

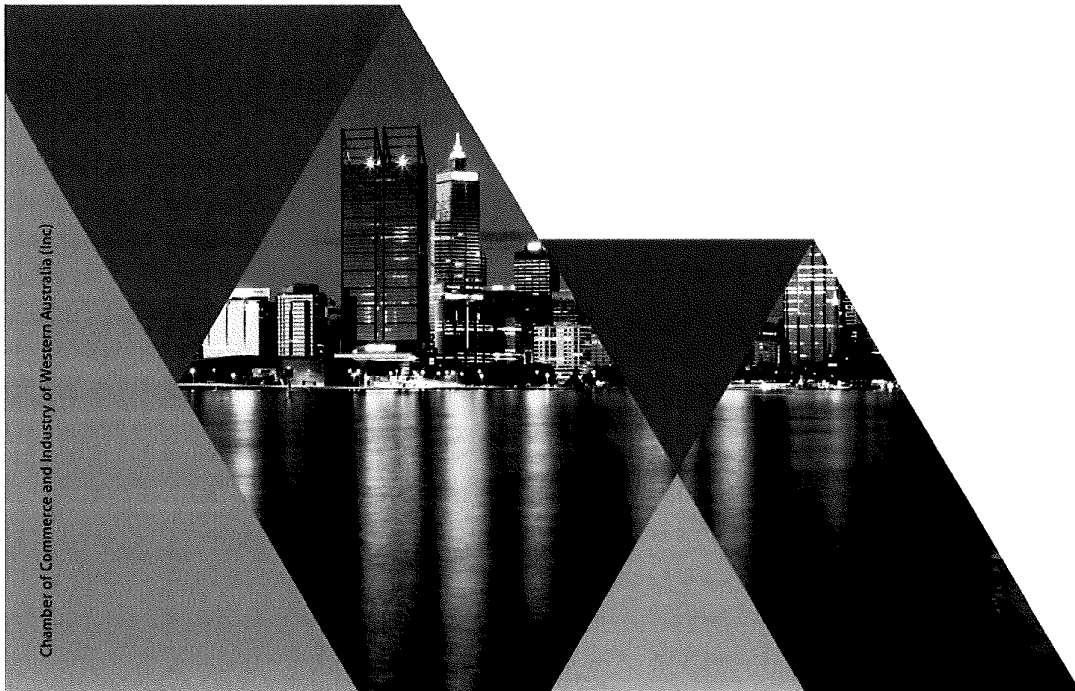
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CCI's Submission to the ERA
Discussion Paper on Microeconomic
Reform in Western Australia.

CCI Advocacy | December 2013



Chamber of Commerce and Industry of Western Australia (Inc)

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About CCI

CCI is the peak organisation representing business in Western Australia. It is the second largest organisation of its kind in Australia, with a membership of over 8,500 businesses across all sectors of the economy. CCI aims to build a competitive and productive business environment in Western Australia by promoting free enterprise through advocacy and essential services that make it easier to do business. CCI's vision is for Western Australia to be a world leading place to live and do business.

Introduction

CCI welcomes the opportunity to make a submission to the ERA Discussion Paper *Inquiry into Microeconomic Reform in Western Australia*.

CCI is supportive of the broad direction of the Discussion Paper, and this submission provides further detail about the key areas of reform that have been identified by the ERA. CCI's submission also discusses a number of other areas which the business community believes are priority areas for reform that have been overlooked or downplayed in the Discussion Paper.

The short timeframe for submissions on this fundamentally important issue has meant that there has been only limited opportunity to explore some of these issues in further detail.

CCI looks forward to continuing to work with the ERA to develop and promote this agenda throughout the Inquiry process.

State Tax Reform

CCI agrees that a program of genuine state tax reform can have a significant impact on the efficiency and flexibility of the Western Australian economy.

While the ability to deliver substantial reform to the state tax system is limited by the high level of vertical fiscal imbalance which currently exists, there is still scope for reform within the existing tax system in the short term.

The ideal tax system has a minimal overall effect on the business sector and the incentives of individuals, and promotes an economic environment that creates employment, income and wealth. It should not impede or reduce the economy's productive capacity.

There is a range of taxation principles commonly identified as being necessary to achieve these goals, which CCI believes should guide any reform to the state's tax system.

- **Equity** – this principle ensures that the tax burden is spread evenly across the population. Horizontal equity requires that taxpayers in similar circumstances should face a similar tax burden; while vertical equity requires that those in different circumstances face a different tax burden with those better able to pay facing a higher burden.
- **Efficiency** – an efficient tax system promotes a strong economy by ensuring that resources are allocated to their most productive use. The system should be administratively efficient so that the costs of managing and complying with tax are not excessive relative to the revenue raised; and it should be economically efficient so that distortions caused by people changing behaviour because of the tax are minimised.
- **Transparency** – a transparent tax system allows taxpayers to identify clearly how much tax they are paying, by identifying what is to be taxed and how the liability is to be calculated
- **Adequacy** – the government requires revenue to fund its expenditure. Tax should raise sufficient revenue to support fiscally responsible spending.
- **Competitiveness** – the size and structure of the tax burden should encourage people and businesses to locate and do business in WA rather than in alternative locations.
- **Certainty and simplicity** – the tax system should be clear and simple to understand, so that taxpayers can anticipate when and how the tax is to be paid and the amount of tax.

CCI considers **the priority reforms in the short term should focus on enhancing the administrative simplicity and efficiency of tax arrangements, and to promote a competitive tax regime.**

A more comprehensive tax reform agenda is an important objective over the longer term to provide the State Government with a much more stable and predictable source of revenue, while making the overall tax base more efficient. However, the ability to achieve meaningful reform will require the Commonwealth and State Tax system as one regime to address the imbalance between the revenue raising capacity and spending responsibilities of the states.

Short-term reform: Simplicity and Competitiveness

The short-term reform program should focus on enhancing the administrative simplicity of the state's major taxes (from a tax payer perspective), while improving the state's overall tax competitiveness with other states.

In its initial submission to the ERA, CCI argued that a range of measures could be adopted by the State Government to enhance the administrative simplicity of taxes in Western Australia.¹ These are presented below:

Tax	Suggested Reform
Land tax	The MRIT should be incorporated into the land tax base. There is no case to have two types of land tax.
Land tax	Adopt a three year "smoothing" approach to land valuation changes, to guard against significant increases or decreases in tax payable (and the associated impact on business planning.
Land tax	Implement a simpler single rate and threshold system.
Transfer duty	Update transfer duty scales to reflect more contemporary property values.
Transfer duty	Reduce the number of rates and thresholds, in line with practice in other states.

There are also a number of changes that should be made to payroll tax arrangements in the short-term that seek to make Western Australia's tax base more competitive compared to other states.

A competitive tax regime helps ensure that Western Australia attracts business investment and moderates the burden of tax on the Western Australian community. The key to maintaining a competitive taxation environment is to apply the principles of taxation to minimise the overall effect of the tax system on the business sector and therefore promote an economic environment that creates employment, income and wealth. The tax system is an important component of the economic environment for business and therefore government should seek to provide an overall taxation regime which is not a deterrent to business investment and operations.

For businesses whose investment is mobile, an uncompetitive tax system may be a determining factor for a business owner considering where to set up its operations.

While tax competition can encourage governments to match best practice in other jurisdictions and to strive to keep the overall tax burden at a minimum, governments should avoid contests in which states compete against each other to attract particular projects with targeted tax incentives and concessions. Such an approach is self-defeating, drawing labour and resources away from existing and prospective industries and reducing their comparative advantage.

¹ See CCI's initial submission to the ERA Microeconomic Reform Inquiry

It also needs to be recognised that State Governments have very limited capacity through their fiscal measures to affect the overall economic conditions in this jurisdiction in a counter-cyclical manner. In that regard, the focus of tax competition should be on ensuring the overall revenue burden is as low as possible and that revenue is raised in the most efficient and least distorting manner.

There is no widely agreed basis for measuring tax competitiveness. All measures have their advantages and disadvantages. At various times, different State Governments have chosen to compare tax regimes using a number of different measures including:

- taxation revenue expressed on a per capita basis;
- revenue relativities based on Commonwealth Grants Commission (CGC) methodology; or
- taxation revenue expressed as a percentage of Gross State Product.

In recognition of the need to maintain a competitive tax environment, a tax competitiveness target has been part of successive Governments ongoing fiscal strategy. The Government currently assesses WA's tax competitiveness across a range of measures.

On a per capital basis, WA now rates as the highest taxing state in the nation using this measure.

While a number of changes could be made to improve WA's tax competitiveness, CCI believes the priority is in relation to payroll tax. In 2011-12, WA had the highest payroll tax rate per capita at \$1,269.95, compared to the average of \$830.98.

Tax	Suggested Reform
Payroll tax	Lift threshold to \$1.5 million to address the bracket creep from rising wages over the past decade. This will again ensure that genuine small businesses, with lower capacity to comply with taxation requirements, are exempt from the tax. A higher threshold will remove the disincentive for small businesses to grow and employ more people. The threshold should also be indexed to ensure these issues do not arise thereafter.
Payroll tax	Reduce the rate of payroll tax payable to the national weighted average (4.95 per cent) to bring the state in line with other states.

Long-term reform: Efficiency

Improving the efficiency of the tax system is a significant area of microeconomic reform, but the ability to achieve substantial change is limited by the state's revenue raising capacity.

In particular, the high level of vertical fiscal imbalance, the situation which arises when in a federation one level of government controls a disproportionately high level of total government revenue relative to its share of spending responsibilities, reduces budget flexibility. This means a large proportion (31 per cent in 2013-14) of general government revenue is granted to the state by the Federal Government – mostly outside of the State's control.

There are also a number of other factors that have limited the state's ability to reform the tax system.

- Royalty income is becoming a larger share of state revenue, rising from five per cent of total revenue to 21 per cent in the space of a decade. However, royalty revenue is difficult to predict, as it relies on forecasting the Australian dollar and commodity prices.
- One of the revenue streams designed to fill the gap between the state's revenue raising capacity and expenditure responsibilities – the GST – is declining, mostly as a result of the increase in royalty revenue to the state.
- The state's population is growing faster than at any other point in recent history, increasing the demand for services from the State Government.

While these factors will limit the ability to undertake substantial reform to the tax system in the short term, improving the efficiency of the tax system remains an important long term objective. In this regard, the ERA should recommend a program of tax reform to be undertaken over the longer term that seeks to reduce the State Government's reliance on transaction taxes and increase its reliance on relatively more efficient taxes such as on immovable property and consumption. However, it is important that such a reform agenda looks to reduce the size of the tax burden on the WA community overall.

Property Taxes

The Henry Tax Review noted that stamp duties are a highly inefficient tax on property and that land tax could provide an alternative and more stable source of revenue for the States. This is because the land tax base is immobile. The ERA should investigate the feasibility of this option for WA.

To improve the overall efficiency of the system, **changes would be needed to broaden the base of the existing land tax regime, which would include the removal of existing land tax exemptions on residential property and other exemptions which are not provided for social purposes.** In particular, the ERA should consider a single rate and threshold system for land, with an exemption threshold that is low enough to ensure the vast majority of owned land in Western Australia is subject to land tax (to ensure efficiency) while not too low as to be administratively inefficient (simplicity). Subject to revenue constraints, the rate of land tax should be as low as possible.

The revenue generated from a broad based land tax should be used to phase out inefficient transfer duties on all transactions (property, non-real business assets and motor vehicles). In some cases duties could be replaced with other forms of taxation (such as motor vehicle registration in the case of transfer duty on motor vehicles) subject to the change occurring in a revenue-neutral manner.

Payroll Tax

CCI acknowledges that, in theory, payroll tax can be classified as a tax on consumption or on labour income, given that the taxpayer (the business employing the person subject to payroll tax) has the option of passing the incidence of the tax through to others. This can occur either by adding the cost of the tax to the price of goods and services sold (effectively making payroll tax a "consumption tax" in a similar vein to the GST) or through to employees in the form of lower wages (effectively making it a quasi-income tax).

However, in practice, payroll tax is not easily passed on by small business to its customers, resulting in increasing the cost base of business and reducing profitability. As a consequence, this distorts economic activity and decision making by businesses. In a 2012 survey conducted by the Australian Chamber of Commerce and Industry, 86 per cent of Western Australian small business respondents who reported paying payroll tax said that if the payroll tax exemption threshold was lifted, or rate of taxation was reduced, they would employ more people.

In this respect, **CCI believes that the abolition of payroll tax is an important objective over the longer term**, which should be considered as part of any tax reform process.

CCI also recognises that from a principled view, it may be economically efficient to have a payroll tax system with as broad a base as possible.

However, **the benefits of maintaining the existing payroll tax exemptions are likely to outweigh any administrative costs, and as a result, the exemptions should be maintained**. CCI has identified the current State Government statutory payroll tax exemptions, and the associated policy intent. The ERA should examine the currently payroll tax exemptions to ensure that any benefits outweigh any efficiency costs.

Exemption	CCI Comment
For the first \$750,000 of Australia-wide wages paid in a calendar year	The exemption threshold of \$750,000 is designed to ensure businesses with small workforces are not required to remit payroll tax. WA's threshold of \$750,000 has been in place for close to a decade, despite average wages growth of some 90 per cent over this time – meaning that smaller and smaller businesses are being required to pay the tax.
For wages paid in the first two years to new Indigenous Australian employees.	This exemption is designed to provide an incentive for businesses to employ Indigenous Australians, who are one of the most underrepresented groups in the Western Australian labour force.
For wages paid to persons with a disability (where the employer receives a Commonwealth or State wage subsidy for the employee)	This exemption is designed to provide an incentive for businesses to employ persons with a disability, who are and underrepresented groups in the Western Australian labour force.
For wages paid by certain types of organisations	Typically, wages paid by organisations that provide a “public service” like charities, hospitals, schools, community support and religious organisations, are exempt from paying payroll tax as recognition that the social benefits they provide are significant enough to warrant some form of support. Government departments are also exempt.
For wages paid to apprentices and trainees	The exemption is intended to provide an incentive for employers to “upskill” their workforce (traineeships) or take on apprentices. The exemption effectively reduces the upfront cost to the employer of sending an employee on training, or makes the employment of an apprentice more economic. The exemption also reflects that in many instances, employees on training may be less productive than if they were not.

Nuisance Taxes

Removal of “nuisance taxes” such as the Perth Parking Levy should not be ruled out, despite their relatively modest scope compared to larger taxes such as land tax and payroll tax.

Regulation and Government Intervention

Regulatory reform is an important strategy to improve the efficiency of the WA economy and must form a key part of any microeconomic reform agenda.

Well designed regulation can help governments achieve their economic, social and environmental goals, but excessive regulation can have a negative impact on productivity by diverting resources away from their most efficient use.

Regulation must provide a reasonable balance between protection and compliance costs. Its design should achieve competitive neutrality, transparency, minimal overlap and duplication, and have an appropriate balance between efficiency and effectiveness.

Too often regulation is poorly targeted, and in many cases unnecessary, which creates a cost burden on businesses. These direct and indirect costs include the cost of meeting the requirements of regulation and the administrative costs of compliance, as well as the costs arising from disincentives, distortions and duplication of regulation.

A 2005 Taskforce on “Reducing the Regulatory Burden on Business” set out six principles of good regulatory process.

- Governments should not act to address problems until a case for further action has been clearly established.
- A range of feasible policy options including self regulatory approaches need to be identified and their benefits and costs assessed within an appropriate framework.
- Only the option that delivers the greatest net benefit for the community, taking into account all the impacts, should be adopted.
- Effective guidance should be provided to relevant regulators and regulated parties in order to ensure that the policy intent of the regulation is clear, as well as the expected compliance requirements.
- Mechanisms are needed to ensure that regulation remains relevant and effective over time.
- There needs to be effective consultation with regulated parties at all stages of the regulatory cycle.

CCI supports these principles as the basis for good regulatory practice.

A more structured approach to regulation

In WA, a more structured approach to regulatory reform is needed to ensure that both existing and new regulations are well targeted, proportionate, and minimise costs to business and the community, while helping Government to achieve its goals.

A recent report by the Productivity Commission found that greater attention to leading practices for monitoring, reporting and accountability would go a long way toward improving the efficacy and rigour of current process for Regulatory Impact Assessment across the country. In particular, the report identifies a range of improvements to the existing system, including:

- transparency measures such as a draft regulation impact statement (RIS) for early consultation, and publishing all RIS' and RIS adequacy assessments, to better inform stakeholders of regulatory impacts and motivate rigour in analysis;
- requiring ministers to provide reasons to parliament for non-compliance with the RIA process and for the granting of exemptions, could encourage greater commitment to the RIA process and facilitate further discussion on the impacts of proposals; and
- accountability measures such as: the auditing of agency decisions on the need for a RIS; the auditing of regulatory oversight body adequacy assessments; and post implementation reviews undertaken through an independent process, would, in time, invoke more effective scrutiny of regulatory proposals.

CCI believes that **regulatory best practice and efficient and timely implementation of regulatory reform could be achieved by transferring responsibility for all regulatory reform and gate keeping matters in WA to a single, sufficiently resourced, independent group**. Regulatory reform requires a serious political commitment, which has typically been difficult to achieve in WA given that responsibility for reform has been spread across different agencies and bodies. CCI believes that the ERA is well placed to act in this capacity.

Such an independent group would be responsible for providing advice to Government on new regulations through a thorough and genuine regulatory impact assessment process, as well as evaluating existing regulations using regulatory best practices. This body should have the necessary powers to carry out its responsibilities.

A single minister should also be made responsible and accountable for red tape reduction. This Minister would coordinate regulatory reform in the State and ensure the government's regulatory reform agenda is transparent and accountable to state parliament.

CCI's initial submission to the ERA Inquiry into Microeconomic Reform provided further detail on a range of specific areas of regulation that should be considered a priority for reform. These included:

- reforms identified through COAG;
- major project approvals;
- deregulation of regional air routes; and
- food safety compliance.

In addition, CCI's submission also outlined reforms to the regulation of product markets. These are discussed in further detail below.

Red Tape Reduction Group Report

The Red Tape Reduction Group Report identified a number of key areas for regulatory reform that would deliver substantial benefits to the business community. However, much of this report still remains untouched. CCI believes that the following recommendations should be implemented as a priority.

Short Term Reforms

Recommendation 5.1

Introduce State and individual agency targets to reduce the existing regulatory burden in Western Australia.

Recommendation 5.2

Introduce agency plans to simplify and modernise existing regulations and processes.

Recommendation 5.3

Introduce Chief Executive Officer accountability for regulatory reform through conditions introduced to their performance contracts.

Recommendation 5.7

Create a one-stop shop with appropriate decision-making authority within the Department of Treasury and Finance or the Department of the Premier and Cabinet to facilitate interagency coordination on regulatory issues.

