CCI's Submission to the ERA Inquiry into Microeconomic Reform Draft Final Report.

CCI Advocacy | May 2014

Chamber of Commerce and Industry of Western Australia (Inc)

About CCI

CCI is the peak organisation representing business in Western Australia. It is the second largest organisation of its kind in Australia, with a membership of over 9,000 businesses across all sectors of the economy. CCI aims to build a competitive and productive business environment in Western Australia by promoting free enterprise through advocacy and essential services that make it easier to do business. CCI's vision is for Western Australia to be a world leading place to live and do business.

CCI's Position on the Reform Agenda

CCI congratulates the Economic Regulatory Authority (ERA) on the development of a strong microeconomic reform agenda for Western Australia.

CCI broadly supports the recommendations put forward by the ERA in its Draft Report. The recommendations presented by the ERA in the Draft Report are largely consistent with the issues raised by CCI in its two previous submissions to the ERA's inquiry.

CCI believes that the reform agenda outlined by the ERA would deliver substantial benefits to the WA economy, and will be an important way to address the structural challenges facing the state's budget position in coming years. In particular, CCI believes the following reforms will deliver a large net benefit for the State:

- Full deregulation of retail trading hours to allow people to shop when they want and for businesses to be free to meet this demand;
- Establishing a single agency responsible for regulatory reform and KPIs on setting regulation reduction targets for senior departmental staff;
- Implementing mandatory regulatory impact statements on new legislation and five year reviews on existing regulations;
- Encourage greater competition in the electricity market, through cost-reflective pricing, flexible electricity charging schemes and rescinding of the domestic gas reservation policy;
- A more robust framework for accessing infrastructure projects, including a transparent cost benefit analysis on all major infrastructure projects, establish a process for the private sector to pitch investment opportunities to government, and expand the use and scope of Public Private Partnerships; and
- The privatisation of public assets and Government Trading Enterprises where it will deliver a net benefit to the community.

However, there are some areas of Draft Report which CCI believes warrants further consideration. In particular, CCI has concerns with:

- *Taxation* – While theoretically, broadening the payroll tax base will deliver a more efficient tax system, the significant shift in the incidence of the tax from large businesses to small and microbusinesses violates the taxation principle of vertical equity. Removing all exemptions may have unintended consequences in terms of administration costs, and adversely affect workforce participation and training outcomes. On this basis, CCI does not believe the move to a broad based, low rate payroll tax regime is practical. However, the ERA's recommended changes to state property taxes have significant merit and should be explored by the State Government.

- *Retail trading hours* - Reducing employee limits on special trading days to just 10 is a step backwards. The ERA has failed to outline a clear rationale behind this recommendation.

- *Congestion charges* -Developing a response to congestion is complex, and congestion charges should be considered as part of a broader, long term strategy to address this issue. The Perth Parking Levy must be considered as part of discussion on congestion charging.

CCI would also like to draw both the ERA and State Government's attention to those areas of reform identified by the ERA as worthy of consideration by government, over and above its final recommendations in this Inquiry into Microeconomic Reform.

The State Government should not limit its desire and intent for reform to an inquiry once every four years – reform should be a continuously high priority on any government agenda. While the reform options set out in the Discussion Paper provide a comprehensive reform program, there are further areas of reform that have not been considered as part of this review that have the potential to deliver significant benefits to the state budget and the WA economy overall.

State Tax Reform

CCI agrees with the ERA's assertion that the State Government's ability to embark on tax reform is very difficult in isolation, given the high degree of vertical fiscal imbalance that exists. The Federal Government holds the vast majority of taxing powers, while the States are responsible for a significant proportion of expenditure. As a result, the ability to reform the most inefficient taxes is limited.

Despite these constraints, the States still have some scope to reform their tax system.

CCI endorses the ERA's recommendation to replace transfer duty with a broad based land tax regime. This recommendation is consistent with the principles of good tax design, as set out in CCI's submission to the ERA's discussion paper in December 2013[1].

Transfer duty is one of the most distortionary taxes, and fails a number of the principles of good tax design. Transfer duty is an inefficient, inequitable, transaction based tax, which distorts activity. Land tax, on the other hand, is one of the most efficient taxation bases available to a government. With this in mind, CCI supports the abolition of transfer duty on residential property, as set out in reform option two in the report.

In considering reforms to the property tax regime, CCI also recommends that the Metropolitan Region Improvement Tax (MRIT) should be incorporated into the broader land tax base to further improve the efficiency of the tax system. The MRIT is an additional land tax levied on taxpayers in the Perth Metropolitan Area, with funds notionally used to improve the amenity of the Perth Metropolitan Area. This is an unnecessary additional levy which adds to the complexity of the tax system.

CCI also recommends that over the long term the State Government should consider adopting a single rate of land tax, removing the current stepped rate system, to ensure that a broad base land tax was as efficient as possible.

The current stepped rate system means that higher valued land is taxed at a higher effective rate. If there is to be a transition to a broad base land tax, this would mean that higher value land would be made relatively more expensive than lower value land, potentially distorting the decision making of households and businesses who may choose to locate their activities on land further away from existing infrastructure and services than would be the case if land tax rates were consistent, potentially harming economic efficiency. However, CCI notes that this has not been considered by the ERA in its Draft Report.

Finally, CCI considers it appropriate that the transition to a broad based land tax regime occurs over an extended period of time, to ensure that decision making is not unduly distorted by the change in policy. Some change in decision making in inevitable, but in many ways this is the intent of the change in policy.

CCI recognises that the removal of all concessions and exemptions on payroll tax would, theoretically, improve the efficiency of the tax system. However, CCI has a number of concerns with the concept proposed by the ERA in practice.

