NSW Business Chamber

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Dear Treasurer

2016-17 NSW BUDGET – NSW BUSINESS CHAMBER BUDGET SUBMISSION

I am writing to request a meeting ahead of the 2016-17 Budget and to outline some of the NSW Business Chamber's (the Chamber) views, which I hope will provide useful reflection as the Government develops its budget strategy for the years ahead.

To begin with, I would like to congratulate your Government for its commitment to and oversight of what can only be described as a very strong budgetary position. In the context of broader concerns about the sustainability of government budgets throughout Australia, it is pleasing that the NSW Budget is in surplus and that the NSW Government is essentially debt free.

But even more pleasing is the recent strength of the NSW economy. Around 170,000 jobs have been created over the past 12 months, while the NSW economy continues to outperform other states in almost all of the key measurement areas. Indeed, the Chamber's December quarter Business Conditions Survey demonstrates that the business community has a high degree of confidence in the NSW economy. This optimism is backed by indications in the survey that improvements in business profits and sales revenue are translating to increased jobs and capital expenditure.

It is in this position of strength that the Government has the opportunity to make long term decisions that will ensure the continued prosperity of the NSW economy. Key steps already taken by the Government include its ambitious infrastructure agenda, its commitment to abolish inefficient taxes (such as remaining intergovernmental agreement taxes and the fire services levy on insurance premiums) and efforts to streamline government interaction with the community through Service NSW and the Quality Regulatory Services initiatives. Each of these will deliver significant benefits to business and the community more broadly. As we have previously noted, the Chamber looks forward to the abolition of stamp duties on non-real business asset transfers, mortgage duty on business transactions and stamp duty on the transfer of unquoted marketable securities by 1 July this year.

Despite these initiatives, considerable opportunities remain for the Government to further improve the operating environment for business and the competitiveness of the NSW tax system. It is in this light that the Chamber submits a number of proposals for your consideration as part of the 2016-17 Budget process. These include:

- improving the efficiency of the NSW tax system by handing back transfer duty "bracket creep";
- positioning NSW as the destination of choice for employers by boosting the competitiveness of NSW payroll tax arrangements;
- continuing the Government's vigilant approach to expense management to ensure the long term viability of the State's finances;
- reaffirming the Government's commitment to red tape reduction by renewing its regulatory reform strategy;
- ensuring that Service NSW is sufficiently well resourced, now and over the longer term, so that it can continue delivering benefits as a highly successful reform initiative; and
- demonstrating the state-wide benefits of the Government's asset recycling program by announcing more infrastructure projects for regional NSW.

A more detailed outline of these proposals can be found at Attachment A.

The Chamber accepts that the impact of these proposals on the Budget's bottom line could potentially be significant if they were to be fully implemented. For example, handing back the full amount of transfer duty "bracket creep" seen over recent years could be in the same order of magnitude as the surpluses projected over the forward estimates. The Chamber therefore encourages the Government to consider the extent to which these proposals could be implemented, even if a decision is taken not to implement them in full.

The Chamber is grateful for the opportunity to continue our engagement with you as Treasurer, and we look forward to working with you into the future. Please contact Mark Frost of the Chamber's Policy unit via email at mark.frost@nswbc.com.au or by phone on 02 9458 7259 should you or your office have any queries about this submission.

I look forward to meeting with you again in the near future.

