The Parliament of the Commonwealth of Australia

Inquiry into the Income Tax Rates Amendment (Temporary Flood Reconstruction Levy) Bill 2011; and the Tax Laws Amendment (Temporary Flood Reconstruction Levy) Bill 2011

House of Representatives Standing Committee on Economics

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Canberra

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Foreword

The natural disasters over the Australian summer have exacted a high price in lives and damage to private property and infrastructure. Under established arrangements with the States, the Commonwealth will be funding over $5 billion in infrastructure repairs and replacement, with the great majority of this work occurring in Brisbane.

In January, the Government decided to fund $1.8 billion of this work through a temporary flood reconstruction levy, which will apply on a one-off basis to individual taxpayers for 2011-12. The remainder of the work will be funded through spending cuts and deferring other infrastructure projects. On 10 February 2011, the Government introduced the Income Tax Rates Amendment (Temporary Flood Reconstruction Levy) Bill 2011 and the Tax Laws Amendment (Temporary Flood Reconstruction Levy) Bill 2011 to implement the levy. These Bills were the subject of the inquiry.

The Committee held a day of hearings on the Bills. At the hearing there was strong support for the reconstruction work, and this reflects community support for the recovery as well. While there was a range of views on whether borrowings, taxes, or spending cuts should be used to fund reconstruction, it was also put to the Committee that, in the context of total annual outlays of $350 billion, any of these three funding methods would be suitable. The Committee has therefore concluded that the House of Representatives should pass the Bills.

I would like to thank the witnesses who attended the hearing and freely gave of their expertise to the Committee. I would also like to thank my colleagues on the Committee who assisted with the inquiry on a topic that has shocked and disrupted the lives of tens of thousands of Australians. The projects that these Bills will fund will play a large role in restoring the lives of people affected by the disasters.

Craig Thomson MP
Chair

Membership of the Committee

Chair	Mr Craig Thomson MP	
Deputy Chair	Mr Steven Ciobo MP	
Members	Mr Scott Buchholz MP	Mr Stephen Jones MP
	Dr Andrew Leigh MP	Ms Kelly O'Dwyer MP
	Ms Julie Owens MP	

Committee Secretariat

Secretary	Mr Stephen Boyd
Inquiry Secretary	Mr David Monk
	Mr Andrew Gaczol
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Terms of reference

On 10 February 2011, the House Selection Committee presented its report referring the Income Tax Rates Amendment (Temporary Flood Reconstruction Levy) Bill 2011 and the Tax Laws Amendment (Temporary Flood Reconstruction Levy) Bill 2011 to the House of Representatives Standing Committee on Economics for inquiry and report. Under Standing Order 222(e), the House is taken to have adopted the Selection Committee's reports when they are presented.

List of abbreviations

QGIF	Queensland Government Insurance Fund
NDRRA	Natural Disaster Relief and Recovery Arrangements

List of recommendations

That the House of Representatives pass the Bills.

1

The flood levy Bills

The natural disasters

The Queensland floods

1.1 The dimensions of the Queensland flood disaster have been staggering. Between 30 November 2010 and 24 January 2011, thirty-five people have died as a result of flood-related incidents.[1] This is the foremost tragedy of these events and the Committee extends its deepest sympathies and condolences to the family and friends of the victims.

1.2 From the end of November 2010 through to mid January 2011, flooding has occurred over large areas of south-east and central Queensland with areas such as Condamine and Chinchilla being flooded several times. In addition, flooding of the Herbert River has occurred in North Queensland with the town of Ingham being isolated. Almost every river in Queensland south of the Tropic of Capricorn and east of Charleville and Longreach, except for the southeast coastal fringe south of Maryborough, reached major flood level at some stage from 26 November 2010 to 7 January 2011.[2]

1.3 The 10-12 January 2011 floods affected south-east Queensland causing major flooding of the Lockyer, Bremer and Brisbane Rivers. These were the most destructive floods of November–January period. The Bremer

1 Queensland Police Service, 'Death toll from Queensland Floods', Media Release, 24 January 2011, viewed on 18 February at http://www.police.qld.gov.au/News+and+Alerts/Media+Releases/2011/01/death_toll_jan24.htm.

2 Bureau of Meteorology, *Frequent heavy rain events in late 2010/early 2011 lead to widespread flooding across eastern Australia*, Special Climate Statement 24, 25 January 2011.

River level at Ipswich peaked at 19.5 metres at approximately 4 pm, which was slightly below the 1974 flood levels.[3] The Brisbane River level at Brisbane peaked at 4.46 metres between 3 and 4 am, which is below the 1974 peak of 5.45 metres.[4]

1.4 Loss of property has been devastating. As of 21 January 2011, the estimate of the total number of houses across Queensland that saw flooding over their floorboards was 5,400 homes. The number of affected houses is 21,000, while a further 15,000 had flooding into their yards. 3,600 homes were also evacuated and 5,900 people evacuated. In response, governments established over 70 evacuation centres.[5]

1.5 The property damage has had a terrible effect on individuals and families. The Australian Council of Social Service stated in evidence:

> Some of this will have an effect on people that lasts many years. Even though the flood itself was relatively short in duration, if your house and all your household possessions were destroyed—family records were often completely lost—that may have all sorts of impacts, material, emotional and psychological. In many cases it will take many years for people to rebuild their lives to the point they were at before the flooding.
>
> ...What we really need to see now is a long-term commitment to help those people affected to rebuild their lives, because we are not exactly sure how the impacts will manifest over time. They will affect different people and households in very different ways. Some people will get over them very quickly; others will take a long time.[6]