Medium and Longer Term Reforms

Recommendation 4.1

The RTRG supports the introduction of 'deemed approval' mechanisms in government decision-making processes to provide certainty about decision making timeframes.

Recommendation 4.2

The RTRG supports the introduction of 'risk-based' assessment in government decision-making processes to remove unnecessary regulation.

Recommendation 4.3

Western Australian government agencies should be encouraged to create single portals for information required in multi-agency approval processes.

Recommendation 4.4

The RTRG supports the introduction of a 'lead agency' framework for multi-agency decision-making processes.

Recommendation 4.5

Western Australian government agencies should be required to publish internal policies and guidelines used in decision-making processes.

Recommendation 4.6

All new and amended quasi-regulations should be subject to a Regulatory Impact Assessment process and the results of this process should be made publicly available.

Recommendation 4.7

Require government agencies to develop target timeframes for decision-making processes and report against them publicly. This report should include:

- calendar days taken to make a decision and calendar days taken during 'stop the clock' periods;
- calendar days taken by other departments to deal with referrals under the assessment process;
- calendar days taken by proponents to respond to information requests; and
- the reasons as to why 'stop the clock' provisions were utilised

Recommendation 10.4 (Local Government)

Applications not approved or refused within the prescribed time period will be deemed approved.

Recommendation 10.6

Local government authorities and state government agencies involved in the planning process should be required to use consistent electronic assessment processes for a variety of purposes, including for:

- lodgement and receiving of applications;
- communicating with developers and applicants;
- requesting and providing further information;
- reviewing the progress of an application;
- tracking and reporting development decisions;
- tracking and reporting Schemes and amendments;
- referral;
- approval processing;
- payment of fees; and
- other purposes.

Recommendation 10.8

Streamlined processes for minor local planning scheme amendments should be implemented, including:

- delegation of decision-making power to an independent decision-making body; and
- reduced advertising timeframes.

Recommendation 10.9

The Planning and Development Act 2005 should be amended to provide the Minister with power, on the recommendation of the Western Australian Planning Commission, to direct local government(s) affected by

a particular State Planning Policy to amend its local planning scheme to give effect to that State Planning Policy.

Recommendation 11.2

Local governments should be required to take no longer than 7 days to assess building licence applications.

Recommendation 12.1

The RTRG supports the introduction of clear statutory timeframes for environmental approval and licensing processes.

Recommendation 14.1

Amend the current arrangements to allow for the private sector and other government agencies to have greater opportunities to develop crown land.

Recommendation 15.3

Model local laws should be prepared for issues that are consistent across the State, and local governments should be allowed to introduce these model laws solely by a council decision.

Recommendation 15.4

Model local laws should be adopted by metropolitan local governments as a matter of priority. Any metropolitan local government seeking variation to model laws should require Ministerial approval.

Recommendation 15.5

All local laws should be reviewed and consolidated. Amend the Local Government Act 1995 to require local governments to list all local laws that are outside the proposed model laws in their annual report.

Retail Trading Hours

Retail trading hours are governed by the State's *Retail Trading Hours Act 1987* and the *Retail Trading Hours Regulations 1988*. The legislative environment sets out different categories of retail shops, which determines their trading hours and in some instances dictates which products can be sold at those times. It also places limits on the number of businesses an owner of a small retail shop can have and dictates how many employees within a shop constitutes a small retail shop.

Over time there have been changes to the retail trading hours' regulatory environment, most recently with the introduction of weeknight trading and Sunday trading from 11am to 5pm. These changes were a positive step forward for deregulating retail trading hours, and have provided businesses and consumers with greater opportunity and flexibility. The September 2013 quarter *Curtin Business School-CCI Survey of Consumer Confidence* found that 84 per cent of consumers in the Perth Metropolitan Area had taken advantage of Sunday trading since it was introduced.

However, the incremental changes that have occurred are now presenting distortions in the market, and in some instances, creating a less competitive retail trading environment. These arbitrary restrictions on businesses ability to trade freely and in a competitive market stifle opportunities for growth and employment.

For instance, current legislation allows small retail shops to trade whenever they like, 7 days a week, 24 hours a day. However, special retail shops can only trade between 6am and 11pm any day, but are restricted by what they can sell whilst general retail shops can sell anything but are restricted by tighter trading hours. This means there are effectively three different trading environments operating at the same time.

CCI believes these remaining restrictions on trading hours and products for sale need to be removed in order to achieve the full benefits of deregulation.

Improved Competition

One key benefit from the deregulation of retail trading hours is an improved level of competition. While the recent extension of trading hours has increased the level of competition on weeknights and Sundays, the current regime still affords an advantage to those who are eligible to trade as small and special retail shops outside of the trading hours for general retail stores.

The existence of these different trading environments means that some retailers are given greater market opportunities than others. This distorts the competitive environment which is so critical to ensure business and consumers are afforded the choices and flexibility they need. For example, a special retail shop such as a hardware store can only sell certain items but cannot sell white goods but can open earlier (from 6am – 11pm on a Sunday) than their competitors who are general retail shops and can only trade on a Sunday from 11 am to 5pm. However, the competitor who is classified as a general retail store can sell white goods during that time.

Another area of concern is the limits placed on small retail shop owners. Owners of small retail shops are restricted by the number of the stores they can own and the ownership structure, not to mention the number of employees they can hire at any one time. Whilst there are some minor legislative proposals going through Parliament now to increase those limits, this quota effectively distorts the market both in terms of employment opportunities and growth of small businesses. Making incremental changes to legislation only moves the line in the sand and doesn't address the real issue of competition.

The benefits from competition of full deregulation were identified back in 1995 as part of the National Competition Policy (NCP), to which WA was a signatory. Along with the other states and territories, Western Australia agreed to implement a number of reforms under the NCP which were designed to improve the wellbeing of Australians by promoting an efficient, dynamic and innovative economy. The deregulation of retail trading hours in WA was a key reform as part of this agenda to improve competition. While the recent change to the trading regime has gone some way to achieve this, the ongoing inconsistencies are at odds with the intention of the NCP.

Greater Choice and Convenience for Consumers

One of the primary benefits from the extension of retail trading hours and the removal of product restrictions is the increased choice and convenience for consumers. While the introduction of weeknight and Sunday trading has gone some way to address this issue, further benefits could be achieved by full deregulation.

Under the current regime, consumers are denied the choice of when and where they can shop outside of the current standard hours for general retail stores. By removing these legislative and regulatory restrictions, consumers will be provided a wider range of goods available at more competitive prices, which can be purchased at a time that is convenient to them.

Importantly, deregulated trading hours allow businesses to have the opportunity to make their own decisions based upon market forces. Full deregulation would mean that shops are able to open at times that maximize the number of customers they will have and assist them to get greatest efficiencies from

their capital investments in leasing costs and operating costs, rather than according to government

Increased retail sales

It is not surprising that one of the primary benefits from extended retail trading hours is that it will help generate higher retail sales, as a result of the increased choice and convenience available to consumers.

A common misconception that often arises during the retail trading hours' debate is that there is a "fixed spending dollar." It is sometimes claimed that people only have so much disposable income to spend, so the retail sector has nothing to gain by making itself more attractive to consumers. However, this is not the case.

Further increasing retailers' opening hours will provide consumers with greater opportunities to engage in retail trade, particularly those consumers whose lifestyle and working arrangements make it difficult to shop during the current prescribed trading hours. The broader economic effects associated with increased employment (and therefore wages) in the sector will also boost retail spending overall.

Another important factor behind growth in retail sales is the emergence of shopping as a form of leisure activity. As a recreational and enjoyable activity, consumers are likely to increase time spent shopping if the opportunity is provided. By allowing greater shop opening hours, the amount spent on discretionary goods and services is likely to increase significantly, with higher retail sales as a result.

Higher Retail Employment

A key economic benefit resulting from the deregulation of retail trading hours is likely to be the increased employment opportunities and higher levels of employment within the retail sector. Further extending trading hours would necessitate the employment of additional staff to meet the extra demand and service additional shifts.

Since the introduction of Sunday trading in metropolitan Perth in August 2012, large grocery retailers have increased their headcount by over 1000 employees. Sunday has now become one of the most popular days for shopping. These benefits are likely to be extended further if trading restrictions are further relaxed.

Another benefit resulting from deregulation of trading hours is likely to be the greater number of employment options. Extending trading hours further will likely to result in greater job flexibility and improved opportunities for all people, but particularly women, youths, older workers, and those with a preference for part time employment. This is an important consideration in today's environment where governments are trying to encourage greater labour force participation, particularly for those people who are not as actively engaged in the labour market.

Potato Marketing Authority

Regulation of the marketing of potatoes in WA dates from Australia's National Security Regulations during the Second World War. The original motive for regulation in the state potato market was to ensure supply and price stability during the war. During this time, the short-term needs of supply and price stability were imperative.

However, the regulation of this industry since the war has aimed mainly to support potato growers, without much concern for impacts on consumers. Regulations restrict what can be grown, when, and by whom.

The issue of potato market regulation is hardly one to spark public outcry. However, the aggregate inefficiencies and costs it lays on the WA economy should be addressed as part of a microeconomic reform agenda.

The key question that needs to be addressed is whether a market failure exists to warrant the regulation. The retail sector is a highly competitive industry. If the buyers of a major retailer succeed in driving down the prices paid to producers but the retailer fails to pass the gains on to customers, then competitors will be able to undercut them. Alternative outlets also exist if consumers are unhappy with the service they get from major retailers. Even if buyer power did represent a genuine market failure, under competition policy principles it must be demonstrated that anticompetitive regulation is the only way to achieve that objective.

CCI sees no role for the Potato Marketing Corporation, and advocates the repeal of the *Marketing of Potatoes Act 1946* and *Marketing of Potatoes Regulations 1989*, and full deregulation of the state's potato industry.

Competition, choice, and prices

Regulation has impeded competition in the WA potato market, leading to higher prices and lower choice for consumers.

By eliminating price competition between growers, the Potato Marketing Corporation (PMC) is able to operate as monopoly supplier to the domestic market. As a result, producers have fewer incentives to innovate or respond to changes in consumer demand. Efficiency and price competitiveness are all sacrificed in the process.

Prices

The lack of incentives has kept pressure on the high retail price of potatoes in WA. The average retail prices of potatoes in WA are amongst the highest in Australia. This places WA consumers at a significant disadvantage. From 2007 to 2011, Perth potato prices have averaged \$2.61 per kilogram² the highest in the country and almost one dollar higher than the Sydney average price, which was the lowest in Australia over this time. In recent years, prices in Melbourne and Adelaide have rivalled Perth for the highest national price. However these price hikes are due to supply conditions coupled with changing consumer tastes.

Prices are not transmitted by the market, but rather by a statutory body. An example of this inefficiency can be seen during market conditions in which low demand or high supply levels warrant a lower market price. Here the PMC has been inclined to set a price floor. The minimum price level is set above the prevailing market price, meaning retailers pay a higher price premium which is conveyed to consumers. Thus, when a minimum price is set at wholesale, there exists a substantial transfer of benefit from the consumer to the producer, as well as a transfer from retailers to producers. In its 1995 report, the Productivity Commission estimated that the price of potatoes in WA was 29 per cent higher than the international benchmark price and it is unclear that this situation has remained unchanged.³

Historically retail prices have closely mirrored wholesale prices in Perth and to a large degree, retailers have tended to pass on to consumers the fluctuations in the wholesale price. Given the correlation between the wholesale and retail price, it is of particular concern that the Act gives the PMC the power to fix prices at which potatoes are sold to wholesalers.

Choice

² Australian Bureau of Statistics, Catalogue 6403.0

³ Industry Commission Report 1995, *The Growth and Revenue Implications of Hilmer and Related Reforms*

Currently there is no incentive for growers to differentiate their goods and gain market share. The regulation affords a single outlet for grower produce, whereby returns to all growers are equalised. These biases, created by regulation, have caused a notable absence of varieties in the WA potato market.

The poor selection of potato varieties (of any great volume) in WA presents perhaps the clearest indication of the manner in which the regulation inefficiently distorts grower choices. State potato production is dominated by the Nadine variety, accounting for 50 per cent of total WA potato production for the past 14 years.⁴

These and a host of other varieties are available all months of the year. However, anecdotal evidence from growers has suggested that regulation has encouraged the production of high yielding varieties and represents a disincentive for growers to test the market with new varieties or respond to consumer tastes. Under the current regime, returns to the grower are determined by the pack-out weights of each variety and thus to allocate factors of production to cultivate varieties that are not widely grown by other producers represents too great a risk to many growers.

Retailers generally require an assurance of regular supply for a particular variety. Such consistency of supply is unattainable for new varieties as growers are unable or unwilling to yield a large enough crop to meet the retail order or are unable to convince other growers to take on a new variety to yield a sufficient supply and ensure adequate returns. This influence may also justify grower preference for cultivation of the Nadine variety that has dominated local production for two decades.

In addition, the mechanism of providing returns to the grower encourages an inefficient allocation of productive resources, as grower outputs are sold at a fixed price determined by the Corporation. This provides growers with an uneconomic incentive to maximise output to maximise returns. Hence, the grower is encouraged to utilise an unwarranted amount of inputs such as fertilizer, pesticides and capital equipment to yield the highest possible output.

Hence the regulatory framework induces an inefficient allocation of resources as such productive inputs could be better employed elsewhere in economy in the absence of regulation. The lure of constructed profit also encourages growers to cultivate potato crops over other cash crops, which may result in lower supplies and higher prices for other fresh produce.

Investment choices are also distorted under the current framework, whereby growers are issued market entitlements to supply a certain quantity of potatoes at a particular time. In order to increase production, growers must effectively purchase production entitlement. This represents a significant disincentive for growers to undertake investment into their businesses as any increase in the scale of production is met by higher regulatory costs. This discourages the grower to invest, innovate and increase production in order to gain market share and earn larger returns.

The influence of regulation severely restricts the choices of consumers and growers. This has had a detrimental effect on the WA community, yielding less choice and higher prices. The structure of the regulation also encourages the grower to allocate resources in an inefficient manner.

Export Development

The development of export markets provides producers with the opportunity to grow profits and extend market share. Most importantly, external markets allow producers to effectively diversify the risk attached

⁴ Potato Marketing Corporation, *Tonnages Sold to Wholesale Merchants*, as at 15 March 2012.

to their production activities. For example, in times of low domestic demand, producers are able to turn their production focus to supplying the export market.

The statutory marketing of potatoes undermines any incentive to explore export markets as local growers already have a guaranteed buyer for their goods in the local market. In addition, there exists a potential disincentive to export, as growers who are not licensed to sell to the local market would be left without an outlet for their non-export preferred potatoes.

Barriers to Entry

Access to WA's potato industry is restricted through licensing. People wishing to cultivate a potato crop must be registered and apply for an area licence or obtain a registration and licence from an existing holder.

The Act gives the PMC the power to refuse application for the registration of a business and reject any application for an area licence. Furthermore, the PMC holds the capacity to refuse transfers of registrations and licences between individuals.

If individuals are unable to register or obtain a licence from the PMC and unable to transfer licences or registrations from existing holders, then they are shut out of the market. Thus, the registration and licensing system represents a major barrier to entry into the industry and restricts competition.

Public Benefit

Regional Considerations

A significant proportion of the state's potato growers are concentrated in certain parts of the state (notably around Manjimup) and these localities will be affected by the impact of deregulation on local growers. Some producers may exit the market as exposure to competition squeezes industry participants who are unable to produce goods at the price, quantity, quality or variety demanded by the market.

This does not mean, necessarily, that they will cease operation – a more likely effect is that they will shift to more profitable crops, while the most efficient producers increase market share.

Even though these processes will sometimes disadvantage rural producers, they are fair and appropriate, returning to consumers the gains which producers previously enjoyed because of market distortions. Their impact on regional communities will be offset if appropriate attention is paid to facilitating structural adjustment and, where appropriate, compensating losers.

Net Public Benefit

It has been argued that the benefits of price stability, production and quality control, and protection of grower returns collectively outweigh the costs associated with production and pricing regulation.

The above analysis clearly points out that the benefits of appropriate supply and strong product quality can be achieved much more efficiently via a deregulated market. Statutory regulation has little part to play in inducing these benefits to the WA economy.

The benefits of price stability are not worth the costs. Deregulated interstate markets do not record wild swings in prices, and today's consumers need little protection from market volatility. In fact WA consumers have suffered under current arrangements, paying the highest price in Australia for their potatoes over the past two decades. Furthermore, WA consumers have less choice of varieties than in other states.

Liquor Sales

Liquor licensing and control is subject to significant regulation, which aims to reduce the harm associated with excessive consumption from a public interest and health perspective. However, the design of the *Liquor Control Act 1988* and the associated regulations do not give due regard to the interests of the hospitality and tourism industry, its desire to service customers, and the impact licensed venues can have on the amenity and vibrancy of an area.

In particular, changes should be made to the “Public Interest Test” for new applications to shift the burden of proof away from the applicant and to the community that will be potentially impacted. The mindset of the Liquor Commission should be that it is up to the community to prove that a new licensed premises will have a negative impact, rather than on the applicant to prove that it will not. This system also produces an implicit bias against potential new entrants to a particular area, promoting existing businesses and reducing competition.

The State Government has commissioned a review into the *Liquor Control Act 1988* which is due to report by the end of this year. **CCI considers changes should be made that seek to remove any unintended anti-competitive consequences, and shift the regulatory pendulum more towards meeting the needs of consumers and businesses.**

Occupational Licensing

Adopting a national approach to occupational licensing will allow for labour resources to transfer more readily between the states and territories, helping ease skills shortages in Western Australia.

While CCI is supportive of the national harmonisation approach, concerns have been raised with the current process as it has adopted the lowest common denominator of standards across states, to set minimum licensing requirements. Taking this approach has industry concerned with the safety implications and employer confidence in the delivery of trades.

For example, as a result of harmonised occupational licensing in the electrical trades, the following changes have caused industry concern:

- Any licensed contractor (builder) will be able to bypass electrical contractors to be on site and engage an electrician under their own licence. This means that any electrician, regardless of relevant experience or whether or not they are up to speed on Australian standards, will be able to do work on public building sites. This may result in increased number of accidents if underqualified or out of practice electricians work on jobs for which they are not suitable.
- The training requirement to qualify for an electrical contractor’s licence would be removed. No longer is an electrical contractor required to be on site to ensure safety and standards are imposed. A builder is now able to oversee this function without the appropriate technical safety and quality knowledge a qualified electrical contractor has. This removes a safety net to ensure quality electrical work is being undertaken on site.
- There will be no requirement for ‘on the job’ training to gain an electrician’s licence. This is concerning as electricians will have limited exposure to actual situational learning experiences in a real workplace. This will endanger not only people on worksites but the new electrician undertaking tasks on site without supervision.

