



8 October 2019

Johnathan Coppel
Presiding Commissioner
Remote Area Tax Concessions and Payments
Productivity Commission
GPO Box 1428
Canberra City ACT 2601

Dear Mr Coppel

**Submission to Productivity Commission Inquiry into Remote Area Tax Concessions and Payments:
Response to Draft Report, September 2019**

The Page Research Centre welcomes the opportunity to make a submission to the Productivity Commission in response to its draft report into Remote Area Tax Concessions and Payments released on 4 September 2019.

The Page Research Centre seeks to inform and influence policy that delivers positive outcomes for rural and regional Australia. Our nation is uniquely reliant on our rural economy and our regional communities, which form the foundation of our national prosperity. For this reason, we work closely with The Nationals, communities, industry and academia to drive research and debate on the issues which affect our regions.

Regional Australia is vital for the prosperity of all Australians

Australia's regions are critical to the health of the national economy. Australia's capacity to pay for our imports of goods and services at a reasonable exchange rate largely depends on the output of firms and workers in regional Australia. Close to 90 per cent of Australia's merchandise exports are produced by the resources and agricultural sectors, the overwhelming majority of whose firms and workers are based in regional Australia.

Our tradeable industries must compete in global markets to survive. Australia's non-tradeable sectors, many of which are centred in metropolitan areas, can often pass on higher costs to consumers and taxpayers. The agricultural and resources sectors cannot. Healthy regional communities play an important role in the long term viability of these industries, by providing services and economic and social infrastructure to ensure these regions remain places where people want to work and live.

Throughout Australia's history governments have always recognised the complementary nature of the capital cities and rural and regional Australia; that Australia is strongest when we have both strong cities and strong regions. A balanced mix of policies to ensure neither urban nor regional Australia are left behind has served Australia well for over a century. Any changes to this balance should be undertaken only after careful consideration. This is particularly important given the protracted drought affecting much of eastern Australia which is posing severe challenges to many farmers and regional communities.

Any decision to reduce money available to people and communities during drought will cause additional hardship and hinder the government's current efforts to provide relief to rural communities.

Comments on draft report

The Page Research Centre supports the Government's initiative in asking the Productivity Commission to undertake this study to ensure that remote area tax assistance remains fair and contemporary.

The draft report is timely and contains much valuable information, particularly given, as the Commission notes, that some of the measures in the tax system to support regional communities date back to the Second World War and have not been substantively reviewed or updated in decades.

However, the Commission's key finding, that the Zone Tax Offset (ZTO) is an 'ineffective and blunt' instrument that should be abolished is not supported. In our view the Commission has been too quick to dismiss the policy rationale and benefits of the ZTO and the potential ways in which it can be made more effective and fit-for-purpose.

As part of its considerations for its final report to Government due in February next year the Commission should more fully consider the ways in which it can be improved and updated to operate more effectively.

Comments are focussed on the key issue of the ZTO, in particular its rationale, effectiveness and scope for improvement and the associated recommendations and findings.

DRAFT FINDING 5.1: There is no compelling justification for a zone tax offset in contemporary Australia

This finding is not supported. It is important that the Government continue to support regional Australia to ensure that any assistance provided through the tax system remains appropriate and effective.

As the draft report notes, the rationale for remote area income tax concessions when they were first introduced in 1945, was to compensate people for the relatively high cost of living, isolation and difficult climate in remote areas of Australia.

These factors remain just as relevant in much of rural and regional Australia today as they were when the scheme was introduced. As the draft report acknowledges (Draft Finding 2.3), the cost of living in regional areas remains higher than in metropolitan areas. This includes higher costs and fewer choices in terms of services and utilities, particularly electricity, gas and water, education, health and access to medical specialists, insurance premiums as well as essentials like food, groceries, fuel and other transportation costs.

