INDUSTRY EFFECTS OF TAX REFORM

This report was compiled following a request for elaboration on evidence presented on 12 November to the Senate Finance & Public Administration References Committee — *Inquiry into Business Tax Reform*.

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Executive Summary

This report uses Econtech's MM303 model to estimate the industry effects of tax reform. It models the GST package known as A New Tax System (*ANTS*). It also models the proposed changes to business tax in the Government's response to the Review of Business Tax (*RBT*).

Econtech has previously estimated the industry effects of *ANTS* in our report for the Senate Inquiry into *ANTS*. The estimates in this report are similar, except they have been updated to take into account the changes to *ANTS* negotiated with the Democrats, including making fresh food GST-free.

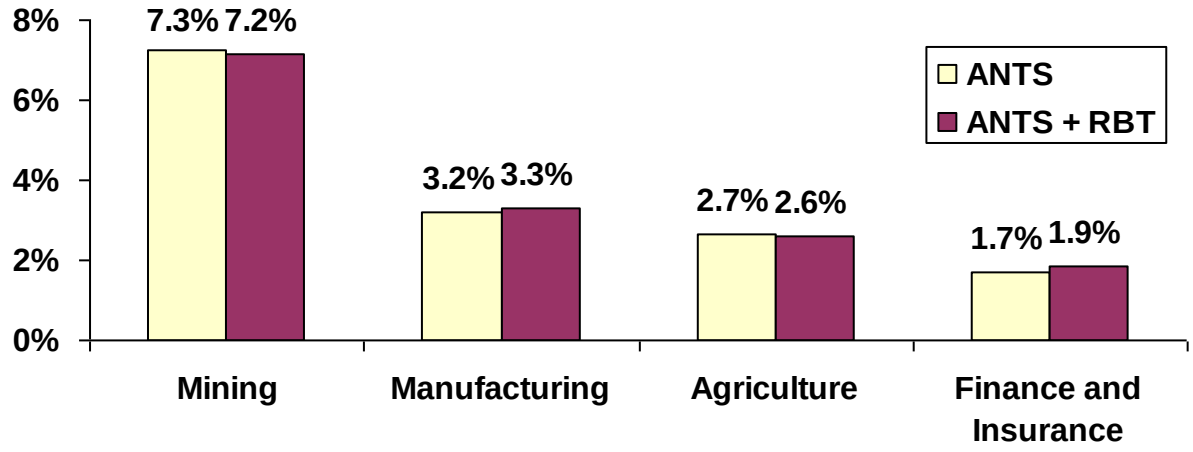
Econtech has also previously estimated the industry effects of various versions of *RBT*. Econtech analysed the draft *RBT* proposals in a report for the Australian Bankers' Association, while Econtech analysed the final *RBT* proposals in work reported in section 25 of the final *RBT* Report. The estimates in this report have been further updated to take into account the Government's response to the final *RBT* Report.

Economy-wide Production Effects

Tax reform aims to remove biases in the tax system that favour some industries at the expense of others. While this leads to changes in the industry pattern of production, it is misleading to refer to "winners" and "losers" from tax reform. It is more accurate to refer to industries as being unfairly disadvantaged or advantaged by the biases in an unreformed tax system. By removing these biases, tax reform yields gains in national welfare.

- *ANTS* increases national production and changes its industry pattern.
  - *ANTS* increases GDP by 1.6 per cent.
  - There are production gains of up to 7.3 per cent for 14 out of 18 industry divisions.
- The gain in national production (or growth dividend) from *RBT* is estimated in another report ("General Effects of *RBT*"); this report holds national production fixed and only estimates the changes in its industry pattern, which are small.
  - This is because *RBT* is a $3 billion tax package while *ANTS* is a $24 billion tax package, so *RBT* is only one-eighth the size of *ANTS*.
  - The change in production for any industry from *RBT* is no more than 0.3 per cent. All 14 industry divisions that gain from *ANTS* still gain once *RBT* is factored in.
- Chart A shows how tax reform has different impacts on different key industries. It shows the impact of *ANTS* alone and *ANTS* plus *RBT*.
  - Because *ANTS* and *RBT* are to be implemented at the same time, the effects of both tax reforms need to be considered together, as emphasised by the Treasurer, Shadow Treasurer and John Ralph.
  - Caution is needed in interpreting Chart A because, as stated above, it does <u>not</u> include the growth dividend from *RBT*, which is estimated in another report.

Chart A
Percentage Changes in Production from Tax Reform



◊ Chart A shows that Mining has the largest gain in production of 7.3 per cent from *ANTS* and 7.2 per cent when the *RBT* measures are also taken into account. More generally, it shows that *RBT* has relatively little effect on production levels compared with *ANTS*.

Economy-wide Costs

◊ An industry tends to lose or gain from *RBT* depending on if it pays more or less tax.

  ◊ *RBT* abolishes accelerated depreciation, a tax concession used widely in the Mining industry, so it pays more tax, shaving its production gain from tax reform to a still high 7.2 per cent.

  ◊ *RBT* lowers the company tax rate, producing a decrease in tax paid by the Finance and Insurance industry. Thus this industry's production gain of 1.7 per cent from *ANTS* increases to a still moderate gain of 1.9 per cent when *RBT* is also factored in. The current business tax system is biassed against the Finance & Insurance industry so it benefits from a move to a more neutral business tax system under *RBT*.

◊ Table A shows the source of changes in industry costs for the integrated tax package. These 12 industries obtain reductions in industry costs from the total tax package.

Table A
Changes in Industry Costs

	ANTS	*RBT*	Total
Agriculture, forestry, and fishing	-1250	20	-1230
Mining	-2000	150	-1850
Manufacturing	-8250	150	-8100
Electricity, gas and water	-1000	190	-810
Construction	-2080	10	-2070
Wholesale trade	-2240	-80	-2320
Retail trade	-2260	90	-2170
Accom., cafes and restaurants	-660	50	-610
Transport and storage	-2540	190	-2350
Communication services	-990	-130	-1120
Finance and insurance	-780	-240	-1020
Property and business services	-2520	-10	-2530

1. Introduction

This report models the long-term effects on industry production of tax reform. It considers the GST tax package known as A New Tax System (*ANTS*) that was passed by Parliament in June 1999. It also considers the proposed changes to business tax contained in the Government's response to the Review of Business Tax (*RBT*), including Stage 2 measures.

Econtech has previously estimated the industry effects of *ANTS* in our report for the Senate Inquiry into *ANTS*. The estimates in this report are similar, except they have been updated to take into account the changes to *ANTS* negotiated with the Democrats, including making fresh food GST-free.

Econtech has also previously estimated the industry effects of various versions of *RBT*. Econtech analysed the draft *RBT* proposals in a report for the Australian Bankers' Association, while Econtech analysed the final *RBT* proposals in work reported in section 25 of the final *RBT* Report. The estimates in this report have been further updated to take into account the Government's response to the final *RBT* Report.

The industry estimates in this report were obtained using Murphy Model 303 (*MM303*), a highly detailed and widely-used model of the Australian economy.

MM303 was used to estimate the effects of *ANTS* on both the industry pattern and total level of national production.

