National Disability Insurance Scheme (NDIS): Funding the Unfunded Commitment

prepared for the Insurance Council of Australia

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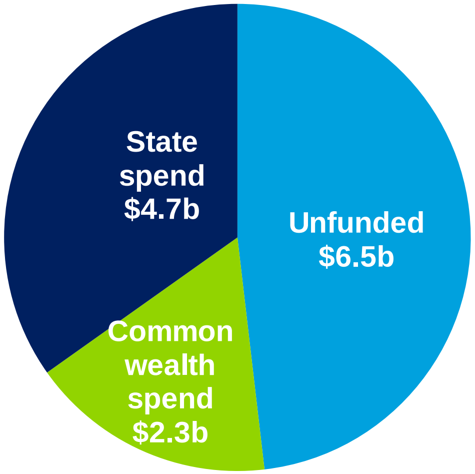
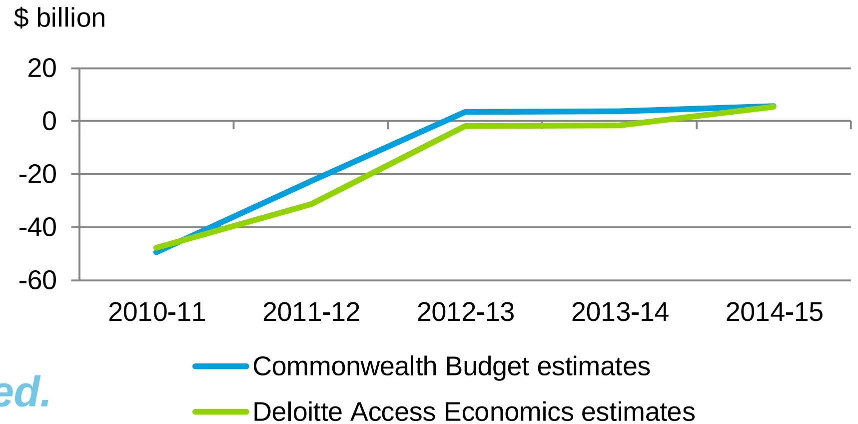
NDIS is currently a $6.5 billion per annum unfunded commitment – this gap cannot be met by budget surpluses in the short term

- The National Disability Insurance Scheme (NDIS) is expected to cost about $13.5 billion per annum.[1]
- Over half this amount is already being spent by State and Commonwealth Governments on existing disability schemes, which would be replaced by NDIS.
- The source of the funding shortfall of $6.5 billion has not yet been determined.
- The Government faces a challenge to return the budget to a sustained surplus.
- The starting point for this year's budget is expected to be weaker than forecast in part because a weaker global economy is affecting tax revenues.
- This suggests the NDIS cannot be funded from surpluses.
- Funding via redistribution of existing budget allocations is likely to be unpalatable and make ERC processes more difficult.





Source: Commonwealth Budget Papers 2011-12, Deloitte Access Economics Budget Monitor November 2011.

An alternative NDIS funding option is required.

[1] Productivity Commission estimates (2011) although subject to confirmation.

