The Case for Reviewing Income Tax Zone Rebates

A report jointly commissioned by:

Regional Development Australia - Darling Downs & SW

for advocacy on behalf of:

The Shires of Bulloo, Quilpie, Paroo, Murweh and the Maranoa Regional Council

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Submission Summary

RDA DD&SW and the five South West LGA's of Bulloo, Quilpie, Paroo, Murweh and Maranoa commissioned Ian Manning, Economics Australia, to update the 2001 report into Regional Income Tax Zones. For 66 years, Income Tax Legislation has included provisions to reduce the tax which would otherwise be payable by residents of remote areas. The major report into the tax system prepared by the Australian Treasury in 1969 (the Henry report) referred to these provisions as the 'zone tax offset'. The current report does not comprehensively examine the offset provisions but does make clear the following recommendations:

(a) 'To remove complexity and ensure government assistance is properly targeted, concessional offsets should be removed, rationalised or replaced by outlays.

(b) 'The zone tax offset should be reviewed. If it is to be retained, it should be based on contemporary measures of remoteness.'

This review has yet to materialise at the Commonwealth level. The remote area tax rebate continues to be offered at rates which were last adjusted in 1993 and have therefore been significantly eroded by inflation. As of September 2011, the rebate was worth around 62 per cent of its value in 1993.

Effective alterations to the Income Tax Zones may provide significant advantages to the ability of remote shires to attract and retain non-resource workers to their towns.

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Brief summary

Remote-area Zone rebates or allowances have been a feature of the Australian Income Tax since 1945 and the social security system since 1984. In 2009 the Henry Report on the Tax System recommended that they should be reviewed, but no action has been taken.

Zone rebates accord with each of the major purposes of the tax system.

- The promotion of economic efficiency and economic development, chiefly by supporting the costs of infrastructure provision in remote areas and so assisting the pastoral and mining industries (where there is a case for compensation for the incidental effects of macroeconomic policy on these industries) and also assisting tourism, defence and indigenous development.

- The ability to pay principle – in this case compensation for lower real incomes due to higher outback prices.

- The benefit principle – recognition of the higher cost of access to essential services from outback areas.

As the Henry review expected, there is also a case for a review of Zone boundaries, of the residence requirements and in particular of the rates, which have not been indexed since 1993.

This paper presents the case for a review.

Income tax Zone allowances and rebates

For 66 years the Income Tax has included provisions to reduce the tax which would otherwise be payable by residents of remote areas. The major report into the tax system prepared by the Australian Treasury in 2009 (the Henry report) refers to these provisions as the ‘zone tax offset’. The report admits that it does not examine the zone offset in any detail but its basic attitude is clear from the wording of its Recommendation 6:

> *“To remove complexity and ensure government assistance is properly targeted, concessional offsets should be removed, rationalised or replaced by outlays. [...]*
>
> *(b) The zone tax offset should be reviewed. If it is to be retained, it should be based on contemporary measures of remoteness.”*

This review has yet to materialise. The remote area tax rebate continues to be offered at rates which were last adjusted in 1993 and have therefore been significantly eroded by inflation. As of September 2011 all classes of Zone rebate were worth around 62 per cent of their value in 1993 (adjusted by the Consumer Price Index for Darwin). Longer term comparisons are more difficult because of changing consumption patterns, rising incomes and the switch from tax deductions to rebates. Updating by the Consumer Price Index the current Zone A rebate is worth roughly 70 per cent of the value of the Zone A rebate to a single worker on average earnings in 1948, but in relation to average weekly earnings the current Zone A rebate is worth only a quarter of its value in 1948.

Given the recent lack of indexation, it appears that the remote area rebate is fated to fade away. This paper outlines the case for retaining and updating it.

1. History of income tax concessions for remote areas

In its present form, the Australian income tax dates from the Second World War. To pay for the war, the Commonwealth increased its rates of income tax considerably and incorporated the various state income taxes into its own tax. When the fighting ended the enhanced income tax continued to be collected, largely to pay for post-war investments in national development and also to enhance the social security system. In line with contemporary practice, the tax featured a schedule of rising marginal rates.

At the time, Australia was experiencing full employment and both businesses and governments resorted to paying ‘district and regional allowances’ to attract workers to remote and tropical jobs, many of which were considered of high priority for national development reasons. Much of the benefit of these supplements was clawed back by the Commonwealth through its marginal tax rates – at the time the top marginal rate was over 75 per cent though the marginal rate for a typical worker was around 18 per cent. In 1945 Zone Allowances were introduced in the form of deductions from taxable income for taxpayers resident in regions where workers commonly received district or regional allowances to compensate them for ‘disabilities of uncongenial climatic conditions, isolation or relatively high cost of living’. Zone Allowance was made available to all taxpayers who spent at least six months of the tax year living in a Zone, not merely those who received district or regional allowances.

