Tax Reform
And
Rural and Remote Health

Submission to Senate inquiry
into
the Government's Tax Reform Package

January 1999

PRINT THIS DOCUMENT

CATALOGUE SEARCH HELP HOME

Tax Reform

And

Rural and Remote Health

- Submission to Senate inquiry
into
the Government's Tax Reform Package -

January 1999

Contents

FOREWORD 3

EXECUTIVE SUMMARY 4

1 INTRODUCTION 6

2 HEALTH SECTOR IMPLICATIONS 8

2.1 Extent of the Health Sector Exemption 8

2.2 Price and Cost Effects 9

3 PUBLIC FINANCE IMPLICATIONS 12

3.1 Long-Term Sustainability 12

3.2 Commonwealth-State Finances 12

4 GEOGRAPHIC EQUITY CONSIDERATIONS 14

4.1 GST as a Retail Tax 14

4.2 Fuel Price Effects 15

4.3 Impact of Income Tax Changes 15

4.4 Impact on Exporters 16

5 INTERPERSONAL EQUITY 18

5.1 Vertical Equity Implications of the GST 18

5.2 Vertical Equity and the Income Tax Changes 19

5.3 Social Security Proposals 20

5.4 Impact on Remote Aboriginal Communities 21

6 RECOMMENDATIONS 22

Foreword

The National Rural Health Alliance is the peak non-government body for rural and remote health.

The work of the Alliance is aimed at improving the health of people in rural and remote areas. It uses a broad definition of ‘health’, with the result that the Alliance’s interests span a large number of policy areas.

The key principles for the Alliance’s work include equity, access and social justice. The Alliance takes an advocacy stance for rural and remote people, who have just as much right to healthy lifestyles, to health itself, and to health services as people in any other part of the country.

The problem for rural health can be encapsulated in two facts: the health of rural and remote people is worse than that of their metropolitan cousins, and they have access to a narrower range of health services. The challenge for rural and remote people is to ensure that they receive a fair share of health services and resources. This ‘fair share’ is at least 30%, as that is the proportion of people who live in non-metropolitan areas.

This submission to the Senate Inquiry has been prepared for the Alliance and is based on the principles enunciated here and on the Alliance’s positions on matters that will be affected by changes in the tax system.

Not all of the views in this submission can be taken as the endorsed views of all twenty Member Bodies of the organisation. However the bottom line for all those associated with the Alliance is the same: the way the tax changes are implemented will determine the impact of the package on health outcomes, on health services and on rural communities. The package as it currently exists needs to be much improved with the health of rural people and their communities in mind.

Tax Reform and Rural and Remote Health

- Submission to Senate Inquiry into the Government's Tax Reform Package -

Executive Summary

The National Rural Health Alliance is the peak non-government organisation concerned with rural and remote health issues. The organisation takes a multi-disciplinary approach, recognising all the elements that go to constituting good health outcomes for rural Australians. Those elements include socio-economic conditions, as well as the provision of high quality health services. Unfortunately, both socio-economic conditions and service delivery are such that the health status of rural and regional Australians is below that of their urban counterparts.

NRHA notes that the Government's tax reform package will provide some cost reductions to the health sector. While it believes that the Government under-states the price effects of its proposals, and hence over-states the cost-reducing impact, it agrees that some cost reductions will occur and welcomes them. Given funding arrangements for the sector, those cost reductions will result in only minor cost savings to health consumers; they should, however, provide some modest improvements in incentives for service provision, which is particularly important for rural and remote Australia.

However, NRHA notes that the health sector exemption will be to the relative disadvantage of less formal types of health care. Access difficulties make those less formal mechanisms particularly important to rural and remote residents. NRHA believes that it will be necessary to exempt food and all over-the-counter medicines from the proposed Goods and Services Tax to minimise this effect.

NRHA supports the Government's view that public finances in Australia need to be placed on a more secure, sustainable basis, and welcomes the extent to which the package will achieve that aim. NRHA believes, however, that this positive impact will be limited by the rigid mechanism for changing the GST rate, and that the rigidity of the mechanism also means that the package will fail to achieve its potential in reducing 'vertical fiscal imbalance'. NRHA believes that a less rigid mechanism is required.