- C grade training licence for apprentices will be abolished. Apprentices no longer are required to undertake the introductory safety overview before working on site. This will lead to unsafe practices on site and employers uncertain of suitability of workers safety standards.

CCI recommends that licensing requirement should meet the safety standards agreed by industry.

Domestic Gas Policy

Growing demand for energy exports, in particular liquefied natural gas (LNG), has created pressures in the domestic market, driving up the price of domestic gas and electricity, and shifting investment incentives.

However, increasing LNG and gas prices, and changes to regulations, have also driven investment in domestic gas processing, including Apache's new plant at Devil Creek and BHP Billiton's Macedon Gas project, and in exploration for unconventional sources of gas. Furthermore, domestic supplies rely on export opportunities to deliver capital investment.

Concerns about the impact of higher gas prices saw the previous WA Government introduce a domestic gas reservation policy. Some 15 per cent of reserves are now required to be set aside for domestic use.

CCI believes that there is no identifiable market failure in relation to the supply of gas to the domestic market, and therefore does not support the reservation policy. Such a policy distorts decision making, and penalises gas producers to subsidise gas consumers. It could also discourage the private sector from investing in exploring our energy resources.

Research by Deloitte Access Economics for APPEA reinforced the distortionary impacts of domestic gas reservation policies. The report estimated that the introduction of a domestic gas reservation policy on the East Coast of Australia would come at a significant cost to the nation's economy, in the order of \$6 billion in foregone GDP by 2025. CCI believes the ERA should examine the implications of the domestic gas reservation policy for WA.

Rather than a reservation policy, the Government should instead continue efforts to improve market transparency and ultimately to increase the liquidity of the domestic market in order to better facilitate the availability of gas to domestic users.

There are a number of reforms that should be undertaken at key points of the gas supply chain which were identified in CCI's 2007 report *Meeting the Future Gas Needs of Western Australia*.

The gas bulletin board and gas statement of opportunities provide the opportunity to better understand gas demand and consider options to improve liquidity in the future. However, the gas bulletin board and statement of opportunities needs time to be refined and develop into a more useful snapshot of gas markets, ultimately to enable broader reform across the supply chain.

Once more information is available, the Government should support a review of the feasibility of a short-term gas trading market in WA. Such a market is already emerging for major domestic users, demonstrating how the private sector can respond to market signals, but more is needed to understand how the market operates and the potential to secure supplies.

For upstream gas producers the review of the North West Shelf Joint Marketing arrangements provides a useful opportunity to consider how best to secure domestic gas and export markets. Furthermore, the emergence of unconventional gas in the Canning and Perth Basins underpins the importance of market signals in driving greater production and opportunities for domestic and export users.

Infrastructure

Infrastructure is a key enabler of economic growth and development and is an important aspect of a vibrant and liveable society. Improving the ways that infrastructure is planned and funded are important considerations as part of a microeconomic reform agenda for the state.

Over the last decade, Western Australia has experienced strong economic and population growth. However, investment in infrastructure has not kept up and constraints in key infrastructure such as roads and airports have added to the cost of doing business, while a lack of social infrastructure has reduced amenities for Western Australians. To remain competitive in the global economy and attract and retain private capital, WA needs to upgrade its existing infrastructure and invest in new infrastructure.

Planning and Co-ordination

There is a pressing need to improve infrastructure planning in WA to avoid gaps and ensure that funding is allocated transparently towards projects that will deliver the greatest benefit to the State. In its 2009 report, the Economic Audit Committee noted that the efficiency and effectiveness of infrastructure delivery in the state has been greatly diminished by a lack of strategic asset planning.

The body responsible for providing co-ordinated infrastructure planning in WA is the Infrastructure Co-ordinating Committee (ICC). The ICC sits within the Department of Planning and reports directly to the Western Australia Planning Commission (WAPC). Its role is to advise the WAPC on planning for the provision of physical and community infrastructure and promotes inter agency co-operation in decisions related to urban development. Representatives on the ICC include government agencies with responsibility for land development, housing, commerce, the environment, state development, energy, minerals and petroleum, water, health, education and transport.

CCI has concerns about the effectiveness of the ICC. While it is intended to be the central infrastructure planning body for the state, this is not always the case. Infrastructure planning is scattered around various government agencies from the Office of Strategic Projects in Treasury, the Department of Planning and the Infrastructure Co-ordinating Committee (ICC). Planning across major resource infrastructure projects tends to go through the Department of State Development as the lead agency. The size of the ICC membership limits its ability to act as a central decision making body. It also lacks any direct industry representative or contact.

A further concern with infrastructure planning in WA is the lack of a long term infrastructure strategy for the state. The importance of such a plan was reinforced by the Council of Australian Governments (COAG) Reform Council, which noted that while the report *Directions 2031* lays a very strong foundation for a housing and land strategy to shape the long term future of Perth, it does not provide actions to form the basis for a wider planning agenda beyond simply accommodating growth.

The State Government does consider infrastructure projects using the Strategic Asset Management Framework (SAMF). The SAMF is a high level policy that looks specifically at an agency's investment proposal via the annual strategic planning cycle and the State Budget. It strongly emphasises the optimisation of existing assets, both for asset planning and management.

However, the policy is very focused at an agency level and does not identify where the State infrastructure priorities are. There has also been limited long term prioritization of public infrastructure planning in Western Australia in recent years. The result of this is unacceptable cost blowouts and delays in delivery of major projects. With no broader strategy around infrastructure development in the State, infrastructure projects have not been prioritised or undergone robust cost benefit analysis.

To remove politics from infrastructure provision and ensure value for money for taxpayers, projects that involve considerable expenditure or have a significant impact in the community must undergo a thorough and transparent cost-benefit analysis (CBA). Cost-benefit analysis (CBA) is a tool that supports evidence-based policymaking and can be used widely for this purpose. A CBA compares the total forecast cost and benefits of a policy to the community and the economy and tests if the benefits of undertaking a project outweigh the costs. This will assist policymakers to determine which policy is the most effective to achieve a stated objective or as a tool to prioritise a potential policy options.

When this does not take place, it results in poor prioritisation and cost blowouts. Recently, there has been increasing concerns regarding announcements made on key infrastructure projects in WA such as the MAX Light rail and the train line to Perth Airport where a proper evaluation of the costs, benefits and risk involved have not been made public.

A CBA should be used to assess options and not to justify a preferred approach prior to an investment decision. As noted by the Business Council of Australia, "CBA conducted after a political announcement is usually an exercise in 'ticking the box', rather than an honest assessment of all the possible approaches to meeting the desired objective".⁵

A good cost benefit analysis guides decision making in the longer term by considering economic and social factors. The analysis has to be rigorous, transparent and objective. Objectivity is critical to ensure that future costs are not underestimated and future benefits overstated. A CBA needs to be straightforward and readily understood by a wide range of people. The credibility of a CBA is also influenced by the suitability of a third party appointed conduct the CBA.

The team engaged to undertake CBA should be multidisciplinary, with the specific skills sets required varying depending on the project under consideration. This should include economists or professionals with experience in calculating both financial and non-financial costs and benefits with vital inputs from management accountants, engineers, public policy administrators and procurement specialists.

WA is lagging behind other States such as Victoria, New South Wales and Queensland that have managed infrastructure from a whole of government perspective and have infrastructure strategies around recognising the importance of infrastructure to economic growth. Other States have also established independent bodies to provide advice on infrastructure investment to the Minister and have participants from public and private sectors. These States have developed long term infrastructure plans from 10 to 20 years.

In addition to the States, the Commonwealth Government is focused on addressing the funding gap for infrastructure projects with strong economic viability through Infrastructure Australia.

Though WA has received some funding for its infrastructure projects through Infrastructure Australia, this is miniscule compared to the funding received in States such as NSW and VIC. In the 2013-14 Commonwealth budget, the Federal Government allocated \$500 million to WA to invest in either the light rail or the train to the airport. However, both projects received a ranking of 'Early Stage' status. In order to receive greater funding from Infrastructure Australia, WA needs to provide more rigorous and robust analysis for infrastructure projects and ensure that they align with Infrastructure Australia principles to receive more funding for key infrastructure projects.

⁵ Business Council of Australia, 'Cost Benefit Analysis' p.4, Source : <http://www.bca.com.au/publications/policy-essentials-cost-benefit-analysis>

CCI believes that an independent statutory body should be set up to provide advice directly to the Premier on infrastructure. The membership of this body should consist of senior and experienced individuals from government and the private sector who have experience in delivering and financing infrastructure projects. The membership should also be limited to a reasonable number so that it can work more effectively to make critical decisions around infrastructure and advise government.

The work this body should look to undertake should include:

- releasing an infrastructure strategy for WA that identifies long term infrastructure priorities for the State, to give businesses certainty and direction. This strategy should not lock the government to build certain infrastructure within a period of time. Rather, it should be a broad and flexible road map for businesses and investors to identify government's infrastructure priorities;
- improving infrastructure co-ordination and planning between agencies through a longer term infrastructure strategy; and
- providing thorough and transparent business case analysis for infrastructure projects to assist with prioritisation.

Funding

With strained government finances and the recent loss of the State's AAA credit rating, the key challenge for government is funding the state's infrastructure requirements.

The private sector can play a major role in financing, designing, building, operating and maintaining infrastructure. Often, the State will achieve better value for money through a contract with the private sector for the delivery of a service compared with the project or service being delivered entirely at the public sector's cost and risk.

Looking at ways to encourage greater private sector involvement in infrastructure provision will be particularly important in the current fiscally constrained environment.

User Pays

User charges will have a large part to play in ensuring the State's longer term infrastructure needs are met. The WA government should consider adopting user charges to pay for infrastructure, to encourage private sector investment into infrastructure and ensure that infrastructure in the State is better utilised.

Having the community pay for infrastructure usage will ensure that infrastructure is better utilised and encourage private investors seeking commercial returns to finance a project.

In Australia, user charges are largely visible through road toll charges in most States apart from South Australia and Western Australia. The benefit of user charges is that it ensures demand is better managed through a pricing mechanism, resulting in improvements in the productivity of networks and reducing the need for costly new investment. The revenue raised from user charges could be used to further invest in infrastructure.

Public Private Partnerships (PPPs)

The Public Private Partnership (PPP) model has served Australia well by delivering high priority infrastructure projects on time and freed up government funds in that process.

A PPP arrangement involves the public and private sectors collaborating to deliver public infrastructure projects such as roads, railways, schools or hospitals and manage the facility, maintenance and service delivery of such projects. These partnerships involve a transfer of certain project risks to the private sector, especially in the areas of design, build, operations and finance over a long term concession period. In PPP projects, it is essential to retain the 'user pay principle' by charging users for the use of infrastructure such as toll motorways. This provides proper market based signals that drive the efficient utilisation of infrastructure and ensure there is an incentive for private sector involvement.

Successful PPP projects in Australia include Melbourne City Link motorway, Sydney Harbour Bridge, Sydney's water filtration plants and New South Wales government schools. Though PPPs have been used extensively in Sydney and Melbourne (and increasingly Brisbane), their use in Perth has been modest.

There is a number of deterrents to greater use of PPPs. The onset of the Global Financial Crisis has resulted in potential investors becoming more selective in their choices to bid with investors shying away from managing risks in projects.

High bidding costs has also deterred further investment in PPPs. Bidding costs for PPP projects are high, with the typical bidding cost for projects with a capital value of \$250- \$300 million averaging at \$2.5 million and about \$5 to 6 million for a \$1 billion project.

Some high profile PPP projects that have been unsuccessful have also meant that the use of PPPs has become politically difficult. One example is the Lane Cove Tunnel in Sydney, which failed due to optimism on forecasting vehicle traffic. This led to a negative perception of PPPs. These perception issues and ill-informed views are a barrier to developing the PPP model. Intense media and public scrutiny of deals that do not go right such as the Lane Cove Tunnel, compared to successful projects such as the Sydney Harbour Tunnel, has created a difficult political environment for these projects to proceed.

A largely unknown pipeline of projects and a perceived lack of commitment to PPPs across Australia is also a barrier to further use of this type of model.

Despite these barriers, there are still innovative solutions and funding opportunities for government to partner with the private sector to build infrastructure. These include:

- the government borrowing, but with private finance guaranteeing the debt – thereby achieving the risk transfer but with lower costs of capital associated with the government borrowing rate;
- longer term outsourcing and contestability across a wider range of assets (power transmission and road maintenance for instance); and
- risk sharing rather than risk allocation for infrastructure procurement.⁶ This could be a more effective procurement model for PPPs where the private sector is hesitant to take on board the demand risks for the project.

However, unlocking private sector funds for infrastructure investment will require clear and dedicated pipeline of projects to justify the deployment of human and balance sheet capital to the WA market.

⁶Aldis, R & Forward, P, 2011, 'Towards a new Public Private Partnership Model', Evans and Peck,
Source: <http://www.evanspeck.com/Publications/Towards%20a%20New%20Public%20Private%20Partnership%20Model%20PPP%20Model.pdf>

Road user charging

Congestion pricing is a possible tool the government could use to reduce road congestion and provide a source of revenue for government. Road congestion has been estimated to cost the Australian economy \$13 billion each year and this figure is expected to grow to \$20 billion by 2020.⁷

A solution to this problem could be the introduction of a congestion tax. This is usually a charge imposed on a vehicle for entering the Central Business District (CBD) of a city during peak hour. This has proven to be an effective mechanism to reduce traffic congestion and raise revenue for governments in other jurisdictions.

Congestion pricing has been used successfully implemented in major cities overseas such as Singapore, London, Stockholm, Milan and San Diego. Distance based heavy vehicle schemes are in operation in Germany, Austria and Switzerland. The London congestion charge generates (gross) revenue of approximately \$380 million per year while the heavy vehicle scheme raises \$5 billion per year. The benefits of a congestion tax includes better utilisation of existing infrastructure, deferred or redirected infrastructure spending, travel time and cost savings and additional revenue.

A key issue with congestion pricing is the cost of using technology to aid in monitoring congestion. In London, congestion charges required an investment of \$400 million. On the contrary, road pricing in Singapore was introduced in 1975 through a manual, low technology system but was still successful in reducing traffic flow into the CBD.

Currently, governments around Australia have attempted to address congestion through a range of different measures. Many of these measures attempt to address congestion but also focus on other objectives such as funding infrastructure and improving environmental outcomes. Hence, these measures impact on road use and indirectly on congestion. These measures include:

- fuel excise;
- road tolls;
- public transport subsidies and priority;
- priority for cars with passengers; and
- car parking levies.

The Henry Tax Review recommended a congestion tax could be introduced across heavily congested parts of the road network.⁸ A congestion tax could replace inefficient taxes such as motor vehicle registration and transfer duty. The report noted that this charge should apply to all registered vehicles using congested roads and that revenue raised from this tax should be hypothecated to be reinvested in transport infrastructure which includes road, rail and public transport programmes.

⁷ Deloitte, 2012, 'Road Pricing: Necessity or Nirvana?',

Source: http://www.deloitte.com/assets/DcomAustralia/Local%20Assets/Documents/Industries/Government%20Services/Public%20Sector/Deloitte_Road_Pricing_Dec2012.pdf

⁸ Treasury, 2009, 'Australia's Future Tax System report to the Treasurer', Source:

http://www.taxreview.treasury.gov.au/content/downloads/final_report_part_1/00_AFTS_final_report_consolidated.pdf

However for congestion pricing to gain political support, it would be necessary for government to demonstrate to the public how revenue hypothecated from congestion pricing could be used to further invest in critical infrastructure and/or reduce the tax burden through the abolition of more inefficient taxes and charges.

CCI believes that further investigation needs to be undertaken into congestion charges and their suitability for WA. A poorly designed congestions charge may add to the tax burden without delivering the intended outcome of reducing congestion.

Infrastructure Fund

Infrastructure Banks are another model that could be used to fund infrastructure. There are several international examples of similar institutions including the European Investment Bank, and the Public Private Partnership (P3) Canada fund. The US government has also been considering setting up a National Infrastructure Bank to fund infrastructure projects in the country. The infrastructure bank works by using public capital to purchase highly rated bonds issued by the bank. These funds are then reinvested in various infrastructure projects.⁹ However, infrastructure banks also need to have the expertise to consider the appropriate project selection and guidelines and processes involved to make informed decisions.

Infrastructure Australia is not supportive of such an idea as it is concerned that such a fund would 'crowd out' private financing institutions. There was also insufficient support from the private sector to formally partner with government through an infrastructure fund.

Royalties for Region

There is also the potential for the government to use revenues from the Royalties for Regions (RfR) programme to invest in infrastructure. Launched in December 2008, the RfR received 25 per cent of the forecast royalty income for the budget year, which was earmarked to improve social and economic infrastructure in the regions and deliver services such as health, education, skills training, water and natural resource management. The programme was also responsible for funding the Mid West Investment Plan, Pilbara Cities, Gascoyne Revitalisation Plan, Kimberly Revitalisation Plan and Super Towns

Though the recent budget allocations do suggest that the funds in the RfR are allocated to regional infrastructure projects, there needs to be more transparency around how the RfR is delivering social and economic infrastructure in the regions. It is important that regional infrastructure undergoes the same stringent assessment process as all other infrastructure projects to ensure that projects which deliver the greatest value for money for taxpayers are prioritised.

Additional areas for consideration

Industrial Relations

Industrial relations regulate the manner in which employers are able to manage and interact with their employees. The June quarter 2013 edition of the *Westpac-CCI Survey of Business Expectations* found that industrial relations regulation was the second highest on a list of regulatory concerns, with some 52 per cent of businesses rating it in the top three (out of nine) areas of concern.

⁹ Committee for Melbourne, 2012, 'Discussion Paper on Funding and Financing Infrastructure in Victoria', Source: <http://www.melbourne.org.au/docs/funding--financing-infrastructure-in-victoria- members-note .pdf>

Western Australia is the only state in Australia to retain its own industrial relations system. Most private sector businesses are covered by the federal industrial relations system, leaving only a minor percentage of mostly small business employees covered by the state system in the private sector in Western Australia. The state system is also the legislative framework covering public sector employees in Western Australia, as well as non-trading entities, such as community services organisations.

After the Federal Government used the *Corporations Act 2001* to include all "Constitutional Corporations" in the federal system, a small number of businesses were left in the state system. These small businesses include sole traders and partnerships, some charitable and not-for-profit organisations and some local governments. The crux of whether these businesses are left in the state system relies mostly on the funding arrangements and/or trading activities of these organisations.

The charitable/not-for-profit and local government financial trading status can vary year to year; which consequently means the organisation's industrial jurisdictional obligations can also change from year to year. There is no clear figure of just how many businesses remain in the state system. The Department of Commerce estimates the number of Western Australian workers who are left in the state system is between 21.7 to 36.2 per cent, it is important to note that this includes public sector employees, which would comprise the majority of the estimation. The true number of businesses left in the state system would be much lower once the public sector has been accounted for.