Despite these challenges, investment in regional Australia has proven in the long run to be a worthwhile and productive use of Australia's scarce resources of people and capital. The Government's Northern Australia White Paper (2015), for example, found that while accounting for 40 per cent of Australia's landmass, northern Australia had only 5.9 per cent of Australia's workforce but produced 11.7 per cent of national GDP.¹ The average worker was around twice as productive as their southern counterparts. While just 60,000 Australians live in the Pilbara region, it produces more economic wealth than around 100 countries.²

Greater development in regional Australia would have other positive spill-over benefits. Australia has one of the most concentrated populations in the world, ranking tenth most urbanised in 2018 among

¹ Australian Government 2015, *Our North, Our Future: White Paper on Developing Northern Australia*, <https://www.industry.gov.au/sites/g/files/net3906/f/June%202018/document/pdf/nawp-fullreport.pdf>

² Remplan Economy, *Economic Profile, Pilbara Region*, <https://www.economyprofile.com.au/pilbara/industries/gross-regional-product>

OECD countries.³ Studies have shown Australia has an unusual population distribution, with a greater share of our population residing in larger cities relative to many other countries.⁴ This results in economic losses ranging from lost productivity due to congestion, to high and ever rising costs for the provision of infrastructure in major cities due to limited supply of land and expensive construction challenges.

Studies have shown that Australia's population concentration in the capital cities causes structural constraints in the capacity to provide new housing at reasonable cost.⁵ Our major cities are so developed that they need costly tunnels and public transport systems to ease their congestion. Providing services in major cities is getting more expensive by the day. Government subsidisation of public transport in the capital cities means Australia's public transport fares cover some of the lowest share of the costs of providing public transport in the world.

There are a number of other non-market impediments to economic advancement in the regions, particularly for new development projects. People in regional Australia face hurdles not faced by those in the capital cities. Most of Australia's cities were founded before the 20th century. Our tax and regulatory framework is set for the conditions of a developed country, which inhibits growth opportunities in developing parts of our country. While it is appropriate that Australia has sound planning and environmental rules and processes, it is a fact that these rules act as a far greater impediment to developing new areas and greenfield projects than those people faced when our capital cities were developed.

High taxes are an impediment to the development of smaller towns that are remote from Australia's major population centres. Investing in smaller towns is often more risky than larger ones, especially if the investments are large. Because there are fewer customers to spread costs, prices are often higher, or payback periods longer. The asymmetric nature of taxation means that risky investments are more exposed to higher tax rates than lower risk investments. Win and the government takes its cut. Lose and the government is not there to help. When Australia's major cities were developed taxation shares of GDP were in single digits. Now they are much higher.⁶

The point here is not that these market and government impediments to economic growth in regional Australia justify bad policy and wasteful government spending. Governments in Australia since before Federation have recognised that for Australia to continue to grow and prosper long-run considerations of national economic development and dynamic efficiency issues must be taken into account when setting policies affecting regional Australia. A 'one-size-fits-all' approach does not work well. Regulations made in a capital city to regulate an entire jurisdiction can have perverse effects for those living in the country.

The current ZTO has gradually been allowed to move out of alignment with the original intention of the policy. The reasons why this has occurred can be debated, but the policy rationale remains.

DRAFT RECOMMENDATION 5.1: The Australian Government should abolish the zone tax offset and the overseas forces tax offset.

In making this recommendation, the Commission also notes that eligibility has not kept up with change in remote Australia, and nearly half of ZTO claimants live in large coastal regional centres. The draft report also notes that inflation and growth in wages have substantially eroded the value of the ZTO. It

³ *UN World Urbanization Prospects 2018*.

⁴ See for example, Arribas-Bel, D., Sanz-Gracia, F. and Ximenez-De-Embun D. 2012, "Kangaroos, Cities and Space: a first approach to the Australian urban system", *Region et Developement*, no. 36, p. 166; Ellis, L. and Andrews, D. 2001, *City Sizes, Housing Costs, and Wealth*, RBA Research Discussion Paper, 2001–08, October and *The Economist* 2016, 'Hot in the city', 2 April, <http://econ.st/1X47PRj>

⁵ RBA 2014, *Submission to the Inquiry into Affordable Housing*, submission to the Senate Economics References Committee, February, pp. 8–9.

⁶ Barnard, A. 1988, *Australians: Historical Statistics*, Vamplew, W. ed., p. 256.

concludes that the economic and employment impacts of the concession are likely to be small, and there is no evidence to suggest that the ZTO currently affects where people choose to live and work.

This recommendation is not supported.

While the erosion of the value of the ZTO is undeniable, the rationale for it or a similar or better targeted scheme remains. In light of this, the more appropriate response is to explore ways to improve the effectiveness of the scheme.

The development of the Commission's final report to Government next year provides an opportunity to develop and assess the likely costs and benefits of a suite of reform options for the ZTO, including the best way to get the most out of this policy if the Government decides to keep the scheme in the current form.

