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## B State and Territory budgetary assistance estimates

### B.1 Introduction

Under Australia's federal system, State and Territory governments (hereafter 'the States') have constitutional responsibility for a number of functions that affect the development of businesses and industries in Australia. They supply or regulate many essential services and plan and fund much general infrastructure. They develop and enforce many forms of social, economic and environmental regulation that affect business practices, and they levy taxes on land, payrolls and the like. And they are responsible for the delivery of public health care, schooling, vocational education and other community services that affect the human side of economic development and the attractiveness of a state or territory as a place for doing business. Thus, the role of State governments in industry and economic development differs in some important ways from that of the Commonwealth.

As part of their activities, State governments also provide significant selective assistance to business and industries in all sectors of the economy. The States operate a number of programs that are designed specifically to enhance business and industry development. Some assistance also arises incidentally, as a by-product of the pursuits of goals not directly related to industry development, such as in social, cultural or environmental policies.

Budgetary assistance to industry, which is a key form of assistance at the State and Territory level, is delivered in a variety of ways. It includes various grants and loans, tax concessions, subsidies for research, promotional activities or staff training, as well as support to help industry adjustment. Local producers may also benefit from subsidised infrastructure or services provided by the government free of charge, such as information, advice and the facilitation of planning approvals.

To provide an indication of the extent and nature of this assistance, for this year's *Trade & Assistance Review* the Commission has prepared estimates of State government budgetary assistance to industry, for the years 2000-01 and 2001-02. Similar estimates were last published as part of the Industry Commission's 1996

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inquiry into *State, Territory and Local Government Assistance to Industry* (IC 1996), which included estimates for the years 1994-95, 1995-96 and 1996-97.<sup>1</sup>

Measuring State budgetary assistance to industry is not straightforward. There is no universally agreed definition of government assistance to industry — the concept can be defined narrowly or broadly. A further problem is that the level of information that is publicly available about particular government programs varies from jurisdiction to jurisdiction. It also varies between portfolios within jurisdictions, and sometimes between different programs within particular portfolios. This hinders consistency in measurement and makes it difficult in some cases to determine whether, and to what extent, a particular program falls within the adopted definition of assistance.

In its 1996 inquiry, the Industry Commission expended considerable effort in determining whether particular State budgetary programs provided assistance to industry. It undertook a number of rounds of consultation with State governments and their officials, it received additional information from other inquiry participants, and it obtained further feedback on its methodology and estimates through its draft report process.

For the estimates in this *Review*, the Commission has adopted as its starting point the definition of industry assistance, and the general classification of programs that provide State assistance to industry, from the 1996 inquiry. To differentiate between ‘core’ industry assistance programs and other programs that provide incidental assistance to industry, the Commission has further classified the different programs in the estimates according to their principal objective. The Commission has also attempted to classify the programs according to the sector they benefit. Finally, the Commission has included estimates of the extent of payroll tax concessions provided for businesses by the States.

The estimates and classifications have been derived mainly from information in State and Territory budget papers. Where available, information has also been incorporated from the annual reports of State government departments, Auditor-General reports and AusIndustry’s business information service. The Commission circulated a draft of its budgetary outlay estimates, and later its program classifications, to State Treasuries for feedback. In turn, in most cases the Treasuries consulted with officials in the relevant government agencies in their jurisdiction.

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<sup>1</sup> The Commission has decided not to update its estimates for assistance provided by local governments, which were relatively small (\$220 million in 1994-95) and resource-intensive to compile.

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While the estimates aid transparency and can facilitate broad comparisons between jurisdictions, data and informational limitations mean that the estimates should be treated only as indicative. For example, as discussed below, some forms of assistance that may appear in the budget statements of one jurisdiction will not necessarily appear in the budget statements of another, at least not in a form that is readily discernable and quantifiable. The Commission has also encountered problems in obtaining expenditure information for some portfolios or programs at a sufficient level of disaggregation to allow it to make precise estimates of the sectoral allocation of assistance and, in some cases, the allocation of assistance according to the principal objective of the program that delivers the assistance. In such cases, the funding generally<sup>2</sup> has been allocated to the sector or objective category deemed to be the predominant recipient of the program's assistance. It should also be noted that classifying a particular program as providing industry assistance does not, of itself, indicate the policy merits or demerits of the program.

In this appendix, the Commission:

- defines assistance and discusses the coverage of the estimates (section B.2);
- presents data on State budgetary outlays, in summary form (section B.3); and
- provides estimates of the revenue forgone from State payroll tax concessions to businesses (section B.4).

