Dissenting report

Background

The recent disasters in Australia have led to a tragic loss of life and have inflicted significant physical damage to both urban and regional areas, especially in Queensland and Victoria.

Many people acted heroically to save the lives of others and many more people have since acted selflessly in assisting the clean-up and reconstruction.

As with previous natural disasters of this scale, the Commonwealth government has an obligation, both moral and under the *Natural Disaster Relief and Recovery Arrangements*, to assist with funding the repair and rebuilding of public infrastructure, as well as providing financial assistance to those in need.

Previously, the support provided by Commonwealth governments of different political persuasions in response to natural disasters did not require the imposition of a new tax to fund, fully or partially, the associated cost. Previously, repair and reconstruction costs were met from consolidated revenue.

As an arbitrary, partial offset to the cost of this incurred and anticipated expenditure by the Commonwealth, currently estimated at $5.6 billion, the Government is introducing a new flood tax. The Government claims this new tax will be temporary. It is modeled that this new tax will raise the Government an additional $1.8 billion in revenue for the financial year 2011-12, levied from around 4.8 million Australians.

There is no apparent link between the revenue raised from the new tax and the total anticipated cost for the recovery. Indeed, the tax was announced before Cyclone Yasi and before any expenditure cuts were announced. It was the first response, not the last.

The Coalition is committed to helping with the reconstruction and recovery required following the natural disasters of summer 2010-11. Additionally, the Coalition remains committed to keeping taxes low. Consistent with the Coalition's previous approach in government, we do not support the Government's new flood tax as a means of meeting these unanticipated costs.

The Coalition remains of the view that the Australian people and business already pay tax with the expectation that their taxes will go to government priorities including natural disasters. The costs of both repair and reconstruction, consistent with precedent, should be met from consolidated revenue and a reprioritisation of spending.

The Coalition holds the view these bills are, therefore, an unnecessary new tax for the Australian people and that the $1.8 billion of anticipated revenue could be met through spending cuts in other areas.

The bills that implement this new tax were referred by the Coalition to this committee for consideration and report.

Government announcement

Following several natural disasters over the summer the Government announced it was looking at the possibility of introducing a new tax to, it claimed, help fund the unanticipated costs associated with the repair and reconstruction of damaged public infrastructure.

On 27 January 2011 the Government announced it was introducing a new flood tax, and would be seeking to introduce the enabling legislation into the Parliament forthwith. This announcement indicated that the flood tax was a small proportion of the total government response of $5.6 billion and that "two thirds of that funding will be delivered through spending cuts". The Coalition members note that much of the announced spending cuts have been reversed and no new spending cuts offered.

The Coalition indicated its support of the reconstruction and repair efforts, and further offered to have the Leader of the Opposition work in a bipartisan manner with the Prime Minister to find the necessary cost savings to enable the Government to meet its liabilities without the need of introducing a new tax.

This offer was rejected by the Government.

The Coalition separately made an announcement on 8 February 2011 of $2 billion in savings measures that would negate the need for any additional tax on the Australian people.

Following the introduction of the enabling legislation - Income Tax Rates Amendment (Temporary Flood Reconstruction Levy) Bill 2011 and the Tax Laws Amendment (Temporary Flood Reconstruction Levy) Bill 2011 the Coalition referred the bills to the House of Representatives Standing Committee on Economics for an inquiry to examine the impact of the new tax.

Inquiry process

The Coalition was mindful of the need to conduct proceedings in an efficient and timely manner to ensure the policy implications of the Government's new tax were examined, whilst not unnecessarily delaying consideration and finalisation of the matter for those affect by the disasters.

The Coalition supported Government Members of the committee on a short, sharp inquiry with a one week reporting deadline.

Mindful of the above, Coalition Members' have genuine concerns over the extremely limited time allowed to question Commonwealth Treasury officials. Although forty-five minutes was allotted and used for this purpose, it was self-evident more time was needed to properly explore the policy implications of these bills.

It was disappointing the Government wasn't willing to work co-operatively with the Coalition Members' to extend the time permitted for the Questioning of Commonwealth Treasury officials. This was despite there being a formal request from the Coalition Members to do so, and in view of adequate time available to the committee through, for example, simply trimming some of the allocated 'breaks'.