Yours sincerely

Stephen Cartwright
CHIEF EXECUTIVE OFFICER

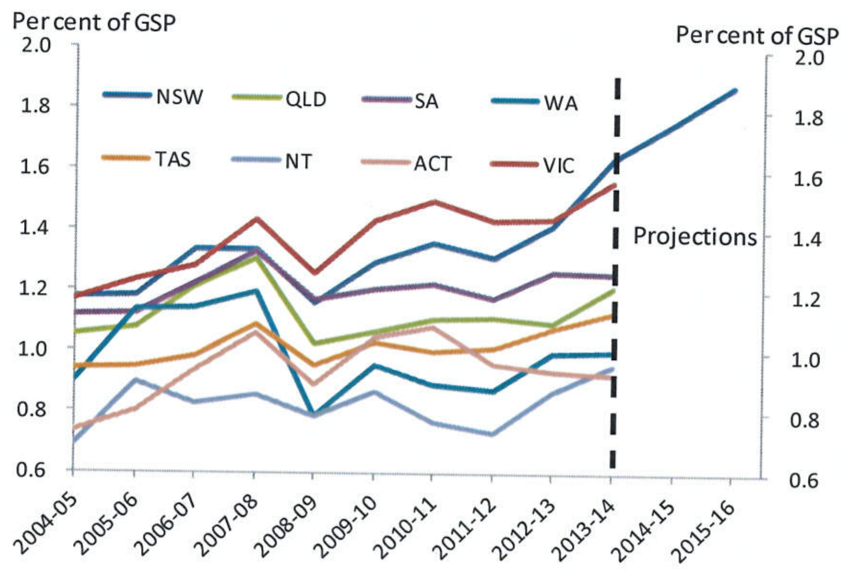
Attachment A – NSW Business Chamber budget proposals in detail

1. Improve the efficiency of the NSW tax system by handing back transfer duty "bracket creep"

Estimates of the relative efficiency of state-based taxes consistently show that stamp duties are among the most inefficient taxes used in Australia. By way of example, some estimates indicate that collecting an additional dollar through conveyancing stamp duty could have a welfare cost equivalent to more than 70 cents. Yet NSW finances are increasingly reliant on conveyancing stamp duty with transfer duty expected to generate more than $8.7bn in 2015-16, twice the average received over the previous decade.

Analysis presented in Chart 1 demonstrates that the NSW tax system is fast becoming inefficient both in absolute terms and relative to other states and territories. The bulk of this deterioration can be attributed to the increase in transfer duty receipts. Over time, increasing reliance on inefficient taxes will weigh on economic activity and harm the long term prospects of the NSW economy. To illustrate, the Chamber has commissioned forthcoming research which suggests that Gross State Product (GSP) could be boosted by more than 1 per cent if conveyancing stamp duty was abolished and revenue was collected through a broad-based land tax.

Chart 1 - The efficiency cost of state taxes



Source: NSWBC estimation based on ABS and NSW Government data together with KPMG estimates of the average excess burden of major Australian taxes.

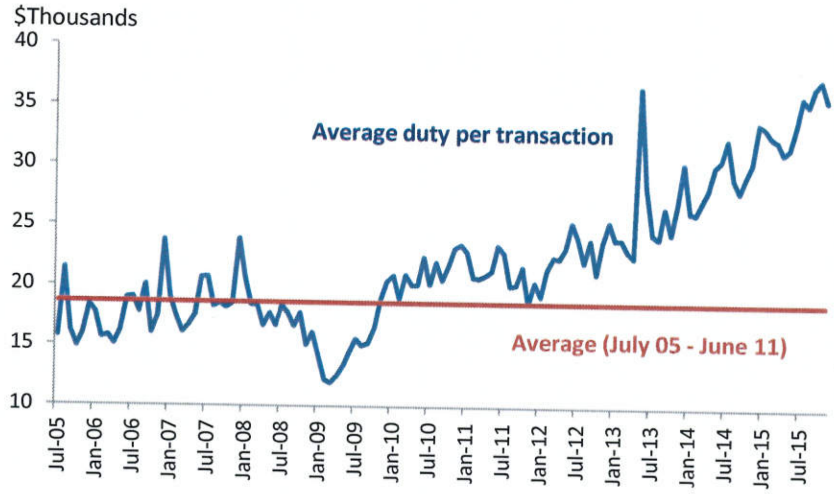
Note: the Y-axis is an estimate, presented as a percentage of GSP, of the welfare losses (also known as the excess burden of taxation) associated with state-based taxes. For NSW, 69 per cent of the increase over this period is attributable to growth intransfer duty receipts.

The increasing importance of transfer duty to NSW Government finances is not the result of active decisions made by the Government but is rather the outcome of a booming property market. But the Government can ultimately decide whether existing tax settings remain appropriate in the future and can adjust policy settings in response to changing circumstances.

Increasing house prices and property turnover are both key factors accounting for the increase in transfer duty receipts over recent years.

