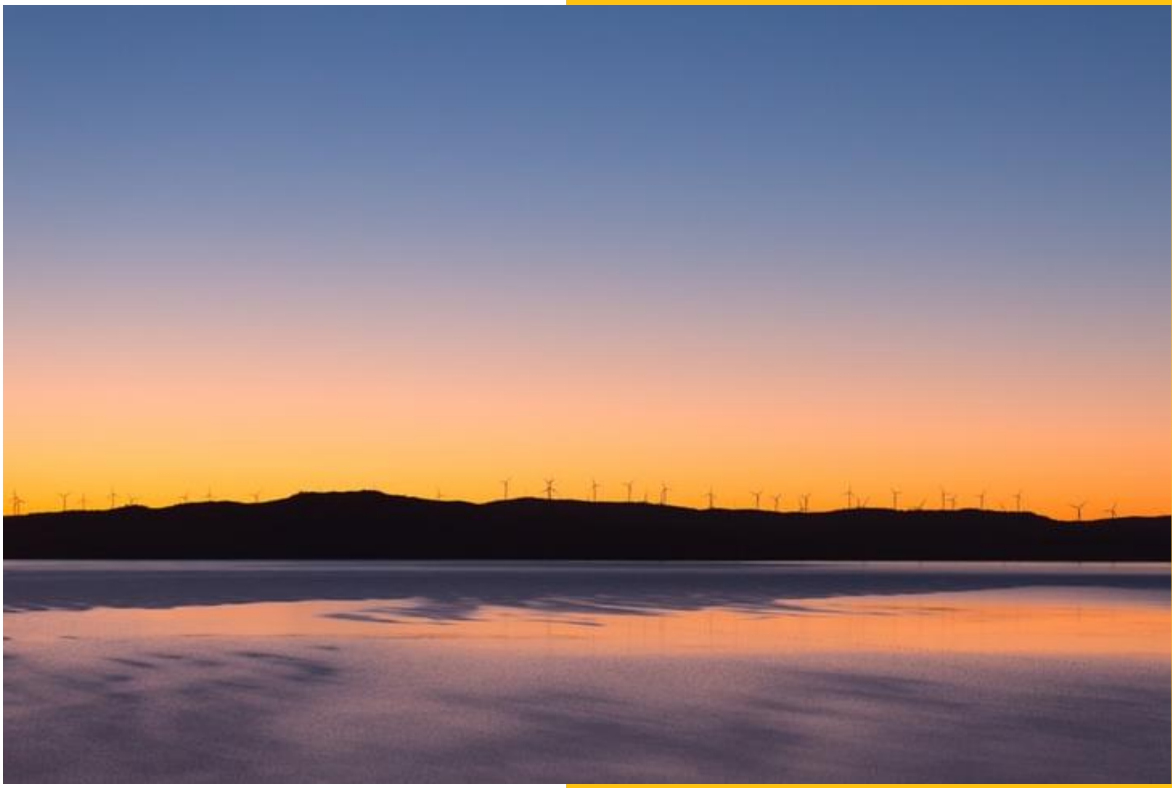
22 November 2019

Federal Financial Relations Review



NSW Business Chamber

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Introduction

The NSW Business Chamber (the Chamber) welcomes the opportunity to provide a submission to the NSW Review of Federal Financial Relations (FFR Review).

The Chamber is one of Australia's largest business support groups, with a direct membership of 20,000 businesses and providing services to over 30,000 businesses each year. The Chamber works with businesses spanning all industry sectors including small, medium and large enterprises. Operating throughout a network in metropolitan and regional NSW, the Chamber represents the needs of business at a local, state and federal level.

The Chamber's 2019-20 pre-Budget submission recommended for the Government to commission an independent review of state taxes and intergovernmental finances with a view to improving the efficiency and sustainability of NSW state finances. We are pleased the FFR Review will offer an opportunity to examine these questions.

Much has been made recently of the need for Australia to embark on a new wave of structural reforms to improve our productivity performance and our future prosperity. The FFR Review provides an opportunity to consider **how** reforms can be implemented. Many earlier reviews have examined potential reforms that could greatly improve the performance of our economy. Yet many of these reforms remain unimplemented.

It is a disservice to the Australian community for the states and territories to be expected to reform in isolation. The most fruitful reform opportunities would necessitate close collaboration between all tiers of government in Australia. As a result, the Chamber welcomes the FFR Review and encourages the Commonwealth to be a constructive partner to this conversation.

This submission raises many concerns relating to funding and tax arrangements affecting the business community. Part 1 considers the sustainability of state finances, Part 2 examines the tax system, Part 3 identifies ways to improve collaboration between governments, Part 4 considers funding arrangements relating to infrastructure, and Part 5 raises concerns with the funding of education and training.

The Chamber appreciates this review will be considered in close consultation with the NSW Productivity Commission's white paper process. We look forward to the opportunity to engage with these reviews.

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Recommendation 1

New proposals involving increased government spending should be considered through a robust public expenditure framework recognising the role of government with respect to the delivery of public goods, and not those that can be delivered and funded privately.

Recommendation 2

The FFR Review should examine how potential changes in the size of government will affect the fiscal gap over time.

Recommendation 3

The Government should ensure the NSW Budget does not have a contractionary effect on the NSW economy given the weaker economic outlook.

Recommendation 4

The NSW Budget should remain in surplus underpinned by robust expense management implemented over the next four years. All announced tax cuts should be implemented, in full and on-schedule. Any improvement in the fiscal outlook should be used to reduce taxation.

Recommendation 5

The Chamber maintains that nominal gross state product be used as the predominant basis for benchmarking expenditure growth and addressing the emerging fiscal gap. The FFR Review should consider whether the *Fiscal Responsibility Act 2012* remains fit for purpose in ensuring the sustainability of state finances.

Recommendation 6

Windfall gains resulting in unexpected improvements in Budget parameters should be quarantined to support future tax reform endeavours.

Recommendation 7

The Commonwealth and other states and territories should engage constructively with the FFR Review.

Recommendation 8

Absent more comprehensive reform (including reform facilitated with support from the Commonwealth), the ambition of recent reforms to transfer duty thresholds should be boosted to ensure the future reform challenge does not become greater.

Recommendation 9

Taxes on insurance should be minimised or abolished to make it easier for businesses to mitigate risk.

Recommendation 10

Local government rates, including the IPART Review, should be considered as part of the FFR Review.

Recommendation 11

Rates ultimately paid by businesses should not be increased to fund local government services delivered to residential ratepayers. Additional mechanisms should be considered to protect businesses from any rate increases that may result from implementation of recommendations from the IPART Review.

Recommendation 12

Payroll tax administration costs warrant a higher threshold than might otherwise be the case. NSW should have a payroll tax threshold that is sufficient to ensure we are competitive with other jurisdictions and which minimises tax administration burdens.

Recommendation 13

Regional employers should be given immediate access to the $1m threshold.

Recommendation 14

Progress should be made toward recommendations 6 and 12 of the PRT Review.

Recommendation 15

Revenue NSW should ensure clarity for businesses engaging in chain of on-hire arrangements by adhering to revenue rulings relating to these arrangements.

Recommendation 16

The FFR Review should consider opportunities to collaborate on the reform of state-based payroll taxes. Options include redesigning the payroll tax base to improve payroll tax administration and replacing existing taxes with alternative revenue sources in partnership with the Commonwealth.

Recommendation 17

The FFR Review should consider options to implement the FESL under a revised model that is fairer and more efficient than the ESL.

Recommendation 18

Current arrangements for funding emergency services are not optimal and should not underwrite new costs. Alternative funding arrangements are needed.

Recommendation 19

The FFR Review should recognise there are both benefits and costs associated with our federation and seek to identify ways to maximise the benefits while overcoming some of the challenges.

Recommendation 20

The NSW Government should recognise that its responsibilities exist within a national context and refrain from implementing idiosyncratic responses that have the potential to obstruct the development of nationally consistent approaches to problems that are not unique to NSW.

Recommendation 21

The NSW Government should learn from the experiences of other jurisdictions and use best practice regulatory standards implemented elsewhere in Australia. This is vital to ensuring NSW is not over-regulated.

Recommendation 22

The NSW Government should continue to take a pragmatic approach to directly address cross-border issues as they arise. All future policies should be assessed for any impacts on cross-border communities, including as part of new regulatory impact assessment processes implemented as a result of the Greiner review. The regulatory and policy environment in neighbouring jurisdictions should be monitored and, if required, changes made to ensure NSW is competitive with the rest of Australia.

Recommendation 23

The FFR Review should consider how programs similar to the Asset Recycling Initiative could be implemented to incentivise and drive reform.

Recommendation 24

Any state-significant reforms that boost the Commonwealth's fiscal position should be returned to the reforming jurisdiction.

Recommendation 25

The financial capacities of local governments should be considered as part of the FFR Review.