Detailed State-by-State estimates are provided in appendices C to J.

## **B.2 Coverage and classifications**

### **Definition of industry assistance**

Under section 10(6) of the *Productivity Commission Act 1998*<sup>3</sup>, industry assistance is defined as:

... any act that, directly or indirectly: (a) assists a person to carry on a business or activity, or confers a pecuniary benefit on; or (b) results in a pecuniary benefit accruing to, a person in respect of carrying on a business or activity.

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<sup>2</sup> In the case of the estimates for New South Wales, there are significant gaps in the funding data available at the sub-program level for the State Development portfolio. The Commission used program criteria and descriptions, and information in Public Accounts Committee reports, to derive a rough estimate for the purposes of allocating of the sub-programs' funding between the regional and general industry development objectives classifications.

<sup>3</sup> A similar definition of industry assistance was contained in the *Industry Commission Act 1989*.

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The Commission's assistance estimates focus on those government measures that support business or industries in a *selective* manner. Selective assistance includes measures that promote individual firms or particular projects (for example, firm-specific investment incentives or assistance for special events) and, more broadly, measures that encourage the development of an industry or sector (for example, the exemption of certain mining activities from paying a generally applied mineral royalty). In other cases, selective assistance can favour certain firms on the basis of their characteristics, such as size (for example, small business funding and payroll tax concessions), location (for example, regional assistance), or the particular activities they undertake (for example, R&D or exports).

### *Industry coverage*

For the purposes of its assistance estimates, the Commission interprets 'industry' broadly to include any economic activity of organisations or individuals. Thus, in accordance with section 10(3) of the *Productivity Commission Act 1998*, industry thus includes not only 'traditional' goods industries such as agriculture, manufacturing and mining, but also services industries such as retailing, banking, construction, tourism, professional sports, entertainment and the arts.

Excluded from the coverage of the estimates in this report are government expenditures on:

- health, education, welfare and governance;
- general infrastructure provision (although infrastructure spending is included where it clearly relates to a particular project or industry/activity);
- recreational, amateur and community sport (although spending on professional sports and events is included); and
- libraries, zoos and botanic gardens (although expenditure on art galleries and museums, film production and other arts support is included).

### *Components of expenditures*

The estimates of State budgetary assistance are measured as government outlays on assistance programs or 'outputs' *excluding* user charges, industry contributions and Commonwealth grants.

In compiling the estimates, the Commission has sought to:

- include both the assistance provided and, where identifiable, the administrative costs of providing such assistance;
- exclude expenditure related to the policy areas of government departments;

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- exclude expenditure related to contracting out on the basis that, of itself, it does not represent assistance but is rather a ‘business’ decision of government. Only where contracting out contains conditions relating to local sourcing or other ‘economic development’ goals would an element of assistance be attributed to such arrangements; and
  - exclude expenditure on the general regulatory functions of government (but include government regulatory expenditures in relation to a few industries, such as mining, which benefit from special provisions in the application of occupational health and safety and environmental regulation, on the basis that this represents an additional cost to society resulting from these industries that should be reflected in the cost and pricing structure of the mining industry.)

#### *Assistance arrangements not covered*

For the current exercise, the Commission has not measured all possible State assistance arrangements, especially where they do not involve budgetary outlays. The availability of suitable data on a consistent basis across different jurisdictions precludes such an exercise, and in some cases it can be difficult to detect arrangements that provide assistance without detailed investigation of a particular scheme in its business and industry setting.

The assistance arrangements that are not covered in the current exercise include:

- Victoria’s flexible electricity tariff management arrangement, which provides a subsidy (estimated at \$150 million per year) to aluminium smelters in that State and is financed by a levy on Victorian electricity consumers, rather than from the budget (Victorian Auditor-General 2002b);
- tax (other than payroll) concessions — such as land tax and stamp duty exemptions which are reported in the budget papers of some States but not in others; and
- State regulations and arrangements that restrict competition.<sup>4</sup>

It should also be noted that the Commission’s assistance estimates exclude a range of government expenditures that might commonly be seen as supporting or promoting industry development. For example, the Commission excludes expenditure on the provision of general infrastructure, such as road funding. It has also excluded the significant subsidies that the South Australian and Northern

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<sup>4</sup> Some of these arrangements, relating to agriculture, are captured in the Commission’s national assistance estimates (section 3.4 in chapter 3). Others, such as regulations applying to the professions in each jurisdiction, are captured in the Commission’s estimates of restrictions on trade in services (section 3.5).