1.6 Of Queensland's 73 local government areas, 51 have had a disaster declaration since these events started and 14 of those local government areas have been severely impacted with very serious flooding. The damage to roads is yet to be assessed in detail, but local governments estimate that some 90,000 km of local government roads have seen some

3 Courier Mail, 'Bremer River at Ipswich peaks at 19.5m, lower than 1974 flood level', 12 January 2011, viewed at http://www.couriermail.com.au/news/queensland/ipswich-residents-evacuate-ahead-of-bremer-river-peak/story-e6freoof-1225985598772 on 18 February 2011.

4 Sydney Morning Herald, "'The worst is gone': Brisbane River begins slow retreat", 13 January 2011, viewed at http://www.smh.com.au/environment/weather/the-worst-is-gone-brisbane-river-begins-slow-retreat-20110112-19nnu.html on 18 February 2011.

5 Queensland Government, Ministerial Media Statements, Premier and Minister for the Arts, the Hon Anna Bligh, Transcript, Press Conference, 21 January 2011, viewed on 18 February 2011 at http://www.cabinet.qld.gov.au/MMS/StatementDisplaySingle.aspx?id=73383.

6 Mr Pisarski, transcript, 16 February 2011, p. 66.

form of damage. This figure does not include federal highways, state roads or railways.[7]

1.7 The implications of this damage and disruption for the national economy are also profound. Initial estimates put the damage at $10 billion, but AMP chief economist Shane Oliver suggested a figure of $30 billion with an estimated $13 billion dollar cut to the March quarter GDP.[8] The Queensland Treasury estimates that economic growth in that state in 2010-11 will drop from an initial figure of 3.75 per cent to 1.25 per cent.[9]

1.8 The Commonwealth Treasury stated that it will take a number of years to calculate a precise cost of the floods.[10] However, it is clear that an enormous human, social and economic cost has been visited upon Queensland.

Cyclone Yasi

1.9 Severe Tropical Cyclone Yasi crossed the Queensland coastline near Innisfail and Cardwell on the morning of 3 February 2011. Rated Category 5, the cyclone featured extreme conditions such as wind gusts of up to 285 kilometres per hour, a lowest air pressure of 929 millibars, recorded at Tully, and a 5 metre storm surge at Cardwell, just south of Mission Beach.[11] As a tribute to the preparations made by the authorities, no-one died as a direct result of the Cyclone. However, the Committee very much regrets the death of a 23-year old man near Ingham, who asphyxiated while using a generator in a closed room during the event.[12]

1.10 The region has large plantations of bananas and sugar cane and these have been extensively damaged. Early estimates were that 75 per cent of the banana crop, valued at $350 million, was wiped out. 100 per cent of the sugar cane crop in the region, with a value of $500 million, is estimated to be destroyed. The CEO of peak body Canegrowers stated:

7 Queensland Government, Ministerial Media Statements, Premier and Minister for the Arts, the Hon Anna Bligh, Transcript, Press Conference, 21 January 2011, viewed on 18 February 2011 at http://www.cabinet.qld.gov.au/MMS/StatementDisplaySingle.aspx?id=73383.

8 ABC News, 'Flood costs tipped to top $30b', 18 January 2011, viewed on 18 February 2011 at http://www.abc.net.au/news/stories/2011/01/18/3115815.htm.

9 Mr Bradley, transcript, 16 February 2011, p. 21.

10 Mr Ray, transcript, 16 February 2011, p. 2.

11 Met Office, 'Australia recovers as Severe Tropical Cyclone Yasi finally weakens in Northern Territory', 4 February 2011, viewed on 18 February 2011 at http://metofficenews.wordpress.com/2011/02/04/australia-recovers-as-severe-tropical-cyclone-yasi-finally-weakens-in-northern-territory/.

12 ABC News, 'Man found dead in cyclone aftermath', 4 February 2011, viewed on 18 February 2011 at http://www.abc.net.au/news/stories/2011/02/04/3129837.htm.

> We've had reports from sugarcane farmers in Tully and surrounds of sugarcane crops which have snapped in half and whole farms that have been completely flattened. Trees are uprooted, roofs are missing and power poles are now lying as flat as the sugarcane.[13]

1.11 The built environment has also suffered. Preliminary figures show that Cyclone Yasi destroyed 150 homes and left a further 650 uninhabitable. Further, 2,275 homes were moderately damaged. Tens of thousands of homes were without power.[14]

The Victorian floods

1.12 The La Nina event that helped cause the Queensland disasters also led to extensive flooding in Victoria in mid-January. The Bureau of Meteorology reported that rainfall records were broken in parts of the state, where up to a summer's rainfall fell in five days. Some locations received over 200 mm of rain in a single day.[15] Press reports indicate that two people died as a result of these floods,[16] and the Committee extends its sympathies and condolences to the family and friends of the deceased.