CCI believes there is no justification for Western Australia to retain its own industrial relations regime, and that the state should refer its industrial relations powers to the Commonwealth Government. The rationalisation and simplification of industrial relations and related legislation will remove unnecessary government duplication of regulation and "red tape", and would promote higher levels of understanding, awareness and compliance. It is costly and unnecessary for the State Government to duplicate an industrial relations system when the vast majority of businesses are regulated by the federal system.

In the Economic Regulation Authority "*Inquiry into Microeconomic Reform in Western Australia Discussion Paper*" (**ERA Discussion Paper**) the ERA concedes that a reform "...may provide savings to the State Government but given the dominance of the Federal Industrial Relations system in Western Australia would not be expected to result in material impacts on productivity in the wider economy."

CCI encourages the ERA to consider the State industrial relations framework as part of the Inquiry.

Costs to the State Government

Referral of powers would result in an instant, significant cost saving for State Government by allowing for the winding up of a number of State Government departments involved in administering the State IR system.

The size and the cost of the WAIRC and associated departments are disproportionate to the number of employers that they exist for and the amount of matters that are brought to the WAIRC is disproportionate to the amount of money spent on maintaining it (not to mention modernising it). For example according to the WAIRC Annual Report **only three** Employer Employee Agreements were lodged for the 2012-2013 financial year¹⁰, this is in comparison to the 816 Enterprise Agreements lodged in Western Australia in the FWC for the same period¹¹. The inefficient allocation of resources allotted to this jurisdiction, proves the

¹⁰ WAIRC, Report of the Chief Commissioner of the Western Australian Industrial Relations Commission On the operation of the *Industrial Relations Act 1979* 1 July 2012 to 30 June 2013. Pp. 32

¹¹ Department of Employment, Trends in Enterprise Bargaining June Quarter 2013. Table 7. Available from: http://docs.employment.gov.au/system/files/doc/other/trends13_0.pdf

productivity gains that could be made by removing the jurisdiction would be worthwhile. The scale of resources in to the output of the jurisdiction is unsustainable in the long term.

The cost saving would be found across the various departments that exist to service the state industrial relations system and a conservative estimate is a cost saving of upwards tens of millions of dollars per year; an amount that should not be taken lightly given the Government's current budget position. Such savings would be derived from winding up the following agencies, and divisions within other Departments.

- The Western Australian Industrial Relations Commission (WAIRC) could be almost completely removed, with only a small core function left to deal with public sector industrial relations. The WAIRC has five full time Commissioners, a President and a number of support staff, and occupies at least three floors of the 111 St Georges Terrace Building (including the Registry). The rent alone in this building would be well over \$750,000 per floor per year.¹² In the 2012-2013 Department of the Registrar's yearly report, it states that for the conciliation and arbitration functions of the WAIRC the State Government provided the WAIRC \$5.896 million for the period. Given that the functions of the WAIRC could be undertaken by the Fair Work Commission (FWC), all of these expenses to the State Government are unnecessary. The duplication of the WAIRC functions could be instantly and sensibly referred to the FWC. As the FWC is federally funded, there would be no cost the State Government for it to handle all Western Australian industrial relations, except for the public sector.
- The Department of the Registrar exists to support the WAIRC. With the abolition of the WAIRC, this department would cease to exist, with any services required to support the public sector industrial relations to be absorbed by other departments. This could deliver substantial savings to Government, given that in its yearly report for the 2012-2013 financial year the department was given \$5.157 million to operate from the State Government. The majority of the costs of the Registrar could be saved by referral; in conjunction with the stated WAIRC costs, the savings of these two departments alone would be well over \$11.053 million per year.
- the Industrial Magistrates Court would also become entirely unnecessary with a referral and its costs as a whole could be saved by its dissolution.
- the Labour Relations division of the Department of Commerce and Wageline could be almost fully downsized to service only the remaining public sector needs, and could be moved back to the Department of Premier and Cabinet, where it was located historically.

The savings that could be generated by the referral of the State's IR powers would be considerable given ongoing efforts to modernise the states IR system. At the end of 2012 the State Government presented a Green Bill to Parliament "*Labour Relations Legislation Amendment and Repeal Bill 2012*". The Bill seeks to modernise the state industrial relations landscape and adopts many aspects of the *Fair Work Act 2009 (FW Act)*. A cornerstone of the proposed amendments is the modernisation of the existing award system. This would increase the workload of the WAIRC and would potentially require the engagement of additional

¹² Looking at archived and current real estate advertisements for 111 St Georges Tce, Perth. The cost of one floor could comprise the following costs \$627.91 per m2 plus an additional \$150.26 per m2 outgoing costs per month with floor space ranging up to 967 m2.

Data from: <http://www.realcommercial.com.au/property-offices-wa-perth-500792335>

<http://www.realcommercial.com.au/property-offices-wa-perth-500546427>

<http://www.realcommercial.com.au/property-offices-wa-perth-500735855>

Registry staff to assist in carrying out the process. The staff would after a time become obsolete and the Registry would be even further overstaffed in an already unnecessary department.

The need for the state system to undergo a modernisation process could be completely alleviated if the industrial relations powers are referred. The process would cost the State Government millions of dollars and would take numerous years to complete. The immense time and money costs that would be spent in the modernisation process could be instantly saved by simply not undergoing the process. In making these changes additional expenses will be incurred in drafting and implementing the legislation and the extensive ongoing refining process that occurs after the legislation has been implemented. Costs would also be borne out of having to re-educate employers and employees in the new legislation. Five years after the introduction of the FW Act, the FWC is still undertaking the award modernisation process and this looks set to continue for at least the next few years.

Costs to business

Essentially if an employer is in the state system, they are being penalised, in comparison to an employer who is in the federal system.

Firstly, there is an uncertainty for many employers who may be in the state system as to whether they are in fact in the state or federal systems. Referral of power removes current jurisdictional uncertainty for all parties – given the various means of structuring an employing entity and transient case law as to what constitutes trading activities employers often need to seek costly legal advice in an attempt to provide clarity as to which system applies.

However due to the nature of this definition, clear advice as to which system applies is not always possible. These businesses are often forced to “jump” between jurisdictions and this often comes a large cost to these employers having to comply with differing legislations year-to-year. Often the employers who need this legal clarification are the ones who rely on funds and grants and can least afford it, particularly as the legal trading status can vary each financial year. CCI is aware of employers who cannot afford this legal opinion and so they operate by ensuring that they abide by both state and federal legislation unnecessarily, imposing on themselves higher costs and compliance, to ensure they are not possibly breaking one of the legislations if they were scrutinised by either Commission.

Employers who are in the state system are also held to a different set of standards to their national employer counterparts. The minimum wage for example is substantially higher in the state system than the federal. The employers who are reliant on paying the minimum wage are the employers who can least afford to pay those additional wages each week. The state minimum wage is currently \$23.70 higher than the federal minimum wage and as can be seen in the table below the difference in the state and federal minimum wages has been creeping up to a larger gap each year.

		FWA	WA
2010	Date of Effect	01/07/2010	01/07/2010
	2009/10 Weekly MW	\$569.90	\$587.20
	\$ difference with WA	-\$17.30	\$0.00
	Increase	\$26.00	\$17.50
		FWA	WA
2011	Date of Effect	01/07/2011	01/07/2011
	2010/11 Weekly MW	\$589.30	\$607.10
	\$ difference with WA	-\$17.80	\$0.00
	Increase	\$19.40	\$19.90
		FWA	WA
2012	Date of Effect	01/07/2012	01/07/2012
	2011/12 Weekly MW	\$606.40	\$627.70
	\$ difference with WA	-\$21.30	\$0.00
	Increase	\$17.10	\$20.60
		FWC	WA
2013	Date of Effect	01/07/2013	01/07/2013
	2012/13 Weekly MW	\$622.20	\$645.90
	\$ difference with WA	-\$23.70	\$0.00
	Increase	\$15.80	\$18.20

An additional cost that these employers will also have to bear will be the modernisation process, if it goes ahead. The key issue for these small, charitable and not-for-profit organisations is that they are often without the necessary dedicated HR departments due to the cost pressures of having non-essential dedicated resources; this means that a modernisation process will cause additional undue financial pressures during the education and implementation process and would likely lead to higher costs and the higher possibility of being non-compliant with the legislation.

While these costs may not be defined as significant on a macro level, these additional cost burdens are significant to the businesses themselves. There will also be additional costs to unions and employer associations in their necessary involvement in the modernisation process.

Impacts on competition

A single industrial relations system covering all employers and employees in Australia ensures there is a fair, efficient, universally acceptable and consistently applied regulatory framework for all business in Western Australia and creates an even playing field across the whole of Australia by removing differing state laws. This would promote business efficiency, competition and allow all business in Western Australia the opportunity to compete on a national and international scale.

The maintenance of two industrial relations systems will also maintain a level of competitive advantage for some employers and disadvantage for other employers, operating in the same industry. Depending on the jurisdiction these employers may be complying with different rates of pay and penalty rates. Some employers are afforded a competitive disadvantage simply by being in the conflicting jurisdiction than a

competitor; this unequal playing field is created by no fault of either employer, but determined by which industrial relations jurisdiction they happen to fall into. Forcing some employers to remain in a state system, forces them to be disadvantaged and compete on an unequal playing field.

By removing the jurisdictional uncertainties employers would have a finite and universal legislation to abide by. The competitive disadvantage that is currently held by state system employers would be removed, as all employers would be bound by the same legislation and be held to the same cost standards. This would also remove employers need to pay for costly legal advice as to which jurisdiction they currently sit, risk the consequence by remaining unsure or by abiding by both sets of legislation. By giving back these employers competitive advantage we would be helping some of the smallest and some of the most worthy employers to compete on a national and international level.

Public Holidays

If the State Government chooses to continue to maintain a state industrial relations system, CCI believes a number of changes should be made to the existing state industrial relations framework to reflect the needs of small business in the state. A review of the state system is necessary in the absence of referral but will add another layer of unnecessary cost to the system and contribute to a further period of counter-productivity. A referral of powers will reap a substantial saving in the tens of millions while a review will cost the State Government even further.

A significant area in which the State Government should take action is to amend the *Public and Bank Holiday Act 1972 (WA)* (P&BH Act). The current legislation results in some businesses being obliged to recognise up to fourteen public holiday days per year, instead of the 10 intended by the legislation. This particularly affects national system employers that operate seven days a week, who are required to pay public holiday penalty rates on two days (rather than one) where a public holiday falls on a weekend.

With the commencement of the *Fair Work Act 2009*, its public holiday provisions have for many Western Australian businesses doubled the penalty rate costs when employees work on those public holidays that fall on weekends. This is as a consequence of the interaction between the FW Act [specifically the National Employment Standards (NES)], modern awards and the P&BH Act.

Additional to the NES prescribing eight public holidays, it also provides that “*any other day, or part-day, declared or prescribed by or under a law of a state or territory...*” Given the P&BH Act provides for additional days where certain public holidays fall on weekends, many WA businesses are obliged to pay penalty rates for both the public holiday and the additional prescribed day. Further, businesses are required to pay ordinary rates on both occasions to those not required to work because it is a public holiday.

Over the 2010-11 Christmas Season six public holidays were appointed for three occasions being Christmas Day, Boxing Day and New Years Day, greater than any other state or territory. The creation of these additional public holidays also creates confusion for employers, contributes to loss of business efficiency, and for WA businesses operating in other states imposes an added responsibility to ensure the relevant state standard is applied.

There is no evidence of any intention by the Federal Government when it introduced the NES to create additional public holidays beyond the Public Holiday test case standard of 10 days. The Explanatory Memorandum states employers are not required to provide public holiday entitlements on two days in respect of one holiday.

CCI recommend amendments are made to the P&BH Act, as follows.

- Where New Year's Day or Australia Day fall on a Saturday or Sunday, a substitute public holiday should be appointed on the following Monday.
- Where Anzac Day falls on a Sunday, a substitute public holiday should be appointed on the following Monday.
- Where Christmas Day or Boxing Day fall on a Saturday, a substitute public holiday should be declared on the following Monday.
- Where Christmas Day or Boxing Day fall on a Sunday, a substitute public holiday should be declared on the following Tuesday.

This amendment reflects the status quo prior to 1 January 2010, aligns with the Western Australian legislation more closely with other states and territories and reflects the standard prescribed by the Full Bench in the Public Holidays Test Case.

Energy

CCI recognises that reforms to the energy market are currently being considered as part of other Government review processes such as through merger of Synergy and Verve, and the review of the wholesale electricity market.

Nonetheless, energy markets remain an important element of microeconomic reform that should be considered by the ERA as part of this Inquiry, given the substantial benefits that would be generated through reforms that will deliver greater competition.

A detailed policy is needed for our state's energy sector over the long term, to provide direction with respect to management and development of energy resources, energy production, security and supply.

Such a plan should look at energy supply throughout the entire supply chain and across different sources of energy, and consider ways to transition to an open, transparent and competitive market. In particular, an energy policy for the state's future should consider:

- international best practice for energy governance, and the role of Government and independent regulators within energy markets;
- the structure and performance of established energy markets in WA and potential areas for change;
- additional infrastructure requirements across the State to support expected growth in demand in coming decades; and
- appropriate pricing signals to better manage demand and encourage capital investment. For many years the price of energy has been artificially restrained, which has resulted in a decoupling of the price of energy from the cost to produce.

In relation to electricity, the reform process that was initiated with the disaggregation of Western Power in 2006 has achieved some important successes, including incentivising over \$2 billion of private investment in electricity generation, achieving greater security of supply, and enabling medium and large size businesses to choose their electricity retailer and benefit from low electricity prices.

The reform process needs to continue for the benefits of electricity reform to flow to small business and to residential consumers. Ongoing and incremental reform of the electricity market is needed to address excess capacity, improve governance and implement important gas market reforms.

Given their currently significant market shares, the Synergy – Verve Energy merger is likely to have a significant impact on the South West Interconnected System electricity market. Significant market share across the market, as well as unfair and anti-competitive behaviour in electricity procurement are serious risks that need to be appropriately managed through the proposed ring fence. Therefore, the anticipated outcomes of the merger, and post merger reforms need to be made clear. In addition, industry needs certainty that interactions between the generating and retailing arms of the new entity are competitively neutral.

CCI believes the government and the ERA must undertake a transparent analysis and consultation of post-merger options for increasing competition. This should necessarily include options for plant shutdowns, asset sales and capital recycling, splitting the merged entity into competing “gentailers”, and/or complete privatisation. Without embarking on one of these options the merger process is unlikely to increase competition. The current excess of capacity provides the state with a unique opportunity to move to the next stage of electricity market reform while supply is relatively secure.

Cost-reflective tariffs

Cost-reflective electricity tariffs have been consistently called for across electricity market reviews at the state and national levels. Cost-reflectivity is a key first step towards genuine retail competition.

In recent years government has recognised the need to move towards cost-reflectivity and should be applauded for its efforts to increase tariffs. However, actual tariff increases implemented consistently fail to reduce the estimated 21 per cent gap between regulated tariffs and the efficient costs of providing electricity. The state government has consistently pushed the pain of tariff increases into the future, as demonstrated by Table Two below. By appointing an independent regulator to set regulated electricity tariffs, government can take some of the politics out of tariff setting and align its procedures with other states.

For government the subsidy required to maintain electricity tariffs below cost-reflective levels has increased to \$420 million in 2012-13, a significant sum of taxpayer funds that could be invested more productively elsewhere in the economy.

In addition, electricity consumers in the SWIS continue to be charged the tariff equalisation contribution (TEC), to ensure the cost of electricity in WA's regions is the same as it is in Perth. Tariff equalisation is a social policy decision, and the TEC inefficiently adjusts prices for SWIS consumers to subsidise those in the regions. Should the government maintain tariff equalisation as a policy, it should be funded from direct revenue, not through the current cross-subsidy.

Retail contestability

In each of its reviews of the wholesale electricity market, the ERA has made a strong case for expanding retail contestability. This is further supported by the majority of other electricity market reviews as outlined in CCI's previous submission to the Inquiry into Microeconomic Reform.

With 65 per cent of the retail market, government owned Synergy continues to hold a significant share of the market and with it a significant amount of collateral and risk in underpinning much of the state's generation. Without opening the significant and stable market for residential and small business consumers, independent retailers will be unable to secure significant capacity from generators, and government will continue to bear a significant amount of risk.

CCI strongly supports the ERA's call for a clear pathway to full retail contestability. Through its mixed market combining bilateral contracts, the reserve capacity mechanism and short term energy market, WA has a structure in place to help provide for efficient and effective competition. In concert with full retail contestability, regulated tariffs should be gradually removed after levels of customer churn increase to rates seen in more competitive markets (for example, Victoria). But even with regulated tariffs, retailers should be free to set prices lower than regulated levels (as occurs in the residential gas market).

Reducing peak demand and encouraging energy efficiency

Policies which enable electricity users to respond to peak demand and to improve energy efficiency are also recommended by a significant number of the reviews considered in Appendix Two.

Significant costs both in the capacity market and in the electricity network are incurred to meet demand for only small periods of the year – peak demand periods. To ensure Western Australia's electricity system is as efficient as possible, peak demand needs to be addressed and accounted for in pricing structures.

The IMO's 2013 Electricity Statement of Opportunities notes that the Individual Reserve Capacity Requirement, changes to the balancing market and the demand side programme have helped to reduce peak demand on the hottest days by almost two per cent of total peak demand. These results demonstrate how appropriate pricing mechanisms in the market can have a material impact on demand. In this case, the incentives at play are part of the reserve capacity mechanism, underlining how incremental changes to market design can have significant positive results. But we shouldn't limit our thinking to participants in the capacity market. Time of use tariffs are a widely supported mechanism for encouraging smaller users to reduce demand during peak periods that should also be available for residential customers in a contestable market.

When combined with smart meters, time-of-use tariffs have proven successful at reducing peak demand, and reducing household electricity bills. In Western Power's Perth Solar City project, households with smart meters with in home displays and time-of-use tariffs have reduced their annual electricity bill by \$115 to \$235, and a 13 per cent reduction in consumption during the "super peak" period. If expanded to a wider range of households this could bring significant network savings while assisting households in actually reducing their electricity bills. This could provide significant relief as tariffs increase towards cost-reflective levels.

Public sector reform

In a time of increasingly constrained government finances, the State Government must consider ways to spend scarce tax payer dollars more efficiently.

Government spending has been outpacing revenue for the past five years. There are now significant costs now built into the operational expenditure of the WA general government and broader public sector, which are difficult to unwind without a program of structural reform.