Recommendation 26

BCR assessments should not structurally disadvantage projects close to state boundaries. While funding arrangements in these locations may be more complicated, NSW communities located in border regions should not be disadvantaged as a result.

Recommendation 27

The Government should continue working with the Commonwealth to review the National Agreement for Skills and Workforce Development and ensure that future funding arrangements meet revised goals.

Recommendation 28

The Government should work with the Commonwealth to increase the availability of VET Student Loans by:

- removing the 20 per cent loan fee on VET Student Loans;
- expanding the eligibility to Certificate III and Certificate IV students; and
- expanding the eligible qualifications and RTOs.

Recommendation 29

The Government should request the Commonwealth to expand the availability of incentives for existing worker trainees.

Recommendation 30

The Government should ensure the Commonwealth funds any shortfall in the Skilling Australians Fund over the life of the agreement.

Recommendation 31

The Government should request the Commonwealth Government introduce a $1,000 National Apprentices Transport Subsidy to assist training workers with the cost of work-related travel.

Part 1 – Sustainability of state finances

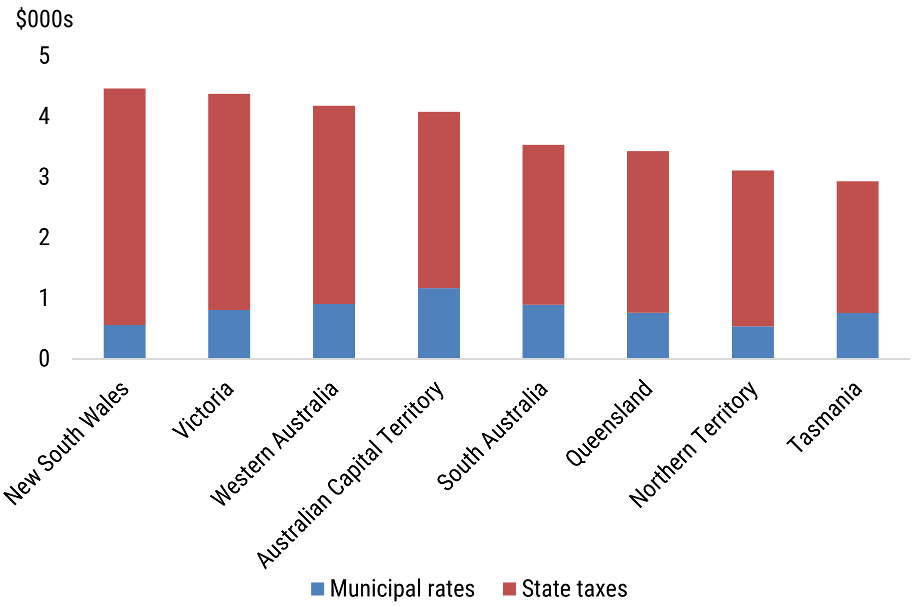
The Discussion Paper appropriately frames the federal financial relations challenge as one relating to NSW's capacity to deliver services to the standards the community expects. As the 2016 NSW Intergenerational Report (2016 IGR) makes clear, NSW faces an emerging fiscal gap which will necessitate either: a recalibration of expectations about the quality and scope of services the Government can deliver, higher taxes, or a combination of both.

The role of government

The Chamber acknowledges that governments play an important role in delivering public goods and services. In turn, we need a thriving private sector so we have the productivity capacity that ultimately funds and delivers these services. It is important for business to be successful so these services can be delivered to the standards the community expects.

Taxpayers are rightfully concerned about the amount of tax they pay. NSW is the highest taxed state with the average NSW resident paying $4,464 per annum in state and local government taxes compared with a national average of $4,087 (see Chart 1).

Chart 1 – State and municipal taxes: Per capita, 2017-18



Source: ABS, NSWBC calculations.

Higher taxes reduce disposable income and create impediments that harm the productive capacity of the NSW economy. While the merits of implementing changes to the tax mix will be considered separately in Part 3, it is almost universally the case that higher taxes — no matter which specific taxes are relied upon — will have a negative effect on the performance of the economy. Although taxes may be used to fund services which contribute to economic capacity (such as skills and infrastructure), there needs to be ongoing ambition to reduce the impact of taxes across the board. We should aspire to reduce taxes rather than increase spending on programs which do not contribute to our economic capacity or that cannot be justified on policy grounds.

Minimising wasteful and unnecessary spending requires a robust public expenditure framework recognising the role of government with respect to the delivery of public goods, and not those that can be delivered and funded privately. Some examples of public expenditure raise questions about the extent to which this benchmark has been met.[1]

There are multiple reform agendas warranting an expansion of financial support from the Commonwealth. These include addressing fiscal gaps and facilitating tax reform. These reform agendas need to be considered together otherwise there is a potential that one will be crowded out by the other. Projections in the 2016 IGR are premised on status quo policy settings and there is an opportunity to present alternative scenarios where there are alternative trajectories depending on how government services evolve over time. These should be considered as part of the FFR Review as it more accurately depicts the nature of the challenge and the decisions we face.

Recommendation 1

New proposals involving increased government spending should be considered through a robust public expenditure framework recognising the role of government with respect to the delivery of public goods, and not those that can be delivered and funded privately.

Recommendation 2

The FFR Review should examine how potential changes in the size of government will affect the fiscal gap over time.

Employers cannot absorb increasing pressure to fund public goods

Robust expense management should not result in cost shifting to the private sector. A concern for the business community are the increasing pressures placed on business to fund, and in some cases deliver, public goods and services which might otherwise be viewed as within the domain of government. Examples span a range of policy areas including healthcare, family support and the funding of local services.

A related concern is where businesses are over-relied upon to fund services delivered by government. Businesses are often seen as an easy target given it is a constituency that does not vote and has a higher perceived ability to pay (even if this is not the reality). For example, residential and commercial real estate is treated very differently for the purposes of taxation and local government rates. As is evident across NSW, businesses pay much higher rates than the residential ratepayers. Equally, the current narrow-based land tax disproportionately affects commercial property owners.

Employers may choose to boost non-monetary benefits as part of their overall remuneration package to employees. But these benefits cannot always be offered

[1] For example, the NSW Active Kids Rebate, to which $291.1m in extra funding was committed over the next four years, does not meet the technical requirements of a public good. Similarly, there has been much public scrutiny over several high profile infrastructure investments including whether they represent value for the taxpayer.

universally. For some businesses it can be difficult to take on additional responsibilities due to size or other factors.

As our standard of living improves, employee benefits previously offered to attract and retain staff become expected as standard for all employees. The concern is not the expansion of benefits expected by the community, but rather whether employers are best placed to deliver and fund them. In many cases, it is the universality of these benefits which may be regarded as important (such as where it supports workers in the management of risk or smoothing out changes in income resulting from changing circumstances). In these cases the responsibility should lie with government rather than employers (otherwise those not in traditional employment, including small business owners, do not have access).[2]

A contemporary example is the expanding consideration of mental health in the workplace. Mental health is a whole of society problem and the workplace will need to feature prominently in future strategies to improve outcomes for the community. However, improved outcomes will only be possible if this work is done within a broader policy architecture that both recognises constraints faced by employers and provides support to businesses within that framework.

The Chamber is glad to see the NSW Government is taking steps to identify and accommodate those constraints in relation to its 'mentally healthy workplaces' strategy, but believes that more work needs to be done to ensure the lessons learned in one jurisdiction are shared with others.

State finances: the contemporary challenge

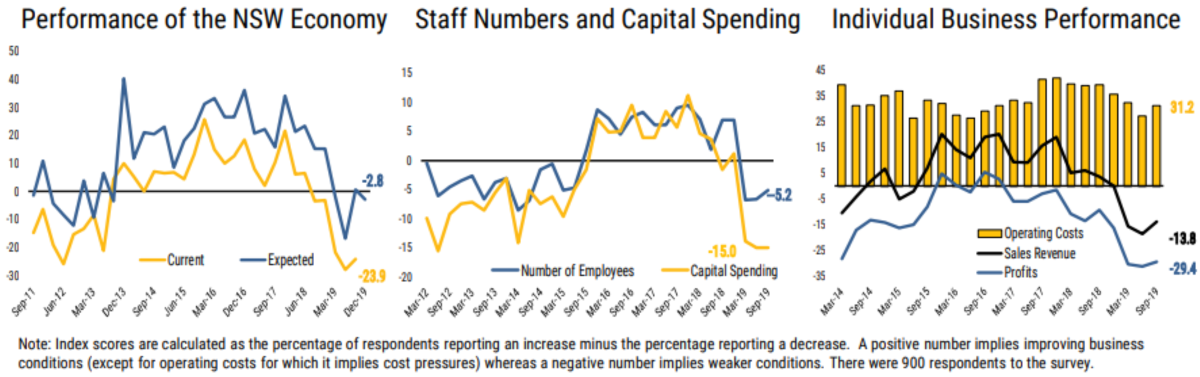
The Chamber's 2019-20 pre-Budget submission recommended for the Government to commission an independent review of state taxes and intergovernmental finances with a view to improving the efficiency and sustainability of NSW state finances. We are pleased the FFR Review will offer an opportunity to examine these questions. There are both near and long-term challenges associated with the NSW Budget.