Overview of funding options that exist for the NDIS

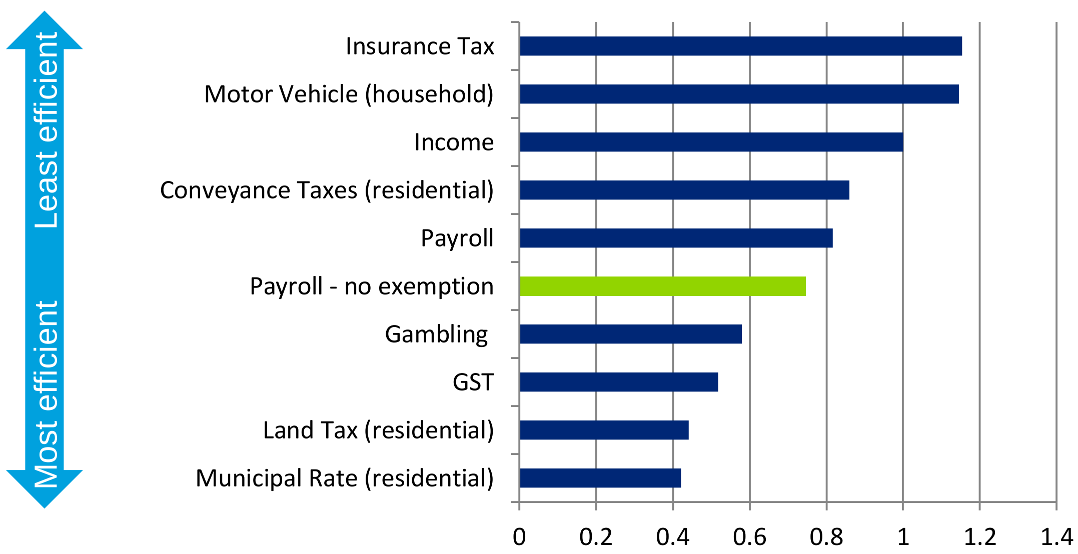
Alternative NDIS funding options	Increase personal income tax	Increase GST rate	Reintroduce fuel excise indexation	Introduce Commonwealth payroll tax
Overview	• Personal income tax rates increased to a level sufficient to raise the required revenue • This is in effect the default option for the Commonwealth to fund the NDIS	• GST rate increased to level sufficient to raise the required revenue	• Fuel excise automatically rises in line with inflation	• Commonwealth payroll tax with no thresholds / few exemptions
Advantages		• Relatively more efficient tax than personal income tax • Existing collection mechanisms	• Relatively more efficient tax than personal income tax • Tax would be linked to rising prices and would not impact relative prices • Environmental benefits from reduced vehicle use	• More efficient than income taxes as it is not taxing capital • More efficient than existing payroll tax systems with thresholds/exemptions • Easy to administer • Provides the opportunity to make existing State payroll taxes more efficient • Giving access to a new growth tax
Disadvantage		• Any change in the rate has been ruled out by the Government for equity and other reasons	• Any change has been ruled out by the Government • Initially may not provide sufficient revenue	• May be depicted as a ‘new tax’

All options offer some attractions yet some are more efficient than others…

Efficiency rankings should be used to guide selection of an option

- The relative efficiency of various Commonwealth and State taxes are measured by the ratio between changes in real household consumption (a measure of economic welfare) and changes in tax revenue.
- Taxes are ranked from least to most efficient, with efficiency reported relative to the efficiency of personal income taxes. The efficiency rankings include 'notional' State payroll tax with no thresholds and no industry-based exemptions.