MM303 was also used to estimate the effects of *RBT* on the industry pattern of production, but holding total production fixed. The effects on *RBT* on total production, or the growth dividend, is estimated in a separate report ("General Effects of *RBT*") using a tailor-made model. *Thus this report understates the production gains for each industry from RBT because it does not take into account the growth dividend identified in the separate report.*

Scope of Tax Reform

The major components of indirect tax reform in *ANTS* are:

◊ the introduction of a GST at a rate of 10 per cent;

◊ the abolition of wholesale sales tax and reductions in excises for petrol and diesel;

◊ the abolition of Financial Institutions Duty (FID) and stamp duties on shares; and

◊ reductions in personal income tax.

The major components of the *RBT* measures are:

◊ a reduction in the company tax rate from 36 per cent to 30 per cent;

◊ the abolition of accelerated depreciation; and

◊ other smaller measures.

Approach of the Analysis

Our approach to using *MM303* to estimate the production effects of *ANTS* has been explained in our report for the Senate Inquiry into *ANTS*. The estimates in this report are similar, except they have been updated to take into account the changes to *ANTS* negotiated between the Government and the Democrats, including making fresh food GST-free.

Our approach to using *MM303* to estimate the industry production effects of *RBT* is a three-step process.

The first step is to extract from the *RBT* Report, and the Government's response, the effect of each *RBT* measure on collections of business tax.

The second step is to allocate each of these changes in business tax collections between industries using a variety of methods.

For company tax, the Australian Tax Office (*ATO*) publishes data on the amount of company tax currently paid by each industry. This can be used to estimate each industry's saving from reducing the rate from 36 to 30 per cent.

It is more complex to estimate the extra tax paid by each industry from abolishing accelerated depreciation. The *ATO* data shows total depreciation deductions for each industry, but not the contribution from accelerated depreciation. Econtech has dealt with this problem by using alternative data sources.

The ABS provided unpublished data on the composition of each industry's capital stock, detailing each industry's use of buildings, road motor vehicles, computers, industrial machinery etc. The Master Tax Guide provides information on stated lives and tax lives for each of these items of capital. Abolition of accelerated depreciation involves increasing the tax lives to equal the stated lives.

The Master Tax Guide information on the increase in tax life for each capital item from abolition of accelerated depreciation was applied to the ABS information on the capital items used by each industry to estimate the extra tax paid by each industry.

Using these and similar methods, estimates were obtained of the effect of each *RBT* measure on the business tax paid by each industry. These estimates were then aggregated to estimate the effect of the total *RBT* package on the amount of business tax paid by each industry.

In the third step, the change in business tax for each industry was fed into *MM303* via changes to each industry's user cost of capital. The resulting simulation provided estimates of how *RBT* affects costs, prices, production levels etc for each industry.

Obviously, each industry will be affected by the change in its tax bill (up or down), which it will ultimately pass on to its customers.. Less obviously, it will also be affected by the changes in tax in other industries. For example, as production changes in one industry it will affect their purchases from other industries. Also, the exchange rate will move in response to changes in the competitiveness of Australia's trade exposed industries. That will affect all trade-exposed industries. All of this is taken into account in *MM303*.

Tax reform aims to remove biases in the tax system that favour some industries at the expense of others. While this leads to changes in the industry pattern of production, it is misleading to refer to "winners" and "losers" from tax reform. It is more accurate to refer to industries as being unfairly disadvantaged or advantaged by the biases in an unreformed tax system. By removing these biases, tax reform yields gains in national welfare.

This report has the following structure. Section 2 estimates the changes in production arising from tax reform. This compares the production changes from *ANTS* alone, with the production changes when both *ANTS* and *RBT* are taken together. Section 3 presents estimates of the changes in tax paid for each industry as a result of *RBT*. It also shows the source of these changes.

2. Effects of Tax Reform on Production by Industry

This section presents estimates from *MM303* of the long-term effects of tax reform on production in each industry.

MM303 model is a detailed, comprehensive computable general equilibrium (CGE) model of the Australian economy, in which 107 industries produce 305 products.

MM303 models existing indirect taxes and the GST in a comprehensive way. This enables it to estimate the effects of *ANTS* on both national production and its industry pattern.

MM303 does not model business tax in the same detailed way. For this reason, the three-step procedure described in the previous section needs to be followed to simulate *RBT* using *MM303*. Even under this three-step approach, MM303 is not suited to estimating the effects of *RBT* on national production, the so-called growth dividend. To overcome this problem, national production has been held fixed and MM303 has been used only to estimate the effects of *RBT* on the industry pattern of production.

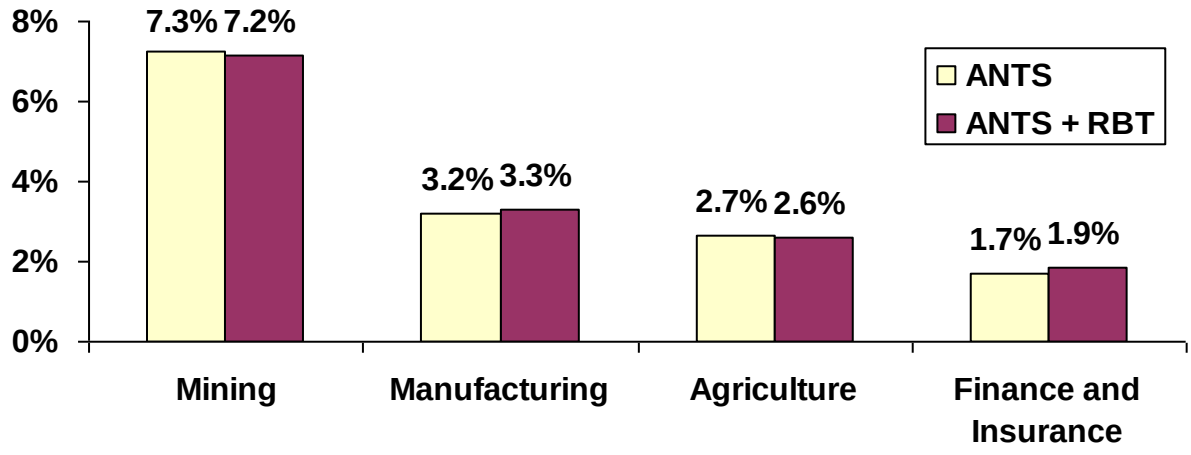
The effects on *RBT* on total production, or the growth dividend, is estimated in a separate report ("General Effects of *RBT*") using a tailor-made model. *Thus this report understates the production gains for each industry from RBT because it does not take into account the growth dividend identified in the separate report.*

MM303 has been used to produce two sets of results in this report.

The first set shows the effects of *ANTS*, which has already been passed by the Parliament.

The second set includes *ANTS* and *RBT*. Thus it shows the effects of tax reform if *RBT* is also passed by the Parliament. Because *ANTS* and *RBT* are to be implemented at the same time, the effects of both tax reforms need to be considered together, as emphasised by the Treasurer, Shadow Treasurer and John Ralph.

Chart 1
Percentage Changes in Production from Tax Reform



To introduce the results, Chart 1 shows effects for four key industries. It shows the impact of *ANTS* alone and *ANTS* plus *RBT*.

Caution is needed in interpreting Chart 1 because, as stated above, it does not include the growth dividend from *RBT*, which is estimated in another report.