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Territory Governments have provided for the Adelaide to Darwin rail link — some \$225 million in 2000-01 — notwithstanding the local industry development rationales put forward in support of those subsidies.

### **Classification of sectoral incidence**

To provide an indication of the industry incidence of State budgetary assistance, the Commission has classified the estimates using the basic four sector classification of the economy that it uses for its national assistance estimates, together with a residual. The sectoral categories are:

- primary production — agriculture, fisheries and forestry;
- mining;
- manufacturing;
- services; and
- unallocated.

Given the goals of the current exercise, the Commission deemed that it would not be worthwhile to attempt to disaggregate the estimates further — for example, into the 36 industry groupings for which the Commission compiles its national estimates.

### **Classification of program objectives**

The programs contained in the Commission's estimates have a range of objectives. Some of the programs have multiple objectives and, in some cases, the objectives or the priority given to different objectives is not immediately clear.

To differentiate between 'core' industry assistance programs and other programs that provide incidental assistance to industry, the Commission has classified the different programs in the estimates according to their principal objective.

#### *Industry development programs*

The assistance programs in this category are defined as those with the principal objective of supporting, maintaining or expanding an industry's (or industries') production or value. The definition includes programs that focus on supporting, maintaining or expanding the production level or value of particular projects or businesses within an industry or industries.

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Examples of programs that fall within this definition are:

- export market development programs;
- tourism marketing programs; and
- general funding of research and development activities.

#### *Regional industry development programs*

Assistance programs in this category are defined as those programs with the principal objective of industry development (as described above) in regional areas only. ‘Regional areas’ in this context refers to areas outside the main urban/metropolitan centre in each state.

Examples of programs that fall within this definition are:

- investment incentives for regional development;
- regional tourism marketing programs; and
- regional business networking programs.

In these cases, the primary aim could be considered to be industry development, or it could be considered to be regional development or decentralisation. Even where the latter objective predominates, such programs can be considered to be ‘core’ industry assistance programs.

Not all programs with a ‘regional’ flavour fall into this category. Some programs may be regionally focused but may have an ‘other’ objective — for example, funding for regional art galleries has a predominantly cultural objective.

Further, some programs that are aimed at industry development have a regional effect due essentially to the location of the target industry. For example, assistance to the agriculture or mining industries has its main effect in regional areas. However, on the basis that this primarily reflects the location of the industry, rather than a regional development objective, the Commission has allocated such programs to the general industry development category.<sup>5</sup>

For programs that provide project- and firm-specific assistance, it can be difficult to determine whether the assistance has a general industry development objective or a regional industry development objective, as sometimes regional considerations are

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<sup>5</sup> Conceptually, one test of whether an assistance program has a predominantly ‘regional development’ objective is whether the recipients of the assistance would still be entitled to that assistance under the program’s criteria if, hypothetically, they were engaged in the activity in a metropolitan area, rather than in a regional area

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one of the criteria considered by governments in assessing applications for such assistance. However, unless there is a clear indication that the focus of the program is to develop industry in regional areas, it has been allocated to the general industry development category.

#### *‘Other’ and ‘not classified’ programs*

This residual category contains programs that have the effect of assisting industry but are deemed not to have general or regional industry development as their primary objective. Rather, in these cases, industry assistance arises as a by-product of pursuit of an ‘other’ objective by government, such as preventing personal injury, protecting the environment and promoting a more equitable society.

Examples include:

- government funding of art galleries, museums and some film production — which can be classed as having a primary objective that is cultural;
- government funding of occupational health and safety regulatory services in relation to the operation of mines — which may be seen as having a primary objective of reducing death and injury; and
- programs intended to promote the advancement of members of disadvantaged groups within the workplace or business world — which may be seen as having a primary objective of equity.

This category also includes programs that are ‘not classified’. These are programs for which the Commission has not determined, with reasonable confidence, whether the program has an industry development, regional industry development or ‘other’ principal objective.

Thus, the ‘other or not classified’ category contains:

- some programs with industry development or regional industry development as their principal objective (but which has not been ascertained with reasonable confidence); and
- all programs with an ‘other’ principal objective.