1.13 At the end of January, the Victorian Department of Primary Industries calculated that the damage to agriculture could be as much as $2 billion. This included over 41,000 hectares of field crops, over 51,000 hectares of pasture, 83,000 tonnes of hay and silage, and almost 2,000 kilometres of fencing.[17]

1.14 In the second reading speech for the Bills, the Prime Minister stated that the Commonwealth would assist in funding repairs for the Calder and Sturt highways.[18] As at the time of this report, the Victorian Government's

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13 just-food, 'Cyclone Yasi hits sugarcane crops,' viewed on 17 February 2011 at http://www.just-food.com/news/cyclone-yasi-hits-sugarcane-crops_id114104.aspx.

14 ABC News, 'Cyclone Yasi destroyed 150 homes', 7 February 2011, viewed on 18 February 2011 at http://www.abc.net.au/news/stories/2011/02/07/3132324.htm.

15 Sydney Morning Herald, 'More Victorian towns to be evacuated', 15 January 2011, viewed at http://news.smh.com.au/breaking-news-national/more-victorian-towns-to-be-evacuated-20110115-19rjo.html?from=smh_sb on 18 February 2011.

16 ABC News, 'Missing boy's body found', 18 January 2011, viewed on 18 February 2011 at http://www.abc.net.au/news/stories/2011/01/18/3115390.htm and Ninemsn, 'Victoria flash floods claim first victim', 7 February 2011, viewed on 18 February 2011 at http://news.ninemsn.com.au/national/floods/8207291/flash-flooding-eases-in-victoria.

17 The Age, 'Victorian damage bill to hit $2bn', 26 January 2011, viewed on 18 February 2011 at http://www.theage.com.au/victoria/victorian-damage-bill-to-hit-2bn-20110125-1a4cf.html.

18 The Hon J. Gillard, *Hansard*, House of Representatives, 10 February 2011, p. 1.

flood traffic alert listed well over a hundred road closures caused by the floods.[19]

Recovery and reconstruction to date

1.15 The Queensland Treasury outlined in evidence progress so far in that State:

> Yesterday, in the Queensland Parliament, the Premier tabled the Queensland Reconstruction Authority Bill. The new, independent authority will manage and coordinate the government's program of infrastructure reconstruction and recovery within disaster affected communities. It will be overseen by a Queensland Reconstruction Board, which will be chaired by Major General Mick Slater and will include two members nominated by the Australian government...
>
> The Commonwealth-state Natural Disaster Relief and Recovery Arrangements, NDRRA, is the primary mechanism for responding in the federation to natural disaster events. The Australian and Queensland governments are developing a national partnership agreement, which is intended to further strengthen the governance and accountability provisions of the NDRRA. This will include detailed performance monitoring and reporting arrangements and new governance arrangements, including the establishment of the Australian Government Reconstruction Inspectorate.
>
> Finally, the Queensland government has established the commission of inquiry into the Queensland floods with wide-ranging terms of reference, including flood preparation and planning, the performance of private insurers, the flood response efforts, land use planning, early warning systems and infrastructure operation. Again, it has a major task, but it is intended that it report by January 2012. I should also say that the recovery effort is already well underway, with priority restoration of essential water, energy and transport services and disaster recovery assistance for affected people in the community. The big task ahead of course is restoration of our community assets and personal homes, and that is a very big challenge for the authority and for the Queensland community more broadly.[20]

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19 Vicroads, Traffic Management Centre Flood Traffic Alert, 'Road Closures' http://mobiletraffic.vicroads.vic.gov.au/floodalerts, viewed 17 February 2011.

20 Mr Bradley, transcript, 16 February 2011, pp. 17-18.

1.16 The Committee acknowledges that many Queenslanders have made significant contributions in the response to the natural disasters in that State. Many people acted heroically to save the lives of others and many people have since acted selflessly in assisting with cleanup and reconstruction.

1.17 One issue the committee explored in evidence was the extent to which the current reconstruction would prepare Queensland for future floods. The Queensland Treasury stated:

> ... the [Queensland Reconstruction Authority] has a very extensive role to play. It will have a capability to look at that issue and it will have the ability to work with local government around the planning of how restoration should occur in severely impacted flood-prone areas. It does have provision to, for example, declare reconstruction areas and to designate areas as acquisition land. When land is declared as acquisition land, owners will be prevented from disposing of the land, other than to the authority or another nominated entity, such as local government. But that will occur only in circumstances where the local government has sought the assistance of the authority in considering the appropriate land planning issues for that area...
>
> In some areas there may be other solutions—for example, raising the levels of houses, which is one option being canvassed; or shifting settlements in some areas to slightly higher areas. There may be a range of local circumstances where they consider appropriate arrangements. Flood mitigation might also be an appropriate strategy in some areas.[21]

1.18 The Committee was also interested in whether it would be possible to use improved construction techniques so that roads would not need to be rebuilt after flooding:

> The [Natural Disaster Relief and Recovery Arrangements] do allow for what is termed 'betterment'. Where there is an opportunity identified for improving an asset's resilience against future events, that is considered by the various funding parties as to whether that would an appropriate investment and then it may be eligible for funding. It is considered on a case-by-case basis for betterment events. Obviously in the scale of infrastructure we are talking about here, the identification of where those opportunities might lie is something that is yet to occur. Certainly we have not

21 Mr Bradley, transcript, 16 February 2011, pp. 26-27.

> allowed in our estimates for substantial betterment. For example, flood-proofing the national highways would be a massive investment which we have not factored into these numbers.[22]

1.19 The Committee appreciates that preparing the affected areas for the next adverse weather event is a technical and costly exercise. But, regardless of whether these Bills are passed, one of the most important outcomes of the reconstruction will be the ability of reconstructed areas to withstand future events, either through better design or better location.