NRHA notes with concern that the structure of a GST is such as that it will inevitably have a greater impact on prices in rural and remote areas than in the capital cities, because of the inclusion of transport and retail costs and margins in the widened tax base. The Alliance notes that the Government proposes an offset to this effect in the form of reduced diesel excise but believes that, on balance, this offset is only partial and hence the package will be to the net disadvantage of rural and remote consumers compared with those in the capital cities. NRHA believes that further action, such as in respect of diesel excise or via some other appropriate mechanism, is required to render the impact of the package neutral between rural and remote residents on the one hand and metropolitan residents on the other. This is even more important if (as the Alliance believes) the package is to be a vehicle for promoting rural economic development.

The Alliance further notes that the regressive structure of the proposed income tax cuts will provide a disproportionate share of benefits to metropolitan residents, where taxable incomes are higher. NRHA supports the proposals to improve social security provisions, but notes that the retention of the 25% benchmark for the pension means that many of those benefits will be eroded.

On the basis of evidence that low income households and rural and remote households spend a larger share of their income on food than do other households, NRHA suggests that the regressive nature of the existing proposals would be diminished by exempting food from the GST. This regressive nature would be further diminished through a scaling back of the proposed income tax cuts for high income earners. The Alliance believes, in addition, that more positive measures to target assistance to low and middle income families are required.

Tax Reform and Rural and Remote Health

- Submission to Senate Inquiry into the Government's Tax Reform Package -

1 Introduction

The National Rural Health Alliance is the peak national body working to improve the health of Australians living in rural and remote areas. The NRHA is comprised of twenty Member Bodies, each of which is a national organisation in its own right. The twenty represent both the consumers of health services and the health professionals providing service to non-metropolitan areas.

The NRHA has a strong multi-professional focus. In its work it emphasises the point that 'health' is much more than the absence of disease. Good health is mental, physical and social well-being. Given this definition, it is clear that a large number of functional areas impact on health outcomes. They include having access to good food, rewarding employment, a comfortable home and positive self-esteem.

To the extent that the Government's tax reform package will impact on the economic and social fabric of rural and remote Australia, it will therefore also impact on the health outcomes experienced by residents of rural and remote Australia.

Those health outcomes are not as good as those of metropolitan residents. Life expectancies, for example, are significantly longer in metropolitan than in rural and remote areas. Male life expectancy is almost one year longer for metropolitan residents than for rural residents, and almost four years longer than for remote residents; for females, the gaps are almost half a year and almost 3 ½ years respectively.[1]

Against this background, the NRHA provides the following comments to assist Senators in their deliberations. While broadly representative of Alliance opinion, these comments cannot be assumed to reflect the views of each of the twenty Member Bodies of the NRHA.

For the NRHA, the tax reform package raises four sets of issues. First, most directly, is the impact of the package on the cost and provision of health services, both generally and in rural and remote Australia in particular. This is the subject of section 2 of this submission.

Second, the NRHA recognises that adequate provision of health and other services to rural and remote Australians, as to all Australians, depends on an adequate and sustainable system of public sector financing – both in general, and for each level of government. At the end of the day, that is the purpose of the taxation system, and

[1] Australian Institute of Health and Welfare, *Health in Rural and Remote Australia*, December 1998, p 10.

hence a major criterion against which the Government's tax reform package is judged in section 3 of this submission.

Third, the NRHA is concerned about equity between those Australians living in rural and remote areas and those living in more densely populated parts of the country. This is not just a matter of fairness – it is incontestable that the economic and social conditions in rural and remote Australia, including the physical health of its inhabitants, are directly linked to an equitable sharing of both the benefits and costs of economic progress on a geographic basis. This is the subject of section 4 of this submission.

Fourth, the Alliance recognises that there is a strong positive correlation between individuals' socio-economic status and their health outcomes. In short, any policy measure which widens economic inequality can be expected to worsen health outcomes, and vice versa. Some comments on the Government's tax package from this point of view are presented in section 5 of the submission.

Finally, the submission seeks to directly assist Senators in their deliberations by concluding with some practical suggestions of ways in which the package can be improved. It is stressed again that these suggestions do not necessarily represent the views of all of the NRHA's twenty Member Bodies. The recommendations represent a serious attempt to suggest improvements which will assist in furthering the social objectives to which we aspire.

2 Health Sector Implications

The NRHA warmly welcomes the exclusion of health expenditures from the coverage of the GST. This should not, however, be viewed as a concession. Given the extent of public sector health funding, to include health in the tax base would require an offsetting increase in expenditure, with no net impact other than an absurd shuffling of paper.