The near-term

NSW is facing new challenges making budget management more difficult than in recent years. A weaker property market has impacted the Budget and other parts of the economy. Dwelling investment has weighed on growth while households are less optimistic and are spending less. The Chamber's Business Conditions Survey[3] suggests business confidence is down with many operating in a holding pattern with factors such as elections, drought and international developments creating uncertainty for business (see Chart 2).

[2] Contrasting the model of health insurance in Australia and the United States illustrates some of the pitfalls.
[3] See https://www.nswbusinesschamber.com.au/Issues/Business-Surveys/Business-Conditions.

Chart 2 — Overview of the September Business Conditions Survey



Source: NSWBC Business Conditions Survey, September 2019.

Lower housing market turnover has led to volatility in stamp duty revenue. Other factors have also affected the revenue outlook including weak household demand which has precipitated downward revisions to GST revenue.

The Chamber views these factors as cyclical in nature and does not consider them to represent a long-term threat to NSW state finances. The reform priority from a fiscal management perspective should instead be to reduce the volatility of state taxes. The Chamber maintains that over the next four years the focus of government should be on limiting the impact of government taxes, fees and charges so that businesses can grow, invest and create jobs in their communities.

Indeed, the Government should ensure the NSW Budget does not have a contractionary effect on the NSW economy given the weaker economic outlook.

Fiscal sustainability over the medium to long-term

Responsible fiscal management over the long term will involve stabilising the NSW tax mix so that it is less vulnerable to property market volatility. In practice, this will involve reducing NSW's over-reliance on transfer duty and moving toward more stable taxes or revenue sources (which ideally are more efficient and do not discourage investment and employment growth).

Robust expense management remains the most important mechanism to ensure prudent fiscal management over the long-term. The Chamber notes that budget surpluses expected over the forward estimates rely on slower expenses growth (with expenses projected to grow at a slower pace than nominal gross state product and revenue). The Chamber supports efforts to realise efficiencies across government agencies as well as considering how digital transformation can drive improvements and efficiencies in government service delivery.

The Government currently commits itself to maintaining expenses growth below long-term average revenue growth as set out in the *Fiscal Responsibility Act 2012*. Expenses growth has been maintained below long-term average revenue growth of 5.6 per cent as defined the *Fiscal Responsibility Regulation 2013.*

The Chamber notes the Government's fiscal responsibility architecture does not directly establish a robust constraint on the size of government given the 5.6 per cent expenses growth ceiling exceeds projected growth of nominal gross state product. It is also significantly higher than forecast revenue growth over the forward estimates. The

Chamber has previously recommended that nominal gross state product be used as the predominant basis for benchmarking expenditure growth and addressing the emerging fiscal gap.[4]

Recommendation 3

The Government should ensure the NSW Budget does not have a contractionary effect on the NSW economy given the weaker economic outlook.

Recommendation 4

The NSW Budget should remain in surplus underpinned by robust expense management implemented over the next four years. All announced tax cuts should be implemented, in full and on-schedule. Any improvement in the fiscal outlook should be used to reduce taxation.

Recommendation 5

The Chamber maintains that nominal gross state product be used as the predominant basis for benchmarking expenditure growth and addressing the emerging fiscal gap. The FFR Review should consider whether the *Fiscal Responsibility Act 2012* remains fit for purpose in ensuring the sustainability of state finances.

Quarantining unexpected budget improvements to support future tax reform

The fiscal outlook is subject to uncertainty and there is always the potential that outcomes will vary from projections. Windfall gains resulting from fiscal conditions that are more favourable than expected should not be used to underwrite government expenditure that cannot realistically be afforded into the future.

The Chamber believes there is merit in building a fund which could provide a buffer for a future Government that embarks on the difficult task of tax reform. For example, such a fund could be used to offer temporary relief for taxpayers most sensitive to a new regime. While such a fund is somewhat illusory, hypothecating windfall Budget improvements represents a pre-commitment from Government that it will refrain from engaging in unsustainable expenditure increases. It also establishes future accountability insofar as the Government would only be able draw on the funds for the purposes of pursuing reform.

The Government has previously invested windfall tax revenues into Restart NSW. This has resulted in $2.3bn in payments as at 30 June 2019. While this has supported fiscal discipline, NSW is beginning to reach infrastructure delivery and project constraints. For this reason there is merit in considering alternative purposes to channel windfall amounts.

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[4] See p3 https://www.nswbusinesschamber.com.au/NSWBC/media/ABI/NSWBC-Budget-Submission.pdf.

There is also the potential to expand the scope of pre-commitment by including improvements in other Budget parameters (such as general-purpose payments from the Commonwealth, or on the expenditure side).

Recommendation 6

Windfall gains resulting in unexpected improvements in Budget parameters should be quarantined to support future tax reform endeavours.

Part 2 – Efficiency of the NSW tax system

When viewed through both a political and economic lens, the Chamber accepts there are significant difficulties in ensuring the efficiency and sustainability of NSW finances. State governments left to their own devices face a dilemma between allowing highly inefficient taxes such as stamp duties grow to meet future revenue needs, or introducing new more efficient taxes — such as a broad-based land tax — which would require significant political and implementation challenges to be overcome.

The Chamber believes there is an opportunity for the FFR Review to break through this dilemma by collaborating across the federation.

National engagement and leadership is needed

We will forgo opportunities to improve outcomes for the Australian community if the states and territories are expected to reform their tax systems in isolation. In many ways this is an optimisation problem: which tier of government can introduce the highest-yielding reform package that the community will accept as fair and in the best interests of the country?

State governments typically levy the taxes which come with the highest economic costs while the Commonwealth possesses far greater revenue-raising capacity. There are gains from trade associated with collaboration on tax reform. The Commonwealth can facilitate reform by providing financial support while state governments can reduce taxes that maximise the economic dividends of reform.

These fundamentals have underpinned some of Australia's best examples of tax reform such as the introduction of the GST which was the result of collaboration between tiers of government.

Previous reviews and thought leadership contributions from other stakeholders have considered many of the best opportunities for collaboration on tax reform. This includes adjustments to the GST and giving states a share of income tax. While the Chamber does not offer any specific recommendations or views at this time, we support a sensible and constructive conversation about the merits of all the possibilities.

Recommendation 7

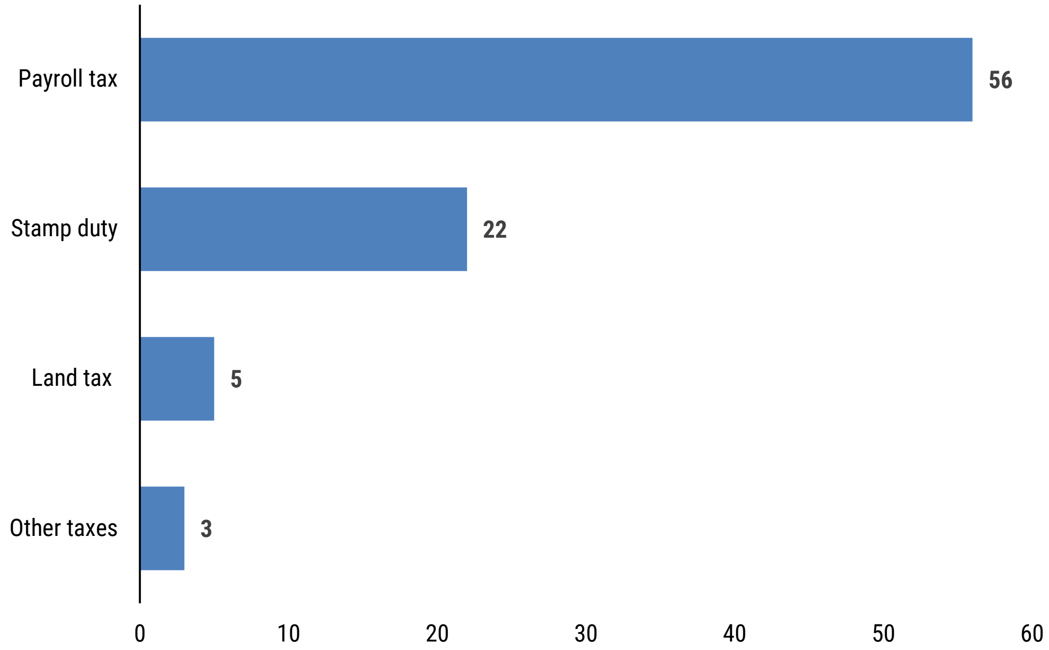
The Commonwealth and other states and territories should engage constructively with the FFR Review.

Business' concerns with the tax system

In broad terms, businesses are concerned with the effect of certain taxes on the financial viability and performance of their business (or specific activities within their business) as well as the administrative complexity of the tax system.