Chart 1 shows that Mining has the largest gain in production of 7.3 per cent from *ANTS* and 7.2 per cent when the *RBT* measures are also taken into account. More generally, it shows that *RBT* has relatively little effect on production levels compared with *ANTS*.

An industry tends to lose or gain from *RBT* depending on if it pays more or less tax.

RBT abolishes accelerated depreciation, a tax concession used widely in the Mining industry, so it pays more tax, shaving its production gain from tax reform to a still high 7.2 per cent.

RBT lowers the company tax rate, producing a decrease in tax paid by the Finance and Insurance industry. Thus this industry's production gain of 1.7 per cent from *ANTS* increases to a still moderate gain of 1.9 per cent when *RBT* is also factored in. The current business tax system is biassed against the Finance & Insurance industry so it benefits from a move to a more neutral business tax system under *RBT*.

We now turn to assess the results on an industry-by-industry basis.

By way of background, *ANTS* is estimated to add 1.6 per cent to GDP. This growth dividend occurs for two reasons.

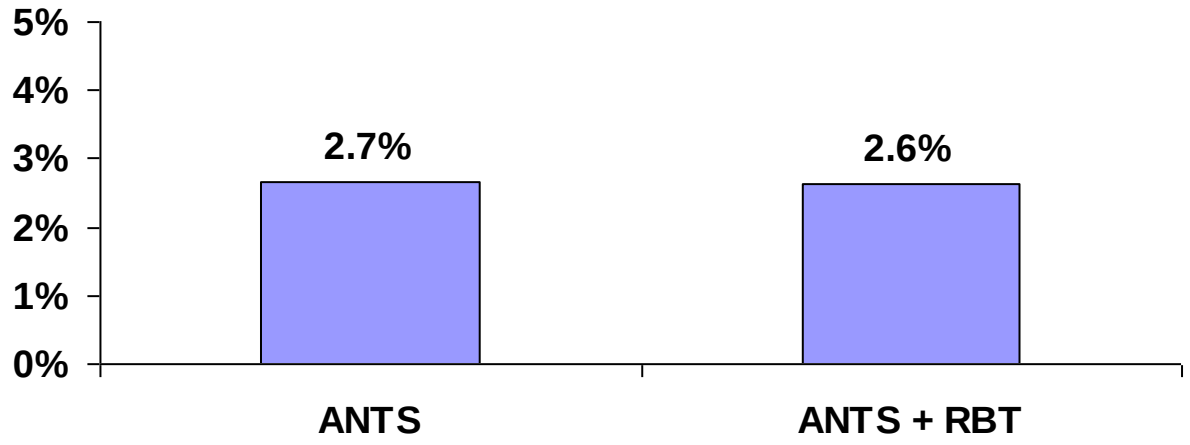
- *ANTS* removes sales tax from business capital including road vehicles, computers and office equipment. This makes business capital cheaper, leading to a more capital-intensive economy. This additional capital adds to national production i.e. there is a permanent gain in GDP.

- *ANTS* represents a move from narrowly-based indirect taxes to a broadly-based GST. This reduces distortions to economic choices, contributing to the permanent gain in GDP.

RBT would also lead to a growth dividend. However, as discussed above, this is considered in another report. In this report, it is assumed that *RBT* has no effect on total GDP. It only affects the industry pattern of production.

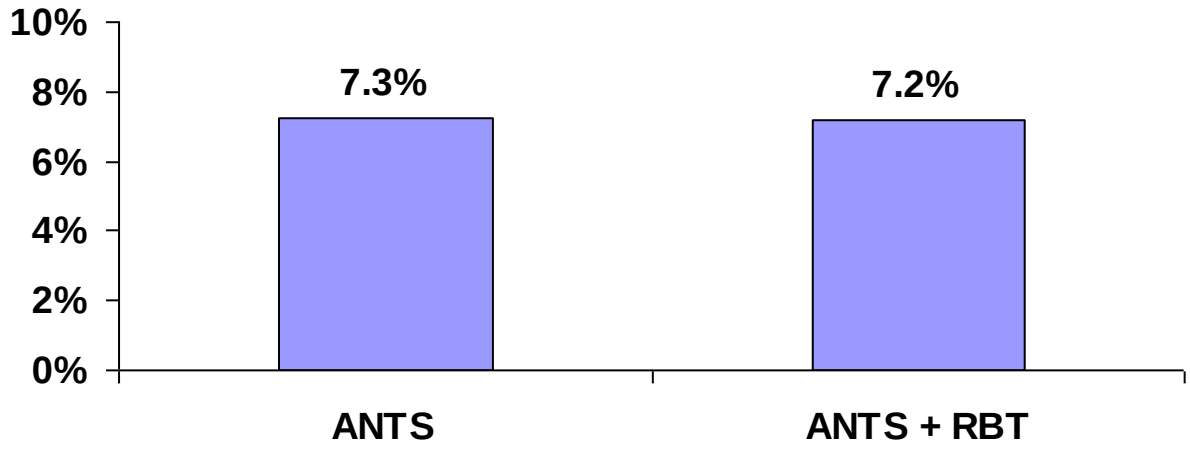
Thus in both the *ANTS* simulation, and the *ANTS* plus *RBT* simulation, the overall gain in GDP is 1.6 per cent. The production gains in individual industries can be compared with this benchmark figure.

Agriculture, Forestry and Fishing



- *ANTS* is estimated to add 2.7 per cent to production in Agriculture, Forestry and Fishing, significantly above the average for all industries, as measured by GDP, of 1.6 per cent.
    - It is sometimes argued that *ANTS* benefits Agriculture because it reduces costs, leading to increased competitiveness. However, *ANTS* reduces costs in virtually all industries, and it is the relative size of cost reductions that matters. In particular, lower business costs in Australia should lead to an appreciation of the $A reflecting the average reduction in costs in all trade-exposed industries, estimated at 3.5 per cent. For Agriculture, this appreciation of the exchange rate and lower costs have broadly offsetting effects on competitiveness. Thus Agriculture does not experience an improvement in competitiveness from *ANTS*.
    - In reality, the main reason that Agriculture benefits from *ANTS* more than most industries is that fresh-food is GST-free, a tax concession worth $4 billion annually. This leads to lower prices for fresh food, while consumer prices overall increase. This increases demand for agricultural products, boosting the production gain to 2.7 per cent.
- *RBT* shaves the production gain for Agriculture from 2.7 per cent to a gain of 2.6 per cent.
    - *RBT* results in a slight net increase in business tax paid by Agriculture estimated at $20 million annually.
    - This is because a large part of Agriculture is unincorporated, so it receives only a small tax saving from the cut in the company tax rate in *RBT*, and this is more than offset by the extra tax it pays from abolition of accelerated depreciation.
- Overall, the $20 million in extra business tax that Agriculture pays under *RBT* is dwarfed by the $4 billion tax concession it receives under *ANTS* from fresh food being GST-free. Thus *RBT* only slightly reduces the benefit Agriculture receives from *ANTS*, leaving Agriculture with one of the largest percentage gains in production of any industry from the tax reform process.

Mining



- *ANTS* is estimated to add 7.3 per cent to production in Mining, the largest gain for any industry.