2.1 Extent of the Health Sector Exemption

NRHA accepts that there is a difficulty precisely defining the scope of the health exemption. It is inevitable that this necessitates some loss of simplicity, and hence additional administrative costs for both business and government. Pharmacies are a case in point, as pharmacies will probably be unique in the extent to which they sell both taxable and exempt items, and hence have to maintain separate record-keeping for each.

Of particular concern to the Alliance is the fact that rural and remote Australians receive a much lower share of public health expenditure than do their metropolitan counterparts. This reflects greater difficulties of access to all forms of health services, as well as the lower proportion of country medical practices that bulk-bill Medicare. These contribute to the relatively poor health outcomes in rural and particularly remote Australia.

In short, compared with their urban counterparts, rural and remote Australians are more likely to remain in their homes than seek hospital or nursing home admission; more likely to seek advice from a pharmacist, nurse or friend than from a doctor; and more likely to use medicines available in general retail stores than those only available in pharmacies.

The difficulty with the GST is that the definition of exemptions is to the relative disadvantage of the less formal forms of health care.

One example arises with respect to pharmaceuticals. The limitation of the exemption to those medicines that must be sold only under the supervision of a pharmacist will mean that wide range of commonly-used ‘over-the-counter’ pharmaceuticals and medical supplies will be taxed, implying both an increase in health costs generally, and the relative disadvantage of those with less ready access to a pharmacy.

There are likely to be similar effects concerning residential as against community care. Indeed, the aspect of this issue within its purview was recognised in part by the Vos Report, which commented that

> “… it was not possible to provide full equivalent treatment between community care services delivered through government programs and those purchased privately”[2]

[2] Report of Tax Consultative Committee, November 1998, p 33.

and so recommended against, for example, including home cleaning services for aged and disabled people in the scope of the exemption.

Clearly, the exemption for hospitals and nursing homes (and similar services such as meals-on-wheels) will encompass some goods and services that would be taxed if supplied by a patient in their own homes or in some cases by commercial and community suppliers. Food is an obvious example; the Vos Committee's comments in relation to home cleaning services are noted above.

The net result of the GST exemption system, therefore, is likely to be both a disincentive to the use of less formal health services, and hence a relative discrimination against those Australians, such as many rural and remote areas, with less access to the more formal services.

One aspect of the package that NRHA, like all those concerned with health outcomes, approves of is the impact of the GST in increasing the price of tobacco prices, and so hopefully making a (small) contribution to public health outcomes in the form of reduced tobacco consumption.

2.2 Price and Cost Effects

The Alliance notes the Treasury estimate that that health sector costs will fall by $820 million or 1.7%. This estimate is the fifth lowest estimated cost impact of the 107 industries considered.[3]

Naturally, any reduction in industry costs is welcome, as that would improve the economic position of suppliers and so hopefully encourage supply of services, which remain in short supply in many rural areas. The Alliance believes, however, that this figure needs to be viewed with caution. It is important to remember the nature of this price reduction. There are no taxes directly levied on health expenditures at present. Rather, the estimated cost reduction comes about from indirect effects as suppliers throughout the supply chain are assumed to fully pass on the effects of the reduced wholesale, fuel and other taxes.

Box 1 contains some advice received by the Alliance on the Treasury's price estimates. This advice is to the effect that the CPI effect could be substantially greater than estimated by the Treasury. This same point would also apply to the estimates of reduced health industry costs, indicating that the Treasury estimate of a 1.7% reduction in health industry costs is likely to be an over-estimate of the true cost reductions.

Moreover, neither of these estimates takes any account of the new administration costs imposed by the GST. These administrative costs will have a greater impact on exempt industries such as health, because exempt industries will not receive the cash flow benefit of the lag between making GST collections and remitting them to the Taxation Office – quite the contrary. Moreover, the private health sector is dominated

[3] Tax Reform White Paper, p 169.

by relatively small firms (eg, medical practices and pharmacies), which incur a larger relative burden of the administrative costs of the GST.

Moreover, any reduction in costs in the health sector will not necessarily reduce costs to consumers - funding arrangements also need to be taken into account. Where consumer prices are zero, or set by government regulation (eg, medical practices that bulk bill Medicare, public hospital services, pharmaceuticals receiving Pharmaceutical Benefit Scheme subsidies, nursing home services) any cost savings will not be passed on to consumers. Hence the most that can be hoped from any cost reductions is that they will reduce the pressure on fees by those doctors who do not bulk bill, will reduce costs for non-PBS pharmaceuticals, and will improve the incentives to supply pharmaceuticals and services such as private hospitals and nursing homes.