Higher rates of property turnover may only be a temporary phenomenon and it is reasonable to expect that property turnover rates will return to trend levels. On the other hand while price growth may have stabilised over recent months, property prices remain at elevated levels. Accordingly, due to its progressive rate structure, the amount of stamp duty payable upon the purchase of a property is now significantly higher and has given effect to a permanent[1] increase in the stamp duty tax take. This is illustrated in Chart 2 below which shows growth in the average duty payable on land-related transactions (which isolates the revenue impact of price increases from those associated with higher than typical turnover rates).

Chart 2 - Stamp duty "bracket creep"



Source: OSR and NSWBC calculations

Growth in transfer duty receipts owing to increasing prices can reasonably be described as "bracket creep" and should therefore be returned. The Chamber estimates that by 2014-15, price-related "bracket creep" had boosted transfer duty receipts by more than $2.3bn when compared with the period before June 2011.[2] This amount does not include additional windfall gains associated with increases in transaction volumes.

The Chamber accepts as a general principle that it would be imprudent to give a permanent tax cut in response to an effect that is only temporary. However, the Chamber considers that the amount of duty payable on a given property should not, at least in real terms, increase over time. Yet this is exactly what the current transfer duty architecture has delivered.

In terms of policy design, a reasonable starting point might be to target stability in the amount of transfer duty payable on the median house price. Progressivity could be maintained by altering rates across the rate structure. Adjusting stamp duty rates to achieve this would effectively amount to a form of indexation.

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[1] The Chamber notes that projections over the forward estimates assume that transfer duty receipts will remain at elevated levels, implying an assumption of continued strength in both prices and transaction volumes.
[2] This amount would be higher if accounting for price-related "bracket creep" which also applies to the growth in transactions seen over recent years. The period between July 2005 and June 2011 is selected as the reference period as it is the period immediately preceding price and transaction growth for which data is available.

But indexation of existing rates would not compensate for past property price increases. In light of the relative inefficiency of transfer duty and the analysis presented in Chart 1, the Chamber considers that a one-off recalibration is required to hand back price-related growth in transfer duty receipts from 2012. In subsequent years, transfer duty rates could be adjusted annually by an independent body such as IPART.

Handing back transfer duty "bracket creep" would have implications for the Budget's bottom line. Based on 2014-15 data, the Chamber estimates that a commitment to hand back all price-related "bracket creep" would have an annual cost in the order of magnitude of between $2bn and $3bn. This is broadly in line with the size of surpluses projected over this period and underscores the need for restraint in spending — a point that will be returned to under heading 3 below.

In the event that not all "bracket creep" is returned, the Chamber considers that at least a significant share of windfall transfer duty receipts (including those received in previous years) should be quarantined for the provision of transfer duty relief. For example, the Government could consider options to provide transfer duty relief in areas where it will deliver the most significant flow on benefits to the economy, such as by:

- providing a stamp duty exemption for commercial property transactions, similar to the approach committed to by the South Australian Government; and
- expanding thresholds that inhibit entry into the First Home - New Home scheme; and
- minimising "tax on investment" impacts by providing a discount on the amount of stamp duty payable on value of improvements.[3]

The Chamber's call to hand back transfer duty "bracket creep" and to restrain growth in transfer duty receipts is not intended to prejudice more ambitious reform options. Actively reducing stamp duty, including through budget-neutral changes to the tax mix, would also deliver significant benefits to the NSW economy.

The Chamber looks forward to releasing forthcoming modelling which demonstrates the economic benefits of abolishing stamp duty and moving towards a broader-based land tax. A key insight from this analysis is that stamp duty is a significant drag on economic activity with changes to the tax mix able to deliver substantial economy-wide benefits. While these benefits would be maximised by implementing a full switch between stamp duty and land tax, even partial steps towards reforming stamp duty could yield significant benefits for NSW.

For example, the NSW Government could move towards the abolition of conveyancing stamp duty on commercial property transactions (as noted above) or could gradually broaden land tax while reducing stamp duty rates (such as the approach being implemented by the ACT Government).

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[3] Stamp duty liabilities are calculated based on the purchase price of property including the realised value of any improvements made to land. This discourages investment in housing and other land-related productive capacity. Taxing improvements at a lower rate would minimise these impacts. The value of improvements could be inferred from the difference between the purchase price and the unimproved value of land.