The Government Members' refusal to permit extra time remains completely unanswered and actually raises more questions as to why the Government gagged further examination of Commonwealth Treasury officials.

> **Ms O'DWYER**—So you are shutting down this line of questioning?
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> **Mr CIOBO**—A forty-five minute session of a nearly two billion-dollar budget levy.
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> **CHAIR**—If you would let me finish, both the coalition and the government have had two people asking questions. I will rotate that different people get the opportunity—
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> **Ms O'DWYER**—You did not say that up front, Chair, that we would not all be allowed to ask a question—

> **Mr CIOBO**—You are gagging further questions.
>
> **Ms O'DWYER**—and you actually gagged my questions before when I wanted to ask questions. I let you know that I had a line of questioning. So, Chair, I think it would be quite inappropriate for you to shut down the line of questioning now, given that we do have the witnesses in front of us today and we do have the opportunity to ask them questions. There is time on our agenda to do so. I think it would be quite improper for you to shut it down. And, if you are proposing to shut it down, my question to you is: what does the government have to hide? Why are they not prepared to let us ask witnesses questions about this levy? [p.15]

Fiscal position of the Government

Commmonwealth Treasury officials were ambivalent on the policy merits of a new tax being introduced on the rationale of being required to meet the repair and reconstruction costs following the summer's natural disasters.

The Commonwealth's Treasury officials promulgated views that the tax – spending cuts were an appropriate fiscal balance in response to the disasters.

Recent events have seen this 'balance' further diminished as the Government continues to reverse announced spending cuts. The Government had announced expenditure cuts and deferred spending of $2.8 billion. As at the date of this report, the Government's has reversed $364 million of announced expenditure cuts to the solar flagships program and national rental affordability scheme to secure the Green's support. It has also reversed $50 million of expenditure cuts for the Australian Learning and Teaching Fund to secure the support of independent Member for Dennison.

Coalition Members also highlight the inescapable reality that had there not been significant waste of taxpayers' money on a number of the Government's poor spending projects already, for example a cost 'blow-out' of around $2.6 billion on the Building the Education Revolution (BER), then there would be no need to impose this new tax on hardworking Australians.

The entire budgeted revenue from this new flood tax is less than what has been wasted in the Government's BER initiative alone.

Additionally, the imposition of the Government's new flood tax establishes a a new and unfortunate precedent. Given Australia's propensity for natural disasters, this new tax could be used by subsequent governments to justify a new tax it felt warranted arising from a natural disaster.

Testimony indicated the repair and reconstruction costs were 'rough estimates' only and therefore the certainty around the size of the new flood tax ($1.8 billion) and the period of time it will be in place (twelve months) cannot be guaranteed if costs prove to be higher.

> **Ms O'DWYER**—…Given that we have heard today from the Treasury that there are only estimates as to the damage that has been caused and the potential reconstruction costs, and given that we know that the levy is going to be a $1.8 billion levy and it is only going to be imposed by the government for 12 months, in circumstances where that estimate proves to be incorrect and the cost is much higher, would you want to see an increase in the levy? And secondly, following up on that, would you want to see the period of time for which that levy applies extended beyond 12 months—assuming the costs are higher?
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> **Mr Bradley**—I think that the imposition of a levy is a matter for the Australian government. If the cost of the natural disaster is higher than we have estimated—and, indeed, we have yet to incorporate the costs of the cyclone into the estimates—then the costing arrangements are clear under the NDRRA. The strategies that each government may then use to fund their relative shares are a matter for them to consider in their relevant budget formulations. I imagine that we will have better estimates leading up to the preparation of budgets for this coming year. [p.19]

Coalition Members note that revenue from the new flood tax will go straight to consolidated revenue. This means the proceeds of the tax are available to Government and subject to any policy change or reprioritisation the Government may see fit. Indeed, the flood tax revenue may not be used for the repair and reconstruction effort at all. Alternatively, there is a high likelihood this new tax will be extended or increased on the grounds there is some pressing need at the time.