Two Zones were defined. Zone A comprised the Australian tropics apart from the Queensland east coast south of Cape Tribulation, and Zone B included the Queensland coast from Cape Tribulation south to Sarina plus the following: a belt of inland Queensland adjacent to Zone A; the far west of NSW, the far north of SA, the WA goldfields and the west of Tasmania. From the beginning, and to this day, Zone A attracted a greater Allowance than Zone B.

In 1955 the Zone A boundary was extended south to the 16th parallel.

From 1958 Zone Allowances were complemented by loadings on the deductions for dependants which had long been a feature of the tax system.

In 1975 the Zone Allowance was converted to a rebate. The additional allowances for dependants were also converted to rebates and Zone residents became entitled to percentage additions to their basic dependent rebates. When rebates for children were merged into Family Allowance payments they remained as an element in the Zone rebate system.

A Public Inquiry into Income Tax Zone Allowances was conducted in 1981. As a result of this inquiry the Zone dependant rebates were increased. A second important change was the creation of Special Areas, defined as places within Zone A or Zone B located more than 250 km by the shortest practicable surface route from the nearest town with more than 2500 people as of 1981. The rebate in the Special Zone has been set at 3.47 times the Zone A rebate.

Finally, in 1984 Remote Area Allowances were introduced as supplements to all the major income-support social security payments. Remote Area Allowances are available to pensioners and some beneficiaries who are permanent residents of Tax Zone A and Special Tax Zones located within Zone B. They are not available in the non-special parts of Zone B. The allowances are paid at the same rate without distinction between the Special Zones and the rest of Zone A. Though not part of the income tax system, these allowances are an obvious complement to the Income Tax Zone rebate. Taken together, they mean that the Commonwealth provides income allowances for nearly all permanent remote-area residents.

2. The Cox Inquiry

The 1981 Cox Inquiry is the only review of the system to date and is therefore worth considering in detail. The four members of the Public Inquiry into Income Tax Zone Allowances called for submissions and arranged public consultations. After going through this process they found that their views diverged so that the team of four members produced three reports with different recommendations. The main report was signed by the Chairman (P E Cox) and S G W Burston and, with reservations, by the other two members. G Slater prepared a minority report with alternative recommendations and A M Kerr added a statement in which he endorsed some recommendations and varied others. However, the Cox inquiry was unanimous in recommending that Zone allowances should continue; the differences between its members concerned the geography of eligibility and the rates of allowance.

It is likely that in any future review much the same arguments will be considered and similar divergences will emerge. We will accordingly base our discussion of the purpose of the rebates on the points raised in 1981. We will also ask whether conditions have changed so as to affect the relevance of the arguments, keeping in mind two obvious differences since 1981:

- the real value of the rebates has declined through failure to index them; and

- the income tax rebates are now complemented by social security entitlements.

There have also been various other, more subtle changes since 1981 and indeed since 1945.

3. The incidence of zone rebates

Serious discussion of remote area rebates is only possible if we know who they benefit. As compared with a situation where rebates are not available, do they benefit employees, granting them higher disposable incomes, or do they benefit employers, allowing them to reduce cash pay rates?

When remote area allowances were introduced in 1945 it was assumed that they were essentially a benefit to employers who would be enabled to attract labour with lower remote-area loadings than would have been required in the absence of the tax allowance. However, much recent discussion of the equity of zone rebates assumes that they have no effect on pay rates and therefore the rebate benefits the employee. It is hard to make a definitive judgement since the answer depends on an unobservable variable: what would remote area wage rates be in the absence of the zone rebate?

Tentative answers are as follows.

- Where the rebate is large (as it was, in relation to wage rates, when the provision was first introduced), it is hard to argue that it will not affect at least some wage rates. When this happens at least some of the benefit will accrue to employers, who may increase the level of remote-area employment in response. Per contra, when the rebate is small (as it is now, in relation to wage rates) it is less likely to be taken into account in wage negotiations.

- Where wage rates are fixed by centralised wage-setting authorities without regard for geographic area, it is more likely that the benefit will accrue to employees. When wage rates are set by ‘the market’, it is more likely that the rebate will be taken into account in setting wage rates and will therefore accrue to employers.

Given the erosion of the value of the rebate in relation to wage rates one would expect a trend towards its benefiting employees rather than employers. However, the trend away from centralised wage determination to bargained rates has increased the chances that the rebate will benefit employers. These two trends cancel out, and the best that can be said is that the incidence of the rebate is likely to vary with circumstances. By contrast, the remote area allowance in social security unambiguously increases the income of its recipients.

4. Decentralisation and industry development

The Second World War was a shock to Australia's sense of security. One reaction to this shock was to seek to raise the national population and in particular to populate the North – those vast regions with population densities way below those not so far away in Asia. It was also believed that there were significant unutilised resources in the North and that exploitation of these resources would be of national benefit. Tax incentives were an obvious element in policies to populate and develop the North.