State-based taxes where businesses are directly involved as taxpayers tend to raise the most concern among the Chamber's members. Not only do these taxes add to administrative burden, their impacts are also highly visible as these taxes are critical to decisions within a business (such as whether to hire new staff or invest). That is why payroll tax is regularly raised as a top concern for our members (see Chart 3). Taxes like payroll are also dispiriting for businesses wanting to create jobs in their local communities and feeling they are unsupported in this endeavour.

Chart 3 - Unprompted responses raising a state tax issue as a concern



Note: Responses collated from free text answers to NSWBC Business Conditions Survey over four surveys between December 2018 and September 2019. Businesses were not prompted to raise a tax issue. Among respondents that raised stamp duty, 11 specifically indicated property-related duty; 1 specifically indicated motor vehicle stamp duty; and 10 did not specify (among the group that did not specify, it can be assumed many would be referring to transfer duty by its more commonly known name).

Source: NSWBC Business Conditions Surveys (as noted above).

But other taxes such as transfer duty also have significant negative impacts on business even if they are mostly affected through second-round effects that are not always obvious to those that do not directly pay the tax. For example, 2016 modelling by KPMG commissioned by the Chamber in *Taking on Tax: Reforming NSW Property Taxes*[5] demonstrated the extent to which industry value added would be boosted by reform to NSW transfer duty, including (but not limited to):

- rental hiring and real estate services (+2.57%);
- construction (+1.51%);
- financial and insurance services (+0.98%); and
- electricity, gas, waste and water services (+0.81%).

Even though they are less obvious, businesses are not blind to the impact of these taxes. Businesses engage with payroll tax on a monthly basis, so it is not surprising that it is among the top concerns of businesses that are liable. But it is particularly notable that

[5] See Table 4.1.4 which demonstrating the impact on industry value added of NSW replacing conveyancing duties with land taxes: https://www.nswbusinesschamber.com.au/NSWBC/media/Policy/FINAL-NSWBC-NCOSS-Taking-on-Tax-Report.pdf.

businesses are also very concerned about stamp duty[6] even though it is less frequently paid by a business (perhaps decades apart for transfer duty in some cases).

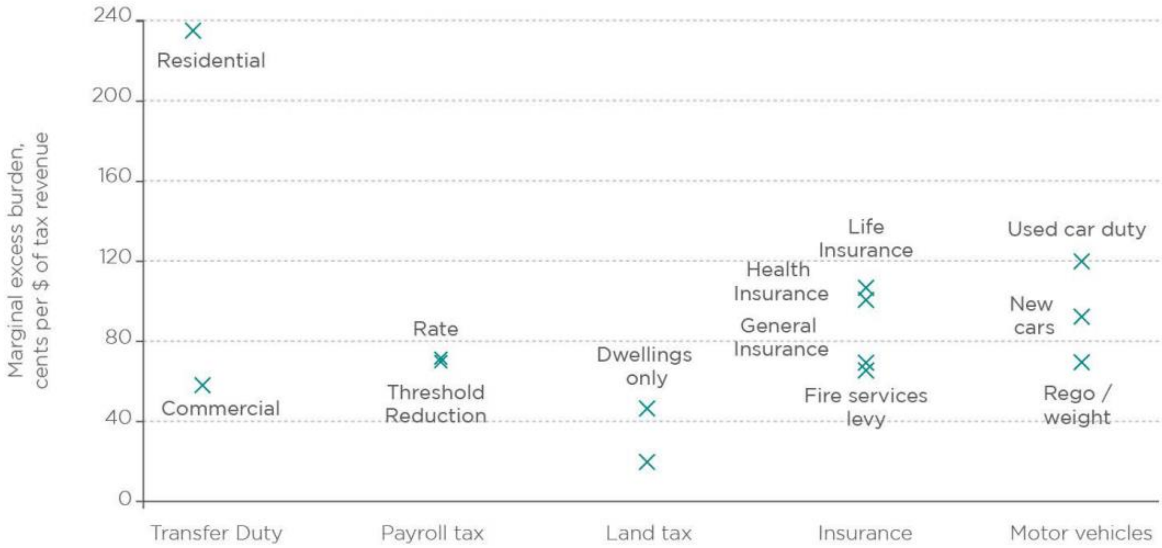
Economic costs: are the right taxes growing?

As with most of Australia's states and territories, the NSW tax base is comprised of taxes that do not meet the needs of a modern and sophisticated economy. These include:

- payroll tax which is a tax on employment;
- stamp duties which are the most economically harmful taxes used in Australia; and
- a range of other smaller taxes and levies, many of which impose significant administrative costs or frictions in markets even though they may raise very little revenue individually.

As noted in the 2016 IGR, transfer duty comes with high economic costs.[7] Yet transfer duty receipts have almost tripled over the past decade. This has resulted in the NSW tax system being one of the most inefficient in Australia (see Chart 4). NSW Transfer duty is the second highest in Australia (on a per capita basis) while total taxes on insurance a higher in NSW than any other state in Australia (see Chart 5).

Chart 4 - Estimates of economic cost of NSW taxes



Source: Centre of Policy Studies 2018, as presented in *Kickstarting the Productivity Conversation,* NSW Productivity Commission.

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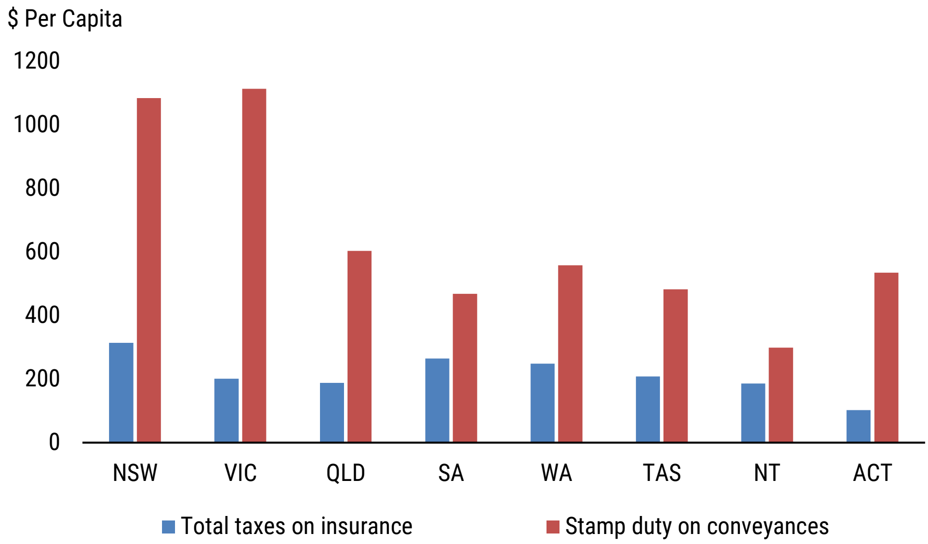
[6] The Chamber judges that many of the 'stamp duty' responses in Chart 3 were referring to transfer duty.
[7] Box 5.1, 2016 IGR.

Chart 5 – High economic cost taxes (selected), 2017-18



Source: ABS, NSWBC calculations

Similarly, payroll tax has grown to be the largest tax in NSW (overtaking total stamp duties in 2018-19), and is forecast to surpass $10bn by 2020-21.

The efficiency cost of payroll tax is only partially observable through modelling. Tax administration costs (which are generally outside the scope of what can be observed through modelling) are particularly high for payroll tax given complexities in the definition of wages and the inability to leverage existing or automated information systems to submit returns. These issues are particularly problematic for SMEs — feedback from our members indicate they incur around $10,000 in tax administration costs in meeting their payroll tax obligations. While some of these costs have been reduced by recent reforms, administration costs remain high for many businesses.[8]

But transfer duty is growing fastest. Despite a decline in transfer duty receipts over the past two years (due to a slowdown in property turnover), Budget forecasts suggest transfer duty will grow faster than all other major taxes (see Chart 6). According to projections in the 2016 IGR, this will continue over the next decade and beyond. These figures foreshadow the increasing economic costs of stamp duty. Decisions ought to be made today to reduce their impact on the economy.