  - Mining receives amongst the biggest cost savings of any industry from *ANTS*. Throughout the economy, *ANTS* provides savings in virtually all costs, the major exception being labour costs, which are assumed to be unaffected. Thus industries that are labour-intensive receive smaller cost savings from *ANTS*. Mining is at the other end of the spectrum, with labour costs that are low relative to revenue, so Mining receives a larger cost saving from *ANTS*.

  - These cost savings in Mining are mostly indirect, being in supply chains feeding into the industry. Mining itself has an exemption from sales tax, and already receives a diesel fuel rebate, so its direct savings from ANTS are small. Nevertheless, once supply chain savings are taken into account, in the long-term Mining receives amongst the biggest percentage cost savings of any industry from *ANTS*.

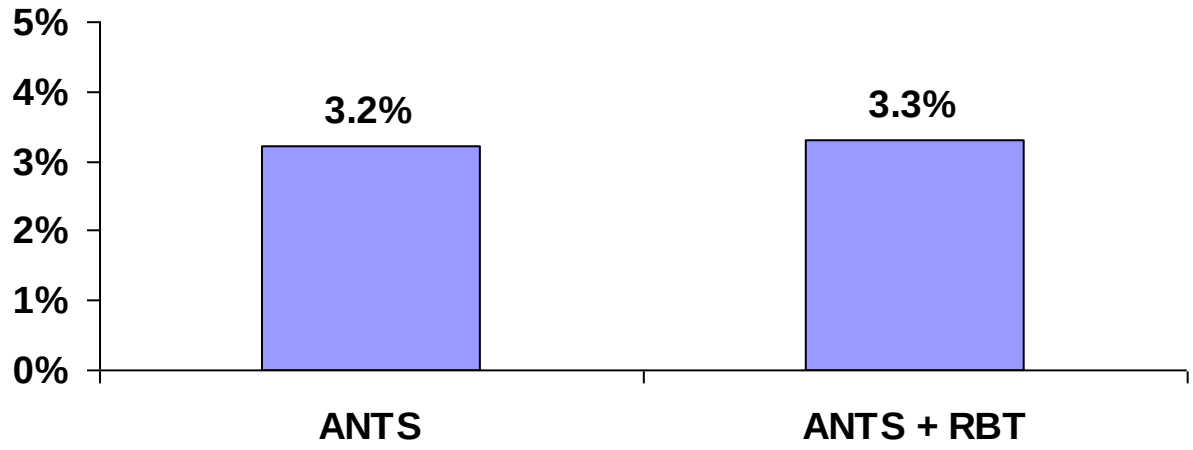
  - In the long-term, the cost savings in Mining comfortably outweigh an expected long-term appreciation of the $A of 3.5 per cent. The resulting improvement in the international competitiveness of the Mining industry leads to a substantial gain in production estimated at 7.3 per cent in the long-term.

- *RBT* slightly reduces the production gain for Mining from 7.3 per cent to a gain of 7.2 per cent.

  - The *RBT* measures will increase tax paid by the Mining industry by an estimated $150 million annually. While the Mining industry does receive a tax saving from the cut in the company tax rate, this is more than offset by the extra tax it pays due to abolition of accelerated depreciation. This is because the Mining industry is a heavy user of the accelerated depreciation tax concession.

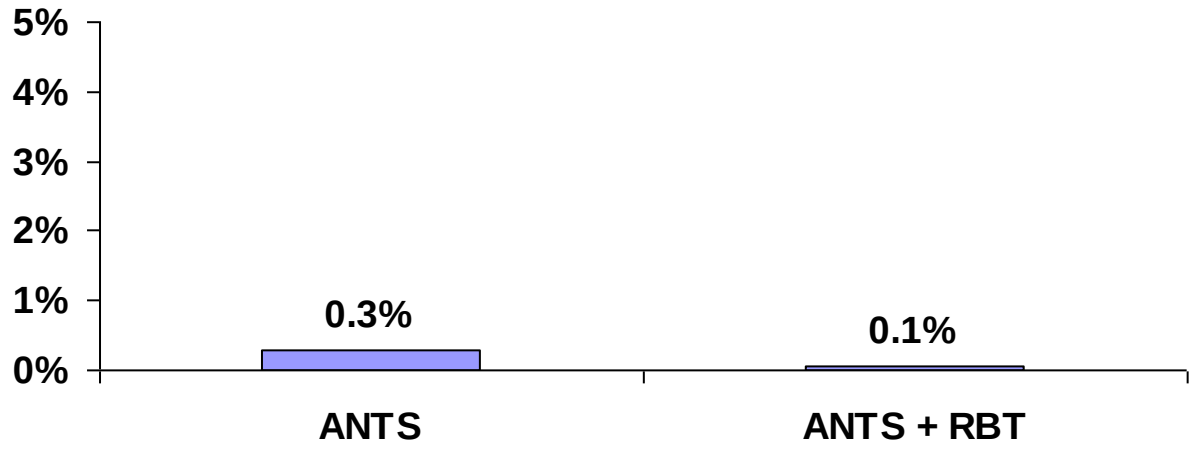
- Overall, the $150 million in extra business tax that Mining pays under *RBT* is dwarfed by its cost savings from *ANTS*, leaving Mining with the largest percentage gain in production of any industry from the tax reform process.

Manufacturing



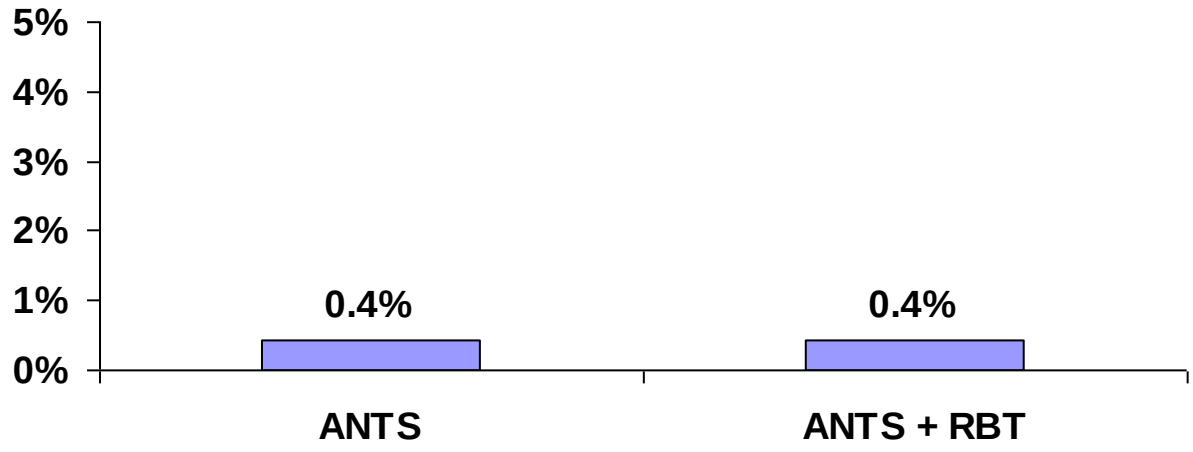
- *ANTS* is estimated to add 3.2 per cent to production in Manufacturing, significantly above the average for all industries, as measured by GDP, of 1.6 per cent.
    - The abolition of wholesale sales tax is of particular benefit to Manufacturing. This is because wholesale sales tax is basically a tax on Australian sales of certain manufactured goods. Its removal will reduce the price of those goods, even after allowing for the offset from GST, stimulating demand and production.
    - Production gains are largest in areas of Manufacturing where sales tax is most concentrated, specifically road motor vehicles and electronic equipment.
    - The only sub-division of Manufacturing that loses production from ANTS is Textiles, Clothing & Footwear. It is exempt from sales tax but will be subject to GST.
- *RBT* slightly increases the production gain for Manufacturing from 3.2 per cent to 3.3 per cent.
    - *RBT* has almost offsetting effects on the amount of business tax paid by Manufacturing in total. The cut in the company tax rate provides a tax saving while the abolition of the accelerated depreciation tax concession means a tax increase. It turns out that, on balance, there is a small tax increase of $150 million annually.
    - Within Manufacturing, there are tax increases for some subdivisions and tax savings for others. In particular, there is a tax saving for the Machinery and Equipment sub-division because it makes little use of accelerated depreciation. Production volumes in this sub-division are particularly cost sensitive, because it is highly exposed to import competition, so it experiences a substantial production gain. This is more than sufficient to offset the production losses in less cost-sensitive areas of Manufacturing. Thus Manufacturing experiences a slight production gain from RBT, despite a small increase in the amount of business tax that it pays in total.
- Overall, *RBT* slightly increases the substantial production gains that Manufacturing is estimated to achieve as a result of the abolition of sales tax under *ANTS*.