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## Some 'special' cases

### *Professional sport, events and the arts*

The Commission's estimates include government expenditures on professional sports as well as the funding of high-profile 'events' and 'games' and associated facilities. The staging of events in many Australian states and territories is often carried out by government-owned companies or agencies, such as the Queensland Events Corporation and the Canberra Events and Tourism Corporation, often with industry or economic development as a key goal or justification for public expenditure on the events. While such events may generate an array of benefits, including non-economic benefits, the public funding of such events nevertheless provides assistance to industries such as tourism. In terms of their principal objectives, the Commission has included all assistance to professional sports and events in the 'other and not classified' category. However, where governments have established separate programs, such as the NSW Olympic Business Roundtable Program, specifically to leverage business and investment activity from the staging of events, those programs have been classed as having an 'industry development' objective.

The Commission's estimates of State assistance include a range of programs that support the arts industry. They include programs that directly subsidise producers of art works and films, and expenditure on art galleries and museums. The funding accounts for around 20 per cent of the total estimates, of which just under half funds the major metropolitan art galleries and museums.

The funding is included in the estimates partly on the basis that museums and art galleries provide assistance to the tourism industries. International tourists make up around a quarter of total visitors to art galleries and major museums (Casey and Werner 2001), and visits to major museums are often incorporated into tourist package tours. Domestic visits to museums are also counted as tourism.<sup>6</sup>

Publicly-funded activities undertaken by museums and art galleries can also add to the income of artists and commercial art galleries, and influence the demand for certain art works. The recent Report of the Contemporary Visual Arts and Craft Inquiry (Myer 2002, 207-210) found that functions performed by art galleries and museums are 'a vital mechanism to support and promote contemporary visual art and craft work'. The Industry Commission's 1996 inquiry also documented some

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<sup>6</sup> The ABS defines tourism broadly to include any visits by people for leisure purposes. According to this definition, most visits to museums and art galleries can be identified as relating to tourism.

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examples of art industry development policies — such as the Arts 21 program in Victoria — which include funding of museums and art galleries at the State level.

Nevertheless, a proportion of this expenditure could well be excluded because, for example, it might be deemed to have only educative or non-economic effects. This highlights the grey areas that can emerge when attempting to define industry assistance and classify programs accordingly.

For the present exercise, the Commission has followed the approach taken in the Industry Commission's 1996 inquiry of including all such funding in its estimates. The Commission intends to explore the nature and effects of government support to the arts sector (and professional sport) in more detail in a separate research project next year.

### *Resource management programs*

Grey areas can also emerge in relation to some government programs that involve resource management issues.

The estimates exclude expenditure related to the administration and management of State-owned resources such as minerals and forests (for example, resource assessment including expenditure on mapping and exploration). The benefits from these activities could be expected to be incorporated in State royalty receipts.

On the other hand, the estimates do include expenditure on information gathering and the management of fisheries. As the benefits of these activities accrue to the participants in the industry, the taxpayer funding of them is considered assistance to the industry. Some agricultural programs also have a resource management component.

The total value of the programs with a resource management component included in the estimates was around \$330 million in 2001-02.

In relation to the programs' objectives, while the expenditures included in the estimates have generally been necessitated by the previous operation of the primary production industries, it could be argued that these programs have a primarily 'environmental' objective and thus should be categorised as 'other' programs. However, on the basis that the principal objective underlying the resource management is 'to support, maintain or expand the extent of an industry's or industries' production level or value', albeit over the longer-term, the Commission has categorised these programs as industry development programs.

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## B.3 Budgetary outlays

The Commission's estimates of State budgetary outlay assistance to industry, based on the foregoing definitions, classifications and methodology, are summarised below. Comprehensive tables for each State, setting out the details of the outlays included in the estimates, are provided in appendices C to J.

### Total outlays

The estimates indicate that State and Territory governments together outlaid around \$3 billion in 2000-01, and \$3.3 billion in 2001-02, on programs that provide assistance to industry (table B.1). As indicated earlier, some relatively minor tax concessions are included in these figures.

Table B.1 **State budgetary assistance outlays, by jurisdiction, 2000-01 and 2001-02**  
\$ million

	2000-01	2001-02
New South Wales	829	751
Victoria	543	778
Queensland	624	732
Western Australia	383	375
South Australia	320	374
Tasmania	116	121
Australian Capital Territory	38	54
Northern Territory	132	126
<b>Total</b>	<b>2 986</b>	<b>3 310</b>

Source: Commission estimates.

### Objectives

Of the total figure for 2001-02, at least \$1.9 billion was directed to programs with a general industry development objective (table B.2). The actual figure may be larger as some of the programs in the 'other and not classified' category may have industry development objectives.

A further \$173 million was directed to programs classified as having a regional industry development objective. This estimate should also be considered to be a lower bound, for two reasons.