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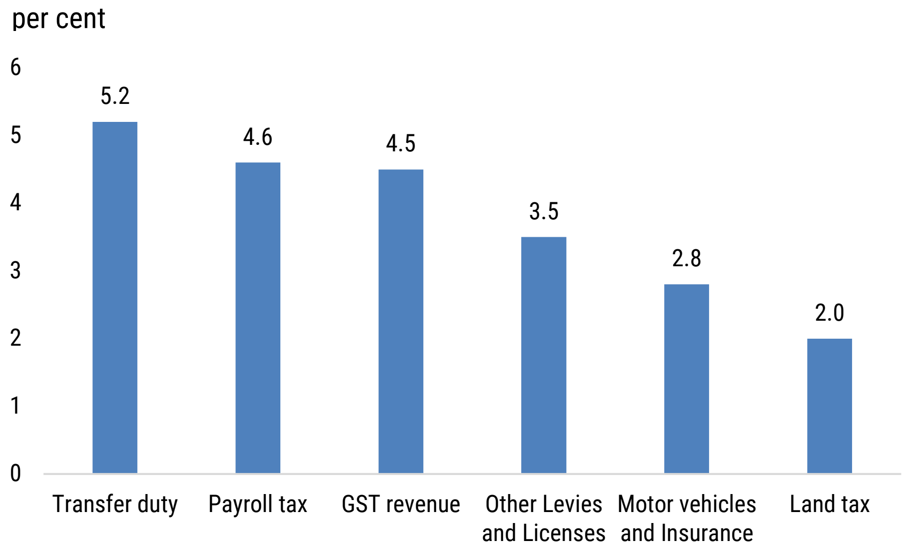
[8] See http://www.fesl.nsw.gov.au/projects-initiatives/review-payroll-tax-administration.

Chart 6 – Growth of NSW taxes



Source: NSW Budget Statement 2019-20-Paper No. 1

The Chamber welcomes recent reforms that increase the value of current thresholds in line with CPI. This will slow the growth in transfer duty but only to a modest extent. The change is a good start but transfer duty will continue to grow over time. This is because indexation does not address growth relating to transaction volumes while the increases to thresholds precipitated by CPI are insufficient to ameliorate bracket creep (the Sydney CPI is currently 1.7% over the year while property prices in Sydney grew by 1.8% in the month of September alone). Indexing to CPI also fails to account for capital improvements which uplift property values.

The benefits of reforming transfer duty are clear. The Chamber's Thinking Business Report — *Taking on Tax: Reforming NSW property taxes* found reform could boost GSP by 1%, household consumption by $1,600 per year, employment by 10,000 jobs, and real after-tax wages by 1.8%.

The Chamber strongly supports reducing the role of transfer duty in the NSW tax system, including by boosting the ambition of recent reforms to thresholds (to at least ensure the reform challenge does not become greater).

Other non-major taxes

While containing the growth in transfer duty is the biggest single challenge in terms of ensuring tax system efficiency, other taxes also impose disproportionate economic costs on the community. This includes close to $2bn collected in stamp duties on motor vehicles and insurance as well as more than $3bn from other levies and license fees.

Taxes which have the effect of increasing the cost of insurance are particularly pernicious. Many of the Chamber's regional members are disproportionately exposed to adverse weather events such as droughts, bushfire and flooding rains. That is why the Chamber advocated for tax changes, including abolishing stamp duty on insurance premiums for commercial and business premises in our *Keeping NSW Number 1* election campaign.[9]

Recommendation 8

Absent more comprehensive reform (including reform facilitated with support from the Commonwealth), the ambition of recent reforms to transfer duty thresholds should be boosted to ensure the future reform challenge does not become greater.

Recommendation 9

Taxes on insurance should be minimised or abolished to make it easier for businesses to mitigate risk.

Local government rates

The Chamber encourages the FFR Review to consider broader reform opportunities in the context of IPART's *Review of the Local Government Rating System* (IPART Review). Given the Chamber's broader policy priorities regarding both local government and property tax reform, we consider it important for the IPART Review to be properly considered.

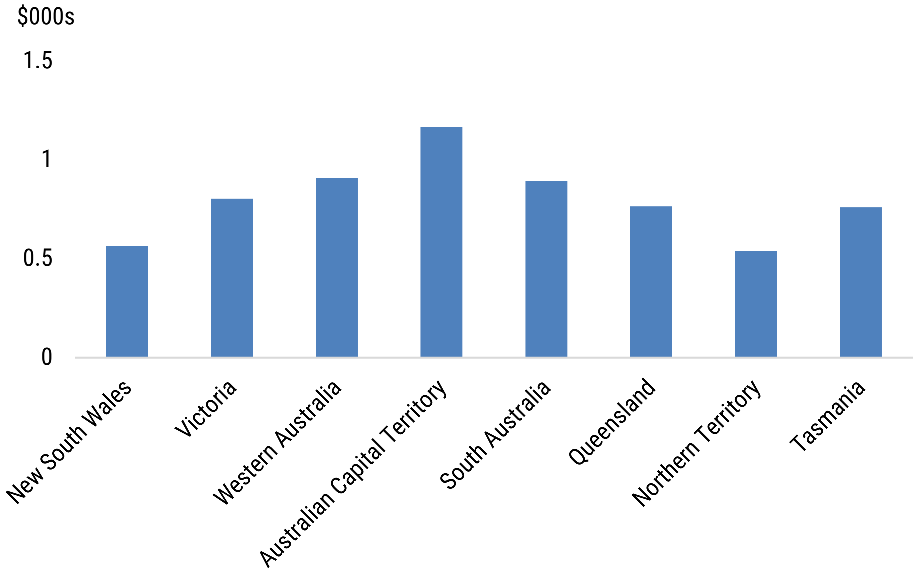
A key recommendation of the IPART Review is to facilitate an expansion to the rates base by moving toward a capital improved valuation method which is argued to be more closely related to drivers affecting the cost of local government services.

The Chamber supports the objective of allowing local governments' own source revenues to grow alongside the efficient cost of delivering local government services. To be clear, the Chamber would strongly oppose circumstances where revenue expands to fund wasteful and inefficient spending.

Insufficient growth in own source revenues will place increased pressure on other revenue sources — such as inefficient state-based taxes — to fund future expenditure. NSW rates are much lower compared to other jurisdictions (see Chart 7). While this is a good thing in isolation, governments must continue to deliver services to the community. If lower rate revenues shifts the burden onto other taxes then it is a false saving.

[9] See: https://www.nswnumber1.com.au/

Chart 7 - Municipal rates per capita



Source: ABS, NSWBC calculations

Lower rates relative to other jurisdictions does not itself imply a lower burden on business. Businesses are often seen as an easy target when it comes to rate settings. A concern is that local governments might prefer to increase rates for a constituency that does not vote and has a higher perceived ability to pay, even if this is detrimental to a local economy. Businesses already pay much higher rates than the residential sector. While some of this can be justified by their higher use of services on average, there is significant potential for cross-subsidisation between business and residential ratepayers. Pressures to grow local government rates should not result in increased pressures for business.

Part of the increased cost of local government services can be attributed to a shift toward high-density housing. It is essential to our economic competitiveness for the productive sector of our economy (business ratepayers) to be shielded from bearing increasing costs incurred by residential ratepayers. The Chamber supports mechanisms allowing the residential rates base to grow in line with the cost of maintaining population serving infrastructure and services in an efficient manner.

In our submission to the NSW Government's response to the IPART Review, the Chamber accepted there was conceptual appeal in increasing the share of total local and state government taxes collected from residential rates, given their relative efficiency.[10] We also accepted there was some conceptual appeal in moving toward a capital improved valuation method on the basis that it could potentially reduce pressures faced by business ratepayers.

On the other hand, the Chamber noted it would strongly oppose changes resulting in an overall higher tax burden for business relative to what would occur under status quo arrangements. This includes examining local government rates in the context of other state-based taxes as part of a deliberate and coherent strategy. It is also necessary to

[10] See https://www.nswbusinesschamber.com.au/NSWBC/media/Policy/190802_SUBMISSION_IPART_Rating-System_FINAL.pdf.

benchmark the efficiency of NSW local governments and their service delivery responsibilities when making comparisons about rate revenue across jurisdictions.

It would therefore be appropriate for this review to examine the potential to improve cooperation between tiers of government to inform the Government's consideration of recommendations from the IPART Review. Our submission to the Government response to that review advocated that recommendations 6 to 8 of the IPART report to be considered as part of the FFR Review.[11]

Recommendation 10

Local government rates, including the IPART Review, should be considered as part of the FFR Review.

Recommendation 11

Rates ultimately paid by businesses should not be increased to fund local government services delivered to residential ratepayers. Additional mechanisms should be considered to protect businesses from any rate increases that may result from implementation of recommendations from the IPART Review.

Payroll tax

The Chamber welcomes recent action to increase the tax-free threshold and implement of recommendations from the NSW Productivity Commissioner review of payroll tax administration (PRT Review).

The payroll tax threshold

One of the reasons the Chamber advocated for an increase in the payroll tax threshold was to reduce payroll tax administration costs incurred by employers. Based on survey feedback from our members, we estimate these costs to be around $10,000 for a business as they become liable for payroll tax.[12] With NSW previously having one of the lowest thresholds in the country, overall tax administration costs were higher in NSW than in other jurisdictions (in absolute and relative terms). A $1 million threshold will go some way to reducing the number of businesses caught up in the administratively onerous tasks associated with complying with payroll tax.

There remains considerable tax administration costs for business notwithstanding the positive outcomes of the PRT Review. That is why the Chamber supports maintaining a payroll tax threshold which is sufficiently high to reduce the number of small employers caught up in the payroll tax system while ensuring NSW is competitive with other jurisdictions.