4.1 'Develop the North'

In 1945 it was commonly believed was that one of the hindrances to populating and developing the North was the 'uncongenial climate'. For decades up until the Second World War most tropical countries were under the control of the European Powers as colonies. In these countries the colonialists managed and the natives worked. The racial division of labour in the tropical colonies meant that the idea that people eligible to be citizens of White Australia could do all the work necessary to develop tropical Australia was still somewhat novel. Populating the North would be a great national experiment and there was a sense that the nation as a whole should participate in the experiment by providing cash rewards to people who went North.

During the 37 years separating the original provision of Zone Allowances and the Cox Committee's hearings in 1981 the Australian population doubled, but not in the pattern envisaged by those who sought to populate the North – the growth was based on manufacturing and much of it occurred in the cities, reflecting deliberate policies of industry development. The Committee held its hearings at a time when Australia was debating government involvement in industry development, particularly tariffs. Tariff cuts were a cause celebre in remote areas where it was argued that abandoning protection would provide a major stimulus to local export industries including pastoral production and mining. It was even argued that, in the absence of tariff cuts, Zone rebates were justified as compensation for the costs of protection. Three decades on, tariffs have been cut, the mining and pastoral industries continue their cycle of boom and bust (currently boom) and the argument for Zone rebates as compensation for tariffs has disappeared. The Australian population has grown by a further 50 per cent, still mainly in the major cities and their immediate surrounds but with one significant change: Darwin has moved from backwater status to become a vibrant if small city.

During the post-war period the cry to develop the North became muted. The memory of recent conflict faded and various high-profile investments to develop the North struck economic trouble (e.g. Humpty Doo rice, the Ord River Dam). At the same time Australians became less anxious about their capacity to survive and work in the tropics, though to this day Australian tourists avoid the North and Centre during the hot and wet seasons. Despite these subsiding anxieties, the Cox Inquiry took the idea of compensation for uncongenial climate seriously. They observed that no place in Australia has a completely congenial climate – everywhere there are episodes when it is too hot or too cold or too wet or too dry. However, some places are less comfortable than others. According to a meteorological discomfort index which emphasises heat and humidity, the most uncongenial region extends eastwards from Kununurra. Even in this area it is now possible (at an expense) to create congenial indoor, car- driving and plant-operating conditions by air conditioning. If air-conditioning is the answer, there is no need for compensation for uncongenial climate but there may be a case for compensation for the cost of air conditioning and, for that matter, for the cost of heating in cold places.

Interest in population geography did not disappear when the metropolitan electorates forgot about populating the North, but was replaced by the promotion of decentralisation, which meant getting jobs out of the capital cities to reduce congestion costs. This argument for decentralisation was, however, irrelevant to Zone rebates since it was not necessary to move more than a moderate distance from the capital cities to avoid congestion – indeed, longer moves into the remote regions tended to increase transport costs.

Though decentralisation provided no more than weak support for Zone rebates, there was still the argument that it was in the national interest to encourage the development of remote-area resources. Though this argument was important in 1945, the Cox Inquiry gave it relatively little attention. All members of the Inquiry, despite their divergences in other respects, seem to have been persuaded that resource development would be better pursued by other means. They provided very little discussion of what these other means might be, though in the 1980s there was a rising body of opinion which held that development should be left to the private sector. The Cox Inquiry concluded that Zone rebates were justified on grounds of 'horizontal equity' but not on industry development grounds. We will consider the equity arguments below, but will first reconsider the economic development arguments.

4.2 The structure of the outback economy

Discussion of the economic development argument for Zone rebates not only requires assumptions about incidence (employee or employer?) but a definition of the remote areas. It would be possible to adopt current tax definitions – Zone A, Zone B, the Special Zone – but, as the Henry report pointed out, these Zones are in need of review. Remote areas can be conceptualised in two main ways.

- Regions of low population density which either lack urban centres or have few and isolated towns.

- Regions with limited agricultural resources apart (perhaps) from small irrigated oases.

The two concepts are related, with the low population density the result of the limited resource base. For the purpose of this discussion the remote area, or outback, will therefore be defined as country where there is no, or very little, arable or forest land. By this definition Victoria, Tasmania and the ACT do not contain any remote areas. In WA, SA and NSW the remote areas comprise all country outback of the wheat-sheep belt and in Queensland all country west of the Maranoa, the Peak Downs and the Tablelands back of Cairns. All the NT is remote except Darwin and its immediate surrounds. To avoid confusion with 'remote Australia' as defined by the ABS (see below), we will refer to this area as the outback.

Though the outback lacks arable land and hence has few farmers, it is by no means lacking in pastoral and mineral resources. This is reflected in the industry distribution of the approximately 150 000 jobs (1.6 per cent of the national total) which were located in the outback in 2001 (Table 1).