Electricity, Gas and Water



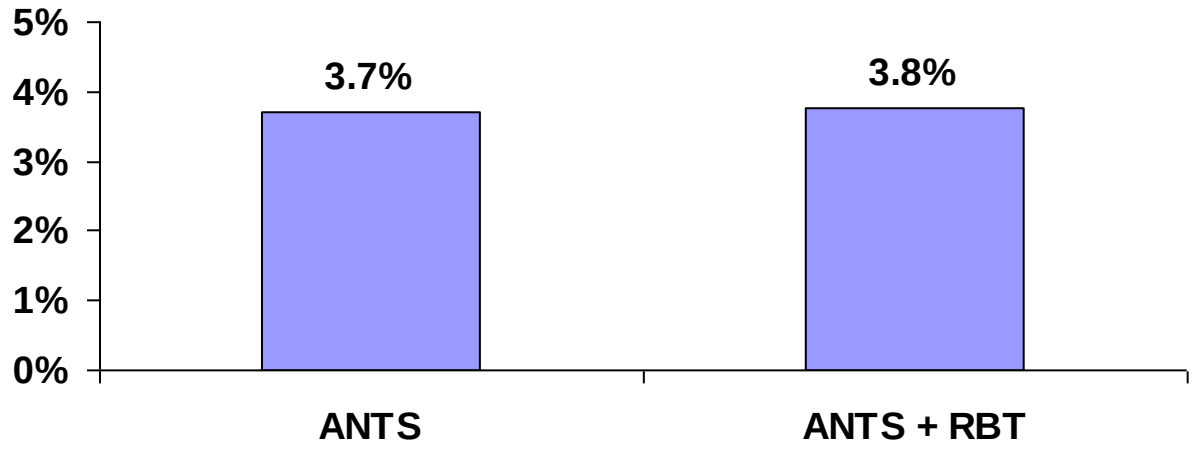
- *ANTS* is estimated to add 0.3 per cent to production in Electricity, Gas & Water.
    - Business demand for Electricity, Gas and Water rises broadly in line with general business activity that is reflected in the gain in GDP of 1.6 per cent.
    - Also, water is GST-free, so consumer demand for water is maintained.
    - On the other hand, the GST of 10 per cent applies to household purchases of electricity and gas, which are not currently subject to wholesale sales tax. This will increase prices and reduce demand by households.
- The *RBT* measures slightly reduce the production gain for Electricity, Gas and Water from 0.3 per cent to a negligible gain of 0.1 per cent.
    - *RBT* increases the amount of business tax paid by the Electricity, Gas and Water industry. The reduction in the company tax rate is of little benefit to the Electricity, Gas and Water industry as it pays little company tax. At the same time, *RBT* abolishes accelerated depreciation concessions, which the Electricity, Gas and Water industry currently uses to a considerable extent.
    - This increase in business tax means that prices must increase slightly in the long-term to achieve the same post-tax rate of return. Higher prices will lead to lower demand and production.
- Overall, tax reform has little effect on production in the Electricity, Gas and Water industry.

Construction



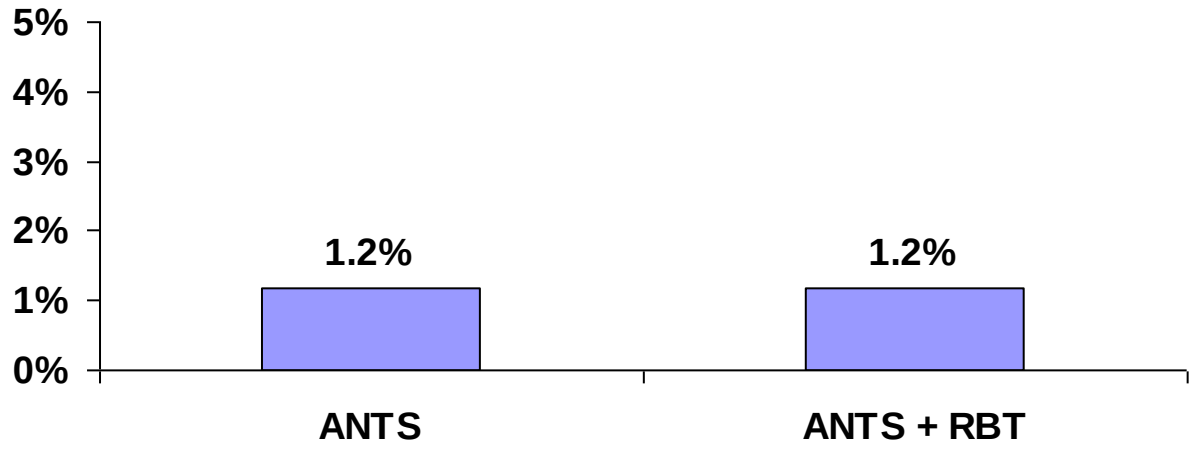
- *ANTS* is estimated to add 0.4 per cent to production in the Construction industry.
    - Businesses purchasing non-dwelling construction will be able claim back GST paid as a credit. In fact non-dwelling construction prices will be lower leading to higher volumes.
    - Dwellings will be input taxed, meaning that they will be subject to GST and no credit will be allowed. Resulting higher prices will reduce the volume of dwelling construction.
    - Overall, higher non-dwelling construction will be almost wholly offset by lower dwelling construction, leaving a small net gain in construction volumes of 0.4 per cent.
- *RBT* has no effect on Construction volumes, leaving the production gain from *ANTS* unchanged at 0.4 per cent.
    - *RBT* reduces the company tax rate, but abolishes the accelerated depreciation tax concession. These two measures have almost exactly offsetting effects on the amount of business tax paid by the Construction industry.
    - With no significant change in the amount of business tax that it pays, production volumes in Construction are virtually unaffected by *RBT*.
- Overall, tax reform has a small positive effect on production in the Construction industry.