The Chamber also maintains there is a need to ensure NSW has a competitive payroll tax rate. Some have proposed abolishing the payroll tax threshold to fund a reduction in the

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[11] See Recommendation 3, https://www.nswbusinesschamber.com.au/NSWBC/media/Policy/190802_SUBMISSION_IPART_Rating-System_FINAL.pdf.

[12] NSW Business Chamber Submission to the 2017-18 NSW Budget, Attachment A.

payroll tax rate to broaden the payroll tax base. While there may be economic benefits in theory, the Chamber maintains that payroll tax in its current form is far too complex and administratively burdensome to support a threshold below $1m. Lowering the threshold to cut the payroll tax rate would also have the effect of shifting the tax burden from NSW's largest employers to the small business sector.

Support for regional employers

The Chamber has advocated for regional NSW to have immediate access to the $1m payroll tax threshold rather than waiting until 2021-22 when it applies across NSW. This would be particularly welcome given the impact of drought and bushfires on regional businesses.

Contractor provisions

An outstanding area of concern is the interaction of the contractor and employment agent provisions of the *Payroll Tax Act 2007.* In our submission to the PRT Review, the Chamber argued that the complexity of these provisions create significant uncertainty and administrative burden for businesses in determining their payroll tax obligations.

The Chamber notes that the definition of wages for the purposes of payroll tax is unique. For example, the definition of wages for payroll tax and workers compensation purposes are not aligned mainly due to the fact that they are designed to achieve different public policy outcomes. But this does not mean these policy trade-offs cannot be re-examined.

The Chamber reaffirms recommendations made in its submission to the PRT Review which recommended the contractor and employment agent provisions be simplified to make reporting, record keeping, and understanding and practicing obligations easier for employers. This includes making progress on the implementation of recommendations 6 and 12 of the PRT Review, both accepted by Government, which relate to the complexity of the contractor provisions.

Chain of on-hire arrangements

The Chamber has become aware of significant uncertainty as to which party is liable for payroll tax in chain of on-hire arrangements (where an employment agent on-hires a service provider to another employment agent who in turn on-hires the service provider to its client).

There is ambiguity over which party is liable for payroll tax as Revenue NSW has the discretion to impose a liability on any one of the employment agencies existing in the chain of on-hire arrangement. The Chamber is aware of a number of cases where Revenue NSW appears to have contravened its own revenue ruling as to which party is liable.

The many businesses using chain of on-hire arrangements now have no certainty as to whether they are liable for payroll tax or not. A lack of certainty gives rise to the risk of overpaying payroll tax (and potentially double taxation if multiple parties report payroll tax liabilities on the same wages) or risking an ex-post payroll tax assessment against them where they will be unable to recover these costs from their clients.

Recommendation 12

Payroll tax administration costs warrant a higher threshold than might otherwise be the case. NSW should have a payroll tax threshold that is sufficient to ensure we are competitive with other jurisdictions and which minimises tax administration burdens.

Recommendation 13

Regional employers should be given immediate access to the $1m threshold.

Recommendation 14

Progress should be made toward recommendations 6 and 12 of the PRT Review.

Recommendation 15

Revenue NSW should ensure clarity for businesses engaging in chain of on-hire arrangements by adhering to revenue rulings relating to these arrangements.

Redesigning payroll tax

Payroll tax administration is a key justification for maintaining tax-free thresholds which are high enough to ensure small and microbusinesses are not caught up in the payroll tax system.

But there is potential to greatly reduce these costs if existing business processes — including accounting platforms and business systems — can be leveraged to reduce tax administration. Unlocking the potential of these systems would require a more fundamental rethink of the design of payroll tax. The Chamber observes that the bulk of the payroll tax base is already reported regularly to the ATO in some form. For example, employers must report fringe benefits, PAYG withholding, superannuation payments and payments made under an employee share scheme. Contractor payments represent the most significant challenge for employers as reporting for payroll tax purposes differs from what is required by the ATO.

If definitions and the payroll tax base were aligned to ATO reporting, employers would be able to utilise systems already in place. While additional metadata may be required to determine the jurisdiction of a payment (as ATO reporting is national), it is plausible that payroll or other business systems would be capable of collecting the required metadata to facilitate seamless reporting.

While the Chamber does not propose any specific reforms, it is conceivable that a reform program similar to the implementation of the GST could facilitate the removal of state-based taxes such as payroll tax subject to their replacement with a suitable alternative.

The Henry Review considered the potential to consolidate payroll taxes into a tax on employee remuneration administered through the PAYG withholding system. It also recommended replacing payroll taxes with revenue from more efficient broad-based taxes that capture the value-add of labour. Each of these options would require careful consideration of implications associated with altering the current payroll tax base, as well as how to distribute revenue between states and territories. They are nonetheless worth examining for their potential to significantly improve the efficiency of our tax system (including by reducing tax administration).

Recommendation 16

The FFR Review should consider opportunities to collaborate on the reform of state-based payroll taxes. Options include redesigning the payroll tax base to improve payroll tax administration and replacing existing taxes with alternative revenue sources in partnership with the Commonwealth.

Fire and Emergency Services Levy

In 2017 the Government announced it would defer the introduction of the Fire and Emergency Services Levy (FESL) to ensure small to medium businesses do not face an unreasonable burden in their contribution to the State's fire and emergency services. The FESL was previously proposed as a fairer and more efficient way to fund the costs of fire and emergency services given the current Emergency Services Levy (ESL) penalises those that take out insurance.

The Chamber was a supporter of the Government's efforts to move towards a fairer model for funding these services. Despite this support, it was clear that under the proposed model some individual businesses would be made significantly worse off even though insurance premium reductions may leave the business sector better off overall. The Chamber welcomed the Government's decision to assess the impact on these businesses.

Now several years after this decision to defer implementation, it is unclear if or when the Government will revisit the FESL into the future. The Chamber believes these reforms remain important.

While the Chamber does not recommend any specific approach, a fairer FESL could be achieved through an alternative rate structure, contribution caps or increasing the role of the fixed component under a revised FESL model. The Victorian model includes a two-tier rate structure on metro and regional property. This approach has the benefit of reducing the impact on property owners in high land value districts that would otherwise account for a disproportionate share of the overall costs.

Recommendation 17

The FFR Review should consider options to implement the FESL under a revised model that is fairer and more efficient than the ESL.

Firefighter compensation

In November 2018, the NSW Government made changes to workers compensation arrangements for firefighters. This was an important step toward ensuring appropriate care for firefighters affected by exposure to carcinogens.

While it is essential to secure adequate funding, these costs will ultimately be passed on in the form of higher property insurance premiums (for residential and business property owners) as well as additional charges to local councils (which will ultimately be passed on in the form of higher local government rates). Some of our members have reported large increases in their insurance premiums resulting from these changes.

Increasing the ESL to cover these payments only exacerbates existing concerns relating to the efficiency costs of insurance taxes. Alternative funding arrangements should be relied upon.

Recommendation 18

Current arrangements for funding emergency services are not optimal and should not underwrite new costs. Alternative funding arrangements are needed.

Part 3 – Effective collaboration between governments

Many of the challenges relating to our federation are long standing. Most stem from the vertical fiscal imbalance between states and territory governments and the Commonwealth. Over the past century, the Commonwealth has taken on greater responsibility for taxation while state governments remain the predominant vehicle for service delivery. This creates a mismatch between the entity responsible for collecting taxes from the community and the entity held accountable for delivering services.

This vertical fiscal imbalance has raised a number of questions for policy makers and stakeholders to the federation:

- Should states have greater powers to collect taxes independent of the Commonwealth to support greater accountability for taxation and expenditure decisions?
- What is the optimal balance of responsibilities between central and subnational governments?
- How can we better harness competitive federalism to incentivise and drive more favourable policy outcomes for the community (including mitigating where its effects may be pernicious)?
- How can we build a seamless national economy while recognising the sovereignty of state and territory governments?
- Can governance structures such as COAG be improved to facilitate more constructive cooperation between governments?

These are big questions that will no doubt feature heavily in the FFR Review. The Chamber notes that many of these questions may be answered differently when viewed through alternative policy lenses. The Chamber does not wish to present a philosophical position, but instead encourage a consequentialist view of how these issues impact the community.

The upside: policy settings must evolve to the new frontier

There are many examples where the NSW economy has been boosted by the forces of competitive federalism.

There are many examples where NSW has been able to gain insights from the experiences of other jurisdictions. This includes in areas such as infrastructure (seeing how other transport modes and approaches have been successful in other jurisdictions), tax policy (gaining insights as to how to better administer our tax system) and regulatory policy (observing the effectiveness of alternative policy frameworks at meeting policy objectives).