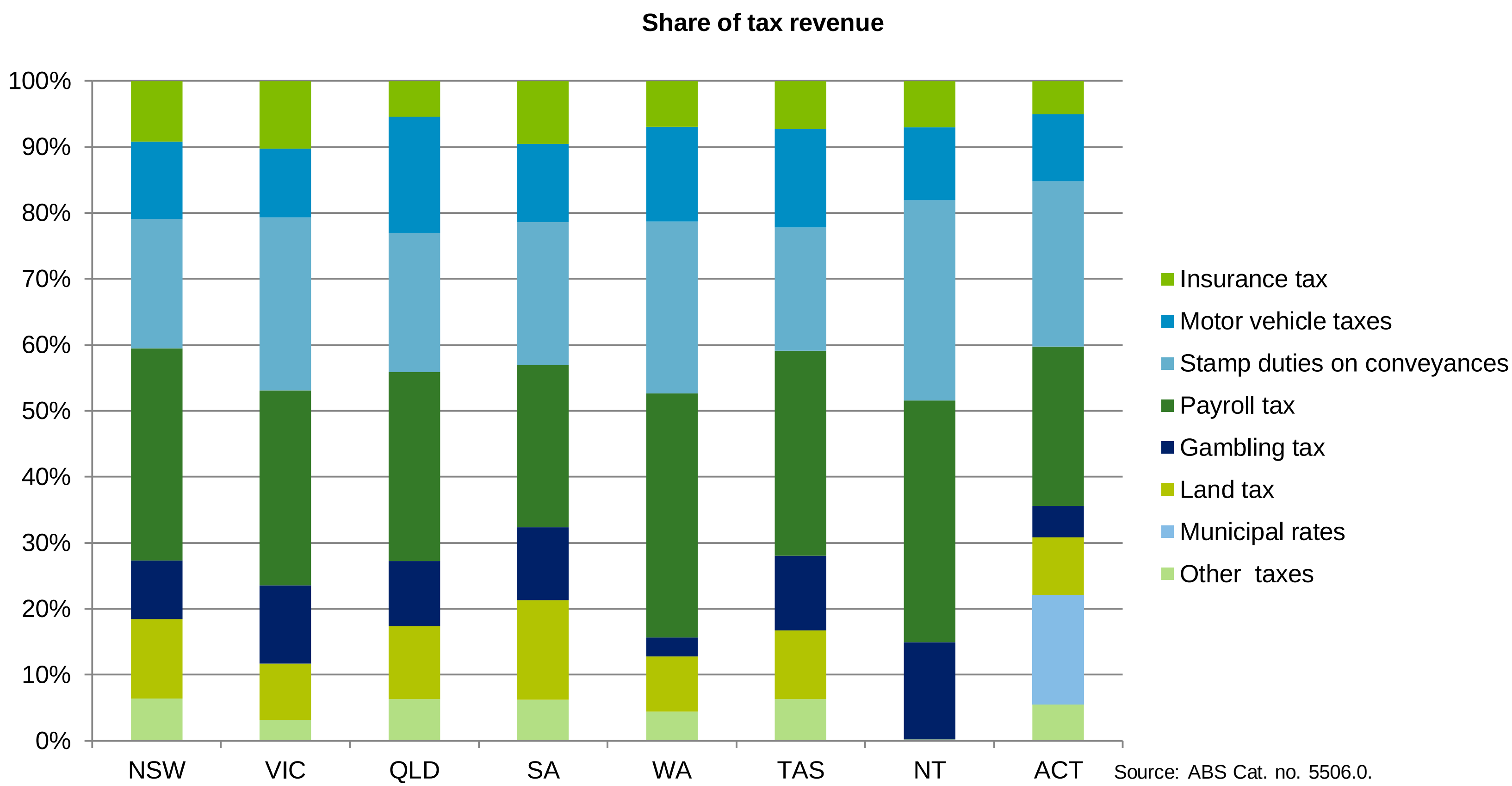
Relative economic efficiency of key Commonwealth and State taxes



Source: Deloitte Access Economics estimates.

Funding options for NDIS should take into account efficiency rankings of taxes

State/Territory revenues are dominated by highly inefficient taxes



Source: ABS Cat. no. 5506.0.

Payroll tax is the largest single tax contribution across most States/Territories. State governments are heavily reliant on inefficient tax bases – insurance taxes and stamp duties (on conveyancing, motor vehicles) account for 30% - 43% of tax revenues.