It is worth noting in this context that there is a lower incidence of doctors bulk-billing Medicare in non-metropolitan areas than in the major cities. This means that any cost reductions to country medical practices should result in some fee reductions to patients – but, as noted above, the effect is unlikely to be significant.

BOX 1 TREASURY CALCULATIONS OF THE CPI IMPACT OF THE TAX REFORM PACKAGE

Treasury's estimate is that the impact of the tax reform package on the Consumer Price Index will be +1.9 percentage points in year 2 (Tax Reform White Paper, p 16). This estimate assumes, *inter alia*, that

1. All indirect tax changes are passed on in full to final consumers
2. Reduced exporters' costs will raise the exchange rate, further dampening price increases (Tax Reform White Paper, p 161).

There are major difficulties with both of these assumptions.

1. Some profit-taking is likely to occur in such a major indirect tax restructure. This may not be great with high profile taxes such as the GST, sales and fuel taxes, but is likely to be much more substantial with taxes such as financial and stamp duties which are deeply embedded in business costs.

2. The assumed currency appreciation rests on a controversial view of exchange rate determination. Some of any reduction in exporters' costs is likely to be taken in profits, and there is unlikely to be a significant supply response, and hence improvement in the trade balance, in a two-year time-frame. The exchange rate is determinated by a wide range of factors – particularly international economic conditions, commodity prices, and the stance of monetary policy. The effect of a relatively modest reduction in exporter costs is likely to be imperceptible.

The estimated revenue effects of the tax package can provide an approximation of the consumer price effect and hence a 'reality check' on the Treasury estimates.

The GST will impose a 10% tax on approximately 90% of consumer expenditure, and in so doing will raise an estimated $31.96 billion in 2001-02 (Tax Reform White Paper, p 100). The net change in other indirect taxes (excluding tobacco) and related measures offsets this by $26.65 billion. $4.5 billion of this is estimated by the Government to go to exporters.

This suggests that if all indirect tax changes are fully passed on, the price impact to consumers (excluding tobacco) will be some 2.8%. If half of the reduction in financial and stamp duties, and all of the other indirect tax changes, are passed on, then the price impact to consumers will be of the order of 3.4%. If, however, none of the reduction in financial and stamp duties, and only 90% of the sales tax abolition, is actually passed on, then the price impact to consumers will be 4.6%.

Moreover, these price impacts will vary between metropolitan and non-metropolitan areas reflecting, on the one hand, the inclusion of all transport and distribution costs and margins to the retail level in the GST base and, on the other hand, the impact of the proposed fuel tax changes.

3 Public Finance Implications

3.1 Long-Term Sustainability

One of the Government's major arguments for its tax reform package is that it will place public finances on a more long-term sustainable basis, in that the indirect tax base will now encompass almost all consumer spending, including rapidly growing service categories, rather than a relatively narrow range of goods.

NRHA applauds any initiative to improve the sustainability of public finances in Australia. There has been increasing recognition in recent years of the role of public expenditures in sustaining economic and social outcomes, particularly in non-metropolitan Australia. This relates not only to health expenditures, but to active public policies in a wide range of areas, including transport, primary industry, economic and community development, education, environment etc.

The Alliance further notes that the GST in particular, and the tax package in general, will have some anti-avoidance benefits, so further improving the sustainability of public finances.

The Alliance supports this aspect of the package and, indeed, is concerned that the package does not go far enough in this direction because of the rigidity of the mechanism to change the 10% tax rate. That mechanism, involving unanimous agreement of all nine Commonwealth, State and Territory Governments, plus the Commonwealth Senate, is clearly designed to ensure that the rate is extremely difficult to change.

The political reasons for such a mechanism are understandable given the tendency for GST rates to rise over time in most countries with such a tax system. The fact that most countries' GST/VAT rates are higher than 10% is, of itself, evidence that the package may not provide sufficient sustainability to public sector finances.

The reality is that tax arrangements need to contain sufficient flexibility to respond to changing public sector finance needs. The proposed mechanism for adjusting the tax does not do this, and there are also vertical fiscal imbalance considerations (discussed in the next section).

3.2 Commonwealth-State Finances

The NRHA agrees with the notion that, in an ideal world, the level of government responsible for expenditure should also be the level of government responsible for raising the necessary revenue. Such absence of 'vertical fiscal imbalance' would maximise incentives for responsible public financial management, and minimise the unnecessary political buck-passing which afflicts the Australian Federation. The Alliance also believes, however, that such an objective is very much secondary to the achievement of outcomes for the citizens of the Commonwealth and States.