Wholesale Trade



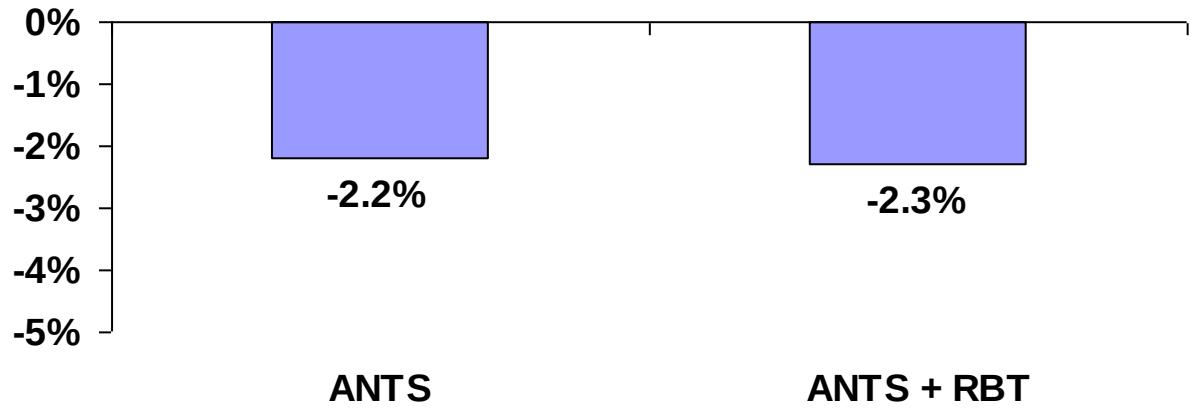
- *ANTS* is estimated to add 3.7 per cent to production in the Wholesale Trade industry.
    - Wholesale Trade is closely linked to the distribution of manufactured goods. The gains to the Manufacturing industry from *ANTS* boost Wholesale Trade.
- *RBT* slightly increase the production gain for Wholesale Trade from 3.7 per cent to a gain of 3.8 per cent.
    - *RBT* reduces the company tax rate, but abolishes accelerated depreciation. Overall, slightly less business tax is paid by the Wholesale Trade industry.
    - As seen earlier, *RBT* also slightly benefits Manufacturing industry, with a flow-on benefit to Wholesale Trade.
- Overall, *RBT* slightly increases the substantial production gains that Wholesale Trade is estimated to achieve as a result of *ANTS*.

Retail Trade



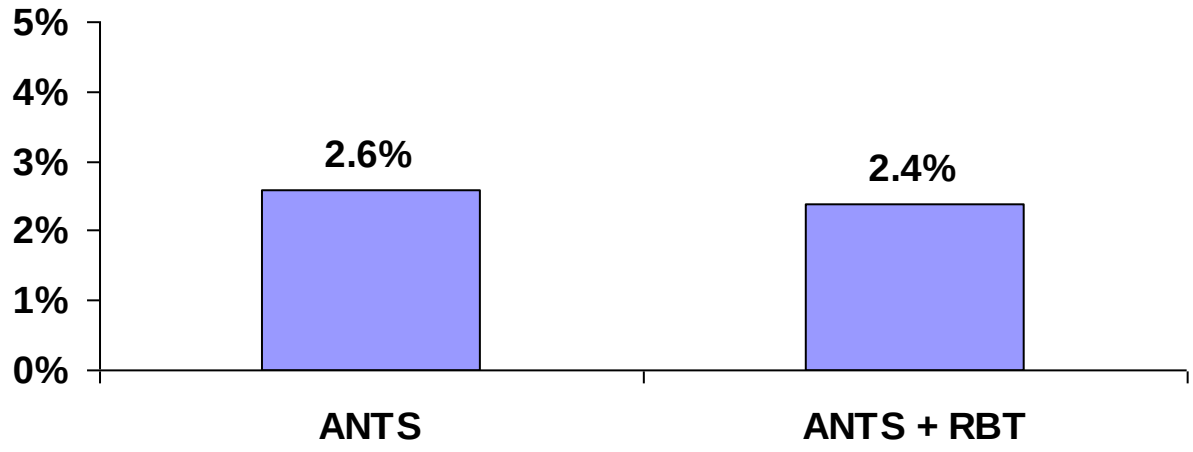
- *ANTS* is estimated to add 1.2 per cent to production in the Retail Trade industry.
    - Retail Trade is heavily dependent on consumer spending. Production in this industry increases in line with the consumer benefits of tax reform.
- *RBT* leaves the production gain for Retail Trade broadly unchanged at 1.2 per cent.
    - *RBT* reduces the company tax rate, but abolishes the accelerated depreciation tax concession. These two changes have broadly offsetting effect on the amount of business tax paid by Retail Trade, although there is a slight increase.
- Overall, *RBT* slightly leaves unchanged the significant production gains that Retail Trade receives from higher consumer living standards under *ANTS*.

Accommodation, Cafes and Restaurants



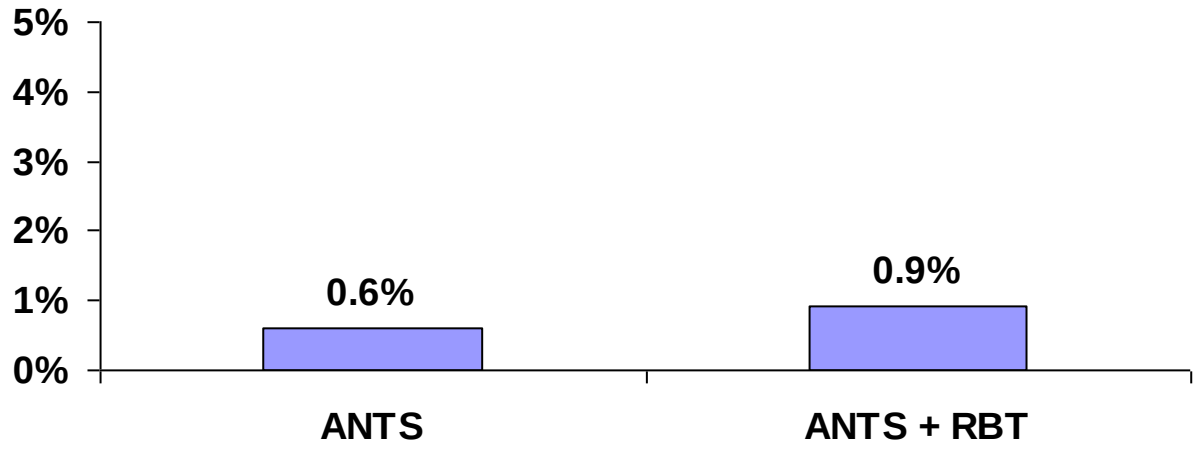
- *ANTS* is estimated to cut 2.2 per cent from production in the Accommodation, Cafes and Restaurants industry.
    - Compared with other industries, *ANTS* provides the Accommodation, Cafes and Restaurants industry with a relatively small cost saving. This industry is labour intensive and *ANTS* is assumed not to provide any saving in labour costs. Rather, savings are in business purchases of goods and services.
    - Household spending on Accommodation, Cafes and Restaurants services will be subject to GST of 10 per cent. Furthermore, spending by foreign tourists on Accommodation, Cafes and Restaurants will also be subject to GST, unlike other exports. GST-induced higher prices for both households and foreign tourists will reduce demand and production in this industry.
- *RBT* slightly increases the production loss for Accommodation, Cafes and Restaurants from 2.2 per cent to 2.3 per cent.
    - *RBT* reduces the company tax rate, but much of this sector is unincorporated, limiting its tax saving from this measure. *RBT* also abolishes the accelerated depreciation tax concession, resulting in extra tax for this industry. Overall, *RBT* results in a small net increase in the amount of business tax paid by the Accommodation, cafes and Restaurants industry.
    - This increase in business tax means that prices must increase slightly in the long-term to achieve the same post-tax rate of return on capital. Higher prices will lead to lower demand and production
- Overall, *RBT* adds slightly to the production loss experienced by the Accommodation, Cafes and Restaurants industry from *ANTS*. This production loss arises mainly because foreign tourists pay GST on this industry's services, even though other exports are GST-free.

