better" State taxes, whether payroll and/or gambling.

3. Replace transaction taxes on property with a broad based land tax as per the Henry Tax Review recommendation.

The ICA submits that the above proposals serve to both significantly improve the overall efficiency of the State tax framework but also to place Tasmanian State taxes on a firmer, sovereign and more sustainable footing. Further, the experience of the ACT administration in abandoning transaction taxes and of the Victorian government in replacing fire levies with a tax on property, serve as a reminder that State governments have the capacity to pursue reforms of their tax bases without recourse to the Commonwealth.