2. Position NSW as the destination of choice for employers by boosting the competitiveness of NSW payroll tax arrangements

As part of its 2011 pre-election campaign document *10 Big Ideas to Grow NSW*, the Chamber proposed cutting payroll tax to 4.95 per cent by 2015 to improve the competitiveness of NSW payroll tax arrangements. The Chamber has in the past advocated for a number of other more modest payroll tax proposals (and to which we have received no definitive response) which included:

- increasing the payroll tax threshold by using funds that would otherwise been allocated to the payroll tax rebate as part of the Jobs Action Plan;
- simplifying processes associated with applying for rebates under the Jobs Action Plan;
- increasing the period upon which an employee needs to be replaced (if tenured for under two years) from 30 to 90 days when receiving a payroll tax rebate under the Jobs Action Plan;
- allowing businesses to align payments with PAYG contributions;
- allowing more businesses to meet their payroll tax obligations on a yearly rather than a monthly basis, particularly where a business is unlikely to incur an annual payroll tax liability but for a given month may exceed the monthly threshold;
- reducing the burden of payroll tax at an estimated annual cost of around $15 million for each 0.01 per cent reduction in the payroll tax rate and around $20 million for a 2.5 per cent increase in the threshold; and
- outsourcing the collection of payroll tax liabilities to the ATO so as to minimise costs for business.

Many of these proposals are as important today as when they were first put to the Government. However, the Budget is in a much stronger fiscal position than on previous occasions such that the Government is now better placed to deliver on more substantial payroll tax relief.

The Chamber notes that the Government increased the threshold to $750 000 as part of the 2013-14 Budget. While the Chamber is pleased that this has been providing a degree of payroll tax relief to businesses in the short term, the removal of indexation disadvantages businesses over the longer term. Indeed, the Government's own figures at the time of the 2013-14 Budget demonstrate that the removal of indexation implies greater payroll tax revenue over the longer term. Further, despite the one-off increase in the threshold, NSW still has the third lowest threshold in the country and has the second highest average rate of payroll tax at common payrolls (for example, payrolls of between $3 and $5 million).

It is for these reasons that the Chamber encourages the Government to raise the payroll tax threshold to $850 000 over a four year period and to reintroduce indexation of the payroll tax threshold in subsequent years.

The Chamber estimates that this would cost around $315 million over the forward estimates. This represents a smaller commitment than the $397 million extension of the Jobs Action Plan announced in the 2015-16 Budget.

While the Chamber does not propose that an increase in the threshold be offset by reduced commitments under the Jobs Action Plan, the Chamber remains sceptical as to whether the rebate approach is the best way of delivering payroll tax relief to hiring businesses. This is because the administrative burden associated with applying for the rebate could potentially be significant whereas the administrative burden of automatically receiving payroll tax relief delivered through adjustments in the threshold or rate would be negligible.

More generally a further concern with both the payroll tax rebate as well as the Small Business Employment Incentive is that it may be under-claimed by eligible businesses leading to a somewhat arbitrary allocation of resources. To illustrate, data obtained from OSR indicates that only 658 new positions (including part time and casual positions) had been registered under the Small Business Employment Incentive by 1 December 2015. This is significantly lower than what the $9 million annual commitment implies (which would be 1,875 new full time equivalent jobs over this period).

The Chamber will continue to liaise with OSR on ways in which access to commitments under the Jobs Action Plan can be improved.

3. Continue the Government's vigilant approach to expense management to ensure the long term viability of the State's finances

The Chamber congratulates the Government on achieving its commitment to ensure that spending growth does not outpace revenue growth. This has been important in delivering the position of strength that the State's finances are in today.

But as noted in the Budget's half yearly review, a significant decline in revenue growth is anticipated over the forward estimates. This raises the prospect that expenditure growth over recent years has overreached what is sustainable over the longer term or indeed what is in the best interests of NSW taxpayers.