As a result, reform to the operation of Government is an important microeconomic reform, that will deliver substantial benefits.

Recognising the potential for a challenging fiscal environment in the future, in 2009 the Liberal-National Government commissioned an inquiry into the operation of the WA public sector, dubbed *The Economic*

*Audit Committee Report (EAC)*¹³. The EAC report provided a comprehensive blueprint for operational reform of the WA public sector, with the overall objective to reduce the ongoing operational expenditure of the State Government through reform to the way the public sector conducted business. However, the EAC report terms of reference did not allow the Committee to examine structural reform to the public sector, which CCI considers vital in reducing expenditure growth.

The EAC report contained 112 recommendations, ranging from increasing the ability of the State Government to deliver on its priorities, better service delivery, increasing competition and contestability for government services and reforms to the way the State Government manages its human resources. Broadly, these can be broken into two components, a functional review of government and management and governance reform.

Overall, reform to the operation of the public sector in Western Australia should aim to redirect scarce government resources to areas of higher priority.

Functional Review of State Government

Western Australia's public sector structure is more complex compared to other states and territories (Table 1). At the end of 2012, the Western Australian public service is home to 163 departments, agencies and trading enterprises, 156 statutory boards and committees, as well 140 local government authorities. Since 2001-02, seven new agencies and two trading enterprises have been created (in net terms).

Table 1 Complexity of Government			
	Western Australia	New South Wales	Queensland
Agencies & Authorities	163	118	32
Boards & Committees	156	97	54
Local Government	140	152	73
Total Government Entities	459	367	159
<i>Source: Respective State Government Services</i>			

It is not clear that the more complex structure of Western Australia's public sector yields a better level of public service. This is of particular concern for the WA business community, as its members routinely deal with a large number of (often overlapping) regulatory, taxation, planning and development agencies. Such a complex structure makes it difficult for government to focus on key needs and priorities, and can incur significant costs, as well as creating a range of management and accountability problems such as:

- a reduced ability for the public sector to allocate its resources efficiently;
- excessive competition between agencies for resources and influence;
- inconsistent or incompatible policy objectives between agencies;
- complex lines of reporting to Ministers;
- duplication of services and administrative burdens;
- blurred lines of accountability and responsibility; and

¹³ Economic Audit Committee. 2009. *Putting the Public First: Economic Audit Committee Final Report*. Accessed online at <http://www.dpc.wa.gov.au/>

- more complex, time consuming, contradictory and confusing relationships between government and business.

Structural reform to the public sector has the potential to be an important first step in eliminating these concerns, and improving the efficiency of the sector. Given the complex nature of the public sector in Western Australia, this would likely involve an overall reduction in the number of government agencies, enterprises and committees.

A full review of the size, scope and activities of government in Western Australia is needed, to identify agencies which do not perform a core role of government, or may no longer be relevant. Such a review should take into account the following guiding principles:

- Activities should be regularly reviewed, the results published, and programs which are no longer valuable or relevant to a core role of government should be abolished.
- Services which can be delivered more efficiently or effectively through the private sector should be contracted out.
- Responsibilities for policy development, regulation and service delivery should be separated wherever possible in order to limit conflicts in the interest and objectives of agencies and ministers. Service agencies should not regulate themselves, competitors or potential competitors, and external agencies should provide objective analysis of public sector agency performance.
- Within these separate spheres of policy development, regulation and service delivery, agencies and departments which share similar core objectives and client bases should be combined under a single agency or authority. Priority should be given to departmental and agency mergers which offer likely efficiencies through pooling or synergies of skills, economies of scope and shared administrative costs.
- Government businesses should operate according to clearly determined objectives and parameters.
- Where community service obligations and standards are imposed, these should be fully and transparently funded from general government and, if in a competitive or potentially competitive market, made contestable.
- Trading enterprises should operate with a commercial focus, aiming to make an appropriate return to government as owner and as tax collector while abiding by government policies on competitive neutrality and other competition policy requirements, and policies such as competitive tendering and contracting.

When considering reform to the structure of the public sector, government should look at all options, including amalgamation, functional reviews, privatisation and contracting out.

CCI believes government should adopt a structured approach to a review of its role in the economy, to determine whether direct government involvement in certain markets is justified. CCI believes there are a number of government agencies and boards that should be investigated as options for privatisation or greater private sector involvement, or abolished or absorbed into other government agencies.

Review of Office of Shared Services program

CCI had long called for a shared services model of internal service delivery in the WA public service, as a way of eliminating duplication and increasing efficiency for functions which need not be duplicated between agencies. This was also a key recommendation of the EAC process, and was embraced by the Liberal Government upon its election in 2008 when the Office of Shared Services was formed.

However, the process did not end up delivering the outcomes and efficiencies it could have, and was eventually scrapped – at significant cost to tax payers.

In principle, a shared services service delivery model should be able to deliver efficiencies for government, and should not be completely ruled out as an option as part of a program of public sector reform. But as a first step, **government must commit to a full review of the Office of Shared Services process** to determine what caused it to fail.

Management and Governance Reform

Reforms to public sector management will also ensure that the sector operates efficiently, and that agencies and individuals are empowered to make decisions and take responsibility for their actions. The EAC report discusses at great length the issues with public sector management practices and governance, and recommends a comprehensive program of reform designed to improve flexibility and enhance accountability. Since then, small changes have been made to the *Public Sector Management Act 1974*, concerning the role of the Public Sector Commissioner and public sector standards. In May 2013, the State Government announced that further changes to the *Public Sector Management Act 1974* would be made to introduce provision for involuntary redundancies as an option of last resort, with Western Australia becoming the last jurisdiction in Australia to introduce such provisions. However, more needs to be done to modernise the employment practices of the WA public service.

The remaining findings of the EAC should be implemented to address these issues. In conjunction with a structured program review of the WA public sector, these reforms should deliver ongoing savings to Western Australian tax payers and allow government room to implement other reform priorities rather than continuing to spend scarce tax payer funds in an inefficient manner.

Governance and accountability framework

The public sector in Western Australia would benefit from the introduction of a whole-of-government approach to accountability and governance. Such a framework would help support planning and service delivery, promote integration and collaboration between agencies and allow for a greater focus on agencies' strategic direction and priorities through a more co-ordinated effort amongst public servants. The EAC found that most government agencies had centralised decision-making structures, largely caused by a lack of accountability mechanisms and limited penalties for poor performance. Broadly speaking, frameworks would result in devolved authority and decision making powers.

To address this problem, the EAC recommended that all public sector agencies should develop (or refine existing) a governance and accountability framework that incorporates:

- the application of an integrated framework and cycle of divisional or area planning, monitoring and evaluation linked to performance reporting;
- project management approach undertaken by divisions or areas for key priority areas, programs and initiatives to support quality planning and implementation;
- divisional or area officers being expressly responsible for the governance arrangements, principles, processes and practices of the relevant division or area and they are embedded, fully understood and applied by staff, and;
- a comprehensive framework of delegations and authorities that leave no doubt as to scope and nature of responsibilities delegated and to which positions/levels.

Review of agency KPIs

A devolution of accountability and decision making authority can only be successful if government agencies are encouraged to review and adjust their key performance indicators (KPIs). This will allow both government and the public more generally to have a clear understanding of whether agencies are meeting their stated outcomes and areas where improvements are necessary.

At present, it is unclear whether the KPIs for a number of agencies are appropriate, or provide a meaningful indication of their performance. Agencies' KPIs are often based upon client or community perceptions of their performance, and the effectiveness of agency-specific processes. As a result, these indicators do not provide meaningful insight into whether agencies are delivering improved outcomes. The accuracy of such indicators is also questionable, given that they are highly subjective, and likely to be inconsistent over time. It is also difficult to assess agency performance against KPIs over a period of time, as reporting methods or the indicator itself has often changed.

A more appropriate set of KPIs would assess agencies' performance against the achievement of outcomes, as well as benchmarking performance against similar agencies in other jurisdictions, or private sector providers.

To address these issues, the EAC recommended **all departments and agencies refine their existing reporting regimes to ensure they are consistent across outcome areas, and that all KPIs are reflective of the scale and risk of the particular activity they are assessing**. Indicators should also follow best practice in so far as they are specific, measureable, achievable, relevant and timely. There may also be a need to reassess the use of customer satisfaction surveys, which may not be the most appropriate way of assessing performance for some government functions.

A more flexible public service

A reformed public service, with greater accountability and a more meaningful set of KPIs, can only deliver improved outcomes for the state if changes are made to public service flexibility. The EAC report found that the public service is characterised by a culture of compliance and risk aversion, rather than a focus on outcomes – a culture which is driven by in large by the prescriptive and inflexible legislation governing public sector employment.

In this context, **CCI considers the recently announced changes to the *Public Sector Management Act 1974* an important step**. By removing the provisions which guarantee a "job for life" for public servants, the State Government has kick started the EAC's recommended approach to increasingly flexibility and accountability amongst the public service. However, more needs to be done to improve the flexibility of the public service.

A key priority should be the removal of the freeze on attraction and retention benefits in the public service. These benefits can and should be used to attract high quality resources to key roles within the public sector, and act as an incentive or reward to high performing staff. This would bring public sector employment practices further in line with the private sector. While there should be some sensible limits in place, and benefits should be subject to review to ensure they are appropriate, public sector managers should have a wide array of options available to them if there is a demonstrated need to use benefits to attract or retain staff. This was a key recommendation of the EAC.

There must also be changes to the way the performance of public sector staff is assessed, and breaches of public sector standards dealt with. In particular, processes should be transparent and encourage staff development, while rewarding substantiated high levels of performance. Meanwhile, the processes for substandard performance should be reviewed to ensure they are simple and effective. These processes

should be universal to all public sector employees, all of whom must be treated fairly and consistently. The EAC's recommendations on this issue should be fully adopted.

A more adaptive Senior Executive Service

These issues are particularly pertinent for the Senior Executive Service (SES) as this group of public servants represent the key body of knowledge and decision making in the public sector and represent important relationships with the business community. A key element of developing a stronger SES is to ensure salary and benefit packages are competitive with similar kinds of packages on offer from private sector organisations. The skills required of a member of the SES are likely to be similar to those of an executive manager in a private sector organisation, yet government agencies are unable to offer flexible salary packages that could enhance the attractiveness of taking on a position in the public sector. Senior public servants should also have specific performance targets as part of their remuneration packages, in line with private sector best practise.

As part of an enhanced benefits package, **members of the SES should also be subject to performance management, in line with their performance against these objectives.** As the gatekeepers of major public decision making, members of the SES should be subject to regular, objective, performance-based feedback; and be rewarded and penalised in line with their performance. An appropriately designed system of performance management would enhance accountability, encourage innovation and push SES members to strive for stronger performance and the associated rewards.

Local Government Reform

The State Government's recent announcement of local government amalgamation in the Perth Metropolitan Area is a positive step for WA businesses. There is little reason for the state's existing structure of local government, with councils of 1,000 residents or less, to continue, and CCI is confident the State Government will honour its commitment to reduce the number of councils in the Perth Metropolitan Area from 30 to 14 by 1 July 2015.

However, the local government reform agenda cannot stop there. While scale economies can be generated by larger, more efficient and better managed local governments, businesses will still be required to deal with inconsistency in the interpretation of regulation and planning regimes. CCI is not convinced that local government should be granted the flexibility to interpret State and Federal Government regulation, and has made reference to specific areas of concern throughout this document.

CCI believes Western Australian businesses would benefit most from consolidation of local government planning regimes, consistent application of regulations, and through streamlined approval processes.

Regional Local Government Reform

Western Australia's regional areas are home to some 110 local government areas, some with a few hundred residents or less. In certain regional centres this infrastructure is at critical capacity levels. In October 2005, the then Minister for Local Government and Regional Development asked the Local Government Advisory Board (the Board) to conduct an inquiry into local government structural and electoral reform. The findings of the research were submitted to the Minister in March 2006 and then for public comment later in the year. The critical findings included:

- many local governments are facing severe demographic pressures that are threatening community sustainability;

- staff attraction and retention is a considerable challenge for many local governments and is threatening their organisational sustainability; and
- local governments are not generating enough revenue to meet their operating demands and are likely to have difficulty in meeting long term infrastructure funding needs.

The WA government recently announced that the Perth Metropolitan Area's 30 councils will be reduced to 14 by 1 July 2015. However, with regional local government facing similar issues in terms of scale economies and revenue challenges, CCI considers it appropriate that a similar review be undertaken for regional Western Australia to identify opportunities for amalgamations that will deliver improved capacity and economies of scale.

CCI believes that there are substantial benefits that could be achieved through reforms to local government in the regions. This will result in a more comprehensive and structured approach to delivering local government services.

Training

State Training Providers (STPs) play an important role in the training market by providing affordable training to students and industry. This training needs to provide students with the skills and knowledge to be able to perform effectively in the marketplace.

Reform to the current operating model of the publicly funded STPs is required to ensure there is the capacity to deliver a skilled workforce to meet the changing needs of industry.

CCI supports the current Review of the State Vocational Education and Training system that has been initiated by the Government. It is an important step in ensuring that the State can set its pathway to improving the quality of outputs and efficiencies invested in the State Training system.

Utilising state training infrastructure more efficiently to meet the growing flexibility demands of industry, must be considered. Partnerships with private providers to utilise state training infrastructure in non-peak times and regional areas should be explored. Attention must also be given to the range of services offered by STPs, particularly in regional areas, where on occasion, essential courses for industry have not been offered due to staffing issues.

Another key area to assess in the training system is the quality of industry consultation and input into the development and relevance of training packages. Industry Training Councils (ITCs) must improve relationships and networks with employers in their industry responsibility. ITCs must improve processes to ensure targeted consultation with relevant industry and employers is undertaken on a regular basis so that training packages can better reflect the needs of industry they are supporting.

Industry expects lecturers to have appropriate qualifications, up-to-date knowledge and skills relevant to the particular industry sector in which they are lecturing. STPs need to improve their operations through better industry engagement to ensure a relevant training product. Partnerships with industry need to be established that allow for trainers to update their exposure to the types of workplaces for which they are training. This will ensure relevancy in training techniques to meet the needs of the modern workplace.

With the commencement of the Future Skills agenda for publicly funded training in Western Australia, public providers of training need to ensure they are prepared for competition in an open market and are still able to offer courses in thin markets. To continue to be relevant, STPs must offer courses that reflect changing industry standards and be guided by current business practices. This means creating effective relationships and partnerships with local industry to develop course content suitable for market needs.

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CCI's Submission to the ERA Inquiry into Microeconomic Reform.

CCI Advocacy | September 2013



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About CCI

CCI is the peak organisation representing business in Western Australia. It is the second largest organisation of its kind in Australia, with a membership of over 8,500 businesses across all sectors of the economy. CCI aims to build a competitive and productive business environment in Western Australia by promoting free enterprise through advocacy and essential services that make it easier to do business. CCI's vision is for Western Australia to be a world leading place to live and do business.

Executive Summary

The Western Australian economy is in a transition period, as years of rapid investment in the state's resources sector begins to slow down, and effort moves into the production phase of the resources cycle. The state's most recent surge in resources sector activity has been unlike any other in the state's history, both in terms of scale and in terms of the lasting legacy it will leave.

CCI considers now a perfect time for the State Government to embark on a new agenda of microeconomic reform that seeks to promote the state's natural and comparative advantages while allowing businesses across the economy to take advantage of the unique position the state finds itself in. The State Government's fiscal position has deteriorated in recent times, which has been highlighted by the recent loss of the state's prized AAA credit rating, which further reinforces the importance of embarking on a microeconomic reform program, which includes a focus on the role of government in the WA economy.

CCI looks forward to working with the ERA to develop and promote this agenda throughout the Inquiry process.

CCI has provided a range of microeconomic reform suggestions covering broad facets of the state's economy, and a number that deal with the machinery and structure of government – which is crucial to ensuring the state is able to make best use of its scarce resources. These recommendations are grouped into five headings.

State Taxes

- Examine the state's **transfer duty** regime to determine whether enhancements can be made to increase efficiency.
- Abolition of **transfer duties on residential property** should be a long-term objective for the State Government, with the example of the ACT's approach a potential case study for reform.
- Incorporate the **Metropolitan Region Improvement Tax (MRIT)** into the broader **land tax** base.
- Simplify the **land tax** scale, and adopt a "smoothing" approach to determine land values for land tax purposes.
- Abolition of **payroll tax** should be considered a longer term priority for the State Government, that it should continue to promote with the Federal Government as part of changes to federal-state financial relations.
- In the short-term, the **competitiveness of the payroll tax base should be a priority**, with reforms to lift the payroll tax threshold to \$1.5 million and have it appropriately indexed, combined with a reduction in the payroll tax rate to a measure like a population-weighted average.

- The **Perth Parking Levy** should be abolished.

Government Reform

- The ERA should conduct a **functional review of government** with a view to reducing the number of government departments and agencies.
- The State Government should consider **alternative service delivery models** with greater private and non-government sector involvement in a broader range of portfolios.
- A review into the **Office of Shared Services** program should be conducted to determine what caused it to fail.
- The State Government should **adopt the Economic Audit Committee's recommendations** on people management and governance in the public sector.
- The ERA should **review the operation of the Royalties for Regions Fund and WA Future Fund** from an efficiency perspective.
- The ERA should **review options for asset privatisation** to free up the state's balance sheet and provide funds for other purposes.
- Appropriate **infrastructure governance structures** should be introduced to provide the private sector with better guidance on government's plans, while ensuring a better prioritisation of investment projects.

Regulatory Reform

- The ERA should **recommend elements of the various COAG Reform Agendas** that the State Government should adopt.
- The State Government should **investigate options for full deregulation of intrastate aviation services**.
- The State's **Liquor Laws** should better recognise the needs of businesses and consumers, and remove anti-competitive provisions.
- The State Government should **refer its industrial relations powers to the Commonwealth**.
- The ERA should investigate approaches that could be taken to **deregulate the taxi industry in Western Australia**.
- The final steps to **full deregulation of retail trading hours and product restrictions** should occur.
- The State Government should **take full control over the application and monitoring of the Food Act 2008**.

Energy Market Reform

- Government must undertake **transparent analysis of post-Verve-Synergy-merger options for increasing competition** in WA's electricity market.
- The State's **electricity tariffs should be made cost-reflective** as soon as possible, while the **tariff equalisation contribution** should be scrapped or financed from direct revenue.

- A pathway to **full retail contestability** must be articulated by the State Government.
- The ERA should examine **how to implement time-of-use pricing** to reduce peak demand and create network savings.
- The State Government **should continue efforts to improve gas market transparency**, which should ultimately lead to an increase in liquidity in the domestic market.
- The State Government **should support a review of the feasibility of a short term gas trading market**.
- The **Renewable Energy Target** should be examined by the ERA to determine how the state can best meet its target obligations.