Table 1 Outback employment by industry, 2006

Industry	Percentage of outback total	Percentage of industry
Mining and associated manufacturing	22	25.6
Pastoral, fishing, hunting, associated manufacturing	5	8.0
Other agriculture and forestry	1	0.9
Tourism	3	3.0
Defence	1	1.8
Government services inc health, education	30	1.9
Construction, transport, trade	29	1.2
Finance, information, professional services	9	0.7

Source: 2006 Census Journey to Work tables.

Three industries were over-represented in outback employment: mining (including associated manufacturing such as smelting and equipment repair), the pastoral industry (plus fishing, hunting and a few meatworks) and tourism (in so far as this can be separated from the more general accommodation and transport industries). Defence and general government service employment was present at slightly above national average rates while all other employment was under-represented in relation to the national average. In particular, the outback generates few jobs in finance, information, professional and scientific services.

4.3 Arguments for assistance to outback economic development

Several strands of argument for assistance to outback economic development can be distinguished. Two of the arguments are familiar from the history of Zone rebates.

- The strategic and moral argument that Australia wishes to occupy, and be seen to occupy, its whole national territory, and to take such measures as are necessary to defend it.

- The argument that resources should be developed.

The question is whether, given the range of policies available, Zone rebates are an efficient means towards achieving these ends. In addition, a new argument has arisen.

- In 1945 and even in 1981 the proponents of developing the North tended to overlook the fact that much of remote Australia was already occupied by indigenous people, admittedly at low density but including regions where a century of efforts to develop profitable settler enterprises had failed. Over the past thirty years indigenous occupation has been recognised by the award of native title over significant parts of remote Australia to Traditional Owners. Social and environmental changes mean that these owners and their families can no longer live on their traditional lands as hunter-gatherers. Though some remote indigenous communities have an assured economic base, many of them depend on a mixture of Centrelink payments and government employment. It is beyond the scope of this paper to enter into the current vigorous debate about the economic future of these communities but it is fair to ask whether Zone rebates may have a role in generating ‘real jobs’ for them.

The economic development argument for Zone rebates thus resolves into the judgement that it is desirable to develop remote areas more rapidly than would take place under 'hands off' policies and that Zone rebates make sense as a component of the resulting economic development policies.

If the benefit of Zone rebates goes to the employee, they may be interpreted as an incentive to employees to undertake remote area work. If the benefit of Zone rebates goes to the employer, they may be interpreted as an incentive to employers to create remote area jobs. Though the discussion could be cast in terms of either interpretation, the present discussion will assume that the benefit of the rebates goes to employers and reduces the cost of remote-area labour. It is, in effect, a wage subsidy.

At this point it must be conceded that the effectiveness of wage subsidies in generating remote area employment and economic development is likely to vary across the outback and also between remote area industries. However, outback areas have several features in common.

- Their industry structure is thin. Typically they have only one or two economic base industries plus support services.

- Their economic base industries are typically trade-exposed – indeed, most are export industries directly dependant on overseas markets.

These characteristics leave the remote areas subject to several market failures.

- Along with other tradable industries, they are exposed to over-valuation of the exchange rate. Australia's chronic balance of payments deficit provides evidence that the exchange rate is, on average, over-valued and that, to correct this, trade-exposed (particularly export) industries should be encouraged vis a vis trade-sheltered industries. This applies to trade-exposed industries generally but is crucial in the remote areas due to their dependence on such industries.

- Not only is the exchange rate over-valued; it fluctuates unpredictably. In addition to the price fluctuations generated by international markets, the trade-exposed industries are further exposed to price fluctuations generated by movements in the exchange rate. Current policy is to welcome these movements for their contribution to short-term macroeconomic management but they have the serious side-effect of increasing the level of risk borne by long-lived investment in the trade-exposed industries. Much of the investment required by outback industries is long-lived, consisting as it does of property improvements and transport infrastructure. Once again there is a case for policies to ameliorate this side-effect.

- This industry structure and low population density mean that the remote areas depend more heavily than others on government provision of infrastructure. An example is telecommunications, which are commercially highly profitable in high-density areas but not so in low-density areas.

These arguments will surface in various forms as we discuss the major outback industries. As shown in the above discussion above, mining now dominates the outback export industries. However, it remains that pastoral production is the classic, and most widespread, outback export industry. We will consider it first.

4.4 Pastoral production

From first settlement the pastoral industries - wool and beef – were seen as the economic mainstay of the outback, as they still are in Western NSW, Western Queensland, Northern SA and much of the NT. Judged by employment, they dominate the economic base of shires such as Central Darling (NSW), Barcoo and Boulia (Qld). In such shires pastoral production may be augmented by hunting (feral goats, kangaroos). Some of the coastal outback supports a fishing industry which, like hunting, is run by small businessmen.