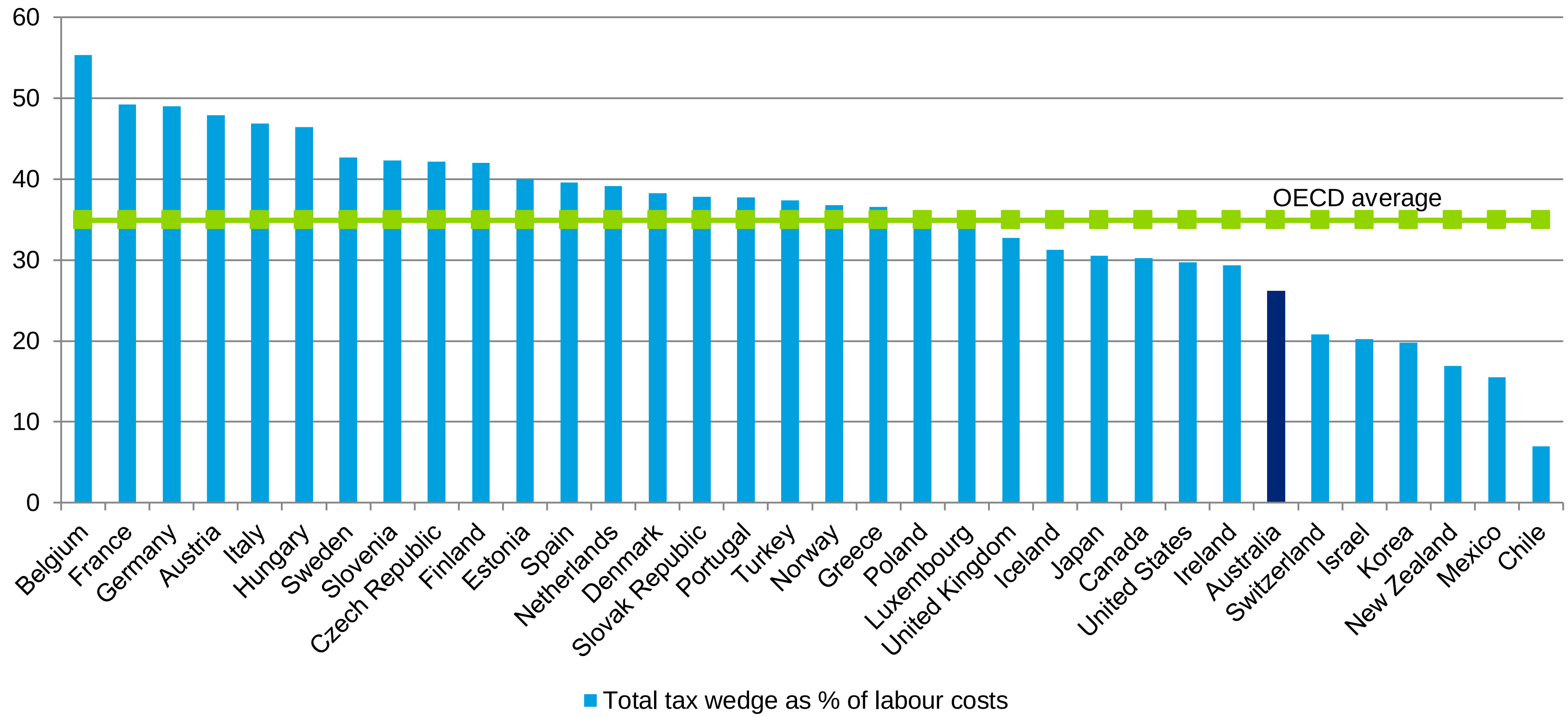
Could NDIS be used as the catalyst for broader tax reform?

- Discussions at the Tax Forum in October 2011 identified reform of inefficient State taxes as high priority and tasked the NSW and Queensland Treasurers with developing a State tax reform plan.
- Little or no progress against this commitment can be evidenced to date.
- The NDIS implies that new revenue sources are needed which presents a challenge.
- By selecting a funding option that assumes total funding of disability services from the States, the Commonwealth could:
    - Fund the NDIS whilst concurrently delivering efficiencies around the tax collection mechanism
    - Enable substantive State tax reform by removing budgetary impediments to the abolition of inefficient taxes
    - Improve the State taxation bases, namely payroll, and provide States with a new growth tax

Depending on the option selected, NDIS offers a real opportunity to enable fundamental State tax reform.

Labour taxes in Australia

- The labour tax wedge in Australia is lower than the OECD average, with a relatively low tax burden on individuals and payroll.



Tax wedge = income and payroll tax plus employee and employer social security contributions, minus transfers.

Source: OECD, *Taxing* Wages, 2011.

Tax wedge for single individual earning the average wage with no dependents.

Labour taxes make up a lower share in Australia relative to international comparisons.

What are the impacts of alternative NDIS options on the economy?

The funding options are modelled assuming that the Commonwealth fully funds the NDIS. Inefficient State taxes are reduced to the extent that States no longer have to make outlays for disability support and services.