Other Issues

- The ERA should conduct a review into the **land development supply chain in Western Australia**.
- The State Government should consider the **appropriateness of local government involvement in land zoning laws** in the context of state planning strategies.
- The State's **major project approvals processes** should be reformed to reduce the burden on major project proponents and streamline the process.
- A **review into the waste management industry** should be conducted to create an environment that fosters greater competition, efficiency and innovation.
- The recently announced **Local Government Amalgamation process** should be extended to regional Western Australia.
- The State Government's **Independent Public School Initiative** is delivering its intended benefits, but should be reviewed to ensure schools are operating efficiently. Standards should also be kept high for schools wanting to become part of the initiative.
- Reform to **State Training Providers** is required to ensure they are meeting the needs of industry.

Economic and Fiscal Context

Following a number of years of very strong economic growth, the WA economy is heading for a period of consolidation, as resource sector investment reaches its peak.

Western Australia's recent run of strong economic growth has been driven largely by demand for the state's resources from developing Asia – and China in particular – which has fuelled an unprecedented wave of investment activity. Over the past decade, business investment grew by an average of 13.1 per cent a year, as resources companies sought to take advantage of this rapid growth in demand from developing Asia by increasing their capacity to extract and export resources from the state.

The state's population has also been growing at above-average rates, with population growth hitting a record 3.5 per cent over the course of 2012. This is almost triple the average rate of growth between 1990 and 2005. The latest demographic statistics indicate the state's population grows by around 1,600 people per week, as record numbers of interstate and international migrants move to Western Australia to take advantage of our prosperous economy.

The impact of the strong growth in developing countries continues to benefit the local economy. WA continues to boast a strong investment pipeline, which has meant that overall conditions still remain very strong. This has been reflected in State Final Demand, which grew by 4.9 per cent in the 2012-13 financial year, on the back of an 8.1 per cent increase in business investment and solid growth in consumer spending.

However, this level of investment activity cannot be sustained over the longer term. As a result, economic growth in WA will moderate in coming years as the investment boom reaches its peak. After growing by 6.7 per cent in 2011-12, and a further estimated 6.3 per cent in 2012-13, CCI expects the WA economy will grow by 5¾ per cent in 2013-14 and 4¾ per cent in 2014-15. In both instances, this is above the state's long-run average of 4.2 per cent per annum.

However, while investment may cease to be a significant driver of growth, CCI expects these recent investments in new capacity to add to the state's export capacity. CCI forecasts exports will grow by eight per cent in both 2013-14 and 2014-15, aided by the commencement of liquefied natural gas exports towards the end of this period.

Outside of investment and exports, CCI expects the long-dormant housing market will begin to be a larger part of the state's growth profile in an environment of low interest rates and rising population. Dwelling investment is expected to grow by eight per cent in 2013-14, and a further two per cent in 2014-15. Meanwhile, consumer spending is expected to remain stable on the back of low unemployment and high incomes; recording growth of 4½ per cent in 2013-14 and 2014-15 respectively.

The shift in the profile of growth presents a significant revenue challenge for the WA Government. Western Australia's fiscal position will become difficult over the coming years as the Government seeks to balance structural issues in the state's revenue base with a record investment program and rapid growth in recurrent expenditure¹. On one hand, the state is constrained in its ability to raise revenue because of the narrow taxes and charges it is permitted to impose; on the other, the state's population is growing faster and richer than at any time in recent history, creating additional demand for government services, like health and education.

¹ See CCI's State Budget Update 2013-14 for further information and opinion on the initiatives contained within the 2013-14 State Budget.

The extent of the challenge was highlighted by the 2013-14 State Budget, which showed that the State's net operating balance is projected to remain in surplus in 2013-14, but will record a \$147 million deficit in 2014-15, largely due to a small decline in revenue between these two years.

However, the true challenge for the WA Government is not slowing revenues; it is the unsustainable growth in spending. For the past five years, spending growth has averaged 10.2 per cent a year, compared to revenue growth of 7.6 per cent. Much of this pressure has been driven by government wages and salaries, which have increased from \$8.9 billion in 2008-09 to \$12.6 billion in 2012-13, and are expected to reach \$15.3 billion by the end of the current forward estimates period.

At the same time, the state's balance sheet has come under pressure as a result of the State Government's significant asset investment program. Between 2006-07 and 2012-13, the WA Government's total public sector net debt has increased from \$2.9 billion to \$18.5 billion as the Government invested some \$33.9 billion in infrastructure and other projects across the state. Investment is projected to remain elevated over the coming forward estimates period, with a further \$26.9 billion in planned asset investment between 2013-14 and 2016-17. Beyond this, the State Government has committed to new major transport projects and the development of a new major stadium, which are currently unfunded.

As a result, the total public sector's net debt position is expected to deteriorate to \$28.4 billion in 2016-17, with gross debt liabilities projected to breach \$50 billion. With a raft of major projects still yet to hit the state's balance sheet, it is conceivable that net debt will climb beyond \$30 billion at some point beyond the current forward estimates period.

The WA Government does recognise the structural budget challenges it faces. The centrepiece of the 2013-14 Budget, the "Fiscal Action Plan" contains a number of important savings measures that will go some way to shore up the fiscal position in the short term and provide the platform for further savings to be achieved over the longer term.

In particular, legislative changes which will allow for involuntary redundancies, and capping the growth in agency salaries and industrial agreements to CPI, as well as reviews of government programs across the public sector and the introduction of sunset clauses on funding for new programs, are important reforms.

However, the size of the fiscal challenge facing the WA government will also require structural solutions to reduce the size of the public sector and improve its efficiency. To address these challenges over the longer term, the WA Government will need to explore ways to more effectively engage the private and community sector to deliver key services.

While the benefits of such a reform agenda will ease the financial stress on the government, it will also boost the state's productive capacity at a time when the economy is still being squeezed by inadequate and inefficient infrastructure and service delivery.

Over the long term, CCI believes the Western Australian economy finds itself in a unique position to benefit from the shift in the world's economic growth centre to our region. As the region continues to urbanise and industrialise, it will create opportunities beyond the supply of bulk commodities; in areas like value-adding manufacturing, services, food production and sharing our knowledge and expertise in areas like engineering, design and technology. The reforms set out in this submission will help place WA in an ideal situation to capitalise on these opportunities.

State Taxes

The Western Australian State Government levies a range of taxes and charges to fund its operation, while receiving top-up funding from the Commonwealth Government through a series of tied and untied revenue grants. The State's three most significant taxes are transfer duties, payroll tax and land tax.

Tax reform is an important part of any microeconomic reform agenda. Reform is needed to ensure the tax system has minimal impact on business and individuals, assists competition, and promotes employment, investment and economic growth. It will also provide the State Government with a more secure and predictable revenue base. Reform should also seek to reduce the overall size of the tax burden faced by the private sector, to ensure as much of the state's scarce wealth is being put to use by the private sector.

Transfer Duties

Transfer duties are transaction based taxes levied on a range of commercial and non-commercial transactions. In most instances, the tax is paid by the buyer of the particular item or property, with the rate determined by the value of the item or property on a step rate scale.

Western Australia levies the following transfer duties.

- Duty on residential and commercial property transactions, and other types of intangible business asset transactions (known as "Transfer Duty").
- Duty on the value of the premium of most kinds of insurance ("Insurance Duty")
- Duty on land transfers by commercial entities or trusts ("Landholder Duty")
- Duty on the licensing of a new or transfer of a used vehicle ("Vehicle Duty")

Transfer duty on property is the most significant of these duties for the State Government from a revenue perspective, raising \$7.2 billion (18.4 per cent) of the State's taxation revenue over the current forward estimates period. Overall, transfer duties raise \$12.7 billion between 2013-14 and 2016-17, or one third of the state's total taxation revenue.

Transfer duties are highly inefficient and distortionary taxes as they are based on transactions, and fail the basic principles of good tax design in that they are narrowly based and inefficient. They lead to inefficient outcomes as businesses and households change their behaviour to avoid the tax, which may mean that resources are not allocated to their most efficient or productive use. Transaction taxes are particularly distortionary in cases where demand for the good or service is highly elastic – such as the purchase or sale of a specific property by or to a specific buyer.

The issues with transfer duties were highlighted by the 2008 Henry Tax Review, which found that conveyancing stamp duties resulted in a net welfare loss of around 40 cents in the dollar for each additional dollar of revenue raised. In the case of insurance duties, the loss was estimated at around 66 cents in the dollar. In particular, Henry commented on transaction duty²:

² Treasury. 2010. *Australia's Future Tax System: The Henry Review*. Accessed online at <http://www.taxreview.treasury.gov.au/>

- “Ideally, there would be no role for any stamp duties, including conveyancing stamp duties, in a modern Australian tax system”; and
- “Transaction taxes...are generally inefficient because the tax rate rises according to how often an asset changes hands, rather than any underlying economic value. There is no ‘economic base’ for transaction taxes.”

CCI recognises that transaction-based taxes, in particular transfer duty on property assets, represent a significant proportion of the State Government’s own-source revenue; and in an environment where the State’s grant revenue is coming under pressure from a declining share of GST, reform that reduces the state’s ability to raise revenue in its own right may be challenging.

However, the abolition of highly inefficient transfer duties remains an important reform over the longer term.

One case study on the potential for longer term reform is the Australian Capital Territory, which in 2012-13 commenced a process of abolishing transfer duty on commercial and residential property over the coming decade. The revenue raised by transfer duty is to be replaced by a broad-based land tax regime³. CCI does not have a view on the cost or benefit of this initiative, although theoretically a broad based land tax is significantly more efficient than transfer duty⁴.

In the meantime, changes should be made to the existing duties regime to improve its efficiency. In relation to Transfer Duty on real property, Western Australia’s transfer duty scales have not been adjusted to take into account the property boom which occurred in the early to mid 2000s, where the Perth Median House Price increased from \$160,000 to its current level of \$505,000⁵. As a result, the “median property” in Perth is now subject to a rate of duty equal to 3.6 per cent of the purchase price (or \$18,000), compared to 2.8 per cent (or \$4,600) in 2000-01. The state’s transfer duty scales for residential and commercial property should be adjusted, to return the effective rate of taxation to levels seen prior to the “property boom” in the early to mid 2000s.

³ ACT Government. 2013. *A Fairer, Simpler and More Efficient Taxation System: Five Year Reform Plan*. Accessed online at <http://www.treasury.act.gov.au/>

⁴ Treasury. 2010. *Australia’s Future Tax System: The Henry Review*. Accessed online at <http://www.taxreview.treasury.gov.au/>

⁵ REIWA. 2013. *REIWA Market Update: March 2013*.

Land Tax and Metropolitan Region Improvement Tax (MRIT)

Land tax in Western Australia is levied on the ownership and usage of land in Western Australia. While a number of exemptions are in place, land tax is generally payable on land that is used for commercial purposes, is vacant but owned, or is a place of residence that is not utilised by the owner.

In Western Australia, land tax is payable on the taxable value of the land on a step rate scale which increases as the value of the land increases. The first \$300,000 of taxable value is exempt from taxation, while land valued at \$11 million or more is taxed at the highest rate (2.43 per cent for every dollar over this amount as of 1 July 2013). Land tax is calculated at the entity level, not on the land parcel level.⁶

Land tax is a significant source of revenue for the State Government, raising some \$3.1 billion over the current forward estimates period. This amounts to 7.8 per cent of the State Government's taxation revenue.

The Metropolitan Region Improvement Tax (MRIT) is a tax levied in addition to the amount of land tax payable, equal to 0.14 per cent of every dollar over \$300,000 of the taxable value of a non-exempt property in the Perth Metropolitan Area. For the purposes of MRIT, the Perth Metropolitan Area is determined by the local government area that the land sits in. Notionally, the MRIT is used to fund the acquisition of land for public facilities such as parks, open spaces and roads, and is expected to raise \$404 million over the current forward estimates period.

Land tax is, according to the Henry Tax Review, one of the most efficient forms of taxation currently levied by any level of Government in Australia⁷. As a tax on an immoveable asset, land tax is significantly less distortionary than other, transaction or value-based property taxes like transfer duty.

However, the land tax regime in Western Australia is complex and in some instances can result in significant fluctuations in tax payable between years due to changes in the value of land.

Western Australia is the only state to levy two kinds of land tax, the broad "land tax" and the MRIT. This results in businesses that are subject to both receiving a bill with separate lines for what amounts to a single tax. The MRIT is also a narrowly-based tax, in so far as it applies to businesses in particular local government areas and the notional revenue raised by this funds infrastructure and other developments which benefit both MRIT-payers and non-MRIT-payers.

While the process of determining the taxable value of land (utilising the Valuer-General's "Unimproved Value" assessment, including the ability for taxpayers to dispute the assessment) is sound, particularly when compared to other states and territories, reforms that seek to make land tax liabilities more predictable for tax payers are desirable. The State Government's current policy of limiting the increase in land values between years to 50 per cent, introduced on 1 July 2009, was a step in the right direction, but can still result in significant year-to-year increases in tax liabilities.

⁶ If one business owns two separate titled parcels of land that are worth \$250,000 each, the total land value that the business is liable for is \$500,000. If land tax was levied at the parcel level, the business would not be liable for land tax as the taxable value of each parcel does not exceed the lower threshold.

⁷ Treasury. 2010. *Australia's Future Tax System: The Henry Review*. Accessed online at <http://www.taxreview.treasury.gov.au/>

Land tax in Western Australia is also subject to a six point scale, which is more than most other states and territories. For example, New South Wales has a simple, two rate and threshold system, with the higher rate only applicable on property holdings valued over \$2,000,000.

While land tax is a relatively efficient tax, reforms can be made to make the application and payment of land tax more administratively efficient for tax payers. In particular, the MRIT should be progressively incorporated into the broader land tax base, in recognition that there is no basis to levy an additional, narrowly based tax on land values. This approach also recognises that current MRIT tax payers are effectively paying for government services that are utilised by non-MRIT tax payers.

The current valuation process is sound, in that the independent Valuer-General is the determinant of land values in the state. This contrasts to the approach of other states and territories, who utilise local government valuations as the determinant of the taxable value of land. However, Western Australia's approach can lead to significant fluctuations in the amount of tax payable by an individual tax payer, which can create compliance difficulties and inhibits the ability of business to plan effectively. In order to mitigate this, CCI recommends that a "smoothing" approach be taken when determining land valuations for tax purposes. This would ensure that tax liabilities are more predictable, while ensuring the land valuation for tax purposes remains contemporary.

Over the medium-term, consideration should be given to reducing the number of land tax scales applicable in Western Australia. The Henry Review found that applying a flat-rate land tax was more efficient than a step-rate system, noting that having higher rates for higher valued land holdings can discriminate against firms that are seeking to build larger land holdings which can be more efficient – particularly for residential development. The ideal system in this regard would be a single rate and threshold system, which does not discriminate against large land holdings.

A move to a single rate and threshold system would also provide the groundwork for an eventual transition to a broader-based land tax regime to replace transfer duty. The theoretical grounds of such a move are well established, however careful consideration should be given to how this could be implemented in the least-distortionary manner (noting that the introduction of a land tax on previously untaxed land reduces land values by the equivalent of the tax payable, discriminating against existing land holders).

Payroll Tax

Payroll tax in Western Australia is levied on private sector employers. The liability is calculated as a rate of the employer's total payroll amount Australia-wide, including entitlements and deductions made in relation to an employee (such as superannuation, bonuses, fringe benefits and termination payments), and is paid in Western Australia on the Western Australian share of the total payroll. The tax is self-assessed, and is payable either monthly, quarterly or annually.

In Western Australia, an employer is liable for payroll tax if the national, group-wide payroll of the employer is more than \$62,500 per month (or is expected to be more than \$750,000 over a year). The rate of tax is 5.5 per cent. There are a range of temporary rebates and exemptions, including for employers employing Indigenous persons and people with a disability. The State Government has committed to increasing the payroll tax exemption threshold to \$850,000, commencing with an increase to \$800,000 in 2015-16 and a further increase to the new \$850,000 threshold in 2016-17.

Payroll tax is a very significant source of State Government own-source revenue, accounting for \$16.6 billion in state revenue over the current forward estimates period. This makes payroll tax the second largest line of own-source revenue for the State Government, and also the second largest line of 'untied' revenue the state receives.

While theoretically the incidence of payroll tax falls onto employees through reduced wages, in practice payroll tax acts as a disincentive for business growth and job creation. The business community views payroll tax as a penalty for successfully growing their business, creating new employment and generating wealth for the Western Australian economy.

Payroll tax has the biggest impact on business decision as the total payroll approaches the exemption threshold, with the effective marginal cost of employing additional labour increasing once the employer moves through the exemption threshold and becomes liable for payroll tax.

Western Australia's payroll tax regime is also one of the least competitive in the country. The Commonwealth Grant's Commission found that in 2009-10, Western Australia's capacity to raise payroll tax revenue was 19 per cent higher than the national rate, and is one of the major drivers behind WA's low share of GST revenue⁸. The state's payroll tax rate and exemption threshold compares unfavourably to other jurisdictions:

	Rate (13-14)		Threshold (13-14)
Western Australia	5.50%	Western Australia	\$750,000
Queensland	4.75%	Queensland	\$1,100,000
New South Wales	5.45%	New South Wales	\$750,000
Victoria	4.90%	Victoria	\$550,000
South Australia	4.95%	South Australia	\$600,000
Tasmania	6.10%	Tasmania	\$1,250,000

Western Australia has the second-highest rate of payroll tax, while having the third-lowest exemption threshold.

CCI believes that payroll tax should be abolished over the long-term, subject to appropriate replacement revenue becoming available. Abolishing payroll tax in Western Australia would provide a significant

⁸ Commonwealth Grants Commission. 2012. *2012-13 Relativity Update*. Accessed online at <http://www.cgc.gov.au/>

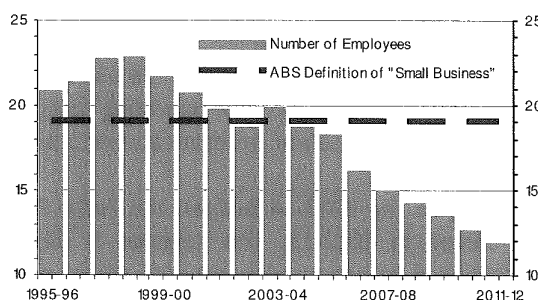
incentive for businesses to grow their Western Australian workforce, as they would be able to employ additional workers in the state without having to pay payroll tax.

However, in the short-term, reform should be made to both the rate and threshold to ensure it minimises the disincentive for businesses that want to grow and employ more people.