When considering the importance of sheep and cattle in the outback it is important to remember that pastoral production also occurs elsewhere, including in the wheat/sheep belt and hilly pastoral areas such as New England and the Monaro. Is it reasonable to argue for Zone rebates for the remote part of the pastoral industry while denying them to the same industry where it operates in closer-settled regions?

4.4.1 Managing a high-risk industry

Government policy towards the remote-area pastoral industry is discussed in a companion piece to the present paper which deals with the position in South West Queensland. Experience in South West Queensland and indeed in the pastoral industry as a whole is that the industry is high-risk as the succession of good and bad seasons interacts with fluctuating commodity prices and the risk-increasing effects of fluctuating exchange rates. For the best part of two centuries the pastoral industry has proved its resilience, not only to price fluctuations but to the sequence of good and bad seasons. Resilience involves prudent accumulation of reserves during the good times and maintenance of capacity during the bad – it is hard to take advantage of the next in the capricious series of booms without productive capacity in place.

Reserves can be accumulated in different ways. One way is cash and off-property investments but another is by making improvements to the property. The pastoral industry has traditionally used a combination of off-property and on-property investment to employ funds generated in the upswings of the seasonal and commodity cycles. Similarly the maintenance phase can be financed by running down investments (and in dire necessity incurring debt) and by postponing on-property investment – but preferably in a way that does not threaten capacity.

At the regional level, these business strategies can be complemented by government action. When the pastoral industry is in a boom phase, government can help to release local resources to participate in the boom by restricting itself to maintenance. When the pastoral industry is in maintenance phase, it is appropriate for governments to attempt to take up the slack, investing in infrastructure as a contribution to readiness for the next boom. It is, of course, as difficult for governments as for businesses to make the necessary financial arrangements, exercising discipline during booms and countering despondency during periods of slack activity, but this is no excuse for not trying.

In this discussion we have assumed that fluctuating commodity prices are inevitable. It has often been pointed out that steady capacity utilisation would be less wasteful than the current alternation between the costs of over-capacity production and the costs of underutilised capacity. While steady prices sufficient to generate a moderate rate of profit minimise costs, there is no known way to achieve this steadiness in commodity markets. The chief lesson from Australia's long and sorry history of government schemes to stabilise of agricultural markets is that intervention at the industry level is hazardous, to say the least, and that governments are best restricted to general counter cyclical policy including the maintenance of infrastructure and its extension during times when activity levels require support.

4.4.2 The case for remote area wage subsidies in the pastoral industry

Against this background, can a case be made for Zone rebates to assist the remote-area pastoral industry? Since the rebates have to be financed, it may be assumed that they (slightly) increase tax rates in non-remote areas and therefore (slightly) reduce employment in these areas. Can a case be made for this?

We have already noted an argument on these lines – the claim, in 1981, that zone rebates compensated for the effect of tariffs on remote-area industry costs. With the cuts in tariffs this argument has lapsed, and in any case it drew a long bow. However, it can still be argued that pastoral employment in remote areas should be encouraged through Zone rebates, as follows.

1. Remote areas depend on trade-exposed industries subject to volatile international prices. These industries are important for balance of payments reasons. Price volatility coupled with a finance sector which is unable to provide insurance against medium-term price fluctuations creates risks which, if not managed, will result in these industries having less capacity (and the non-tradable industries having more capacity) than desirable in the overall long-run allocation of resources. It is neither possible nor desirable that the price volatility should be removed. In lieu of removal of price volatility, other ways should be sought to ensure that capacity is maintained, particularly in downturns.

2. The prohibition of direct industry-specific subsidies by World Trade Organisation rules means that indirect industry support measures are relevant. Possible indirect support includes skills training, subsidies to research and market development, government provision of infrastructure and wage subsidies available on a regional rather than an industry basis.

3. The advantages of wage subsidies on a regional basis are stronger than they appear prima facie, in that such subsidies assist the maintenance and development of regional infrastructure (defined broadly to include support services) on which the pastoral industry depends.

4. The case for regional wage subsidies is strongest in the remote areas, due to their high level of risk. Not only are the seasons more variable than in the closer-settled regions but the thin industry structure means that there is little flexibility to turn to alternative sources of income when the pastoral industry is suffering from a downturn.

5. The case for wage subsidies is strongest when the industry is in maintenance phase but can be made generally, in that wage subsidies compensate across the trade cycle for the higher than average (and partly artificial) risks which otherwise result in the pastoral industries attracting less investment than is economically efficient.

The market failure case for wage subsidies in remote areas where the pastoral industry provides the economic base therefore rests on these areas being much more dependent on a trade-exposed industry subject to volatile prices than the rest of the country. Not only are they dependent, they are depend on a community basis; the residents as a whole contribute, through their social networks and support services, to the productive capacity of the pastoral export industry.