National disaster relief and recovery arrangements

1.20 The Queensland Treasury advised that there have been long standing agreements between the Commonwealth and the States that govern responsibility for funding infrastructure recovery and that their operation depends on certain thresholds being met. In this case, the agreements require the Commonwealth to pay three quarters of infrastructure costs.[23]

1.21 The Commonwealth's responsibilities in rebuilding state infrastructure directly affected by a natural disaster are outlined in a ministerial determination from 2007, titled *Natural Disaster Relief and Recovery Arrangements*. Broadly, the Commonwealth has agreed to fund 75 per cent of rebuilding essential state infrastructure for all damage in a financial year assessed above the higher of two thresholds, and 50 per cent of rebuilding for all damage assessed between two thresholds. The thresholds are calculated as a proportion of state revenue. In the case of Queensland for 2010-11, the two thresholds are $83 million and $146 million.

1.22 Therefore, given the extreme scale of the Brisbane floods, the Commonwealth will be funding 75 per cent of almost all of the damage to essential infrastructure. This spending is not discretionary. In effect, the Commonwealth has become the insurer for State governments for extreme natural disasters.

Insurance

1.23 The Insurance Council of Australia advised the Committee that private insurers have allocated reserves of $2 billion to meet costs arising from the Queensland floods, which comprises 43,000 claims. For Cyclone Yasi,

22 Mr Bradley, transcript, 16 February 2011, p. 27.

23 Mr Bradley, transcript, 16 February 2011, p. 24.

$0.5 billion has been allocated, comprising 30,000 claims.[24] The Council advised that, if they followed historical patterns, these figures would continue to increase and reach close to their final amounts in three months.[25] These claims relate to homes and businesses.

1.24 The Committee explored the issue of whether there were any barriers to individuals privately insuring their properties and contents against flood. The Council stated that the market for flood insurance was now well developed:

> There is no market failure in flood insurance for riverine flood ... it is available in the market and it has been for some years now, and has been heavily advertised. Our experience in flood zones is that consumers who are aware that they are in a flood zone generally do seek out flood cover and take out the cover. It is a little too early to tell how far that has gone for this particular event, but we expect that towards the end of the month we will have some data around that point. There is a small element of people now who for whatever reason—potentially that they did not understand that they live in a flood zone, that they did not understand the product or that they have not researched it appropriately—have chosen a product that on its face does not cover the flood risk.[26]

1.25 However, the Council identified two outstanding issues. The first is developing a standard definition for flood, which the industry first attempted in 2007. However, the industry's initial proposal was rejected by the Australian Consumer and Competition Commission and insurers are using their own definitions where they underwrite the risk. The industry has recommenced discussions with the Government on a standard definition.[27]

1.26 The second issue is developing publicly available flood data that insurance companies can use to accurately determine the flood risk for individual properties and that individuals and businesses can use as well. The Council stated that freely available, high quality information would improve insurance products and that the Commonwealth could have a central, coordinating role:

> There is a great deal of good government flood data available at the moment but it is patchy, some of it is old and some of it is

24 Mr Sullivan, transcript, 16 February 2011, p. 47.
25 Mr Sullivan, transcript, 16 February 2011, p. 55.
26 Mr Sullivan, transcript, 16 February 2011, p. 52.
27 Mr Sullivan, transcript, 16 February 2011, p. 52.

> difficult for us to obtain. As to your question about the level of government, at the moment most states approach it by delegating it to local government. That presents a difficulty for other users of the information at a national level who then need to go and negotiate with individual local governments right across the country. Our view is that this is national infrastructure and that it should be done centrally and federally with the cooperation of the states so that for the first time, much like they have done in the US, all Australians can get access to high-quality flood mapping that properly informs them of their risks.[28]

1.27 In relation to the State of Queensland, the Queensland Treasury stated in evidence that they had investigated reinsuring their risks externally but ultimately did not do so.[29] After the hearing, the Queensland Treasury provided further advice:

> QGIF [Queensland Government Insurance Fund] is a self insurance fund established by the State to manage property (excluding infrastructure such as roads, railways etc), general liability and other risks. It also excludes loss or damage due to natural disaster events for which funding is available under NDRRA.
>
> Re-insurance for QGIF was investigated in detail by Queensland Treasury in 2004 in relation to property and general liability. This did not cover State roads, railways or Local Government assets. Quotes were obtained through QGIF's insurance advisor.
>
> ...the quotes related to broad property exposures subject to risk sharing parameters (e.g. limits per event and retention amounts) and therefore did provide some limited property cover for such events.
>
> In the circumstances, if re-insurance was secured and subsequently retained, subject to any variation in terms over time, it could have been called upon to a limited extent during current events, noting that damage to State building assets is currently estimated at around $150 million (some of which is not eligible for NDRAA funding and will be funded from other insurance/State sources). The value for money of this cover would also depend

28 Mr Sullivan, transcript, 16 February 2011, p. 53.

29 Mr Bradley, transcript, 16 February 2011, p. 20.

> upon an assessment of other factors such as the cost of premiums and retention amounts (i.e. risk retained by State) over time.[30]