Transport and Storage



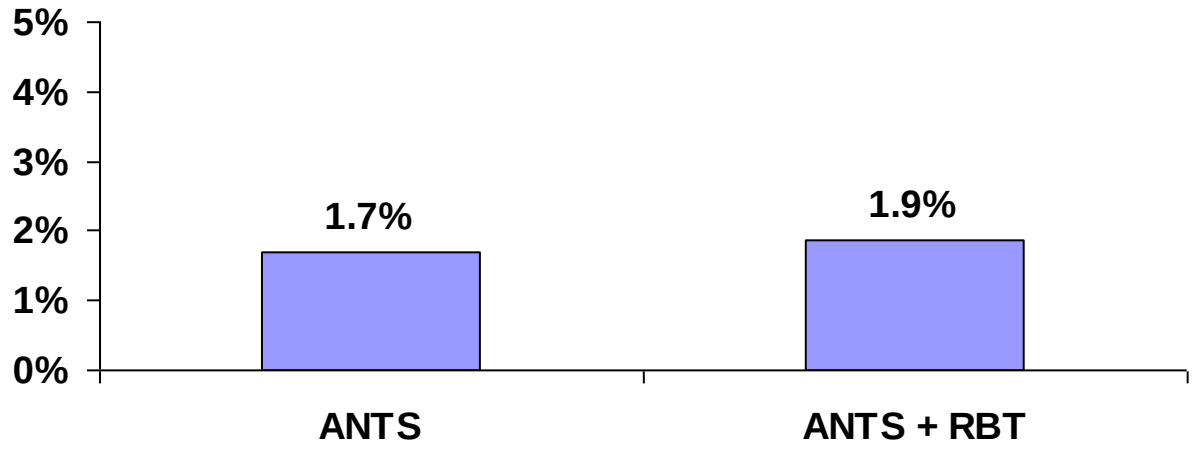
- *ANTS* is estimated to add 2.6 per cent to production in Transport and Storage, significantly above the average for all industries, as measured by GDP, of 1.6 per cent.
    - Land transport is significantly cheaper under ANTS, due to cuts in excise rates for diesel fuel and petrol. This leads to lower land transport prices, which boosts demand and production.
- *RBT* slightly reduce the production gain for Transport and Storage from 2.6 per cent to 2.4 per cent.
    - *RBT* abolishes accelerated depreciation concessions, which the Transport and Storage industry currently uses to a considerable extent. This is only partially offset by the cut in the company tax rate.
    - This increase in the amount of business tax paid by this industry means that prices must increase slightly in the long-term to maintain the same post-tax rate of return on capital. Higher prices will lead to lower demand and production.
- Overall, *RBT* shaves from 2.6 per cent to 2.4 per cent the substantial production gain that Transport and Storage experiences as a result of *ANTS*.

Communication Services



- *ANTS* adds a moderate 0.6 per cent to production in Communications.
    - Compared with other industries, *ANTS* provides Communications with a relatively large cost saving. Communications is a capital-intensive industry, not a labour-intensive industry, and *ANTS* provides savings in capital costs but not labour costs.
    - This cost saving means that business communication prices will fall because businesses can claim GST paid as a credit. Business use of Communications is expected to rise broadly in line with the predicted gain in GDP of 1.6 per cent.
    - Because of GST, households will face higher communication prices, although the price of standard letters and local phone calls are being held unchanged by government policy. Higher household prices for some communications will reduce demand and production.
    - Overall, under *ANTS* an increase in business use of Communications will be partly offset by a decline in household use, leaving a net rise of 0.6 per cent in production volumes.
- *RBT* increases the production gain for Communications from tax reform from 0.6 per cent to 0.9 per cent.
    - *RBT* cuts the company tax rate, providing a significant reduction in business tax for this sector, which is dominated by corporates. This is only partly offset by the loss of the accelerated depreciation tax concession. Thus there is a net fall in business tax paid by this sector.
    - This fall in the amount of business tax paid by this industry means that prices can fall slightly in the long-term while still maintaining the same post-tax rate of return on capital. Lower prices lead to higher demand and production.
- Overall, *RBT* boosts the production gain for Communications from tax reform from 0.6 per cent to 0.9 per cent.

Finance and Insurance



- *ANTS* is estimated to add 1.7 per cent to production in Finance and Insurance, similar to the average for all industries, as measured by GDP, of 1.6 per cent.

    - Under the GST, banking is input taxed, meaning that no GST will be charged on sales, but no refund can be claimed on GST paid on purchases. Consistent with ACCC guidelines, this increase in bank costs is expected to be passed on to bank customers in the form of small increases in bank fees, charges and interest rate margins.

    - *ANTS* also abolishes Financial Institutions Duty (FID) on bank accounts from 1 July 2001. Thus this is a delayed measure, coming in one year after most other measures in ANTS. Abolition of FID will make banking cheaper, despite higher fees, charges and margins, stimulating demand and production.

- *RBT* slightly increases the production gain for Finance and Insurance from 1.7 per cent to 1.9 per cent.

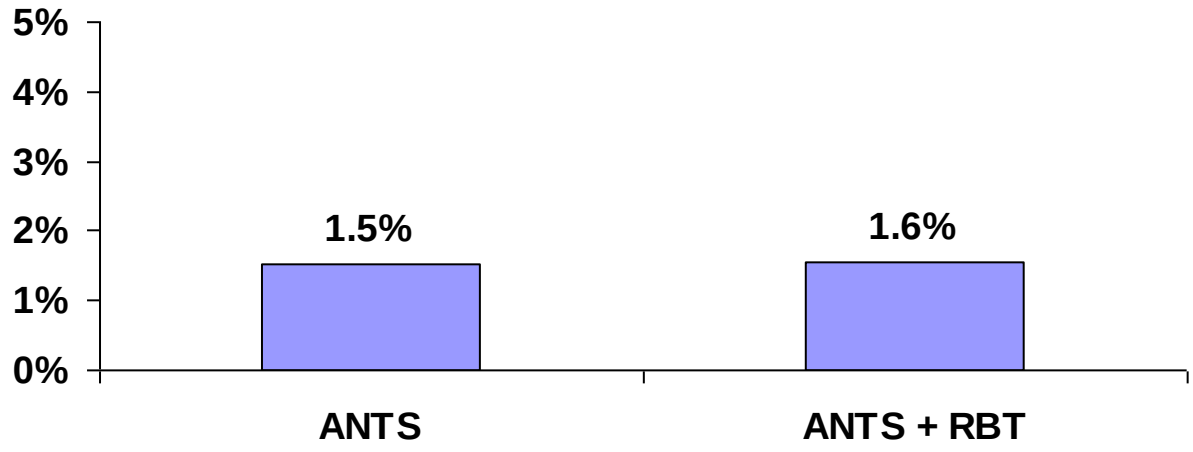
    - *RBT* reduces the company tax rate. Since the Finance and Insurance industry currently pays about one third of company tax, this produces a large tax saving.