While the State Government has committed to increasing the payroll tax exemption threshold to \$850,000 on 1 July 2016, this will not keep small business out of the payroll tax net. Prior to being adjusted next year, the state's payroll tax threshold had remained unchanged since 2003, when an employer could employ approximately 15 staff before becoming liable for the tax. The strong economic and wages growth in the state since then has meant that businesses can now only employ nine workers based on average earnings before becoming liable (see Chart).

Payroll Liability Threshold

Number of Employees Before Liable, AWE Basis



Source: ABS Cat. 6302.0, WA OSR, CCI

Ensuring the state's payroll tax regime is the most competitive as possible should be a priority in the short-term. The payroll tax threshold should be lifted to \$1.5 million, to exempt small business and enhance the attractiveness of the state as a place to employ people. Once this is achieved, an appropriate indexation policy should be implemented, to ensure this competitiveness is maintained.

Western Australia's payroll tax rate should also be progressively reduced below the national population-weighted average (currently 4.9 per cent). A move to a lower payroll tax rate would provide an incentive for businesses to employ more people in Western Australia, and place more of the state's scarce resources into the hands of the private sector to invest and create new employment.

Perth Parking Levy

The Perth Parking Levy is a charge administered under the *Perth Parking Management Act 1999*, and applies to all non-residential parking bays within the Perth Parking Management Area (broadly, an area bound by Thomas St to the West, Kings Park Round/Mounts Bay Round/The Swan River to the South and East, and the Graham Farmer Freeway to the North). To allow a non-resident to park their vehicle (excluding motor cycles) in this area, holders of a permit are required to pay an annual licensing fee of between \$630.80 and \$728.70 for each bay⁹.

The Perth Parking Levy is intended to provide the State Government with funds with which to develop policies and strategies to decrease the use of cars in the Perth Parking Management Area. The revenue raised largely goes towards the operating costs of the free CAT Bus system, but is also notionally used to improve pedestrian safety, promote access to public transport and alternative transport modes.

According to the 2013-14 Budget, the Perth Parking Levy raised \$33 million in 2011-12, and a further \$38 million in 2012-13. This revenue is deposited into the Perth Parking Licensing Account, and appropriated to various departments within government to undertake *Perth Parking Management Act 1999* activities.

The Perth Parking Levy is unfair and contravenes good public policy and good tax policy. It taxes a narrowly-targeted class of citizens in order to meet the cost of providing a particular benefit to another group of narrowly-classed citizens. The tax has an adverse economic impact because it increases the relative costs and diminishes the amenity of doing business in the CBD. Because demand for car parking bays is highly inelastic, it does not act as a deterrent for users of cars, but rather increases costs for businesses, and their customers, in Perth city which increases pressure on businesses to relocate.

CCI believes the Perth Parking Levy should be abolished, and activities and expenditure associated with the *Perth Parking Management Act 1999* subsumed into the broader operation of government. CCI also questions the role of the State Government in the management of parking bays within a specific Local Government Area. While there may still be a role for regulation of the number, location and type of parking bays within the CBD area, the State Government should devolve this power to the City of Perth in line with practice for other Local Government Areas.

⁹ Department of Transport. 2013. *Licensed parking in Perth: A guide to licensing non-residential parking bays for 2013-14*. Accessed online at <http://www.transport.wa.gov.au/>

Government Reform

In a time of increasingly constrained government finances (see Economic and Fiscal Context), the State Government must consider ways to spend scarce tax payer dollars more efficiently.

Government spending has been outpacing revenue for the past five years. As a result, there are significant costs now built into the operational expenditure of the WA general government and broader public sector, which are difficult to unwind without a program of structural reform.

Recognising the potential for a challenging fiscal environment in the future, in 2009 the Liberal-National Government commissioned an inquiry into the operation of the WA public sector, dubbed "The Economic Audit Committee Report" (EAC)¹⁰. The EAC report provided a comprehensive blueprint for operational reform of the WA public sector, with the overall objective to reduce the ongoing operational expenditure of the State Government through reform to the way the public sector conducted business. However, the EAC report terms of reference did not allow the Committee to examine structural reform to the public sector, which CCI considers vital in reducing expenditure growth.

The EAC report contained 112 recommendations, ranging from increasing the ability of the State Government to deliver on its priorities, better service delivery, increasing competition and contestability for government services and reforms to the way the State Government manages its human resources. Broadly, these can be broken into two components, a functional review of government and management and governance reform.

Overall, reform to the operation of the public sector in Western Australia should aim to redirect scarce government resources to areas of higher priority.

Functional Review of State Government

Western Australia's public sector structure is more complex compared to other states and territories (Table 1). At the end of 2012, the Western Australian public service is home to 163 departments, agencies and trading enterprises, 156 statutory boards and committees, as well 140 local government authorities. Since 2001-02, seven new agencies and two trading enterprises have been created (in net terms).

Table 1 Complexity of Government			
	Western Australia	New South Wales	Queensland
Agencies & Authorities	163	118	32
Boards & Committees	156	97	54
Local Government	140	152	73
Total Government Entities	459	367	159
Source: Respective State Government Services			

It is not clear that the more complex structure of Western Australia's public sector yields a better level of public service. This is of particular concern for the WA business community, as its members routinely deal with a large number of (often overlapping) regulatory, taxation, planning and development agencies. Such a complex structure makes it difficult for government to focus on key needs and priorities, and can incur significant costs, as well as creating a range of management and accountability problems such as:

- a reduced ability for the public sector to allocate its resources efficiently;

¹⁰ Economic Audit Committee. 2009. *Putting the Public First: Economic Audit Committee Final Report*. Accessed online at <http://www.dpc.wa.gov.au/>

- excessive competition between agencies for resources and influence;
- inconsistent or incompatible policy objectives between agencies;
- complex lines of reporting to Ministers;
- duplication of services and administrative burdens;
- blurred lines of accountability and responsibility; and
- more complex, time consuming, contradictory and confusing relationships between government and business.

Structural reform to the public sector has the potential to be an important first step in eliminating these concerns, and improving the efficiency of the sector. Given the complex nature of the public sector in Western Australia, this would likely involve an overall reduction in the number of government agencies, enterprises and committees.

A full review of the size, scope and activities of government in Western Australia is needed, to identify agencies which do not perform a core role of government, or may no longer be relevant.

Such a review should take into account the following guiding principles.

- Activities should be regularly reviewed, the results published, and programs which are no longer valuable or relevant to a core role of government should be abolished.
- Services which can be delivered more efficiently or effectively through the private sector should be contracted out.
- Responsibilities for policy development, regulation and service delivery should be separated wherever possible in order to limit conflicts in the interest and objectives of agencies and ministers. Service agencies should not regulate themselves, competitors or potential competitors, and external agencies should provide objective analysis of public sector agency performance.
- Within these separate spheres of policy development, regulation and service delivery, agencies and departments which share similar core objectives and client bases should be combined under a single agency or authority. Priority should be given to departmental and agency mergers which offer likely efficiencies through pooling or synergies of skills, economies of scope and shared administrative costs.
- Government businesses should operate according to clearly determined objectives and parameters. Where community service obligations and standards are imposed, these should be fully and transparently funded from general government and, if in a competitive or potentially competitive market, made contestable.
- Trading enterprises should operate with a commercial focus, aiming to make an appropriate return to government as owner and as tax collector while abiding by government policies on competitive neutrality and other competition policy requirements, and policies such as competitive tendering and contracting.

When considering reform to the structure of the public sector, government should look at all options, including amalgamation, functional reviews, privatisation and contracting out.

CCI believes government should adopt a structured approach to a review of its role in the economy, to determine whether direct government involvement in certain markets is justified. CCI believes there are a number of government agencies and boards that should be investigated as options for privatisation or greater private sector involvement, or abolished or absorbed into other government agencies.

Review of Office of Shared Services program

CCI had long called for a shared services model of internal service delivery in the WA public service, as a way of eliminating duplication and increasing efficiency for functions which need not be duplicated between agencies. This was also a key recommendation of the EAC process, and was embraced by the Liberal Government upon its election in 2008 when the Office of Shared Services was formed.

However, the process did not end up delivering the outcomes and efficiencies it could have, and was eventually scrapped – at significant cost to tax payers.

In principle, a shared services service delivery model should be able to deliver efficiencies for government, and should not be completely ruled out as an option as part of a program of public sector reform. But as a first step, government must commit to a full review of the Office of Shared Services process to determine what caused it to fail.

Management and Governance Reform

Reforms to public sector management will also ensure that the sector operates efficiently, and that agencies and individuals are empowered to make decisions and take responsibility for their actions.

The EAC report discusses at great length the issues with public sector management practices and governance, and recommends a comprehensive program of reform designed to improve flexibility and enhance accountability. Since then, small changes have been made to the *Public Sector Management Act 1974*, concerning the role of the Public Sector Commissioner and public sector standards. In May 2013, the State Government announced that further changes to the *Public Sector Management Act 1974* would be made to introduce provision for involuntary redundancies as an option of last resort, with Western Australia becoming the last jurisdiction in Australia to introduce such provisions. However, more needs to be done to modernise the employment practices of the WA public service.

The remaining findings of the EAC should be implemented to address these issues. In conjunction with a structured program review of the WA public sector, these reforms should deliver ongoing savings to Western Australian tax payers and allow government room to implement other reform priorities rather than continuing to spend scarce tax payer funds in an inefficient manner.

Governance and accountability framework

The public sector in Western Australia would benefit from the introduction of a whole-of-government approach to accountability and governance. Such a framework would help support planning and service delivery, promote integration and collaboration between agencies and allow for a greater focus on agencies' strategic direction and priorities through a more co-ordinated effort amongst public servants.

The EAC found that most government agencies had centralised decision-making structures, largely caused by a lack of accountability mechanisms and limited penalties for poor performance. Broadly speaking, frameworks would result in devolved authority and decision making powers.

To address this problem, the EAC recommended that all public sector agencies should develop (or refine existing) a governance and accountability framework that incorporates:

- the application of an integrated framework and cycle of divisional or area planning, monitoring and evaluation linked to performance reporting;
- project management approach undertaken by divisions or areas for key priority areas, programs and initiatives to support quality planning and implementation;
- divisional or area officers being expressly responsible for the governance arrangements, principles, processes and practices of the relevant division or area and they are embedded, fully understood and applied by staff, and;
- a comprehensive framework of delegations and authorities that leave no doubt as to scope and nature of responsibilities delegated and to which positions/levels.

Review of agency KPIs

A devolution of accountability and decision making authority can only be successful if government agencies are encouraged to review and adjust their key performance indicators (KPIs). This will allow both government and the public more generally to have a clear understanding of whether agencies are meeting their stated outcomes, and areas where improvements are necessary.

At present, it is unclear whether the KPIs for a number of agencies are appropriate, or provide a meaningful indication of their performance. Agencies' KPIs are often based upon client or community perceptions of their performance, and the effectiveness of agency-specific processes. As a result, these indicators do not provide meaningful insight into whether agencies are delivering improved outcomes. The accuracy of such indicators is also questionable, given that they are highly subjective, and likely to be inconsistent over time. It is also difficult to assess agency performance against KPIs over a period of time, as reporting methods or the indicator itself has often changed.

A more appropriate set of KPIs would assess agencies' performance against the achievement of outcomes, as well as benchmarking performance against similar agencies in other jurisdictions, or private sector providers.

To address these issues, the EAC recommended all departments and agencies refine their existing reporting regimes to ensure they are consistent across outcome areas, and that all KPIs are reflective of the scale and risk of the particular activity they are assessing. Indicators should also follow best practice in so far as they are specific, measureable, achievable, relevant and timely. There may also be a need to reassess the use of customer satisfaction surveys, which may not be the most appropriate way of assessing performance for some government functions.

A more flexible public service

A reformed public service, with greater accountability and a more meaningful set of KPIs, can only deliver improved outcomes for the state if changes are made to public service flexibility. The EAC report found that the public service is characterised by a culture of compliance and risk aversion, rather than a focus on outcomes – a culture which is driven by in large by the prescriptive and inflexible legislation governing public sector employment.

In this context, CCI considers the recently announced changes to the *Public Sector Management Act 1974* an important step. By removing the provisions which guarantee a "job for life" for public servants, the State Government has kick started the EAC's recommended approach to increasingly flexibility and accountability amongst the public service. However, more needs to be done to improve the flexibility of the public service.

A key priority should be the removal of the freeze on attraction and retention benefits in the public service. These benefits can and should be used to attract high quality resources to key roles within the public sector, and act as an incentive or reward to high performing staff. This would bring public sector employment practices further in line with the private sector. While there should be some sensible limits in place, and benefits should be subject to review to ensure they are appropriate, public sector managers should have a wide array of options available to them if there is a demonstrated need to use benefits to attract or retain staff. This was a key recommendation of the EAC.

There must also be changes to the way the performance of public sector staff is assessed, and breaches of public sector standards dealt with. In particular, processes should be transparent and encourage staff development, while rewarding substantiated high levels of performance. Meanwhile, the processes for substandard performance should be reviewed to ensure they are simple and effective. These processes should be universal to all public sector employees, all of whom must be treated fairly and consistently. The EAC's recommendations on this issue should be fully adopted.

A more adaptive Senior Executive Service

These issues are particularly pertinent for the Senior Executive Service (SES) – as this group of public servants represent the key body of knowledge and decision making in the public sector and represent important relationships with the business community. A key element of developing a stronger SES is to ensure salary and benefit packages are competitive with similar kinds of packages on offer from private

sector organisations. The skills required of a member of the SES are likely to be similar to those of an executive manager in a private sector organisation, yet government agencies are unable to offer flexible salary packages that could enhance the attractiveness of taking on a position in the public sector. Senior public servants should also have specific performance targets as part of their remuneration packages, in line with private sector best practise.

As part of an enhanced benefits package, members of the SES should also be subject to performance management, in line with their performance against these objectives. As the gatekeepers of major public decision making, members of the SES should be subject to regular, objective, performance-based feedback; and be rewarded and penalised in line with their performance. An appropriately designed system of performance management would enhance accountability, encourage innovation and push SES members to strive for stronger performance and the associated rewards.

Government Funds

While the vast majority of state government funds are directed from and to the Consolidated Revenue Account, in recent years the State Government has created a number of special purpose funds to house tax payer money. At a time where government resources are becoming increasingly strained, CCI believes a review of the relative efficiency of operating special purpose accounts which tie up resources is warranted. In particular, the Royalties for Regions Fund and Western Australian Future Fund should be examined to determine whether they are delivering the best outcomes for WA taxpayers.

Royalties for Regions Fund

The Royalties for Regions Fund is established under the *Royalties for Regions Act 2009*, and receives an annual appropriation equivalent to 25 per cent of the State's onshore mining and petroleum royalties. The proceeds of the fund are directed at projects and programs in Regional Development Commission areas in Western Australia.

The Fund has three subsidiary accounts, and provision for additional subsidiary accounts that can be created for specific purposes. As of 30 June 2013, the Royalties for Regions Fund has a balance of \$881 million, following receipts of \$1.27 billion and payments of \$1.08 billion over the course of 2012-13. Provisions in the legislation limit the closing balance of the fund to \$1 billion. The 2013-14 Budget revealed that the Royalties for Regions Fund is expected to expend \$4.8 billion over the current forward estimates period, of which \$207 million (4.3 per cent) is administrative costs.

CCI has long held concern about the efficiency of the Royalties for Regions fund. While there is recognition of the need to invest in the regions after years of underinvestment by successive governments, it is unclear that Royalties for Regions represents the best way to achieve this. It is important that funds are being directed towards projects that will deliver the greatest benefits to regional communities. There is little transparency about where the funds are currently being directed and it is unclear whether funds are being used for priority projects. In the immediate term, this must be addressed to ensure scarce tax payer resources are delivering projects which produce an economic return and enhance the overall efficiency and productivity of the state.

Assuming no change to the current policy of 25 per cent of royalties being appropriated into the Royalties for Regions Fund, the amount of revenue being directed into the Fund will rise from three per cent of total State revenue in 2008-09 to 5.7 per cent by the end of the current forward estimates period. CCI believes this is an unsustainable situation in the long-term, particularly as:

- little change is likely to the GST distribution process, which results in the state "losing" over 80 per cent of its mining royalty revenue through lower GST grants than would otherwise be the case;
- royalties will continue to grow in importance to the state's general revenue base; and,
- the State Government's fiscal capacity will come under increasing pressure.

The Royalties for Regions Fund has been operating for five years. CCI considers the time is right for an assessment of the relative merits of continuing the Royalties for Regions policy from an economic efficiency perspective, considering the position of the state's finances (see Economic and Fiscal Context).

Western Australian Future Fund

The Western Australian Future Fund (WAFF) was established in the 2012-13 Budget, and operates under the *Western Australian Future Fund Act 2012*. The Fund is designed to capture some of the return on the

state's finite resource assets for future generations. WAFF is currently in the "seed accumulation stage", receiving some \$1 billion in funding between 2011-12 and 2015-16 from the Royalties for Region Fund (in relation to an efficiency dividend and the dividend of the change in royalty rates for fines iron ore); and will receive an annual appropriation of at least one per cent of the state's royalty income each year from 2016-17 onwards.

Financial modelling indicates that this fund will be worth \$4.7 billion in 2012-13 dollars upon its maturation in 2031-32, when legislation permits it can begin to be drawn down to fund economic and social infrastructure. The Fund is managed by WA Treasury and WA Treasury Corporation, and is permitted to invest in relatively safe, low yield assets like government and highly-rated corporate bonds.

CCI produced a policy paper discussing the issues surrounding sovereign wealth funds in early 2012.¹¹ The paper found that while there was some merit in creating a fund from an intergenerational wealth perspective, the pre-conditions for establishing a fund were not evident in Western Australia. Generally speaking, wealth funds have been created in jurisdictions with low or negative government debt positions, very high rates of revenue generation from non-renewable sources and not at times where there are capacity constraints in the economy. In 2012, and today, Western Australia does not meet any of these criteria.

The viability of the WAFF should be examined as part of this inquiry. CCI believes that in an environment of scarce government resources, quarantining funds which could be used to build economic capacity today and to pay down debt is not the best use of scarce tax payer resources. The intergenerational wealth transfer effects that the WAFF is seeking to generate can be made through improvements in the economic capacity of the Western Australian economy today, which would provide more jobs and wealth in the future.

¹¹ Chamber of Commerce and Industry of Western Australia. 2012. *Examining the Issues of Sovereign Wealth Funds*.

Asset Privatisation and Governance

Over a number of decades, there has been increasing recognition that government's role in infrastructure provision is changing. Increasingly sophisticated financial models, higher standards of governance in both public and private sectors, and constrained government finances have led a number of jurisdictions, around Australia and the rest of the world, to pursue alternative asset ownership models which move infrastructure off government balance sheets and into the stewardship of the private sector.