In this context, the NRHA notes the Government's plan to replace financial assistance grants with automatic hypothecation of GST revenue. NRHA welcomes the fact that this arrangement will place State finances on a sounder long-term basis, and so assist State planning, including in the area of health service provision.

However, this arrangement does not represent a reduction in 'vertical fiscal imbalance' – quite the contrary. Because of the rigidity of the arrangements for altering the GST rate and base, and hence its revenue, this represents a net reduction in individual States' control over their own revenue-raising efforts.

For this reason also, therefore, the Alliance suggests that a less rigid mechanism be adopted. On 'vertical fiscal balance' considerations, each State and Territory should be able to determine its own tax base and rate. It is recognised that this would require measures to address Constitutional limitations on State indirect taxes.

Alternatively, at the very least, it is suggested that a majority of Governments, including the Commonwealth Parliament, rather than a unanimity, be able to effect a change in the tax rate.

4 Geographic Equity Considerations

4.1 GST as a Retail Tax

Unlike existing indirect taxes, the proposed GST will effectively apply at the retail level, and so will incorporate in its base all the transport, handling and distribution costs, as well as profit margins, incorporated in the final price to consumers.

These costs are substantially higher in country areas than in the cities. This is not only because of additional transport costs, but also because these costs and margins are spread over smaller volumes and so add more to individual unit prices

- the basket of prices published by the ABS[4] shows, for example, that the average price of the 57 items in the basket is 15% higher in Darwin, and 6% higher in Hobart, than in Melbourne. Soap, for example, is 12% higher in Darwin, and 14% higher in Hobart, than in Melbourne. This can be taken as illustrative of the price disadvantages facing consumers in major country towns – the disadvantages faced by rural and, in particular, by remote residents would be even greater.

A switch from the existing indirect tax arrangements to a GST will, of itself, inherently result in a greater cost increase to rural and remote Australians than to those in metropolitan areas. This can be best illustrated by some arithmetic examples.

Take a good worth $10 at the metropolitan wholesale level, but with additional costs and margins to the retail level of $8 in the city, $10 in country towns, and $14 in remote areas. These are reasonably representative relative figures. At zero wholesale sales tax, therefore, the good would be priced at $18, $20 and $24 respectively; with a 22.5% sales tax its final price would be $20.25, $22.25 and $26.25 respectively

- if the good is not subject to sales tax, then its price will rise by 10% in all three areas. However, this represents $1.80 in the city, $2 in the country town, and $2.40 in the remote area. The impost therefore represents a higher proportion of a given income level in the remote area than in the country town than in the city

    - as the Tax Reform White Paper points out in a different context, it is the relative impact on disposable incomes that matters – and a GST inherently has a greater impact on the disposable incomes of rural and remote people than of city residents

- if the good is currently subject to the 22% sales tax, then its price will fall from $20.20 to $19.60 in the city (a reduction of 3.0%), and from $22.20 to $22 in the country town (a reduction of 0.9%), but would rise from $26.20 to $26.40 (a rise of 0.8%) in the remote area.

---

[4] ABS, *Average Retail Prices of Selected Items*, cat 6403.0, September quarter 1998.

As the Consumer Price Index is based on capital city prices, this relatively larger increase in rural and remote areas than in the cities would not be captured by the index.

4.2 Fuel Price Effects

The NRHA recognises that the Government's tax reform package provides for a significant reduction in diesel fuel prices. The resulting reduction in transport costs should provide an offset to this greater relative incidence of the GST on rural and remote areas compared with urban areas.

It is unlikely, however, that the offset will be complete, ie, it is likely that the net impact will be a larger increase in prices in non-metropolitan than in metropolitan areas notwithstanding this fuel price effect. For one thing, not all transport is via diesel-powered vehicles – petrol engines, and in remote areas light aircraft and barges, are also used.

Using the second arithmetic example presented in section 4.1 above, reduced diesel excise would have to reduce the total of transport and distribution costs and margins by 4 percentage points more in the country town, and 6 percentage points more in the remote area, than in the city to restore the *status quo ante* of relative disposable incomes. For this to be the case, diesel excise alone would have to constitute more than 12% of all transport and distribution costs and margins to the country town and 24% to the remote area. This would be very much the exception rather than the rule.