- First, as with the general industry development programs, some regional industry development programs may have been placed in the ‘other and not classified’ category.
- Second’, and more significantly, the way the regional industry development category has been defined, in conjunction with the way the Commission has classified various programs, means that some significant assistance expenditures that support regional industries have been excluded from the category.

Were spending on primary production and mining to be included in this category, the total expenditure on regional industry development would have amounted to some \$1.3 billion in 2001-02.

The estimates also include \$1.2 billion of programs for which the principal objective of the program is unclear, or for which industry assistance arises incidentally in the pursuit of an ‘other’ objective, such as an environmental, cultural or equity goal.

**Table B.2 State and Territory budgetary assistance outlays, by objectives, 2000-01 and 2001-02**  
\$ million

	2000-01	2001-02
General industry development	1 721	1 942
Regional industry development	116	173
Other or not classified	1 149	1 196

*Source:* Commission estimates.

## Sectoral incidence

In relation to the sectoral incidence of assistance, the Commission has had place a number of programs in the ‘unallocated’ category due to difficulties in locating sufficient information on the program beneficiaries. The Commission received little feedback from State Treasuries in relation to this aspect of the draft estimates that it circulated for comment.

Even so, the clear majority of program funding covered in the estimates is directed towards the services sector — some \$1.5 billion in 2001-02 (table B.3). Of this, at least \$360 million was industry assistance delivered through general or regional industry development programs (table B.4), mostly for tourism. However, most of the programs included in the estimate for services have ‘other or not classified’ objectives. These include programs directed towards the arts industry and major professional sporting events.

Primary production attracted almost \$1 billion of industry assistance from State outlays in 2001-02. Although less in dollar terms than the estimates for the services sector, this assistance represents substantially more as a proportion of sectoral gross product.

The mining sector receives little assistance from State government outlays.

The estimates also record little assistance for the manufacturing sector, but these figures are likely to be an underestimate. This is because a number of the programs in the ‘unallocated’ category appear likely to predominantly assist businesses and industries in the manufacturing sector, along with some businesses in parts of the services sector. Most of these programs come under the ambit of the relevant State departments with responsibility for ‘industry’ or ‘state development’. These departments generally have a limited role in relation to the provision of assistance to the mining and primary production sectors, which have their own, dedicated agencies. Further, the limited information publicly available on program beneficiaries suggests that a significant proportion of the companies and industries assisted by these departments involve manufacturing operations. Were three quarters of the unallocated category to assist manufacturers, the total for the sector would be around \$600 million in 2001-02. By the same token, were just half of the unallocated category to assist the manufacturing sectors, its total would be around \$430 million in 2001-02.

**Table B.3 State and Territory budgetary assistance outlays, by sector, 2000-01 and 2001-02**  
\$ million

	<i>2000-01</i>	<i>2001-02</i>
Primary production	918	971
Mining	121	136
Services	1 360	1 438
Manufacturing	58	93
Unallocated <sup>a</sup>	529	673

<sup>a</sup> The category includes a number of programs in which there were limited information available about beneficiaries of assistance. This has precluded allocating the programs to a particular sector.

Source: Commission estimates.

**Table B.4 State and Territory budgetary assistance outlays, by sectors and objectives, 2000-01 and 2001-02** (\$ million)

	2000-01	2001-02
Primary production	918	971
– General industry development	906	959
– Regional industry development	2	1
– Other or not classified	9	11
Mining	121	136
– General industry development	54	62
– Regional industry development	..	..
– Other or not classified	66	74
Services	1 360	1 438
– General industry development	318	358
– Regional industry development	1	1
– Other or not classified	1 041	1 079
Manufacturing	58	93
– General industry development	58	93
– Regional industry development	..	..
– Other or not classified	..	..
Unallocated <sup>a</sup>	529	673
– General industry development	384	471
– Regional industry development	112	170
– Other or not classified	33	32

<sup>a</sup> The category includes a number of programs in which there were limited information available about beneficiaries of assistance. This has precluded allocating the programs to a particular sector.

Source: Commission estimates

## B.4 Tax concessions

In addition to budgetary outlays, State governments also provide industry assistance through concessional arrangements to the taxes they levy.