No economic argument in favour of a new tax

There was a suggestion by both the Federal Treasury and Queensland Treasury that the size and scale of this most recent disaster was different to disasters in the past. Previous recent examples include Cyclone Larry in 2006 and the Black Saturday bushfires in Victoria in 2009 saw 173 people killed; 2,000 homes destroyed; and, at most recent estimate, $4.4 billion worth of damage. The size and scale of this disaster is, tragically, comparable.

> **Mr CIOBO**—…Why is this different from those previous situations? And why was there not a need to impose a new tax previously?
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> **Mr Ray**—I think the short answer to the question is that in those previous cases the government of the day decided not to impose a tax. [pp.7-8]

Economic expert, Mr Saul Eslake, provided very strong evidence that the introduction of a new flood tax was one of "political choices rather than economic imperatives." [p.29] He went on to say "My point is simply that the decision to choose to fund a third of the cost through a levy is a political choice rather than an economic one." [p.30]

Economic experts, Mr Saul Eslake and Prof. Warwick McKibbin, both highlighted there were three pathways (or a combination thereof) available to a government to meet unanticipated costs associated with, for example, natural disasters. These are:

- Impose a new tax or increase an existing tax/taxes;
- Reduce spending in another programme/programmes;
- Borrow the necessary funds and repay the debt over time.

According to the evidence presented, the weight of economic opinion was that it would be highly undesirable to fund disasters reconstruction and relief with new taxes as both a matter of principle and precedent.

> **Mr Eslake**—...I would be concerned if every time a significant or expensive natural disaster or indeed any other exigency fell to the Australian government the response was to slug the 40 per cent of the population who are considered rich enough to bear an additional tax burden. I think that would be problematic, although there is an element of political judgment in that as well as economic. But, obviously, if you continue to increase marginal rates of tax on a segment of the population by large amounts or with high regularity over time then there could well be some adverse consequences for incentives to work, save, invest and the like, which have been well documented in the economics literature. [p.36]
>
> **Prof. McKibbin**—…I wish to comment on the principle of how to finance the cost of a natural disaster or any temporary negative economic shock. The main reason for focusing on this issue, despite the relatively small amount of money involved in the current case, is to make sure that important principles are in place

> for future disasters and future economic decisions which may be of significantly larger magnitude.
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> Most economists who study public finance would support the view that taxation is not the optimum way to finance the reconstruction of infrastructure after a natural disaster. The argument has a long tradition in economics. [p.37]
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> **Prof. McKibbin**—…My view is that we should always, where possible, establish good principles for economic management because when the big decisions have to be made we have a framework in which to act, whereas if we continue to do what we have always done we end up becoming a banana republic. We have to e very careful that all decisions, even the small ones, are done in the appropriate way. [p.39]

The economic consensus was clear. The Government's decision to impose a new flood tax was based purely on 'politics' and not on 'economics'. Furthermore, the economic experts, Mr Eslake and Prof McKibbin were clear in their view that the Government's new tax was the least preferred policy response.

> **Prof. McKibbin**—…I think that in the case of a disaster it is almost uniformly accepted by economists, in principle, that a tax is not the best way to fund it.[p.39]

Evidence was provided as to the impact of the floods on GDP growth and the significance of the flood tax in this context. It is clear from the evidence that despite the Government's argument that the flood tax is required because of the 'unprecedented' economic disaster of the floods, this is not born out by Treasury's evidence.

> **Mr JONES**—A couple of questions about Queensland's contribution to GDP and the impact of the flood and disasters in Queensland on GDP. Has the treasury done some modeling on the impact of the disaster on—
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> **Mr RAY**—Yes we have. The government has published the broad results of that. Our estimate is that it will affect GDP growth by about half a percentage point in 2010-11, negatively, and most of that will be in the March quarter. Then in the recovery phase there will, as a result, be some increase in GDP growth.
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> **Mr JONES**—How important does treasury think it is for the rapid rebuilding, replacement and repaid of public infrastructure to meet those GDP estimates or forecasts?

> **Mr RAY**—We would think that the primary need for rapid rebuilding of the infrastructure is to help affected communities. That would be our primary concern rather than the GDP forecast. [p.11]

Unintended consequences of the flood tax

An unintended consequence of the Governments new flood tax is that it may create a disincentive for people and companies to donate to disaster relief efforts in the future. There is real concern large donations from corporate entities and individuals will be undermined as a consequence of the view that a 'temporary disaster tax' of some form or other will be imposed by the Government.