4.3 Impact of Income Tax Changes

Another aspect of the geographic equity of the package relates to the structure of the income tax reductions. Those reductions provide maximum benefits for taxpayers earning in excess of $50,000 per annum, with the maximum benefit to a taxpayer on $75,000.[5]

However, rural and regional residents earn, on average, lower taxable incomes than their city counterparts. Table 1 shows average taxable incomes across metropolitan, rural and remote areas. On average, metropolitan incomes are some 15% higher than rural and remote incomes.

Because of the structure of the proposed income tax changes, this means that the change in disposable incomes is higher in metropolitan areas (4.9%) than in rural and remote areas (3.9%).

[5] Tax Reform White Paper, p 178.

Table 1 – Taxable Incomes by Region

Region	Average Taxable Income, 1995-96 $	%age Increase in Disposable Income from Proposed Income Tax Changes
Eight Capital Cities	32,002	5.0
Other metropolitan	29,546	4.0
TOTAL METROPOLITAN	31,764	4.9
Large Rural Centres	27,056	3.8
Small Rural Centres	26,892	3.8
Other Rural Areas	27,434	3.8
Remote Centres	33,953	5.8
Other Remote Areas	31,665	4.8
TOTAL RURAL & REMOTE	27,694	3.9
TOTAL AUSTRALIA	30,344	4.3

The analysis presented above suggests that the price impacts of the package will be greater than that forecast by Treasury, and that the price impact will be greater in non-metropolitan than in metropolitan areas. If the CPI impact is 3.4%, as suggested in section 3, but nearer to 4% in rural and regional areas, then it can be concluded that the Government has made some improvement to the net position of the 'average' metropolitan taxpayer, but little or no improvement to the real disposable income of the average non-metropolitan taxpayer.

In the Alliance's view, there is a case for an interventionist strategy to promote rural development[6]. One element of such a strategy could include taxation measures to encourage the development of economic activity in rural areas. It is clear from the above analysis that the Government's tax reform package could have the opposite effect.

4.4 Impact on Exporters

The Government estimates that the package will reduce exporters' costs by some $4.5 billion per annum. With a large proportion of Australia's export income deriving from rural and remote areas, a large proportion of this benefit can be expected to flow to these areas. For example, the Government estimates that the cost reductions will total $1,140 million (or 2.8%) to agriculture, $2,970 million (4.4%) to mining and $3,430 million (or 3.7%) to the food and mineral processing industries. Rural and regional Australia may gain a disproportionate share of these gains (though by no means all), so assisting economic activity and providing an offset to the relative disadvantages in real incomes estimated above to arise from the package.

However, there are four major qualifications to this conclusion as well.

[6] *A Blueprint for Rural Development*, NRHA Discussion Paper, August 1998.

First, the estimated reduction in exporters' costs of $4.5 billion depends, like all the price estimates in the Government's White Paper, on the assumption that all indirect tax changes are passed on in full. As this is unlikely to be the case, the actual extent of the cost decreases are likely to be somewhat less than this figure.

Second, the Government's modelling assumes that some part of the impact of this on exporter incomes will be offset by a resulting exchange rate appreciation.

Third, only a proportion of any reduction in exporter costs will in fact be retained in rural and remote areas. Some, particularly in mining, will be taken as profits to shareholders residing elsewhere; and some will be spent on goods and services supplied from elsewhere.

Fourth, this raises the broader question of any 'trickle-down' effect to other rural and remote Australians. 'Trickle down' has been discredited as a social strategy in recent years. Farmers constitute around one fifth of all rural and remote residents and, while they provide the economic base for much of rural Australia, it cannot be concluded that a large proportion of any gain for the rural sector will be spread throughout the remainder of the rural and remote population.

5 Interpersonal Equity

The NRHA's approach to policy and social issues derives from recognition of the strong positive correlation between health status on the one hand and socio-economic status on the other. Without going into details, it suffices to say at this point that any policy measure which improves economic equality will also improve health outcomes, and the reverse is also terue.

It is this recognition that gives rise to the Alliance's view that the appropriate strategy is one of 'worst first' – that is, that health and other policy initiatives should give number one priority to those in greatest need. In rural Australia, that is still the remote Aboriginal communities.

5.1 Vertical Equity Implications of the GST

The Alliance notes with concern the assumption underlying Treasury's analysis of the tax proposals of constant patterns of expenditure across household groups. This is a ridiculous assumption to make.

The Alliance accepts that there are difficulties with the data available in providing more realistic estimates of household expenditure patterns and therefore of the impact of the tax reform package across different groups.[7] However, the White Paper's argument as to why the Household Expenditure Survey (HES) cannot be used at all for this purpose, adjusted as necessary, is unconvincing – one wonders why the ABS publishes the HES at all if the data quality is as poor as implied by the White Paper.