Disadvantage due to geographic isolation is not limited only to the smaller communities, but is also found in the larger centres and to formulate policy on the future of these assistance measures based on the size of communities in areas remote from the major population centres would adversely impact on the Government's overall policy objectives for regional, remote and isolated communities.

The three existing measures, Zone Tax Offset, Remote Area Allowance and the Fringe Benefits Tax and Remote Area Concessions are part of an important suite of public policies aimed at encouraging more people to remain in and move to the more isolated areas of Australia.

Any decision on the future of these measures must only be taken after further consideration of their contribution to overcoming the many factors impacting on the affected communities, including: higher living costs; lack of choice in goods and services; remoteness from and limited access to essential services such as health and education; unpredictable swings in social and economic conditions from weather events and associated costs for insurance and mitigation; lack of infrastructure and public transport services; population growth through decentralisation from the capital cities; and challenges in attracting workers to essential primary production and mining projects.

While the dollar value of each of the assistance measures paid to individuals may seem small to those not living in the remote and isolated areas, in total they provide a considerable contribution to the economy of the communities involved and an incentive for people to work in the remoter parts of Australia.

The Commission states in the draft report that market wages should adjust to reflect any higher returns to economic activity in regional and remote Australia, allowing people to afford the higher costs, and hence obviating the need for the zone tax offset. This may be the case for workers directly employed in large capital-intensive mining projects who enjoy high wages, like those in the Pilbara example cited above. However, while such projects are important contributors to regional and national wealth, the number of workers directly employed by such projects represent only a small proportion of people in regional Australia.

Economic conditions in regional Australia tend to be more volatile than those in the larger cities, due to swings in commodity prices and climactic conditions such as the current prolonged drought conditions. The small size of many regional labour markets increases economic vulnerability for many small businesses and workers.

The number of submissions and comments to the Commission inquiry that called for an expansion of the ZTO, shows how widely valued it is to people living in remote and regional Australia. There may not only be an argument to better target them, but also to increase their dollar value and hence contribution to achieving the stated policy objectives.

Options for reshaping zone tax offsets should be explored further in the final report

In addition to bringing the value of ZTOs up to date with living cost increases for those in the most remote locations, there would be merit in exploring options for providing additional more targeted regional support.

Such a scheme would have greater potential to drive regional development and the movement of people to remote areas of Australia.

An option would be to implement a trial scheme providing a targeted and more substantial tax rebate to individuals in selected tightly defined areas with substantial economic development potential. This will create a real incentive for workers and families to move to undeveloped but promising areas of our nation. The amount of rebate to be provided would need to be substantial enough to change behaviour and spur development and population growth in a region.

These trial areas could be selected for their potential to: create sustainable economic development and growth; link with existing transport corridors and encourage development over a broader area; reduce welfare dependency in remote areas; and their capacity to contribute a saving to the budget and reduce indigenous disadvantage.

The implementation of such a scheme would need to have clear performance targets and be subject to rigorous independent review after five years, with any extensions or widening of the program contingent on clear evidence of success.

Further work

Based on the responses to the Commissions interim report The Page Research Centre will assess the need for it to undertake further work into the present financial assistance measures for remote locations on the contribution these measures make to the social and economic wellbeing of regional, remote and isolated communities and as to how they may be better targeted.

Finally, as the Commission has noted in the draft report, this inquiry has highlighted the dearth of systematic, comparable and reliable data on the relative costs of supply of goods and services to regional Australia. Investment by the Australian Government in better data in this area would yield dividends in a number of ways. Government policy design and service delivery across a wide range of areas would be improved. Consistent and up-to-date data would also help improve national economic efficiency and productivity by highlighting markets and industries where a lack of competition is resulting in monopolistic and monopsonistic behaviour by large firms seeking to exercise their market power in ways that reduce economic efficiency, needlessly pushing up prices for goods and services. These problems are something workers, small businesses and consumers in regional Australia are particularly vulnerable to given the often thin markets for goods and services, as well as limited number of buyers of products and services in many regions.

We look forward to the Commission's final report and ask that it take account of the issues raised in this submission.

Yours sincerely

Kristian Jenkins
Executive Director,
Page Research Centre Ltd
Ph: (02) 6273 8382
Mob: 0410 254 123
kristian.jenkins@page.org.au
www.page.org.au