Funding options modelled:[2]

- **Scenario A**: Commonwealth raises $11.2 billion from an increase in personal income tax;
- **Scenario B**: the Commonwealth raises $11.2 billion from the reintroduction of fuel excise indexation;
- **Scenario C**: the Commonwealth raises $11.2 billion from a Commonwealth exemption free payroll tax. Within this scenario, States have two options:
    - **Scenario C1**: the States make no changes to their existing payroll tax arrangements (that is, a dual system of payroll tax from both the Commonwealth and the States);
    - **Scenario C2**: the States 'base share'[3] this payroll tax to reform their payroll tax systems for the equivalent amount of revenue.

Key assumptions:

- The Commonwealth will need to raise an additional $11.2 billion on top of the $2.3 billion already being spent on disability support. Of this, $4.7 billion will be used to offset State tax reforms and net $6.5 billion will be raised to fund the NDIS.
- Under all scenarios the States remove $4.7 billion of their most inefficient State taxes, with taxes on insurance being the first to be abolished, followed by motor vehicle stamp duties. This assumption is consistent with the proposition that the NDIS be used as a means of initiating State tax reform.
- The participation effects of the NDIS are the same for each scenario modelled.

[2] using a multi-sector/multi-region general equilibrium model of the economy.

[3] States use the Commonwealth payroll tax base for their own payroll taxes and set their own tax rate above the Commonwealth rate.

An exemption/threshold free payroll tax is most efficient

The NDIS is designed to improve welfare and these effects are not modelled here. The NDIS transfers resources from one group to another, with the additional $6.5 billion raised in taxes returned to the NDIS participants.

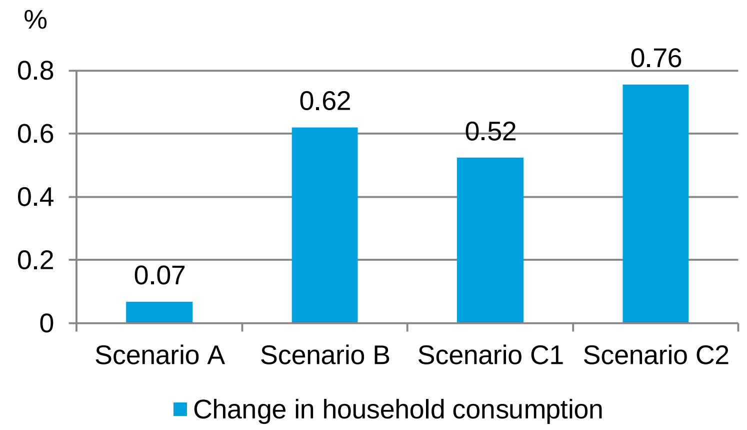
The efficiency losses arising from the extra $6.5 billion in taxes is more than offset by the efficiencies resulting from removing the $4.7 billion in inefficient State taxes.

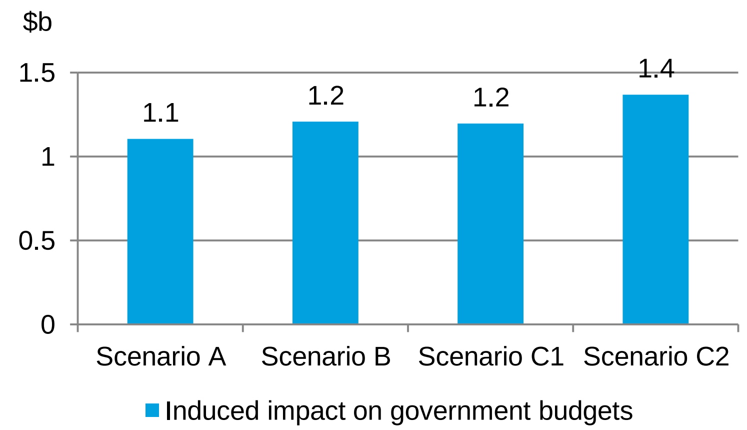
This results in an increase in economic welfare as measured by household consumption. This increase is largest for Scenario C2.

The abolition of inefficient State taxes in favour of more efficient options increases economic activity which results in an increase in tax revenues.

This is largest for Scenario C2 as there are additional efficiencies arising from reforming the inefficient State payroll tax bases.