### Types of concessions

State governments provide concessional arrangements to firms, usually large and ‘footloose’ firms, on a case-by-case basis after negotiations between the firm and the government. This firm-specific assistance primarily takes the form of tax holidays, concessional rates or rebates to State taxes, most notably to land and payroll taxes, and are usually phased out after a specified period of time. In

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addition, the value of the concession may be conditional on the firm meeting agreed targets (eg the number of jobs created) and can give rise to ‘contingent liabilities’, where the actual amount of the future concession is unknown but capped at some maximum level. As noted earlier, some of these concessions are recorded along with the outlays data set out in the previous section, although they are not identified separately. Indeed, details of these firm-specific assistance arrangements are nearly always kept confidential.<sup>7</sup>

Industry also benefits from across-the-board concessional tax arrangements that apply to all firms (eg tax-free thresholds) or those engaged in particular activities (eg social welfare activities). Even though they apply to all firms, the presence of the tax-free threshold effectively discriminates among firms on the basis of size, as it causes the average effective tax rate to increase with the size of the payroll.<sup>8</sup> The latter concessions favour firms in the social-welfare related industries. The Commission does not include these in its assistance estimates.

A general tax threshold is justified at some level because of the administration and compliance costs involved in collecting the tax, particularly small amounts of tax from a very large number of small businesses. Up to some point, these costs will outweigh the revenue collected.

However, the levels at which the general tax thresholds are presently set (table B.5) are hard to justify on those grounds (see box B.1).

### *Estimates of tax revenue foregone*

A number of State budget papers publish estimates of the tax revenue foregone from exemptions to their taxes (table B.6). By their own estimates, the amount of revenue foregone is substantial. However, the coverage and detail of the costing of tax revenue foregone varies considerably among States. For example, New South Wales does not cost the revenue foregone from its tax-free threshold. Victoria has estimated that the same exemption reduced its payroll tax revenue by \$1.4 billion (Victorian Government 2001, 311). Thus, the estimates in the budget provide an incomplete picture of the amount of revenue foregone. The extent of this incompleteness varies between States.

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<sup>7</sup> The ACT is a notable exception, as it publishes the details of the tax concessions it grants in the annual report of the Chief Minister’s Department (2001, 125-7).

<sup>8</sup> Firms with a payroll less than the tax-free threshold are exempt from payroll tax, while firms with a payroll above the threshold pay tax on the amount exceeding the threshold (table B.5). The payroll tax schemes in Queensland and Western Australia effectively ‘claw back’ the tax-free threshold so that, above a certain level, tax is payable on the entire payroll. Hence, larger firms pay proportionately more tax on their payroll than do smaller firms, many of which pay none.

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### Box B.1 **Are existing payroll tax thresholds tax-efficient?**

In its simplest form, an efficient payroll tax threshold will equate the marginal revenue foregone at the threshold with the marginal cost of collecting that revenue. Given that collection costs are positive, some form of tax-free threshold will be efficient.

To illustrate, the payroll tax threshold in New South Wales — which is broadly representative of those in other states — was \$600 000 in 2000-01 with an average marginal tax rate for the financial year of 6.30 per cent (table B.5). This means that the revenue foregone per firm at the threshold was \$37 800 (ie \$600 000 x 6.30%).

Collection costs consist of:

- the compliance costs incurred by firms in meeting their legal obligations; and
- the costs incurred by the government in collecting the revenue.

The average cost to firms of meeting their payroll tax obligations varies significantly. Most of the studies reviewed by Commission staff (Lattimore 1998, 30) found compliance costs of between \$1000 to \$5000 per firm for firms employing less than 20 employees, a figure roughly equating to a payroll of \$600 000.

The administration costs of collecting payroll tax are relatively low. The NSW Budget Papers allocated \$10.7 million to collect \$4515 million of payroll tax revenue in 2000-01 (NSW Government 2001, 19-37—19-38). This translates into an average collection cost of \$2.35 per \$1000 of payroll tax revenue.

If the tax-free threshold was lowered, the average collection costs for each additional taxpayer would undoubtedly be higher due to higher additional processing and enforcement costs per extra dollar of revenue obtained. However, in the absence of suitable data, it is unclear how much higher they would be. Were they 10 times the current average for smaller firms, administration costs would still be in the order of \$25 per \$1000 of revenue collected. On this basis, the administration cost on the payroll tax revenue foregone at the tax-free threshold would be less than \$1000 per firm.

Thus, conservative interpretations of the available evidence suggest that total collection costs on a payroll of \$600 000 are likely to be in the order of \$6000 per firm, considerably less than the \$37 800 revenue foregone at the threshold. This suggests that the payroll tax threshold is considerably higher than could be justified on tax-efficiency grounds.