1.28 On the day of the hearing, the Queensland Treasurer stated in the Queensland Parliament that it would be difficult to obtain reinsurance for flood risks for state infrastructure assets and that other state governments do not externally insure their roads:

> I am still unaware of any government in Australia that has natural disaster insurance which would have covered the losses from the event in Queensland. Of those states which do pay a premium to a private insurance company, it is the norm that, firstly, council owned infrastructure is not insured and not included and, secondly, roads are excluded from the policy. This is an important point. The damage bill from the floods had been estimated at $5 billion, as I said. Of this, $2 billion was for local government infrastructure and $2.5 billion was for the road network. That equates to $4.5 billion worth of costs that would not be covered under the insurance coverage some other states hold...
>
> I have noted with interest recent comments from unnamed industry sources that natural disaster insurance for Queensland is readily available. Previous market soundings have indicated that an insurance premium would likely be in the hundreds of millions of dollars. It would also involve a complex, lengthy and costly due diligence process. This is not just a matter of ringing different companies to get a better quote on your home and contents insurance.[31]

1.29 On the other hand, the Insurance Council of Australia argued that there may be ways in which it may be possible to access the global insurance market as a way of increasing the options for governments in Australia to manage their risk and to make a link between managing the risk and financial responsibility for it:

> There is the instrument of the national disaster relief guidelines that are available. They are essentially a COAG instrument. There is the opportunity to use those arrangements to look at better ways of, if you like, globalising the reinsurance risk. One such way could be to have an independent agency, such as APRA, examine state government reinsurance arrangements. APRA examine the private sector arrangements and there are guidelines for that.

30 Queensland Treasury, submission 6, p. 1.

31 The Hon A.P. Fraser, *Hansard*, Queensland Parliament, 16 February 2011, pp. 110-11.

> This is not unusual; the Obama Fiscal Commission actually recommended the idea of local authorities—in their case, state governments as well—examining reinsurance arrangements and offloading it that way for very much the same reasons we experience here, that the federal agencies often have to step in and assist state governments in the US, particularly those who are in the disaster zones, such as with Katrina, Andrew and the like.[32]

1.30 Another issue raised by the Council is that the tax review, *Australia's Future Tax System*, recommended that insurance taxes should be abolished.[33] The argument in the review report is that these taxes are inefficient and lead to a welfare loss. Alternative taxes are available.[34]

1.31 In the view of the Committee, these natural disasters are a reminder that there is a range of significant policy issues in the insurance field that would benefit from a Government-sponsored review. The Committee encourages the Government to consider such a process to address the issues brought out by these recent events.

The Commonwealth's policy response

The announcement

1.32 On 27 January 2011, the Prime Minister announced a package to help rebuild flood-affected areas. The Government estimated that its contribution to reconstruction of essential infrastructure would be $5.6 billion.[35] The Committee received evidence that Commonwealth funds would not be paid for private recovery efforts.[36]

1.33 The Prime Minister's announcement stated that, of the $5.6 billion, $1 billion would be funded through delaying some infrastructure projects, $1.8 billion through the one-off levy, and $2.8 billion in spending cuts. The largest of these were:

- the Cleaner Car Rebate Scheme, providing $429 million

32 Mr Sanchez, transcript, 16 February 2011, p. 54.
33 Mr Sanchez, transcript, 16 February 2011, p. 55.
34 Australia's Future Tax System, *Report to the Treasurer: Overview* (2009) pp. 12-13, 51.
35 The Hon J. Gillard, *Hansard*, House of Representatives, 10 February 2011, p. 1.
36 Mr Ray, Commonwealth Treasury, transcript, 16 February 2011, p. 10.

- $350 million from total of $800 million allocated to the Priority Regional Infrastructure Program
- the Capital Development Pool, providing $299 million
- $264 million from the National Rental Affordability Scheme, reducing the dwelling target from 50,000 to 35,000.

1.34 Although the inquiry did not concentrate on these spending cuts, the Committee received criticisms about the reduction in the rental scheme from Saul Eslake and the Australian Council for Social Service.[37]

1.35 To the Committee's knowledge, the Commonwealth has not made an estimate of its contribution to Cyclone Yasi. In evidence, Treasury stated that it expected the total public sector cost would be similar to that for Cyclone Larry in 2006, which was $0.5 billion. However, on the day of the hearing, the Queensland Treasurer announced in the Queensland Parliament that his estimate of the cost of Cyclone Yasi would be $800 million.[38] The Commonwealth Treasury expects that detailed estimates will be published in the forthcoming Budget.[39]

The response of the markets

1.36 The markets were sensitive to the effects that rebuilding may have on inflation and interest rates, but responded in a positive way to the announcement. For example, Citi stated that 'The package helps to moderate some pressures on inflation from the flood' and, 'At the margin the package assists the RBA in managing the inflation impact from the rebuild'.[40] The Commonwealth Bank reported:

> There are some attractive features to these proposals. Adding an (essential) rebuilding overlay to an economy already at full employment carries with it some inflation risks. Making room by lifting taxes and cutting spending looks appropriate even though the fiscal backdrop remains very good.[41]

1.37 Christopher Joye, the Managing Director of Rismark commented:

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37 Mr Eslake and Mr Pisarski, transcript, 16 February 2011, pp. 30, 59.