Equally, the very nature of competitive federalism means that NSW policy settings must evolve to meet new frontiers of best practice as demonstrated in other jurisdictions. Failing to do so would risk losing economic activity to neighbouring jurisdictions that are more attractive to start or grow a business. For example, competitive federalism provides a ceiling on taxes such as payroll tax and the amount of regulation that governments can reasonably expect businesses to comply. These gains are not zero sum as all Australians benefit from a business environment that is more conducive to economic prosperity. It also encourages Australia to improve its standing in a more competitive global economy.

The downside: policy settings are inconsistent and there is weak accountability

On the other hand, many of the Chamber's members operate in national or international markets. Many state-based differences in regulatory requirements create unnecessary frictions for businesses that operate across state borders.

This is a particular issue for SMEs seeking to expand nationally. Businesses need to comply with a complex array of laws and regulations, many of which aimed at achieving the same policy objectives. This includes differences in licensing requirements, tax administration and industry-specific regulation. While some larger businesses may have the scale to acquire the expertise needed to ensure compliance (whether in-house or otherwise), many SMEs do not and may refrain from expanding into new markets.

A further issue is the lack of accountability and cooperation in important policy areas for the Australian community. Part 4 of this submission considers some of the challenges relating to skills policy in Australia, though these experiences can be generalised into more common experiences across areas such as health, infrastructure and education. Not only is there duplication of effort with bureaucracies existing at both the state and federal level, but there is also a lack of common vision and accountability which gives rise to blame shifting and poor coordination.

What should be done?

The key is to maximise the upsides and minimise the downsides of our federation. While accepting this is a significant challenge, there needs to be clear recognition as to the rights and accountabilities of state governments and the Commonwealth, particularly where they face competing political pressures. This will necessitate a broader conversation about how governments collect and distribute revenue in Australia.

Absent more fundamental reform, the Chamber supports building on the work of earlier initiatives and ensuring they remain embedded in our national policy conversation. For example, the *National Partnership Agreement to Deliver a Seamless National Economy* has delivered significant policy gains in areas such as consumer policy (see Box 1).

Apart from the broader challenges identified in the discussion paper, the Chamber considers that NSW should demonstrate national leadership in partnership with other states and territories rather than by going it alone. While the NSW Government has a responsibility to respond to its constituents, the Chamber maintains it should do so in a national context. Where policy challenges are not unique to NSW, the Government should not implement idiosyncratic responses that have the potential to obstruct the development of a nationally consistent approach.

Box 1 – A National Consumer Policy Framework

Prior to 1 January 2011, various state-based fair trading acts and the Commonwealth's *Trade Practices Act 1974* constituted Australia's consumer policy framework. While these acts broadly served the needs of consumers in a similar manner, there were some inconsistencies meaning businesses and consumers had different rights and obligations depending on the jurisdiction in which they lived.

Even where requirements were essentially the same, legislation was structured in an inconsistent manner while state-based fair trading offices took a different approach to education and compliance.

The Australian Consumer Law (ACL), which came into effect on 1 January 2011, provided greater consistency in the manner which states and territories administered their responsibilities for consumer policy.

The ACL had significant benefits for the Australian community. For consumers, it supported initiatives enabling consumers to become aware of their rights and responsibilities. For businesses, it made it easier to operate and ensure compliance in national markets. The Productivity Commission provided a broad estimate that the total benefits of a national consumer policy framework could be up to $4.5bn.

Yet it is now close to nine years since the ACL came into effect and already there are signs that national consistency has been weakened. State governments have been pressured to introduce state-based solutions to meet policy objectives.

Recommendation 19

The FFR Review should recognise there are both benefits and costs associated with our federation and seek to identify ways to maximise the benefits while overcoming some of the challenges.

Recommendation 20

The NSW Government should recognise that its responsibilities exist within a national context and refrain from implementing idiosyncratic responses that have the potential to obstruct the development of nationally consistent approaches to problems that are not unique to NSW.

Recommendation 21

The NSW Government should learn from the experiences of other jurisdictions and use best practice regulatory standards implemented elsewhere in Australia. This is vital to ensuring NSW is not over-regulated.

Ensuring cross-border competitiveness

Policy changes — no matter which side of the border they occur — can create imbalances and disproportionately impact communities located close to the border. In recent times, these impacts have been seen with the implementation of the container deposit scheme (CDS) and changes to payroll tax in neighbouring jurisdictions.

To ensure future policies do not give rise to new cross-border issues, the Chamber maintains all new policies should be subject to specific consideration as to how border communities will be affected. The Chamber notes it is difficult for this to occur without robust regulatory impact assessment processes. The NSW Cross-Border Commissioner has a vital role in advocating for the interests of border communities, however it is challenging for the Commissioner to properly assess policies if a broader assessment of costs and benefits (including proper stakeholder consultation) is not performed.

The NSW Government should also continually monitor policy changes in neighbouring jurisdictions and make changes to the regulatory and policy environment to ensure NSW businesses are not disadvantaged. Equally, national cooperation should be prioritised where policies are likely to have significant cross-border implications and NSW should not 'go it alone' unless there is a clear and compelling need to do so.

Recommendation 22

The NSW Government should continue to take a pragmatic approach to directly address cross-border issues as they arise. All future policies should be assessed for any impacts on cross-border communities, including as part of new regulatory impact assessment processes implemented as a result of the Greiner review. The regulatory and policy environment in neighbouring jurisdictions should be monitored and, if required, changes made to ensure NSW is competitive with the rest of Australia.

Incentivising reform

The Chamber notes this review will not consider the way GST is distributed. While accepting the core mechanisms used to distribute GST are unlikely to change in the near term, the Chamber maintains that impediments to reform need to be considered.

A particular concern for NSW is that it's relatively large property tax base means it is expected to rely on highly inefficient taxes such as conveyancing stamp duty to a greater extent than other jurisdictions. NSW is therefore put in the difficult position whereby it must maintain higher taxes or risk losing its share of GST revenue.

In the Chamber's submissions to the Productivity Commission's review of Horizontal Fiscal Equalisation, we recommended consideration of mechanisms to compensate jurisdictions wishing to pursue tax reform.[13] These concerns were highlighted in Boxes 4 and 5 of the Inquiry Report indicating NSW could lose up to $1.3bn in GST payments if it sought to halve transfer duty.

In practice, such a model could involve a system of reform incentive payments from the Commonwealth which operate outside the scope of the existing HFE arrangements. For example, payments to states and territories under the Asset Recycling Initiative bolstered the case for reform in their respective jurisdictions.

Previous experiences suggest that considerable financial resources are needed to develop reform packages that are accepted by the community. Much of the scope to incentivise and drive economic reform sits with the Commonwealth.

While the method of GST distribution was recently altered to address concerns raised by stakeholders (principally those concerned about WA's GST share), it is unclear the extent to which equalising to the standard of NSW or Victoria will ameliorate reform disincentives. Further, the Chamber notes that NSW taxpayers will be the largest contributor to the Commonwealth's top-up payment to ensure the GST pool remains

[13] June and November 2017, see https://www.nswbusinesschamber.com.au/NSWBC/media/Policy/sub027-horizontal-fiscal-equalisation.pdf and https://www.nswbusinesschamber.com.au/NSWBC/media/Policy/subdr085-horizontal-fiscal-equalisation.pdf;

sufficient to cover potential losses to states and territories resulting from a larger GST share to WA.

Recommendation 23

The FFR Review should consider how programs similar to the Asset Recycling Initiative could be implemented to incentivise and drive reform.

Returning the dividends of reform

Part 6 of the discussion paper cites National Competition Policy (NCP) and the Hilmer reforms as an example of where the Commonwealth, in partnership with the states and territories, have incentivised productivity-enhancing reforms.

Key to the success of these reforms was a system of NCP payments. It is unsurprising the Harper Review recommended competition policy payments from the Commonwealth to ensure Budget revenue gains accrue to the jurisdictions undertaking reform.[14]

Recommendation 24

Any state-significant reforms that boost the Commonwealth's fiscal position should be returned to the reforming jurisdiction.

Horizontal fiscal equalisation: Local government focus

Contemporary debates around Horizontal Fiscal Equalisation (HFE) have tended to focus on fiscal imbalances existing between state and territory governments. However, similar issues can be raised with respect to local governments. There is also scope to further examine the efficiency of local government service delivery in this context.

The Chamber observes that local governments face vastly different abilities to rely on rates, fees and charges to meet the needs of their local communities. To illustrate, for Bourke Shire Council only around 12 per cent of revenue comes from rates and annual charges compared to 37 per cent for Hornsby Shire Council. Equally, many local governments face higher service delivery costs associated with factors such as their remoteness and population density. In practice, this means some local governments do not have their own ability to fund services to the same standard as can be delivered in other parts of the state.

Local governments receive a complex array of grants and contributions for both operating and capital purposes. Many of these payments involve the potential for the types of duplication, inefficiency and malincentives that may arise with payments between state governments and the Commonwealth.