In particular, the fact that, over time, price increases facing each demographic group have closely mirrored those of the CPI generally is not relevant in this case. The Government's tax reform package represents a major, one-off, change in the structure of indirect taxes and hence prices. That change will obviously have an impact on relative prices and hence, in the absence of evidence (as distinct from assertion) to the contrary, it must be assumed to have a differential impact across households according to their expenditure patterns.

As is well-known, and is demonstrated in Table 2, low income households tend to spend a higher proportion of their incomes on food than do higher income households. Similarly, non-metropolitan households tend to spend a higher proportion of their incomes on food than do metropolitan households (14.7% compared with 13.2%). Hence exempting food from the GST would have a positive income distribution effect, both in vertical and geographic equity terms.

[7] Tax Reform White Paper, pp 162-3.

Table 2 – Household Expenditure Patterns, %age of total weekly expenditure

Group	Food	Apparel	Health	Recreation
All Australians	13.7	4.2	3.3	9.8
Region				
Metropolitan	13.2	4.2	3.2	9.6
Other Urban	14.5	4.1	3.5	10.5
Rural	15.5	3.8	3.8	9.4
Total Non-metropolitan	14.7	4.0	3.6	10.2
Income Decile				
Bottom 20%	18.6	4.3	4.6	11.8
Second 20%	18.5	4.0	3.9	10.8
Third 20%	15.2	4.3	3.4	10.2
Fourth 20%	13.2	4.3	3.3	9.2
Top 20%	10.8	4.1	2.9	9.3

Source: ABS, *Household Expenditure Survey*, cats 6533.0, 6535.0, 1993-94.

5.2 Vertical Equity and the Income Tax Changes

As noted above, the proposed income tax changes provide the greatest benefit to taxpayers earning more than $50,000 per year, with the maximum benefit, in both absolute and percentage terms, for those earning $75,000 per year.

The Government's objective of reducing effective marginal tax rates on middle income earners is accepted, but to raise the threshold for the 47% marginal rate to nearly twice average weekly earnings (recalling that the majority of income-earners earn below the 'average'), goes well beyond what is required to meet this objective.

Moreover, NRHA notes that the Government estimates the net impact of the GST and the income tax changes on the disposable incomes to low to middle-income earning taxpayers (with incomes in the $20,000 to $35,000 per annum range) of 2% or less. In section 4 above, it was suggested that the Government's estimate of the price impact of the indirect tax changes is likely to understate the true price impact, probably by nearly 2%, and possibly by more.

Subtracting 2% from the Government's estimates of real disposable income changes resulting from its tax package gives a very different picture of the distributional impact of the package. In particular, whereas the Government suggests that a single taxpayer earning $20,000 to $25,000 per year will gain an improvement in disposable income of 1.3%, this analysis suggests a more likely scenario is that such a person will experience a real income loss of 0.5%. For a taxpayer on $75,000, on the other hand, the Government's estimate would only be reduced from 7.3% to a still very healthy 5.5%.

5.3 Social Security Proposals

NRHA recognises that social security changes also have to be taken into account in this analysis.

In particular, the Alliance warmly welcomes the changes to family payments which will have the effect of reducing the ‘effective marginal tax rate’ applied to many lower income families. This addresses a major structural deficiency in the current income support arrangements and removes a potential ‘low income trap’ from many families. With rural and remote areas containing a higher proportion of both children[8] and low income earners, it is likely that these changes will provide greater relative benefits to rural and remote areas than to metropolitan areas.

NRHA also notes that other social security payments are to be increased to compensate for the price impact of the indirect tax changes.

The proposed 4% increase in pensions looks generous against an expected CPI impact of 1.9%, but very much less so against the higher CPI impacts the Alliance expects. In particular, it is virtually no increase at all compared with the 3.4% price effect estimated as most likely in section 3 above. The Alliance therefore expects that the Government will have to bring into effect its commitment to “ensure that over time this increase remains at 1½ per cent above the actual CPI impact”.[9]

Moreover, NRHA notes with concern that the Government intends to maintain its benchmark for the single pension of 25% of average weekly earnings (AWE). AWE is likely to be largely unaffected by the tax package, with the direct tax changes approximately matching (exceeding, according to the Government) the net price impact of the GST as far as average working families are concerned.