Providing wage subsidies to all outback employers, rather than just to the trade-exposed pastoral industry, strengthens the capacity of the region as a whole to support export production while avoiding interference with the market allocation of resources within the remote areas and interfering no more than marginally with the allocation of resources between the remote and non-remote areas. The capacity of local and state governments to maintain infrastructure and the capacity of local service suppliers (retail, equipment maintenance, social facilities) are enhanced along with the capacity of pastoralists to maintain their properties

4.5 Mineral resource exploitation

Though the pastoral industry is the classic outback activity, the mining industry is currently very active in a number of outback regions.

4.5.1 Mineral resource exploitation and the pastoral industry: similarities and differences

The mineral resource industry covers mining broadly defined to include production of metal ores, energy minerals and non-metallic minerals plus mineral exploration, services to mining and related manufacturing activities such as ore beneficiation and heavy equipment repair carried out close to mine sites. This industry has several characteristics in common with the pastoral industry.

- Many of its operations, to the extent of a quarter of total industry employment, are in the outback as defined for this paper.
- The industry is trade-exposed and has to cope with the vagaries of international commodity markets and the Australian dollar exchange rate.
- Like the outback pastoral industry, the mining industry has the choice of making do with the levels of infrastructure provided by the Commonwealth, state and local governments, or providing its own.

Despite the likenesses there are major differences.

- Most parts of the mineral resource industry are capital intensive and wages are a minor proportion of costs. Wage subsidies are therefore unlikely to affect the location or level of industry activity. However, they may affect resource allocation decisions within the industry, particularly resource allocation to labour-intensive industry activities such as site remediation.
- The exploitation of mineral resources is extractive whereas pastoral production is sustainable provided overstocking is avoided. The extractive nature of the industry is reflected in different financial arrangements: miners have to pay royalties to the State governments. The high profitability of the mining industry during the current boom has generated debate as to whether the states and territories are levying sufficient royalties to compensate future generations for the sale of the resource (see discussion in the companion paper). Those who argue that the industry is being subsidised through low royalty payments are likely to argue that it should not receive any further benefits from wage subsidies.
- The exposure of the mining industry to fluctuating exchange rates is limited by the fact that the industry is largely overseas-owned, which means that its capital transactions are carried out in overseas currency rather than Australian dollars. This reduces risk and hence the argument for compensation for uninsurable risk.
- The financial strength of the large overseas-owned corporations which dominate mining lessens the case for wage subsidies.

- Mining industry employment is concentrated in a small number of major outback centres. The four Pilbara shires plus Kalgoorlie and Mt Isa together account for nearly half of total outback mineral resource employment. These workers have access to reasonable urban facilities, which lessens the case for wage subsidies to ease recruitment.

- As noted in the companion paper, the mining industry has adopted a completely different employment strategy to the other remote-area industries, one which may further reduce the case for wage subsidies. As pointed out in the companion paper, many of the firms in the industry have adopted a policy of high wages, low expenditure on workforce development and low job security. A major element in this strategy is fly-in fly-out and the question raised is whether wage subsidies should apply to fly-in fly-out workers.

We will first consider fly-in fly-out and then return to the more general case.

4.5.2 Fly-in fly-out

Currently whether a fly-in fly-out worker can claim a Zone rebate depends on the six month rule. A claim can be made if the worker spends more than six months worth of nights in the Zone during two successive financial years. It is not unknown for employment contracts to be drawn up with an eye to satisfying this requirement. It would be a simple matter to withdraw eligibility from fly-in fly-out workers by extending the residence requirement to (say) ten months in each year, or alternatively to reduce the residence period so as to include visiting professional personnel who stay for shorter periods.

The decision here depends on conceptualisation. If the wage subsidy is simply a wage subsidy to industries which are under-investing due to uninsurable risks arising from price and exchange rate volatility, it would be appropriate to extend it to all persons employed in such industries, whether in remote areas or no. If, however, the wage subsidy is a form of compensation to those who employ the residents of communities which are heavily dependent on the risk-exposed export industries and which contribute to the prosperity of those regions, it is not appropriate to extend it to fly-in fly-out workers. Looked at this way, fly-in fly-out workers should be seen as belonging to the labour markets of their region of primary residence. It was argued in the companion piece that the mineral exploitation industry, with exceptions, has not been highly committed to regional development – and when it is committed to such development, it is likely to develop a resident workforce which would be eligible for remote area rebates under a ten-month rule.

A second argument for excluding fly-in fly-out workers from wage subsidies was also reviewed in the companion piece: fly-in fly-out is perceived as imposing unnecessary costs on workers' families. If this is the case, the least the Commonwealth can do is to refrain from subsidising it. Exclusion of fly-in fly-out workers while continuing to support resident employment provides employers with an incentive to the latter.

It should also be noted that, in so far as fly-in fly-out workers spend their incomes in their places of permanent residence and not in the remote regions, arguments for compensation for high living costs or for high costs of access to public services do not apply to them.