> **Prof. McKibbin**-…Finally, there is the problem of unintended consequences. Announcing a tax to finance flood reconstruction has the danger that it may cause those who have generously donated money to the various flood relief campaigns for those in particular need to be unhappy that they are being forced, through the taxation system, to make additional payments in excess of what they were willing to give. By being surprised this way, people may not donate as much in the event of future natural disasters because they will expect that the government will tax them again. Thus, imposing a flood levy to finance infrastructure may make people more reluctant to give to disaster relief in the future. [p.38]

Evidence was also presented that a levy is an especially inefficient way to fund rebuilding and reconstruction costs because of the high compliance, collection and enforcement costs, especially in circumstances where exemptions apply.

> **Prof. McKibbin**-…An additional public finance argument against a levy—and this is as distinct from both borrowing and cutting spending—is that there are significant compliance and enforcement costs associated with introducing a new tax. These may be significant, especially when there are exemptions from the levy that will need to be assessed on a case-by-case basis. These transaction costs will reduce the amount of revenue that is available for spending on reconstruction, and thus it is the highest cost way of financing the rebuilding in the current case. [p.39]

Professor McKibbon referred to 'churn' and said that up to 10 per cent of the revenue of the tax could be lost through churn and collection. [p.39]

The Commonwealth's introduction of these bills creates and further entrenches the 'moral hazard' for the Commonwealth vis a vis the states. This existing moral hazard exists whereby states do not obtain commercial insurance cover for their assets given the long-standing disaster recovery arrangements that effectively see the Commonwealth underwrite state government assets

> **Mr Bradley**—As I mentioned in my opening comments, the NDRRA is the established mechanism by which the Australian federation manages the risk of catastrophic events...
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> … We have considered the issue or reinsurance for our captive insurer, but at the time that we considered that we did not consider that that represented value for money for the state. It is the case that some other states do have reinsurance arrangements in place... [p.20]
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> **Mr CIOBO**—So it is more frequent and yet the view is taken that it was still not wise to seek reinsurance. Is that what you are saying? When I say not wise, uncommercial, not necessary, superfluous, whatever word you want to use.
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> **Mr Bradley**—We did not take that decision in relation to natural disaster events because of longstanding arrangements which are in place for natural disaster at a national level.
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> **Mr CIOBO**—Because the Commonwealth will step in and pick up the tab.
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> **Mr Bradley**—There are sharing arrangements which work and have worked over a long period of time between the Commonwealth and the states. [p.24]
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> **Mr CIOBO**—Are there insurance products available on the market today that would cover the public costs that are being borne in this situation?
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> **Mr Sullivan**—There are examples internationally in far more disaster prone areas—for example, in parts of the Caribbean and in Alabama in the US—where they have taken out these products to fund their own recovery efforts. In many cases those would not fund 100 per cent of a recovery effort. That would be a matter of how much appetite for risk the state has, how much they want to push out to global reinsurers. There are certainly products

> available. They are highly configurable, and you can accept as much or as little of the risk as you like. [p. 49]
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> **Mr CIOBO**—... With respect to what I would phrase 'moral hazard,' we heard from Queensland Treasury's representative that part of their consideration in electing not to seek re-insurance on public infrastructure assets was the spread of costs and responsibility for the reconstruction efforts, which he said under arrangements with the Commonwealth represented somewhere between as low as 25 per cent and as high as 75 per cent, borne by the Commonwealth, depending on the intensity of damage following a natural disaster. I am interested in your economic comments around the moral hazard of a state government electing not to obtain insurance because of the Commonwealth stepping in. Is that of potential significance for the Commonwealth down the track?
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> **Mr Eslake**—Prima facie the answer I would give to that question is yes. As I understand it, some other state governments do have reinsurance policies in place to cover them for at least part of the cost of natural disasters. The Queensland government and previous Queensland governments have made different choices. To the extent that the Queensland government's choice has been influenced by the knowledge that three-quarters of the cost that would in the first instance fall to the Queensland government would subsequently fall to the Commonwealth, I think that is something the Commonwealth ought to be rather concerned about. [p.33]

The Committee heard clear evidence that reinsurance cover is available to all Australian governments vis a vis natural disaster cover.