The positive induced impact on government budgets reduces the size of tax increases required to raise funds for the NDIS.





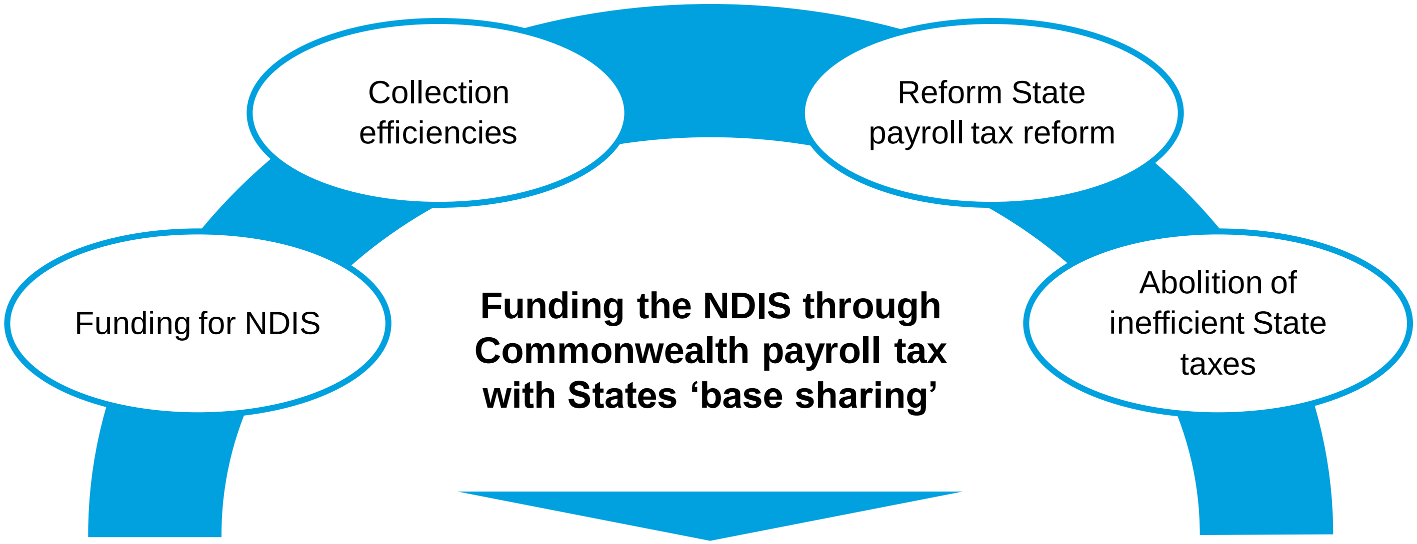
Increased consumption and reduced pressure on government budgets.

Rates for an exemption/threshold free payroll tax system

	Current headline payroll tax rate (%)	New payroll tax rate with no exemptions/thresholds (%)
Commonwealth	-	1.81
New South Wales	5.45	3.01
Victoria	4.90	2.71
Queensland	4.75	2.33
South Australia	4.95	2.27
Western Australia	5.50	3.17
Tasmania	6.10	2.31
Northern Territory	5.50	2.16
Australian Capital Territory	6.85	1.56

A Commonwealth payroll tax would only need a rate of 1.81% to raise the required $11.2 billion. By removing thresholds/exemptions, States can lower rates while maintaining existing revenues.

An exemption/threshold free payroll tax delivers significant benefits



$11.2 billion for NDIS
0.76% increase in household consumption
Additional $1.4 billion in tax revenue

No exemption Commonwealth payroll tax –delivering funding and reform.

What would a national payroll tax scheme to fund NDIS look like?

The Australian Government can fully fund the Commonwealth's responsibilities to the NDIS (estimated to be $13.5[4] billion). through a relatively efficient[5], broad-based payroll tax with limited exceptions.