Although beyond the scope of this study, a more comprehensive assessment of an efficient payroll tax threshold would also take into account:

- the effect of payroll tax on labour supply and labour demand;
- any production inefficiencies flowing from the non-neutral treatment of firms of different sizes; and
- the welfare losses associated with other State taxes which potentially could be reduced were the payroll tax threshold increased.

*Source:* Estimates based on NSW Government (2001) and Lattimore (1998).

**Table B.5 Payroll tax regimes, 2000-01**

<i>State/Territory</i>	<i>Type of scheme</i>	<i>Tax-free threshold</i>	<i>Maximum marginal tax rate</i>
New South Wales	Single marginal rate	\$600 000	6.40% (from 1 Jun 2000) 6.20% (from 1 Jan 2001)
Victoria	Single marginal rate	\$515 000	5.75%
Queensland	Deduction system	\$850 000	4.90%
South Australia	Single marginal rate	\$456 000	6.00%
Western Australia	Marginal rates	\$675 000	5.56% <sup>a</sup>
Tasmania	Single marginal rate	\$606 000	6.53%
Northern Territory	Single marginal rate	\$600 000	6.60%
Australian Capital Territory	Single marginal rate	\$850 000	6.85%

<sup>a</sup> Rate applying to payrolls exceeding \$5.625 million.

Source: NSW Treasury (2001, 12).

To provide an upper bound on the extent of industry assistance from these exemptions, the Commission has calculated an alternative estimate of the payroll tax revenue foregone from businesses other than those in the social welfare sector. To this end, it has compared the actual amount of payroll tax collected by the States from the relevant industries with the revenue that they could have raised without the exemptions and concessions.<sup>9</sup> This process updates the payroll tax revenue estimates for 1993-94 published in the 1996 report (IC 1996, 12). (Those estimates focused only on payroll tax revenue foregone, because the exemptions associated with other taxes have less of an industry assistance focus and are harder to cost.) The resulting estimates indicate that the tax revenue foregone from payroll tax in 2000-01 was approximately \$5 billion (table B.7), only marginally higher than the States' own estimates (table B.6).<sup>10</sup> This represents an increase of around 60 per cent in nominal terms over the equivalent figure for 1993-94 (table B.8).

This increase is predominantly due to growth in wages and salaries, and thus the potential tax take, rather than changes in the rate of State tax concessions. The States have benefited from strong growth in the payroll tax base, which grew by 45 per cent in nominal terms over the same period.<sup>11</sup> This has enabled them to raise

<sup>9</sup> The payroll tax bases used are the ABS estimates of employee compensation in all non-social welfare industries (ABS 2001). The exclusion of all social welfare industries — defined here to be *Government administration and defence, Education and Health and community services* — may understate the size of the payroll tax base as the for-profit part of these industries are often subject to payroll tax. Hence, the true revenue cost of the general exemptions may be higher and the revenue cost of the social welfare exemptions lower than suggested.

<sup>10</sup> The social welfare exemptions are estimated to cost an additional \$7.7 billion Australia-wide.

<sup>11</sup> This growth in the tax base varied between States with the Northern Territory and Queensland experiencing the strongest growth, while Tasmania and South Australia experienced the weakest growth.

additional revenue despite raising the tax-free threshold and lowering the marginal tax rates. Had the States kept the same payroll tax rates in place as they had in 1993-94, they could have collected an addition \$1.5 billion from non-social welfare payrolls in 2000-01 (table B.9).

**Table B.6 Budget estimates of payroll tax revenue foregone, 2000-01<sup>a</sup>**  
\$ million

<i>Exemption</i>	<i>NSW</i>	<i>Vic.</i>	<i>Qld</i>	<i>SA</i>	<i>WA</i>
Social welfare <sup>a</sup>	523.2	363.0	197.2	108.0	6.5
General business exemptions <sup>b</sup>	na	1 441.0	691.1	240.3	517.0
Design of payroll tax system <sup>c</sup>	122.5	120.0	75.0	na	14.5
<b>Total revenue foregone</b>	<b>645.7</b>	<b>1 925.0</b>	<b>963.9</b>	<b>357.6</b>	<b>538.0</b>
Payroll tax revenue collected <sup>d</sup>	3,981	2,540	1,170	570	833
Potential payroll tax revenue	4,627	4,465	2,134	928	1,371
Share of potential revenue (%)	14.0	43.1	45.2	38.6	39.2

<sup>a</sup> Exemptions costed in budget paper have been grouped into the three categories of exemptions listed. Tasmania, the Northern Territory and the ACT do not publish comparable estimates. <sup>b</sup> Exemptions applying to hospitals, local government, education, philanthropic institutions and employment assistance. <sup>c</sup> Revenue foregone from the definition of payroll, the cost of operating a deduction scheme (Queensland only) and the exclusion of Commonwealth Government departments and agencies from payroll tax. <sup>d</sup> Actual payroll tax revenue collected as published by the ABS.