The policy need for this form of cover is especially pronounced with respect to the Commonwealth Government given its 'traditional underwriter' status vis a vis the states.

The passage of these bills will serve to further 'cost shift' state governments responsibilities to seek commercial cover for public infrastructure to relying on the Commonwealth Government and newly created precedent of imposing a new tax to meet expenses previously borne from consolidated revenue.

The Coalition is also concerned that people aged between 55 and 60 years of age who draw down on their retirement income, will be paying a percentage of their life savings towards the flood levy.

> **Mr BUCHHOLZ**—…I have a concern that if people under 60 years of age who are looking to retire draw down on their super in that cycle they will pay a percentage of their life savings into the levy…
>
> **Mr Willcox**—…We are aware of an issue having been raised in the parliament, yes. [p.13]

Who will pay for this flood tax?

The ACTU made the argument that "those who can most afford it" should pay the tax. [p.69]

Taxpayers will incur the new tax imposed by these bills once their taxable income exceeds $50,000 a year unless they have received the Australian Government Disaster Relief Payment.

It should be noted that the average wage in Australia is currently $65,000 a year and the additional tax burden will be felt by average Australian families. The ACTU was supportive of this threshold despite the fact that it cuts in below the average wage.

There is also a high likelihood of inequities arising as a consequence of the design and implementation of this new tax if the bills are given passage. There is no guarantee that people indirectly affected by the disasters won't have to pay this new tax.

> **Prof. McKibbin**—…I am sure that there are Queenslanders out there who had no insurance, who incurred significant damage and did not receive any assistance from the government. They will now be hit with the levy.[p.43]

Conclusion

Coalition Members note the very short time allowed for inquiry and comment on the Bill and believe it was insufficient to fully examine all aspects and consequences of the Government's new flood tax.

That notwithstanding, Coalition Members sought to work constructively with the Government on the examination of the impact of the Bill, especially to bring confidence to those adversely affected by the floods in Queensland and Victoria by not unnecessarily delaying consideration of this Bill.

The imposition of this new flood tax is entirely arbitrary and not required in the context of a $350 billion annual budget for the Commonwealth.

The policy rationale for the imposition of this new tax is economically very weak and the worst choice out of the three options available to the Government of the day.

There is sufficient scope within the existing parameters of the Commonwealth's budget for the anticipated $1.8 billion to be raised from this new flood tax to be achieved through expenditure savings.

Had the Government not wasted billions of dollars of taxpayers money already in mismanagement and budget 'blowouts' such as the BER and roof insulation debacle, there would be no need for this new tax.

The Government's imposition of this new flood tax runs contrary to historical precedent with no recent Commonwealth Government having to impose a new tax to meet the costs associated with the repair and reconstruction effort following a natural disaster/s.

The passage of these bills will create a dangerous new precedent allowing a government to impose a new tax in response to a natural disaster, or any other 'unforeseen' event claiming it was unanticipated expenditure and warrants a special revenue item.

There are foreseeable unintended consequences arising from the imposition of this new tax. These include the likelihood that the Government's policy response on this occasion will actually create a disincentive for Australians' to donate toward their fellow Australians in times of trouble under the belief the Government will impose a new tax which will be used for that purpose.

The passage of these bills will further entrench the moral hazard of the Commonwealth vis a vis the states as 'political' and 'fiscal' cover is provided to state governments to not seek commercial reinsurance arrangements for public infrastructure on the basis the Commonwealth will effectively 'underwrite' the costs of repair and reconstruction.

Despite Government statements that the tax will not be extended or increased, and that no further taxes will be imposed for any additional natural disasters, the government has a record of broken promises. The only way that Australian families can be guaranteed that they will not be slugged with more taxes is to stop the imposition of this new tax.

Recommendation

For the reasons outlined above, Coalition Members of this Committee recommend the Bill be rejected.

Mr Steven Ciobo MP, Deputy Chair

Mr Scott Buchholz MP

Ms Kelly O'Dwyer MP