38 The Hon A.P. Fraser, *Hansard*, Queensland Parliament, 16 February 2011, p. 110.

39 Mr Ray, transcript, 16 February 2011, p. 12.

40 Brennan P, Williamson J, 'Australia Letter from Canberra, The PM's Speech,' Citi, 27 January 2011.

41 Blythe M, 'Costing the floods' Economics: Update, Commonwealth Bank, 27 January 2011.

> More specifically, the government is trying to reduce the inflationary consequences of the floods for fear of the influence they will have on monetary policy. This makes sense.
>
> ... if you want the real proof in the pudding of the government's case, consider this – interest rate futures markets have rallied hard today in response to the package, materially reducing the probability of future rate hikes on the basis that the measures are anti-inflationary.[42]

1.38 Craig James, CommSec's Chief Economist reported as follows:

> ...this is the right levy for the times – modest in size, temporary, progressive and applying to those on higher incomes...
>
> The fact that the Government is cutting spending and applying a new levy on Australian consumers may reduce the need or urgency for the Reserve Bank to lift interest rates over the year.[43]

Conduct of the inquiry

1.39 On Thursday, 10 February 2011, the Prime Minister introduced the Income Tax Rates Amendment (Temporary Flood Reconstruction Levy) Bill 2011 (the Tax Rates Bill) and the Tax Laws Amendment (Temporary Flood Reconstruction Levy) Bill 2011 (the Tax Laws Bill) into the House of Representatives.[44] On the same day, the House Selection Committee referred the Bills to the House of Representatives Standing Committee on Economics for consideration and report.[45]

1.40 The Committee announced the inquiry and called for submissions on Friday, 11 February. The Committee received eight submissions and these are listed in Appendix A. The Committee held a public hearing on the Bills on Wednesday, 16 February. The organisations and individuals who attended the hearing are listed in Appendix B. The submissions and the transcript of the hearing are available on the Committee's website.[46]

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42 Joye C, 'On the government's flood tax,' Switzer, viewed on 18 February 2011 at http://www.switzer.com.au/the-experts/christopher-joye/on-the-governments-flood-tax/.

43 James C, 'Flood levy proposed – but is it necessary?' Switzer, viewed on 18 February 2011 at http://www.switzer.com.au/business-news/news-stories/flood-levy-proposed---but-is-it-necessary/.

44 The Hon J. Gillard, *Hansard*, House of Representatives, 10 February 2011, p. 1.

45 House of Representatives Selection Committee, Report 13, 10 February 2011, p. 3.

46 Go to http://www.aph.gov.au/house/committee/economics/index.htm.

The proposed operation of the Bills

Structure

1.41 The Bills raise a one-off levy that applies to individuals' taxable income in 2011-12. It is projected to raise $1.56 billion in 2011-12 and $235 million in 2012-13. Funds raised will be paid into Consolidated Revenue. There is no legal requirement in the Bills that they be used for reconstruction activities, but the Commonwealth has given such a commitment under the National Disaster Relief and Recovery Arrangements

1.42 The levy does not apply if a taxpayer earns less than $50,000 annually. If the taxpayer earns between $50,000 and $100,000 in 2011-12, then the income above $50,000 is taxed at a rate of 0.5 per cent. If the taxpayer earns more than $100,000 annually, then they pay $250 (the tax on their income up to $100,000) and then their income above $100,000 is taxed at 1 per cent. Table 1 shows the amount of tax that individuals pay at various levels of income.

Table 1 Levy amounts for various levels of taxable income

Annual taxable income ($)	Levy amount ($)
0	0
25,000	0
50,000	0
68,125	91
75,000	125
100,000	250
125,000	500
150,000	750
175,000	1,000
200,000	1,250

Source *Analysis based on the Explanatory Memorandum for the Bills*
The Prime Minister's announcement gave $68,125 as the figure for average weekly full time earnings.

1.43 With this structure, the levy is clearly progressive. In evidence, both the Australian Council of Social Service and the Australian Council of Trade Unions supported this feature.[47]

1.44 Certain classes of taxpayers can be excluded from the levy. This comprises those people who were affected by a natural disaster between 1 July 2010

47 Mr Pisarski, Ms Kearney, transcript, 16 February 2011, pp. 59, 68.

and 30 June 2012. In order for the exemption to apply, the Treasurer must make a legislative instrument to this effect. The Bills place no restriction on how such a legislative instrument would operate, so it is subject to the full operation of the *Legislative Instruments Act 2003*. In particular, the instrument would be subject to disallowance and the Treasurer would be required to consult before making the instrument. The Committee finds this exemption to be inherently fair.

1.45 The Explanatory Memorandum provides the following advice on how the levy will interact with other parts of the tax system:

- A trustee will be liable for the levy where they have income that is taxed as if the income was of an individual.
- The levy cannot be reduced by non-refundable tax offsets.
- Credit entitlements can be applied against the levy.
- The Tax Office will issue new withholding schedules and will generally take the levy into account in determining pay as you go instalment amounts.

1.46 The Tax Laws Bill specifically limits the levy to income from the 2011-12 year. The Income Tax Bill includes sunsetting provisions. Therefore, further legislation would be required for the levy to be extended to other financial years. The levy applies to only one income year.

1.47 The Committee does not have any concerns about the drafting of the Bills. In this regard, the levy is a straightforward matter and no witnesses raised issues about this.