Finally, the extent to which remote area employers resort to fly-in fly-out is also influenced by fringe benefits tax. A review of this tax is beyond the scope of this paper but would have to be incorporated into any considered review of the Zone rebates.

4.5.3 Exploration and infrastructure

Mineral production sites – mines, quarries, well-heads and processing facilities – generally have specialised infrastructure requirements which are, rightly, provided by the industry. However, one crucial part of the mineral industries depends more heavily on general infrastructure – mineral exploration. This is also a high-risk part of the industry because many mineral explorers find nothing. This risk is magnified financially since it arises well in advance of any resulting revenue.

Around 8000 people are employed in mineral exploration nationally, which is a little over 10 per cent of the workforce employed in mining broadly defined. Of these around 1500 work in the outback plus, perhaps, a further 900 or so who work at no fixed address. Even if we add these numbers together, mineral exploration is responsible for less than 2 per cent of outback employment and many of these are likely to be flying-in and flying-out. Employment in mineral exploration is spread across the continent, with concentrations in the capital cities (particularly Perth) and the mining provinces.

Where mineral explorers are engaged in proving up and extending deposits which are already in production they may rely on purpose-built industry infrastructure, but where they are seeking new deposits far and wide they rely on the transport, supply and support facilities that happen to be in place. Support to the providers of these facilities, whether by wage subsidies or otherwise, assists mineral exploration, leading to a case for wage subsidies to infrastructure provision useful to mineral exploration.

The case for wage subsidies to the outback mining industry in general is less strong than for the pastoral industry, particularly in boom times such as the present, but is likely to become stronger when it becomes a question of maintaining capacity during a slump and when the industry is providing infrastructure of general benefit. Wage subsidies also reduce the cost of remediation, thus encouraging the industry to take this responsibility seriously. There is also a case for wage subsidies to outback resident workers as a way of lessening the advantages of fly-in fly-out to employers.

4.6 Defence

Four significant defence complexes are located within the current Tax Zones A and B, at Cairns (Q), Townsville(Q), Darwin/Berrimah (NT) and Katherine (NT). In total, these installations account for 13 per cent of persons employed in the defence of Australia (compared with Canberra, 16 per cent). However, only about 1250 defence personnel are employed in the outback as defined in this paper and they constitute less than 1 per cent of total outback employment.

It may be argued that the Commonwealth does not need to provide itself with wage subsidies in order to employ its own employees – it could equally well charge full taxes and use the proceeds to raise employee wages. On this argument there is no need for Zone rebates for Commonwealth employees, including defence personnel. However, Zone rebates are only a wage subsidy if their eventual incidence benefits the employer; technically they are a tax rebate claimed by employees. It would therefore be administratively inconvenient to deny them to Commonwealth employees while allowing them for other income recipients.

It is more important to note that the effectiveness of defence personnel depends not so much on the location of their bases as on the ease with which they can access the areas which they are to defend. Access is mainly by road, though also by air and sea. Local and state governments have substantial responsibility for roads and airstrips in remote areas. There are no explicit Commonwealth payments which recognise the defence importance of these assets, though this is partly taken into account in Commonwealth grants for roads and other local government expenditures. Wage subsidies assist in equalising costs so that similar amounts of grant yield similar amounts of road maintenance. The main defence argument for outback wage subsidies is thus an argument for infrastructure subsidies.

4.7 Tourism

A number of Australia's major tourist attractions lie in remote regions along with a considerable further number of potential attractions. Remote locations which have developed significant trade over the past three decades include Kakadu, Uluru, Broome and Shark Bay. Many less well-known remote locations have also developed tourism as part of their economic base.

Governments have acknowledged the importance of tourism as an economic activity by regulation to maintain standards and assistance with publicity. They also provide the transport infrastructure which underpins tourism. Remote-area transport infrastructure is undergoing steady improvement which has generated additional tourism activity. However, there are plenty of opportunities to develop the industry further.

The current high Australian dollar is proving that tourism is a trade-exposed industry with a claim on outback wage subsidies not dissimilar to that of the pastoral industry. Like defence it also depends on transport infrastructure, not to speak of basic social infrastructure. In this way it generates an argument for wage subsidies to the provision of outback infrastructure broadly defined.

4.8 Lands in traditional ownership

Much effort has been expended over many decades in trying to find an economic base for communities living on traditional lands, including experiments with agriculture, silviculture, pastoral production, tourism and mining. In some places these experiments have succeeded but, scattered across remote Australia, there remain many indigenous communities which depend on welfare payments and hence on Remote Area Social Security Allowances. When employment is available it benefits from Zone rebates.