Collaboration between state and local governments has the potential to deliver significant benefits to the NSW community. For example, the *Easy to do business* programs has demonstrated significant benefits in pilots where local governments have partnered to streamline administrative procedures for approval processes relating to

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[14] Recommendation 48 regarding competition payments.

starting a business, applying for outdoor dining permits, and local government procurement.

As noted earlier, it would be appropriate for this review to examine the potential to improve cooperation between tiers of government to inform the Government's consideration of recommendations from IPART's *Review of the Local Government Rating System*.

Recommendation 25

The financial capacities of local governments should be considered as part of the FFR Review.

Part 4 – Infrastructure

As the Discussion Paper identifies throughout, infrastructure provision is a significant area of overlapping responsibility and activity between Commonwealth and state governments. NSW has reaped the benefits when federal-state cooperation on infrastructure works well. Money accrued from asset recycling programs continues to be used to support infrastructure delivery, especially in rural and regional NSW. Collaboration on the Western Sydney City Deal and the associated developments around Western Sydney Airport paint a positive picture of inter-governmental working.

Yet these positive examples sit alongside frequent negotiations between NSW and Commonwealth governments over which body should be responsible for funding some particular infrastructure project – Metro West being the latest example. In part, this is an inevitable consequence of avoiding hard and fast rules for who must pay for what types of projects. This flexibility is advantageous in many ways, providing multiple paths to successful completion of a project and avoiding situations where projects fall through funding gaps for not fitting pre-specified criteria.

However, as a consequence, it also often subjects project funding to the relative bargaining power governments. Of course, this presents something of a false distinction. Whether funded out of Canberra or Macquarie Street, taxpaying individuals and businesses are ultimately responsible.

Infrastructure in a national context

Infrastructure in NSW also has the ability to deliver benefits for other parts of the country. Roads, rail lines, and energy transmission routes pass through NSW while connecting with multiple other states, providing services and value beyond the borders of NSW. Ports and airports in NSW provide international connections for freight and travellers, not all originating in NSW. As a result, it is appropriate to envisage an ongoing Commonwealth role in delivering infrastructure in NSW; the Discussion Paper's implicit objective of reducing states' dependence on the Commonwealth may not be the appropriate way to think about the Federal-state relationship in the context of infrastructure.

Rather than seeking "reduced dependence", the Discussion Paper's other questions point to the more relevant challenges in this area – preserving flexibility while allowing for accountability over spending on infrastructure, and developing a stable working relationship that avoids ad hoc decision-making and bargaining power exercises.

Cross-border infrastructure assessments

The cross-border impacts of some infrastructure investments also create challenges for the cost benefit assessment process. A further issue relates to the funding of infrastructure close to state boundaries (for example, in centres such as Queanbeyan, Albury and Tweed Heads).

Excluding or discounting benefits which occur out-of-state can tip the balance between approval and rejection. This means that if 50% of the benefits of a project in Albury flow to residents in Wodonga, then in a BCR analysis the benefits of a project are halved. This makes it more difficult to demonstrate the merits of projects which may be BCR-viable in other centres. This problem can, in theory, be overcome through close coordination with other jurisdictions or user charging for interstate users, but this seldom occurs in practice with evidence suggesting a funding shortfall over many years in these centres. There is a role for federal-state (and for that matter state-to-state) deliberation, to enable cost-sharing that corresponds to the benefit-sharing that would occur were the project to go ahead.

Recommendation 26

BCR assessments should not structurally disadvantage projects close to state boundaries. While funding arrangements in these locations may be more complicated, NSW communities located in border regions should not be disadvantaged as a result.

Part 5 – Education and training

While Vocational Education and Training (VET) is a state and territory responsibility within the Australian Constitution, responsibility for public funding of the VET system is shared with the Commonwealth under the *Federal Financial Relations Act 2009*. This often leads to inconsistency, complexity, confusion and overlapping responsibilities between the different levels of government and a set of rules and funding arrangements that are difficult for employers and students to understand and follow, particularly as they often result in significant variations in course fees across different jurisdictions.

Businesses have reported finding existing VET funding arrangements complex and duplicative – particularly larger businesses operating across more than one jurisdiction.

National Agreement for Skills and Workforce Development

The National Agreement for Skills and Workforce Development (the Agreement) and its associated Specific Purpose Payment has been funded in the 2019-20 Commonwealth Budget over the forward estimates. However, the Agreement itself contains targets ending in 2020.

Accordingly, it is timely for the Agreement to be reviewed in consultation with the Commonwealth and the review should consider opportunities to harmonise VET funding arrangements across jurisdictions, while ensuring growth funding from the Commonwealth is in line with CPI (at minimum) rather than in line with wage increases. We note the PC has recently announced a review of the Agreement.

Recommendation 27

The Government should continue working with the Commonwealth to review the National Agreement for Skills and Workforce Development and ensure that future funding arrangements meet revised goals.

VET student loans

While we have no objections to the introduction of market principles in the VET system, it has been consistently shown that higher contributions by individual students reduces the number of VET enrolments, particularly when compared with contributions made by university students. Therefore, ensuring VET courses have low initial fees would encourage more students into VET.

One way of doing this would be for the Commonwealth to expand the availability of VET Student Loans which are currently only available for diploma qualifications and above. In addition, they are only available for students studying at some registered training organisations (RTOs) and in some qualifications. Finally, there is a 20 per cent loan fee for many students and a cap on the loan amount[15] which results in students having to pay the difference between the course cost and the loan amount.

By comparison, funding and the student loan system for university education is far more generous and less complex. In many instances, the Government not only pays a

[15] See https://docs.employment.gov.au/system/files/doc/other/vet_student_loans_information_booklet.pdf.

substantial proportion of university student fees but also makes loans available to cover the remainder, with no loan or application fee.[16]

This creates incentives for students to choose a university qualification over a VET qualification, particularly when there is no initial outlay for a university qualification.

Recommendation 28

The Government should work with the Commonwealth to increase the availability of VET Student Loans by:

- removing the 20 per cent loan fee on VET Student Loans;
- expanding the eligibility to Certificate III and Certificate IV students; and
- expanding the eligible qualifications and RTOs.

Existing worker trainees

The Commonwealth should consider re-introducing a scheme to support existing worker trainees. Under current arrangements, employers are charged full fees to train existing workers in some higher level traineeship qualifications. This acts as a deterrent to business investment in upskilling and retraining workers to address future skills needs.

Introducing and expanding the availability of a commencement incentives for existing worker trainees will offset the expense of training fees and encourage employers to develop the management skills of their employees, thereby effectively building the trades and services leaders of the future. This provides prospective managerial staff with a positive view of the vocational training sector and in the longer term fosters a culture of training with the organisation.

Recommendation 29

The Government should request the Commonwealth to expand the availability of incentives for existing worker trainees.

Shortfall in Skilling Australians Fund

The 2019–20 Commonwealth Budget announced funding for a new $525.3 million skills package: *Delivering Skills for Today and Tomorrow*.

This package incorporates the Skilling Australians Fund (SAF), which commenced on 1 July 2018 and provides funding to a range of projects aimed at growing the number of apprentices and trainees. The SAF is partially financed by a levy paid by employers who sponsor foreign skilled workers under certain permanent and temporary visa classes.

However, there has been, and is likely to continue to be, a shortfall in the funding available to the SAF due to lower numbers of visas being sponsored by employers. Accordingly, funds have been made available in the Commonwealth Budget to address this shortfall and, in 2018-19, $34.2 million was made available by the Commonwealth.

[16] See https://www.studyassist.gov.au/sites/studyassist/files/ed18-0137_hecs-help_booklet_acc.pdf?v=1545356053.

However, there does not appear to be further funding within the forward estimates.

Recommendation 30

The Government should ensure the Commonwealth funds any shortfall in the Skilling Australians Fund over the life of the agreement.

Apprentice incentives

One of the key issues negatively affecting completion rates is apprentice travel. Incentives directed at apprentices are primarily designed to supplement wages (such as the Living Away From Home Allowance) and the costs associated with training (for example, for tools and equipment not paid for by an employer).

A significant barrier to apprenticeship engagement, however, remains the cost and availability of transport. Work sites are often a significant distance from the apprentice or trainee’s residence. The cost of purchasing and maintaining a vehicle is prohibitively expensive, a significant issue given that apprentices and trainees in rural and remote areas often do not have access to public transport meaning apprentices must invest in the significant cost of securing and maintaining a vehicle.

As a result, the only way for younger apprentices to travel to work is to car pool or rely on relatives for transport. These options may not be available for many young people experiencing disadvantage. The Commonwealth should consider introducing a $1,000 National Apprentices Transport Subsidy to offset part of the cost burden associated with transport and address a key barrier to the supply of people interested in undertaking an apprenticeship or traineeship. The subsidy could be used to limit the cost impact of travel (e.g. for vehicle registration, public transport costs).

Recommendation 31

The Government should request the Commonwealth Government introduce a $1,000 National Apprentices Transport Subsidy to assist training workers with the cost of work-related travel