While the Chamber remains cautiously supportive of the Government's commitment to allocate higher than forecast revenues to Restart NSW, it notes that windfall transfer duty gains are already factored into the forward estimates. As a result, there is a real risk that temporary gains in transfer duty (such as those owing to temporarily elevated turnover rates) are underwriting permanent increases in recurrent expenditure. Given the Chamber's view that transfer duty "bracket creep" should be returned to the taxpayer, spending restraint becomes an even more important priority.

The Chamber supports a fiscal strategy that would position the Government to deliver a lower overall tax burden on the economy. While the Government remains on track to meet its commitments under the *Fiscal Responsibility Act 2012* (expenditure growth below 5.6 per cent), the Chamber contends that expenditure growth should not imply an increase in the overall tax burden (given that all expenditure decisions must be paid for eventually). That is, all other things being equal, real expenditure growth should not exceed growth in GSP. This is broadly achieved over the forward estimates through lower than typical expenditure growth in 2017-18 and 2018-19 which, if achieved, would sustain the downward trajectory in expenditure as a percentage of GSP.

The Budget's half yearly review also points to the decision by the Australian Government to reduce health and education grant funding as well as anticipated changes in GST relativities. While the Government may be pursuing options for more secure and stable funding from the Commonwealth, the Chamber considers that it would be imprudent to make expenditure decisions that rely on hypothetical funding arrangements. In practice this may require a more vigorous strategy to identify areas of inefficiency and consideration of where service levels are beyond what can be afforded over the longer term.

The 2016 NSW Intergenerational Report (IGR) will provide an opportunity for the Government to give detailed consideration into the longer term fiscal challenges faced by the State. Increasing health costs, as an example, will generate pressures on government budgets throughout Australia given they are expected to grow faster than revenue and the economy.

The Chamber acknowledges that improvements in efficiency — when defined in terms of the costs at which current services are delivered — cannot completely account for the shortfall. However it is reasonable to suggest that considerable areas of health expenditure are either wasteful or poorly targeted (even if delivered in an efficient manner). Indeed the Productivity Commission's 2015 research paper into efficiency in health highlighted that there is considerable scope to improve Australia's health system and that more can be done to promote clinically and cost effective health care.

The Chamber therefore urges the Government to utilise the IGR to explore strategies that NSW can implement to reduce the rate of growth in health costs, and to prepare community expectations on the extent to which service-level trade-offs may be required. There is value in setting targets to constrain and ensure accountability around health expenditure.

More generally the Chamber acknowledges that the levers for managing health costs are not wholly controlled by the States. The Chamber has previously proposed that hospital funding responsibilities be handed to the Commonwealth and acknowledges that the distribution of responsibilities in a federal system is an impediment to the development of more integrated cost reduction strategies. Notwithstanding this, the Chamber calls on governments at all levels to work collaboratively, including through the Commonwealth's current federation white paper process.

The Chamber welcomes the NSW Premier's recent remarks that potential health funding from the Commonwealth be negotiated on the basis of achieving progress toward a more efficient health system.

4. Reaffirm the Government's commitment to red tape reduction by renewing its regulatory reform strategy

Prior to its election in 2011, the Government committed to reducing the level of regulatory burden faced by business and the community by 20 per cent. This objective was translated into a red tape reduction target of $750 million to be achieved by June 2015. Other commitments have also benefited business including the:

- "one on, two off" policy which has constrained the flow of new regulations (including a requirement for any new regulatory burdens to be offset on a one-to-one basis at the portfolio level);
- Quality Regulatory Services initiative which requires regulators to adopt a flexible and risk-based approach to administering their responsibilities; and
- Service NSW reviews of the barriers faced upon setting up a business by sector.