Full-rate pensioners and other social security recipients, however, will not receive any benefit from income tax reductions, but will face cost increases as a result of the indirect tax changes. As ongoing increases in real AWE erode the relative value of the pension back to the 25% benchmark, pensioners and other social security recipients will find themselves receiving exactly the same income as they would have in the absence of the tax reform package, but with the additional costs. On the basis of current rates of real average income growth of around 2% per annum, this point would be reached only two years after the introduction of the package.

---

[8] According to AIHW, *op cit*, p 7, children (persons aged under 15 years) make up 23.3% of the population of rural areas and 27.0% of the population of remote areas, compared with 20.4% of the population of metropolitan areas.

[9] Tax Reform White Paper, p 16

5.4 Impact on Remote Aboriginal Communities

Whereas 3% of all Australians live in remote areas, 30% of indigenous Australians live in remote areas.[10] Remote aboriginal communities are in virtually unique circumstances, and so will be uniquely impacted by the tax reform package.[11]

In particular

- their low incomes mean that they spend a high proportion of their income on essentials such as food and clothing
- remoteness means that the costs of transporting goods to them are high
- many suppliers are in a monopoly position, and so may not pass on some of the cost-reducing elements of the package (eg, diesel excise reductions)
- a diverse range of transport means are used. Highly perishable goods are usually imported by light plane; communities in the remote inland generally receive non-perishable goods by truck while those on the coast will often receive them by barge
- economic enterprises in remote communities often include arts and crafts production and tourism enterprises, both of which will be taxed by the GST.

Hence it can be expected that the impact of the Government's tax reform package on those communities will be a price impact exceeding the estimated 1.9% CPI estimate, as the costs of goods actually purchased will rise by more than this amount, and there will only be a partial offset through reduced diesel excise. The taxation treatment of welfare housing will be an important determinant of the impact on housing in remote communities. On the income side, there could also be an adverse impact through the taxation of arts and crafts and tourism enterprises.

---

[10] AIHW, *op cit*, pp 6,8.

[11] The following draws on O Stanley, *The Impact of the Government's Proposed Tax Package on Rural and Remote Indigenous Communities*, 21 August 1998, http://www.atsic.gov.au/tax_package.htm, accessed 1 January 1999.

6 Recommendations

Although there are many problems with it as is exists, the Government's tax reform package should result in a number of benefits, including:

- improved sustainability of public sector finances
- reduced costs to important industry sectors such as health and exports
- improved family payment measures, particularly the elimination of 'low income traps'.

NRHA does, however, believe that the package can be improved in four major respects.

First, the Alliance believes that food should be exempted from the GST. Such an exemption would remove the bias in the package against the less formal forms of health care more widely used in rural and regional Australia. For this reason, the food exemption should include an exemption for all 'over-the-counter' medicines and other medical supplies. A food exemption would also improve the equity of the package as far as low income earners are concerned. Because food is a higher proportion of rural and remote expenditures, and because of the role of rural and remote areas in food production, such an exemption would also improve the equity of the package from an urban/rural perspective.

Second, the NRHA believes that greater efforts need to be made to redress the relative cost disadvantage of the proposed indirect tax changes on rural and remote Australians. Removing food from the GST would be a positive step in this direction. However, even with the proposed diesel fuel excise changes, this is unlikely to fully redress this cost disadvantage, and certainly would not provide a new tax-based incentive for rural economic development. Further reductions in fuel taxes, or some other mechanism with a particular benefit for non-metropolitan Australia, are required to achieve this aim. The Senate could consider a special inquiry into remote areas (including their indigenous communities) and the tax system.

Third, the NRHA suggests that the rigid mechanism for altering the GST rate will diminish the impact of the package in providing certainty and sustainability for public sector finances and, indeed, will worsen the problem of 'vertical fiscal imbalance'. NRHA believes that each State and Territory Government should be able to take its own decisions over such a major source of revenue or, at least, that the unanimity requirement be replaced by a requirement that changes be approved by a simple majority of State and Territory Governments.

Fourth, the NRHA believes that greater efforts should be made to use the tax reform package to promote a progressive income redistribution. As non-metropolitan Australians earn, on average, less than their metropolitan counterparts, this would promote regional, as well as interpersonal, equity. The Government's proposals do precisely the opposite, with the greatest benefits going to taxpayers earning above $50,000 per annum, and hence with a disproportionate share of the benefits going to metropolitan residents. The extent of the proposed increase in the threshold for the top marginal tax rate is clearly excessive. More broadly, additional efforts should be made to concentrate the benefits of the package on low to middle income earners – particularly if food is not to be exempted from the GST. end