Source: NSW Government (2001, B-15–B.16); Victorian Government (2001, 311); Queensland Government (2001a, 56); Government of South Australia (2001a, Appendix E, 4); Government of Western Australia (2001b, 211); and ABS (2002d, 14)

**Table B.7 Potential payroll tax revenue foregone, 2000-01**  
Excluding social welfare industries<sup>a</sup>

<i>State/Territory</i>	<i>Actual payroll tax revenue</i>	<i>Potential payroll tax base</i>	<i>Average effective tax rate<sup>b</sup></i>	<i>Potential revenue foregone<sup>c</sup></i>
	\$ million	\$ million	%	\$ million
New South Wales	3 981	92 168	4.32	1 826
Victoria	2 540	65 420	3.88	1 222
Queensland	1 170	39 872	2.93	784
South Australia	570	15 351	3.71	351
Western Australia	833	23 762	3.51	488
Tasmania	165	3 774	4.37	81
Northern Territory	95	2 430	3.91	65
Australian Capital Territory	158	3 725	4.24	97
<b>Australia</b>	<b>9 512</b>	<b>246 503</b>	<b>3.86</b>	<b>4 914</b>

<sup>a</sup> Excludes *Government administration and defence, Education and Health and community services*. <sup>b</sup> *Actual payroll tax revenue expressed as a share of the Potential payroll tax base*. <sup>c</sup> *(Maximum marginal payroll tax rate - Average effective tax rate) x Potential payroll tax base*.

Source: Estimates based on ABS (2002d, 14); and ABS (2001, 29-46).

**Table B.8 Payroll tax revenue foregone, 1993-94 and 2000-01**  
Excluding social welfare industries<sup>a</sup>

<i>State/Territory</i>	<i>1993-94<sup>b</sup></i>	<i>2000-01<sup>c</sup></i>	<i>Change</i>
New South Wales	1 105	1 826	721
Victoria	765	1 222	457
Queensland	278	784	506
South Australia	161	351	190
Western Australia	192	488	296
Tasmania	59	81	22
Northern Territory	45	65	20
Australian Capital Territory	37	97	60
Australia (current prices)	2 628	4 914	2 286
<b>Australia (constant prices)</b>	<b>3 034</b>	<b>4 914</b>	<b>1 881</b>

<sup>a</sup> Excludes *Government administration and defence, Education and Health and community services.*

<sup>b</sup> Revenue foregone estimated using wages, salaries and supplements as the tax base. <sup>c</sup> Revenue foregone estimated using compensation of employees in 2000-01. The ABS estimates of compensation of employees in 1993-94 is essentially the same as its estimates of wages, salaries and supplements.

Source: Estimates based on IC (1996, 12); NSW Treasury (2001); ABS (2001, 29-46); and ABS (2002d, 14).

**Table B.9 Effect of payroll tax rate changes on potential payroll tax revenue foregone, 1993-94 to 2000-01**  
Excluding social welfare industries<sup>a</sup>

<i>State/Territory</i>	<i>Maximum marginal tax rate 1993-94</i>	<i>Maximum marginal tax rate 2000-01</i>	<i>Change in maximum marginal tax rate</i>	<i>Potential payroll tax base 2000-01</i>	<i>Potential revenue foregone 2000-01<sup>b</sup></i>
	%	%	% points	\$ million	\$ million
New South Wales	6.85	6.30	-0.55	92 168	507
Victoria	7.00	5.75	-1.25	65 420	818
Queensland	5.00	4.90	-0.10	39 872	40
South Australia	6.10	6.00	-0.10	15 351	15
Western Australia	6.00	5.56	-0.44	23 762	105
Tasmania	7.00	6.53	-0.47	3 774	18
Northern Territory	7.00	6.60	-0.40	2 430	10
Australian Capital Territory	6.85	6.85	0.00	3 725	0
<b>Australia</b>				<b>246 503</b>	<b>1 512</b>

<sup>a</sup> Excludes *Government administration and defence, Education and Health and community services.*

<sup>b</sup> Change in maximum marginal tax rate from 1993-94 to 2000-01 x Potential payroll tax base in 2000-01.

Source: Estimates based on IC (1996, 641), NSW Treasury (2001, 12); and ABS (2001, 29-46).