Incidence of the levy

1.48 During the hearing, Treasury provided advice on the number of taxpayers who will be paying the levy. The total number of taxpayers earning in excess of $50,000 is 4.84 million. From this figure is subtracted 185,000, which is the number of people who are expected to be declared exempt from the levy on the basis of being in a natural disaster area. This leaves 4.66 million people who are expected to pay the levy. This is out of a total number of taxpayers of 10 million, so just under half of taxpayers will be subject to it.[48]

1.49 By way of comparison, the Committee asked Treasury what proportion of taxpayers paid the one-off increase to the Medicare levy (from 1.5 per cent

48 Ms Mrakovic and Mr Parker, transcript, 16 February 2011, pp. 3-4.

to 1.7 per cent) to help pay for the gun buyback scheme in 1996-97. Treasury replied that 6.9 million individuals paid the Medicare levy in this year, out of 8.6 million taxpayers, comprising 80 per cent of taxpayers.[49]

Superannuation payouts

1.50 The Police Federation of Australia raised the situation of someone who takes a superannuation lump sum during 2011-12 and whether this would unfairly increase their tax burden.[50] Treasury responded that some taxpayers would pay extra tax in these circumstances, but that they could rearrange their affairs to mitigate this effect because it only applies for one year:

> ...the issue relates to people who have reached preservation age for the purposes of superannuation, which is 55, and who retire and draw down a lump sum payment in the period ahead of the so-called tax-free super age of 60, so between 55 and 60 years of age. There is a potential for such people to draw down a large lump sum payment from a tax superannuation fund and, in that case, that large lump sum payment would be taxable income. If they draw down such a large lump sum payment during 2011-12 ... that would form part of their taxable income and would then be subject to the levy in the way that any other form of taxable income would be subject to the levy...
>
> ... this all turns on a case where the individual decides to take all of their superannuation as a lump sum payment in that particular year... It would be possible, for the example, for them to take a smaller amount as a payment for them to live on through the year and roll over the rest of their superannuation, which would therefore mean that it would not be considered taxable income through the year and would not attract the flood levy.
>
> The situation is one where the relevant individual, given their personal circumstances, really ought to seek some advice on their circumstances...[51]

1.51 Treasury also made the point that, if someone did incur a sizeable flood levy through a superannuation payout, for example of $6,500, then this would imply that they had a taxable income in the period of $725,000, which would mean that they would pay income tax of approximately

49 Treasury, submission 7, p. 1.

50 Police Federation of Australia, submission 5, p. 1.

51 Mr Willcock, transcript, 16 February 2011, pp. 13-14.

$85,000 and a Medicare levy of approximately $11,000. Therefore, the flood levy would comprise only a small component of their taxes for that year.[52]

The views of economists

1.52 At the hearing, the Committee questioned two economists, Saul Eslake and Professor Warwick McKibbin, about the economics of the proposed levy. The main point raised by Mr Eslake was that the reconstruction costs are small when compared with Commonwealth finances (e.g. annual spending is approximately $350 billion), which means that, in practical terms, the Government could raise the funds in several ways:

> ...compared with what the government did decide, there were at least two other alternatives that could have been pursued without damaging consequences for the Australian economy. The first of those is that the government could have elected to fund part or indeed all of the $5.6 billion that it estimates will be its share of the reconstruction and rebuilding effort through additional borrowings...I say that because the numbers entailed here, the $5.6 billion, represent a very small proportion of GDP, about 0.4 per cent of one year's GDP...
>
> Differences of that order of magnitude are not the stuff of which increases in interest rates, for example, are made...
>
> The second choice that they have could have made was to have funded more than they have decided of the Commonwealth's costs by further reductions in expenditure as opposed to a levy. In my view, there certainly would have been scope for further reductions in government spending...
>
> What I am here to say is that it is of no significance to the quality of economic management or to the outcomes for interest rates or other aspects of Australia's economic performance whether the government's reconstruction effort is funded entirely by borrowings, entirely by reductions in government expenditure or by some combination of the three.[53]

1.53 Mr Eslake summarised his opinion as follows:

52 Mr Willcock, transcript, 16 February 2011, p. 14.

53 Mr Eslake, transcript, 16 February 2011, pp. 29-30.

> When I say that had they decided to fund all of it by borrowing... the basis for that judgement is that the additional borrowing entailed in the government choosing to fund all of it by adding to the deficit is so small relative to the economy that it would have had neither any impact on the economy itself nor on the level of interest rates nor on the judgements which financial markets and others would have made about the credibility of the government's fiscal policy. Had the cost been 10 times what has been estimated on this specific occasion then I think their judgement might have been different, but that is because of the size rather than because of the intrinsic nature of the decision itself.[54]

1.54 Professor McKibbin took a more theoretical approach. His argument was that, in general, borrowing is a better way of meeting one-off reconstruction costs than increasing taxes or cutting other spending because it maintains demand when the economy has suffered a shock. The proviso is that a government should initially be in a sound financial position. If a reconstructing government has high levels of debt or there are other circumstances that cause lenders to doubt that it will repay borrowings, then it may need to take other approaches:

> There are at least three main ways to finance rebuilding. The first is to raise taxes, which further reduces private demand and therefore reduces economic activity even further. The second is to cut government spending, which also reduces economic activity...
>
> The third is to increase the fiscal deficit temporarily—and I stress 'temporarily'—to borrow to refinance the rebuilding. The advantage of borrowing is that this does not directly reduce economic activity today, but spreads the cost of rebuilding over many decades into the future. The macroeconomic goal should be to reduce the negative effects of the disaster soon after it occurs. Only borrowing achieves this objective. Both cutting spending and raising taxes worsens the decline in economic activity in the short term.
>
> The role of the government in income smoothing and risk sharing for the national economy is a fundamental tenet of sensible public finance policy. Of course, the general rule may not apply in all cases. If a government has no economic credibility then the ability to borrow may not be an option, and so pay as you go may be necessary. Also, if government debt to GDP were very high, the

54 Mr Eslake, transcript, 16 February 2011, p. 34.

> additional borrowing may raise the risk premium on government debt and therefore incur additional costs in excess of benefits for income-smoothing purposes. [55]

1.55 As Professor McKibbin noted,[56] the Commonwealth Government is in a sound financial position, especially when compared with other developed economies. Therefore, his analysis suggests that, as a matter of economics, borrowing would be optimal.

1.56 Two other topics arose in the discussion of the economics of the Bills. Firstly, the Committee asked Professor McKibbin what effect the Bills would have on inflation. Although he did not have the opportunity to do any modelling in response, Professor McKibbin responded that it would 'probably have a downward impact on inflation' by reducing aggregate demand.[57] Secondly, Mr Eslake noted that imposing the levy was not material to the current projections as to when the Budget would return to surplus. In other words, the Budget is still estimated to return to surplus in 2012-13:

> Therefore, if the government decided not to collect a levy but instead funded the amount that the levy is expected to raise by additional borrowings there would still be a large budget deficit in 2011-12, but not by so much bigger a margin as to have any impact on interest rates, financial markets or the economy. And there would still be a budget surplus for 2012-13, less than currently forecast but only by the amount of about $200 million that the levy is expected to collect in that year plus perhaps an additional $100 million of extra interest payments on the additional borrowings that the government would have to undertake primarily in 2011-12. So the levy is not designed to have any impact one way or the other on the government's target for returning the budget to surplus by 2012-13.[58]

Conclusion

1.57 At a time of widespread tragedy and devastation, the broad spectrum of Australian society has responded to the floods and other natural disasters in a multitude of ways, such as through donations of money or goods,

55 Professor McKibbin, transcript, 16 February 2011, pp. 37-38.

56 Professor McKibbin, transcript, 16 February 2011, p. 38.

57 Professor McKibbin, transcript, 16 February 2011, p. 43.

58 Mr Eslake, transcript, 16 February 2011, p. 31.

giving others temporary accommodation, or cleanups. Governments are repairing and rebuilding infrastructure. The question presented by the Bills is how governments might pay for the rebuild.

1.58 The Committee is of the view that we can fund the recovery of essential infrastructure so as to reflect our wider response to the disaster. In evidence, the Australian Council of Trade Unions referred to our need to take collective responsibility for each other:

> ... as a nation, we believe we need to take collective responsibility for each other's welfare, particularly in times of disaster, and a progressive levy on wage and salary earners is consistent with this principle.[59]

1.59 The work of volunteers, emergency services, the Defence Forces and others in the recovery has been entirely consistent with this idea of collective responsibility, which is also the philosophy behind the levy. Therefore, the Committee recommends as follows.

Recommendation 1

That the House of Representatives pass the Bills.

Craig Thomson MP
Chair
21 February 2011

59 Ms Kearney, transcript, 16 February 2011, p. 69.

Dissenting report

Background

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

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

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

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

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

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

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

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

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

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

Government announcement

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

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

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

This offer was rejected by the Government.

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

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

Inquiry process

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

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

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

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

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

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

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

Fiscal position of the Government

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

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

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

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

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

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

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

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

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

No economic argument in favour of a new tax

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

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

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

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

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

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

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

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

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

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

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

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

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

Unintended consequences of the flood tax

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

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

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

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

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

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

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

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

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

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

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

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

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

Who will pay for this flood tax?

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

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

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

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

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

Conclusion

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

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

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

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

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

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

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

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

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

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

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

Recommendation

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

Mr Steven Ciobo MP, Deputy Chair

Mr Scott Buchholz MP

Ms Kelly O'Dwyer MP

A

Appendix A – Submissions

No.	Provided by
1	Cairns Peace by Peace
2	Ms Diana Rickard
3	Ms Jane Siebum
4	Ms Kathleen Crotty
5	Police Federation of Australia
6	Queensland Treasury
7	Commonwealth Treasury
8	Commonwealth Treasury
9	Mr Andrew Thomas

B

Appendix B – Witnesses

Wednesday, 16 February – Canberra

Department of the Treasury

Ms Maryanne Mrakovcic, General Manager, Tax Analysis Division, Revenue Group
Mr David John Parker, Executive Director, Revenue Group
Mr Nigel Ray, Executive Director, Fiscal Group
Mr Michael Willcock, General Manager, Personal and Retirement Income Division

Queensland Treasury

Mr Gerard Bradley, Under Treasurer

Insurance Council of Australia

Mr Alex Sanchez General Manager Policy, Economics and Taxation
Mr Karl Kanib Sullivan, General Manager Policy, Risk and Disaster Planning Directorate

Australian Council of Trade Unions

Ms Gerardine Kearney, President

Australian Council of Social Service

Mr Adrian Pisarkski, Deputy President

Mr Saul Eslake, Private capacity

Professor Warwick McKibbin, Private capacity