Historically, infrastructure has always been viewed as a public good provided by the government for the benefit of the broader community. However, infrastructure assets do not necessarily operate efficiently in the hands of government. Private sector operators, with a profit maximisation objective, are better placed to operate infrastructure that requires efficiency. This can include assets such as ports, water and energy infrastructure.

There are a range of privatisation models that can be employed to achieve this outcome. This includes recycling capital from privatisation, bundling assets and selling them off, assets being purchased by superannuation funds and privatisation through longer term leases, such as the case of port privatisation in New South Wales and Queensland.

Asset privatisation in Western Australia could result in a more efficient framework that ensures the wealth generated from assets most benefits the community. A more efficient operating model for key infrastructure assets also has broader benefits to the state's economy; driving productivity and reducing bottlenecks. In recent times, Queensland and New South Wales have shown the potential benefit of asset privatisation, through the privatisation of the Port of Brisbane as part of the Queensland Asset Sales programme and the privatisation of Port Kembla and Port Botany. Both ports were sold through a 99 year lease with capital recycled into other infrastructure assets.

There has also been limited long term prioritisation of public infrastructure planning in Western Australia in recent years. The result of this is unacceptable cost blowouts and delays in delivery of major projects. Infrastructure planning in the State has been left scattered around various government agencies from the Office of Strategic Projects in Treasury, the Department of Planning and the Infrastructure Co-ordinating Committee (ICC). Planning across major resource infrastructure projects tends to go through the Department of State Development as the lead agency. A lot of the infrastructure investment occurs from major resource projects that initiate secondary infrastructure impacts such as housing and services.

There is also no clear prioritisation governing the development of infrastructure in WA. Many infrastructure projects in WA are announced as political decisions without undergoing a thorough cost benefit analysis. Prioritisation also needs to take place where investment decisions around social and economic infrastructure need to take place.

The lack of prioritisation has led to WA missing out on significant funding for infrastructure projects from Infrastructure Australia (IA). In the 2013-14 Commonwealth Budget, WA received only 6 per cent of the total infrastructure funding, which was significantly less to what other States received. Infrastructure Australia only committed to contributing \$500 million to either the light rail or the train to the Perth Airport subject to a business case. This is largely due to a lack of an infrastructure strategy to guide infrastructure planning in the State. The 2009 Economic Audit Committee report recommended long term planning and improving the role of the ICC to advise government on infrastructure priorities as part of its review. To date, none of these changes have been implemented.

The recent recommendations from the Infrastructure Finance Working Group (IFWG) report recommended that governments review existing assets to identify those that have the potential to be transferred to

private ownership as way to free up the state's balance sheet. This could lead to productive, allocative and dynamic efficiency gains over the longer term.

CCI believes the ERA is well placed at this point in time to conduct a review of the state's government-owned infrastructure assets and assess those which could be operated more efficiently by the private sector.

Regulatory Reform

Government regulatory intervention in the state's economy is seen as a priority area of reform for both the business community and the State Government. The State Government's most recent attempt at comprehensive regulatory reform, the *Red Tape Reduction Group*¹², has largely remained on the shelf, and represents a strong starting point for regulatory reform priorities.

CCI also believes that the ERA, in line with its new function as an advisor to government on microeconomic reform, could assume the role of regulatory gate keeping from the WA Department of Finance. The ERA is better placed to act as the gatekeeper, being an independent advisor to government on regulatory issues. In assuming the role, the ERA should give regard to the national Regulatory Impact Assessment protocols developed by the Council of Australian Governments (COAG), as well as the Productivity Commission's report on benchmarking Australia's Regulatory Impact Assessment processes¹³.

Broadly, the ERA should examine new items of regulation proposed by government and consider whether:

- the case for regulation is strong enough to warrant government intervention; and
- in circumstances where government intervention is warranted, that regulations are constructed in the most efficient and effective manner.

More broadly, CCI considers there are a number of areas of reform that could be adopted by the State Government to improve the efficiency of the state's economy.

COAG Reforms

The Council of Australian Governments (COAG) process contains a number of significant areas of reform that CCI believes are worthwhile in the context of deregulation and streamlining for business – particularly those operating across multiple jurisdictions. The *Seamless National Economy* agenda is an important area of reform for the Western Australian economy through the COAG process that remains incomplete, while the *Business Advisory Forum* process appears to have stalled. The Productivity Commission's review into the benefits of the *National Competition Policy* agenda, which preceded the *Seamless National Economy* and *Business Advisory Forum* reform agendas highlights the gains that can be made through national reform of this nature.¹⁴

However, Western Australia is yet to fully implement the reforms that it has agreed to under each of these three national COAG agreements. CCI considers it appropriate that these areas of regulatory and competition reform be considered a high priority for implementation, acknowledging that they will deliver benefits to the state's economy and for the business community.

¹² WA Treasury. 2010. *Reducing the Burden: Report of the Red Tape Reduction Group*.

¹³ Productivity Commission. 2012. *Regulatory Impact Analysis: Benchmarking. Productivity Commission Report*. Accessed online at <http://www.pc.gov.au/>

¹⁴ Productivity Commission. 2005. *Review of National Competition Policy Reforms: Final report*. Accessed online at <http://www.pc.gov.au/>

Outstanding *National Competition Policy* reforms

While the *National Competition Policy* agenda has been subsumed into the *New National Reform Agenda*, the WA Government is yet to implement all of the agreed reforms. These include:

- the need to fully deregulate retail trading hours laws in WA, which currently impede competition by prescribing when shops can trade and by allowing some stores to trade outside of regulated hours as long as they are 'small' and/or located in certain areas (discussed further in Retail Trading Hours and Product Regulations);
- removing Western Australia's archaic potato marketing regulations (the Potato Marketing Board), which restrict competition by allowing the State Government to restrict the availability of land for growing potatoes for fresh consumption, and an ability to fix the wholesale price of such potatoes, while requiring that they be sold to the Government's statutory marketing authority; and
- liberalising the state's fuel pricing regulations, which impede competition in petrol retailing by requiring that retailers fix their prices for at least 24 hours and notify these prices to the Government, and the setting of maximum wholesale pricing for fuel. The State Government should also give consideration to abolishing *FuelWatch*, which has not created the downward pressure on prices it was intended to.

Outstanding *Seamless National Economy* agenda reforms

Western Australia is not alone in having outstanding *Seamless National Economy* agenda reforms. However, these reforms have the potential to significantly reduce compliance costs for businesses, particularly those operating in more than one jurisdiction. These reforms include:

- adopting a national system of occupational health and safety regulation. While CCI supports a national push to harmonise OHS legislation and regulations, it is unclear that the benefits fully outweigh the costs. This needs to be subject to further analysis to determine whether the cost to business of adopting new regulations and codes is too great for the initiative to be worthwhile;
- adopting a national approach to occupation licensing will allow for labour resources to transfer more readily between the states and territories, helping ease skills shortages in Western Australia; and
- developing a single "construction code" covering builders and plumbers. While the State Government is conducting a review into the plumbing industry, this should lead to the development of the single code upon its completion.

Outstanding *Business Advisory Forum* reforms

The role of the COAG *Business Advisory Forum* is not clearly defined. However, the process has identified a series of potential reforms which CCI considers worthy of consideration by the State Government; either to implement in its own right or to be placed on the broader COAG agenda. These reforms include:

- a national approach to environmental and major approvals, through the adoption of a consistent national model of environmental approval that removes one layer of government (either Federal or State) and greater use of "strategic assessments" (discussed further in Major Project Approvals). The Productivity Commission is also completing a report into this matter; and
- the removal of non-complimentary climate change initiatives at a State-level, acknowledging that it largely duplicates Federal Government policy initiatives.

Regional Air Route Regulation

Western Australia's intrastate aviation market is subject to government regulation that grants individual airlines a monopoly over particular routes, under agreements that guarantee a minimum level of service on that route. The regulation exists largely to ensure regional Western Australians have access to aviation services.

Prior to 2001, the Western Australian intrastate aviation industry was not regulated. With the collapse of Ansett, the State Government imposed regulation on certain routes to restrict competition. Solo carriers were guaranteed protection from competition if they continued air services to less travelled regional areas such as Albany, Geraldton, Laverton and Meekatharra.

Qantas dominates the Western Australian market, offering more than double the capacity of a combined Virgin Australia/Skywest from Perth to regional destinations. Qantas operates scheduled services to eight destinations in Western Australia from Perth to Broome, Port Hedland, Karratha, Learmonth, Paraburdoo, Newman, Geraldton and Kalgoorlie. However, the acquisition of Skywest has almost doubled Virgin Australia's Western Australian regional capacity direct from Perth. Though competition has increased in some areas, a range of regional routes remain regulated.

CCI is concerned that the current regulatory framework is not in the public interest, especially in the current economic climate where WA is the nation's fastest growing economy and experiencing strong population growth. This policy is disadvantageous to Western Australia as domestic flight capacity is lower than cities on the eastern seaboard, resulting in higher prices.

For example, a flight from Perth to Albany – a regulated route – costs on average \$224.50, which equals \$0.59 per kilometre travelled. By comparison, a flight from Perth to Bali costs on average \$219, which equals \$0.08 per kilometre, or 13 per cent of the cost per kilometre travelled. A flight from Perth to Kalgoorlie on the other hand costs on average \$229, equating to \$0.38 per kilometre travelled. While there are many drivers of the cost of air travel, the difference between this regulated route (Perth to Albany) and deregulated routes (Perth to Bali and Perth to Kalgoorlie) is significant.

The State Government should investigate options for the deregulation of intrastate air services, to encourage the competition that is needed to support the State's economic growth. This includes more airlines allowed into the market to ensure lower fares, the best possible service and more frequent and flexible flights among competing airlines that will benefit businesses, regional communities and travellers.

Liquor Reforms

Liquor licensing and control is subject to significant regulation, which aims to reduce the harm associated with excessive consumption from a public interest and health perspective. However, the design of the *Liquor Control Act 1988* and the associated regulations do not give due regard to the interests of the hospitality and tourism industry, its desire to service customers, and the impact licensed venues can have on the amenity and vibrancy of an area.

In particular, changes should be made to the “Public Interest Test” for new applications to shift the burden of proof away from the applicant and to the community that will be potentially impacted. The mindset of the Liquor Commission should be that it is up to the community to prove that a new licensed premises will have a negative impact, rather than on the applicant to prove that it will not. This system also produces an implicit bias against potential new entrants to a particular area, promoting existing businesses and reducing competition.

The State Government has commissioned a review into the *Liquor Control Act 1988* which is due to report by the end of this year. CCI considers changes should be made that seek to remove any unintended anti-competitive consequences, and shift the regulatory pendulum more towards meeting the needs of consumers and businesses.

Industrial Relations Framework

Industrial relations regulate the manner in which employers are able to manage and interact with their employees. The June quarter 2013 edition of the *Westpac-CCI Survey of Business Expectations* found that industrial relations regulation was the second highest on a list of regulatory concerns, with some 52 per cent of businesses rating it in the top three (out of nine) areas of concern.

Western Australia is the only state to retain its own industrial relations system. Most private sector businesses are covered by the Federal IR system, leaving only a small percentage of mostly small business employees covered by the State system in the private sector in Western Australia. The State system is also the legislative framework covering public sector employees in Western Australia, as well as non-trading entities. Having two industrial relations systems causes confusion amongst employers and results in a duplication of costs for government and business. The State system is also outdated and lacks the flexibility needed by small business in order to effectively manage and engage their staff.

In addition, the distinction between what constitutes a State and National system employer can be confusing. There is great uncertainty over whether some types of businesses such as charitable organisations and local government authorities are covered by the federal or the state systems. Changes to the funding arrangements for the not for profit sector can also result in these employers shifting in and out of the State and National systems depending upon the mix of trading and non-trading activities. This imposes a further cost burden to the businesses who can least afford it, of having to potentially comply with two sets of legislation.

CCI believes there is no justification for Western Australia to retain its own industrial relations regime, and that the state should refer its industrial relations powers to the Commonwealth Government.

The arguments in favour of a full referral of the state's industrial relations powers are as follows:

- Referral of power removes current jurisdictional uncertainty for all parties – given the various means of structuring an employing entity and transient case law as to what constitutes trading activities employers often need to seek costly legal advice in an attempt to provide clarity as to which system applies. However due to the nature of this definition, clear advice as to which system applies is not always possible. These businesses are often forced to “jump” between jurisdictions and this comes a large cost to these employers having to comply with differing legislations year-to-year.
- A single IR system covering all employers and employees in Australia ensures there is a fair, efficient, universally acceptable and consistently applied regulatory framework for all business in Western Australia
- A single IR system creates an even playing field across the whole of Australia by removing differing state laws. This would promote business efficiency, competition and allow all business in Western Australia the opportunity to succeed on a national and international scale.
- The rationalisation and simplification of IR and related legislation will remove unnecessary government duplication of regulation and “red tape”, and would promote higher levels of understanding, awareness and compliance. It is costly and unnecessary for the State Government to duplicate a industrial relation system where the vast majority of businesses are regulated by the Federal system.
- Referral of powers removes duplication, which would result in an instant, significant cost savings for State Government by allowing for the winding up of a number of government departments. The cost savings would be found across various departments:

- the Western Australian Industrial Relations Commission (WAIRC) could be almost completely removed, with only a small core function left to deal with public sector industrial relations issues. The WAIRC has five full time Commissioners, a President and a number of support staff, and it occupies at least three floors of the 111 St Georges Terrace Building (including the Registry). Given that the functions of the WAIRC can easily be undertaken by the Fair Work Commission all these expenses to the State Government are not necessary.
- the Department of the Registrar, which in its yearly report states for the 2011-2012 financial year cost \$10.5 million dollars to operate. The functions of the Registrar would be entirely redundant and any services required to support the public sector industrial relations could be absorbed by other departments in the event of its removal. The majority of the costs of the Registrar could be saved by referral;
- the Industrial Magistrates Court would become entirely redundant with a referral and the its costs as a whole could be saved by its dissolution; and
- the Labour Relations Division of the Department of Commerce could be almost fully downsized to service only the public sector needs remaining and could be moved back to the Department of Premier and Cabinet where it was located historically.

As part of its election platform the State Government identified changes to the State IR system. These changes would incur additional cost to Government and businesses. In making these changes additional expenses will be incurred in drafting and implementing legislation, including the costs associated with educating employers and employees of the changes.

A cornerstone of the proposed amendments is the modernisation of the existing award system. This would increase the workload of the WAIRC, potentially requiring the engagement of additional Registry staff to assist in carrying out the process. There will also be a cost to unions and employer associations in their necessary involvement in this process.

The maintenance of two industrial relations system will also maintain a level of competitive advantage and disadvantage for employers operating in the same industry who have to comply with different rates of pay and penalty rates for non standard hours. This means that for employers in particular industries, some employers have a competitive advantage over others. If the State Government chooses to continue to maintain a State IR system, CCI believes a number of changes should be made to the existing State IR framework to reflect the needs of small business in the state. A review of the State system is necessary in the absence of referral but will add another layer of unnecessary cost to the system, a referral of powers will reap a substantial saving in the tens of millions while a review will cost the State Government further.

One area in which the State Government should take action is to amend the Public and Bank Holiday Act. The current legislation results in some businesses being obliged to recognise up to fourteen public holiday days per year, instead of the ten intended by the legislation. This problem has arisen out of the interaction between the Public and Bank Holidays Act 1972 (WA) and the Fair Work Act 2009 (Cth). This particularly affects businesses that operate seven days a week, who are required to pay public holiday penalty rates on two days (rather than one) where a public holiday falls on a weekend. This additional cost to business should be removed by amending the Public and Bank Holiday Act 1972 (WA). By amending the legislation to provide for the substitution of a public holiday where it falls on a weekend, rather than an additional day, this is an unintended consequence of the legislation and an unnecessary cost burden to all business in Western Australia that can be easily rectified by the State Government.

Taxi Industry Regulation

The taxi industry in Western Australia is regulated through the *Taxi Act 1994* and the associated *Taxi Regulations 1995*. The current regulation of Perth's taxi industry could be responsible for higher prices and poorer service for customers than would otherwise be the case in a deregulated market. While the provision of a reliable taxi service may be viewed as an arm of coherent transport policy, CCI is not convinced that government should maintain its current level of intervention in the taxi industry.

Taxi operators must recover the cost of licences from operating revenues, while high barriers to entry limit the potential for competition in the taxi industry. The current regulatory structure discourages the provision of a taxi service which matches variations in demand according to the time of day, week or year. High leasing or plate costs mean that a vehicle must operate for most of the week in order to cover capital costs - it would not be profitable to only run a vehicle when demand is at its peak, even though this is the most profitable time to run a taxi.

Numeric limits on the number of taxi licences and regulated minimum hours of operation mean that additional vehicles cannot be made available to service peak demand even if it were economic to run a peak-only service. The result is delays for customers wanting to use taxis at times when demand peaks, and in some cases failure to get a service at all.

CCI suggests that the ERA investigate the approaches that could be taken to deregulate the taxi industry in Western Australia, which would lead to greater competition and therefore enhanced reliability and lower prices for consumers.

Retail Trading Hours and Product Regulations

Retail trading hours are governed by the State's *Retail Trading Hours Act 1987* and the *Retail Trading Hours Regulations 1988*. The legislative environment sets out different categories of retail shops, which determines their trading hours and in some instances dictates which products can be sold at those times. Appendix one summarises the current system of product and hours regulation¹⁵.

Over time there have been changes to the retail trading hours regulatory regime, most recently in August 2012 with the introduction of Sunday trading from 11am to 5pm. Sunday trading in the Perth metropolitan area was a major positive step forward for deregulating retail trading hours. It has provided businesses and consumers with greater choice and flexibility. The September quarter *Curtin Business School-CCI Survey of Consumer Confidence* found that 78 per cent of Western Australians had taken advantage of Sunday trading, with the share rising to 84 per cent in the Perth Metropolitan Area.

However, the incremental changes that have occurred over the years have created further distortions, particularly in relation to the types of products that can be sold. These arbitrary restrictions on businesses' ability to trade freely and in a competitive market stifle opportunities for growth and employment and discourage an entrepreneurial culture in WA.

CCI believes that in order to achieve the full benefits of deregulation these remaining restrictions on trading hours and products for sale need to be removed. While changes to retail trading hours are subject to an Act of Parliament, and would need to be removed via a legislated instrument, the regulations governing product restrictions can be changed at ministerial or departmental discretion, and should be the priority for abolition in the short term.

Since the introduction of Sunday Trading, it is unclear why the final steps towards full deregulation could not be progressed. CCI does not consider there a case for government restriction on the ability for retailers to sell their products and services to consumers based on the day of the week or time of the day. In this regard, CCI considers a final move to fully deregulate retail trading hours in Western Australia overdue and necessary to ensure business is able to compete on a level playing field.

¹⁵ See Appendix One: Western Australia's retail trading hours regulations.