    - *RBT* also abolishes the accelerated depreciation tax concession, but the Finance and Insurance industry makes little use of this concession anyway.

    - This reduction in the amount of business tax paid by this industry means that prices may fall slightly while still maintaining the same post-tax rate of return on capital. Lower prices lead to an increase in demand and production.

- Overall, tax reform is estimated to provide the Finance and Insurance industry with a production gain of 1.9 per cent. Most of this gain is due to abolition of FID under *ANTS*, but the cut to the company tax rate under *RBT* also makes a contribution.

Property and Business Services



- *ANTS* is estimated to add 1.5 per cent to production in Property and Business Services, similar to the average for all industries, as measured by GDP, of 1.6 per cent.
    - Property and Business Services mostly sells to business customers, who will generally be able to claim back any GST as a credit. Thus its demand and production increases in line with general business activity. Thus it is unsurprising that this industry's percentage gain in production is similar to that for GDP.
- *RBT* slightly increases the production gain for Property and Business Services from 1.5 per cent to 1.6 per cent.
    - *RBT* reduces the company tax rate, but abolishes accelerated depreciation. Overall, less business tax will be paid by the Property and Business Services industry because it makes only limited use of the accelerated depreciation concessions.
    - This reduction in the amount of business tax means that prices can be slightly lower in the long-term with the industry still maintaining the same post-tax rate of return on capital.
    - Lower prices will lead to higher demand and production.
- Overall, the percentage production gain for Property and Business Services from tax reform broadly follows that for GDP.

3. Changes in Tax Paid by Industry

To undertake the analysis presented in section 2 of the effects of *RBT* on industry production volumes, it was necessary to first estimate the effect of *RBT* on the amount of business tax paid by each industry. This section presents those estimates, covering the 12 more commercial industry divisions in the Australian economy.

This section also presents estimates of the gross reductions in costs for industries arising from *ANTS*. This helps put the effects of the *RBT* measures in proper perspective. *RBT* is a $3 billion tax package, the annual cost of cutting the company tax rate from 36 to 30 per cent. By comparison, *ANTS* is a $24 billion tax package, the annual cost of its cuts to existing indirect taxes. Because *RBT* shifts only one-eighth of the amount of revenue as *ANTS*, its effects on industry costs are much smaller.

3.1 Changes in Tax Paid from *RBT*

Table 1 shows the direct effects of the *RBT* measures on tax paid by industry in 2003/04. Table 1 also shows estimates of the gross cost reductions arising from *ANTS* (allowing for both direct and indirect effects) and the total of these two changes. These provide a point of comparison for *RBT*.

Table 1
Changes in Industry Costs ($ million)

	ANTS	*RBT*	Total
Agriculture, forestry, and fishing	-1250	20	-1230
Mining	-2000	150	-1850
Manufacturing	-8250	150	-8100
Electricity, gas and water	-1000	190	-810
Construction	-2080	10	-2070
Wholesale trade	-2240	-80	-2320
Retail trade	-2260	90	-2170
Accom., cafes and restaurants	-660	50	-610
Transport and storage	-2540	190	-2350
Communication services	-990	-130	-1120
Finance and insurance	-780	-240	-1020
Property and business services	-2520	-10	-2530

The first two columns of Table 1 show that, because it is a much smaller tax package, *RBT* generally has a smaller effect on industry costs than *ANTS*. Generally, the effect of *RBT* is in the order of one-tenth of the size of the effect of *ANTS*.

The second column of Table 1 shows that six industries will have changes in tax paid of over $100 million from *RBT*. The four industries that will pay significantly more business tax are Mining; Transport and Storage; Manufacturing; and Electricity, Gas and Water. The two industries that will pay significantly less business tax are the Finance and Insurance industry and the Communication Services industry.

The Finance and Insurance industry will receive larger benefits from *RBT* than other industries. This result occurs because of the current company tax payments by this industry.

The Finance and Insurance industry currently pays about one third of all company tax. This is despite the industry only contributing about 6 per cent of national output. Since it currently pays so much company tax, it will receive large benefits from the cut in the company tax rate from 36 per cent to 30 per cent.

The Finance and Insurance industry currently makes little use of the accelerated depreciation concession. Therefore, its abolition produces only a small increase in company tax paid for this industry.

3.2 Sources of Changing Tax Paid from the *RBT* Measures

The *RBT* measures can be broken down into three main components. These are:

- the reduction in the company tax rate from 36 per cent to 30 per cent;
- the abolition of accelerated depreciation; and
- other *RBT* measures.

Table 2 shows the dollar contribution to these changes in tax paid from the reduction in the company tax rate, the abolition of accelerated depreciation and the other *RBT* measures. Estimates of the cost reductions from *ANTS* are also included to illustrate the relative size of *ANTS* and the *RBT* measures.

Table 2
Source of Changes in Industry Costs from *RBT* Measures - by Industry ($m)

	30% Company Rate	Remove Accel. Dep'n	Other *RBT* Measures	*ANTS* at 30%	Total *RBT* Measures
Agriculture, forestry, and fishing	-39	84	-52	22	15
Mining	-316	385	82	-4	147
Manufacturing	-554	662	14	26	148
Electricity, gas and water	-9	167	31	2	191
Construction	-83	86	10	-2	11
Wholesale trade	-251	131	32	11	-77
Retail trade	-133	173	34	16	89
Accom., cafes and restaurants	-29	77	0	1	48
Transport and storage	-87	285	-15	9	192
Communication services	-175	133	-33	-53	-129
Finance and insurance	-940	67	6	628	-240
Property and business services	-303	210	16	69	-7

Note: Results in this table are unrounded, so the last column does not exactly match the RBT results in Table 1, as they are rounded to the nearest $10 million.

Table 2 shows that the major effect of the *RBT* measures arises from the reduction in the company tax rate and the abolition of accelerated depreciation. The net effect of the other *RBT* measures tends to be smaller.

For some industries, the effect of the reduction in the company tax rate is very different from the effect of the abolition of the accelerated depreciation tax concession. The *RBT* measures will have their largest impact on taxes paid in those industries.

The Finance and Insurance industry will pay nearly one billion dollars less tax as a result of the reduction in company tax rates. In contrast, the abolition of accelerated depreciation will result in it paying less than one hundred million dollars extra tax. This gap occurs because the Finance and Insurance industry currently pays about one third of total company tax, but makes little use of accelerated depreciation. Most of its capital is in areas where accelerated depreciation concessions are minimal, such as computers.

Other industries are affected by the changes to a smaller extent. The effects of the lower company tax rate and abolishing accelerated depreciation are nearer to being offsetting. For example, the Mining industry would pay about $316 million less tax and $385 million more tax as a result of these two respective measures, leaving a relatively small net position of paying $69 million more.