These policies have delivered significant regulatory savings to business and the community, and the Chamber congratulates the Government on its progress. However, the Chamber would contend that regulatory reform remains a work in progress with member feedback suggesting that regulation continues to weigh on business activities. While government reporting suggests that the $750 million target has been exceeded, it is not clear that the overall stock of regulation has been reduced by 20 per cent once the impact of new regulatory burdens is accounted for. Further, while the Government is committed to making NSW the easiest place to start a business, it is not clear what is being done to improve the operating environment for existing businesses given the expiration of commitments made under the Government's previous term. It is for these reasons that the Chamber encourages the Government to:

- extend the red tape reduction target (which expired in June 2015) by setting an ambitious target to be achieved by the end of the current term (such as a 30 per cent reduction in regulatory burden relative to 2011 levels);
- improve reporting (including against identified targets) and the availability of information on how the Government is meeting its regulatory reform commitments;
- extend and recalibrate the "one on, two off" policy to require a net reduction in regulatory burden upon the imposition of any new regulation as well as that there is no net increase in regulatory burden on a sectoral basis;
- ensure there is an active and well-resourced body tasked with responsibility for the Government's overarching regulatory reform agenda as well as ensuring robust regulatory impact analysis when considering policy options; and
- initiate a system-wide approach to ensuring that best practice design principles are applied to the existing stock of regulation, even in circumstances where this does not necessarily lead to a reduction in regulatory burden.

The Chamber will continue to liaise with the Minister for Innovation and Better Regulation and the Minister's department on a more detailed set of proposals. However, the 2016-17 Budget process provides an opportunity for the Government to commit to a new regulatory reform agenda as part of its broader economic strategy. This includes setting new objectives and ensuring that the apparatus of government is sufficiently resourced to ensure they can be achieved.

5. Ensuring that Service NSW is sufficiently well resourced, now and over the longer term, so that it can continue delivering benefits as a highly successful reform initiative

The Chamber welcomes recent indications that the Government will consider where greater efficiency gains can be made within the apparatus of Government. The Chamber agrees that there is considerable scope to identify areas of overlap within the bureaucracy, and to ensure that the existing functions of government are delivered in the most cost effective manner. Action in this area will contribute further to the Government's management of expenses and will deliver better value on behalf of the taxpayer.

While supportive of efforts to target greater efficiency, the Chamber is strongly of the view that the community-wide benefits of initiatives such as Service NSW need to be appropriately considered when making assessments of efficiency. In this regard, costs need to be seen from the perspective of the community at large so that they are not simply shifted in pursuit of a narrowly conceived notion of efficiency. Service NSW is a highly effective reform initiative which reduces the costs of interacting with government. The Government should be making investments in areas that improve efficiency and Service NSW is an exemplary model of how this can be achieved.

The Chamber notes the Auditor General's recent report: *Realising the benefits of the Service NSW initiative*. While the Chamber agrees with the general principle that decisions of government should be backed by a robust assessment of alternative options as well as their costs and benefits, the Chamber contends that the benefits of the Service NSW initiative are well in excess of any costs. Any ambiguities in the business case highlighted by the Auditor General's report are likely to be around the order of magnitude of those benefits rather than whether the project benefits exceed its costs. The Chamber therefore discourages the Government from making any negative adjustments to the funding of Service NSW, and indeed considers that continued expansion of Service NSW should be appropriately resourced over the longer term.

6. Demonstrate the state-wide benefits of the Government's asset recycling program by announcing more infrastructure projects for regional NSW

As you are aware, the NSW Business Chamber was a leading and consistent advocate of the leasing of NSW's electricity assets (poles and wires).

Echoing the calls we made in our landmark 2011 Election campaign *10 Big Ideas to Grow NSW*, during the 2015 state election, we called on the next state government to *"fund and deliver more infrastructure through public asset swaps"* identifying the sale of the state's poles and wires as a key opportunity to address NSW's infrastructure backlog and its productivity challenges.

With the Government proceeding with a long term lease of 49 per cent of the States' poles and wires, more than $20 billion is expected to be unlocked for investment in new public infrastructure.

While the Chamber has welcomed the announcement of key projects identified for funding under the poles and wires including the proposed new Sydney Metro line and Western Harbour Crossing, there has been little detail forthcoming on the announcement of regional infrastructure projects.

We note that $6 billion from the proceeds from the leasing of the poles and wires has been reserved for investment in new regional infrastructure. At the time of consultation on Rebuilding NSW, the Chamber's Regional Advisory Councils from across the state worked with other regional representative bodies (including local Regional Development Australia boards) to respond to the call from Government for submissions on priority projects.

We call on the Government to use the budget process to bring forward priority projects funded under Restart NSW for regional NSW to help support business, investment and employment growth outside metropolitan centres.