- Payroll tax is just one of many taxes on labour income imposed by governments in Australia. CCI does not consider it appropriate that the State Government adopt a change affecting a shared tax base in isolation of a broader, program of taxation reform which considers the Federal and State Tax systems as one regime.

[1] These principles are equity, efficiency, transparency, adequacy, competitiveness and certainty/simplicity.

- The introduction of a broad based, low rate payroll tax regime fails the principle of equity, in so far as the incidence of the tax will fall to those organisations with a lower capacity to pay, due to the "revenue neutral" constraint the ERA has imposed. CCI's concerns in this regard are threefold.

    - Payroll tax exemptions granted for labour such as apprentices and trainees, Indigenous Australians and persons with a disability are targeted at lifting workforce participation amongst these groups. The removal of these exemptions should not occur without consideration as to the impact that this would have on the government's policy goals in workforce participation.

    - Payroll tax exemptions granted to charities, religious organisations and benevolent institutions are in recognition of their lower capacity to pay than private sector organisations. Removing the exemption violates the taxation principle of horizontal equity. However, there may be scope to clarify the definition of each of these groups, to ensure the exemption is targeted at those institutions with a lower capacity to pay.

    - Reducing the payroll tax exemption threshold to zero significantly shifts the burden of taxation from larger entities to small and micro businesses, which generally have a substantially lower capacity to pay. This fails the taxation principle of vertical equity.

- CCI is concerned that the broad based, low rate payroll tax proposed in the discussion paper would result in an additional 209,778 entities being required to remit payroll tax. Given that there will be no net gain in revenue for the Government, the administration and compliance costs associated with the 18-fold increase in tax payers are likely to limit the efficiency gains of the move and, potentially, lead to less net revenue due to the increase in resources required to monitor and administer the regime.

In considering any reforms to the tax system, the ERA should also consult Treasury and/or the Commonwealth Grants Commission, to determine the broader implications to the state's revenue base, particularly from horizontal fiscal equalisation process.

Retail Trading Hours and Product Regulations

CCI endorses the ERA's recommendation that retail trading hours in Western Australia should be fully deregulated, noting that "customers are better equipped than the Government to determine when and where they want to shop". The current retail trading hours regime restricts consumer choice, reduces competition, and has no economic rationale. While CCI broadly supports the recommendations set out in the ERA report, there are some areas of concern.

Employment Restriction on "Special Trading Days" – CCI supports the approach to designate three "Special Trading Days" which are exempt from full deregulation of retail trading hours, noting the cultural and social significance of Good Friday, Christmas Day and ANZAC Day. However, the ERA has not outlined a strong case for reducing the employment threshold for businesses to open on these days to 10, from its current 18 (and possible move to 25, subject to legislation which is before the Parliament). Absent this case, CCI suggests the ERA be guided by current government policy regarding employment thresholds for Special Trading Days.

Product Regulations - Throughout its discussion of retail trading regulation in Western Australia, the ERA notes a number of the anomalies which are created by the system of "store classification" and "product regulations" which accompany the *Retail Trading Hours Act 1987*. However, it is not clear whether the ERA is also recommending that the product regulations be amended in line with changes to trading hours. The full benefits of deregulation will not be realised unless these accompanying product regulations are abolished and this should be a clear recommendation of the ERA's final report.

Congestion Charging

Traffic congestion is a significant issue facing the Perth Metropolitan Area, as reflected by the ERA in its Draft Report. The issue is broader than passenger vehicle movements into and out of the city during the working week, although this is when it is most severe. With Western Australia's population projected to approach five million by the middle of the decade – from its current 2.5 million – it is unlikely that congestion will ease without government action. To date, government's response has been to add capacity to transport networks, through widening roads and additional vehicles on public transport networks. This type of response has a finite limit.

CCI supports the ERA's view that congestion in the Perth Metropolitan Area is a significant issue for the economy, as it has a detrimental impact on productivity and is unlikely to ease without government action. In its submission to the ERA's discussion paper, CCI stated that a "congestion tax" type charge had been utilised in other, larger cities around the world and had been somewhat successful in reducing congestion in these areas.

A congestion charge seeks to increase the relative cost of operating a vehicle in a defined area compared to not operating a vehicle in the defined area. The mechanism is designed to discourage travel by vehicle at the margin, and encourage substitution for other modes of transport. A congestion charge is a complicated mechanism, as discussed in the ERA's Draft Report, and would require substantial work to ensure it works effectively to reduce congestion.

Congestion charging has the potential to form part of the solution to the city's congestion challenge, but it is not the only answer. On this basis, CCI suggests the ERA recommend that further work be explicitly conducted within government to determine the appropriate response to congestion management. As part of this work, the feasibility of a congestion charge should be examined.

The Perth CBD is already under the influence of a congestion charge, in the form of the Perth Parking Levy (PPL). The PPL is a State Government tax levied on each parking bay in the Perth CBD earmarked for use by non-residents, and seeks to raise the relative cost of operating a vehicle in the CBD area. The funds raised, $38 million in 2012-13, are notionally used to improve safety, public transport use and the operation of the free CAT Bus system.

The PPL is, in effect, a congestion charge, in that users of parking bays are unaware of the levy, making it an indirect tax and therefore largely ineffective in combating congestion. It is important that the Perth Parking Levy is considered as part of any investigation into the use of congestion charging in Perth. The State Government is already looking at ways to reduce congestion, announcing in the 2014-15 State Budget that it would increase the Perth Parking Levy by 50 per cent over the next two financial years. The added revenue would be used to fund additional activities designed to reduce congestion into and out of the Perth CBD.

If a congestion charge is to be proposed, this levy should be abolished and the activities being funded by it subsumed into the broader operations of government.