Properly structured, this could deliver:

Collection efficiencies	• The collection agency can utilise existing mechanisms, i.e. the Business Activity Statement (similar to the Superannuation Guarantee Levy) • The tax will be administratively simple and compliance would be relatively straightforward • The States can then opt-in to use this platform to collect their own payroll taxes. If States do opt-in, they would not be penalised by the Grants Commission – it would remain a separate income stream that is not considered when determining GST allocations
Improving the efficiency of State payroll taxes	• Removal of inefficient minimum thresholds/exemptions in existing State payroll tax systems • Harmonisation of the payroll tax base across all States • States still retain flexibility and can determine their own rate of payroll tax at their own discretion, taking into account interstate competitiveness, and without compromising VFI
Broader State tax reform	• Currently, States cannot afford to abolish inefficient taxes from their budgets • If the Commonwealth assumes full funding responsibilities for the NDIS, States can use the outlay savings from disability services (estimated to be $4.7 billion) to remove the most inefficient State taxes (such as insurance taxes and stamp duties)

[4] Existing Commonwealth outlays of $2.3 billion, existing State outlays of $4.7 billion and additional $6.5 billion needed for the NDIS.

[5] The Henry Review noted that payroll taxes are one of the more efficient taxes, although the existing payroll tax is estimated to have a relatively high welfare cost, reflecting the effect of the tax-free thresholds.

Supporting materials

Budget outlook for States

$ million	2010-11	2011-12	2012-13	2013-14	2014-15
New South Wales	1,264	-718	292	156	152
Victoria	517	148	220	909	1,273
Queensland	-2,127	-4,058	-1,293	-873	-529
South Australia	-53	-367	-453	-234	334
Western Australia	784	442	768	787	471
Tasmania	-32	-114	48	-15	2
Northern Territory	384	95	-11	-28	-37
Australian Capital Territory	20	-37	-24	2	57
Total – all states	757	-4,609	-453	704	1,723

Source: State Budget Papers 2011-12.

Distribution of State/Territory revenue

2009-10 ($ million)	NSW	VIC	QLD	SA	WA	TAS	NT	ACT
Payroll	6,158	4,056	2,687	900	2,298	271	152	273
Property	6,766	5,045	3,447	1,566	2,409	309	127	610
Land taxes	2,296	1,178	1,033	553	519	91	0	98
Municipal rates	0	0	0	0	0	0	0	188
Stamp duties on conveyances	3,739	3,604	1,978	787	1,615	163	126	283
Other	120	204	298	183	248	36	0	33
Government borrowing guarantee levies	439	52	112	29	28	18	0	0
Other stamp duties	172	7	26	14	0	0	1	8
Gambling	1,706	1,632	927	401	176	99	61	53
Insurance	1,761	1,403	508	347	428	64	29	57
Fire service levy	554	538	0	0	0	17	0	0
Third party insurance taxes	135	140	59	52	0	4	0	0
Taxes on insurance n.e.c.	1,073	725	449	295	428	43	29	57
Motor vehicle taxes	2,255	1,437	1,651	435	895	130	46	114
Stamp duty on vehicle registration	587	573	398	145	332	32	21	29
Other	1,668	865	1,252	290	564	98	25	84
Other	504	168	155	0	0	0	0	21
Total revenue	**19,150**	**13,741**	**9,375**	**3,649**	**6,206**	**873**	**415**	**1,128**

Source: ABS Cat. no. 5506.0.

What are the impacts of alternative NDIS options on the economy?

	Scenario A Increase in personal income tax	Scenario B Reintroduction of fuel excise indexation	Scenario C1 Commonwealth payroll tax	Scenario C2 Commonwealth payroll tax with States 'base sharing'
State taxes removed	-$4.7b	-$4.7b	-$4.7b	-$4.7b
Commonwealth income tax increase	$11.2b			
Commonwealth payroll tax			$11.2b	$28.1b
State payroll tax				-$16.9b
Fuel excise increase		$11.2b		
Total additional tax raised (partial equilibrium)	$6.5b	$6.5b	$6.5b	$6.5b
Induced impact on government revenues	$1.1b	$1.2b	$1.2b	$1.4b
Change in household consumption	0.07%	0.62%	0.52%	0.76%

A payroll tax with no thresholds/exemptions is the most efficient funding option

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