Wage subsidies assist the states, local governments and non-profit agencies in provision of welfare-oriented employment (including health services and education). They also assist with the provision of physical infrastructure, including the transport and communication facilities without which there is little hope that 'real jobs' will become available. For example, it is sometimes argued that real jobs could arise in land conservation, including from such measures as the recent Carbon Farming Initiative. These developments will require local transport between communities and the places to be conserved, not to speak of transport facilities for tourists to come and admire the conservation.

4.9 Service employment

The industries discussed so far – the outback export or economic base industries – account for roughly one-third of outback employment (Table 1). The remaining two-thirds comprise employment in various service industries, including transport, trade, education, health services and government services. In discussing the outback export industries the importance of these service industries was emphasised: the economic viability of outback export industries (including defence) depends on infrastructure; that is, on the adequacy of the services provided by the service industries. As a general rule these industries are labour intensive (particularly health and education) and stand to benefit from wage subsidies. Indeed, much of the economic case for outback wage subsidies rests on their contribution to infrastructure provision and the indirect contribution this makes to the export industries.

4.10 The contribution of Zone rebates to outback development

In Section 4.3 it was argued that Zone rebates have a place in encouraging outback economic development and by this means underwriting the effective occupancy of the Australian continent, both by indigenous communities and by the general population. In particular, wage subsidies are helpful in two ways.

- By assisting with the provision of infrastructure in the broad sense, so benefiting the economic base industries of the outback and enabling them to fulfil their role in utilising the resources of the outback to the national benefit.

- By countering high levels of uninsurable risk in the major outback export industries.

Additional benefits arise because the assistance to infrastructure helps with defence and will potentially contribute to the self-improvement of the remote indigenous communities.

5. The Higher Education Contribution Scheme

We have so far considered Zone allowances as primarily an Income Tax provision. However, the provision could be extended to the Higher Education Contribution Scheme. The HECS has many virtues as a means of financing higher education. It is essentially a tax measure since it relies on income tax assessments to recoup, thus avoiding many of the problems of private-sector student loan schemes – though with the corresponding disadvantage that repayment can be avoided by emigration.

An incentive to young professionals to work in the remote areas could be provided by the Commonwealth forgoing HECS repayments which would otherwise have been exacted from residents of remote areas.

It is now time to turn to the equity arguments for Zone rebates considered by the Cox Inquiry.

6. Costs of living

Remote area rebates have frequently been defended as compensation for higher costs of living in remote areas. This is most easily argued if one takes the view that the benefit goes to employees – the concession then goes to increase the taxpayer's disposable income to compensate for higher prices. However, in a free labour market it is likely that price compensation has already been included in the wage package and that the benefit of the rebate goes to employers. In this case the rebate (partly) compensates employers for the higher costs of labour hire in the remote regions, where these costs relate to the higher cost of living.

The Cox Inquiry took the simple approach. If the taxpayer rather than the employer benefits from the rebate, it is arguably fair to that income received should be adjusted for geographic price differentials. Comparing two people on the same cash wage, the one who has to pay higher prices has the lower ability to pay taxes. However, as always there is a contrary argument. If geographic differentials reflect different costs in service provision or different land costs, they have a function in providing incentives to the efficient location of economic activity. Compensation will blunt the incentives. A taxpayer who objects to the higher prices charged in the remote areas has the option of shifting elsewhere and the incentive argument says that this is exactly what he should do; he should not be granted a concession. In this conflict of values the Cox inquiry inclined towards the 'real income' or 'horizontal equalisation' view. Essentially they argued that the incentive effects were less important than the inequity of depressing the standard of living of outback employees.

It is one thing to claim that the cost of living is higher in remote areas than in some reference area, say the metropolitan areas. It is quite another to give this monetary expression. The following observations are more or less agreed.

- Transport costs add to the price of widely-distributed consumers' goods in remote regions.
- In small remote towns there are further additions due to diseconomies of small scale, including less than truck load shipments and/or high warehousing costs for larger shipments. Consumers can avoid these costs only at the considerable expense of driving to a larger town.
- Remote area consumers are further disadvantaged by the limited range of goods and services on offer.
- Housing cost differentials are more complicated – in general, the unimproved value of the underlying land is less than in metropolitan areas but the costs of construction are greater, both subdivision costs and dwelling costs.
- Construction costs are particularly high in small towns which lack resident tradespeople, since transport and accommodation costs have to be met.

The Cox Inquiry noted that the ABS had, in the late 1970s, prepared an experimental index of relative retail prices for food across Australia's major metropolitan areas and a large selection of country towns. Where a weighted average of prices in the eight capital cities was set at 100 this index yielded values of 110 in Cunnamulla and Charleville, the only two centres assessed in South West Queensland. It was only in the Pilbara that larger and smaller centres could be compared, with an index value of 115 in Port Hedland and 136 in Marble Bar. Judging by this differential, Thargomindah would probably turn in a value around 125. The index was experimental and was not continued, but the differentials thus documented accord with current anecdotal experience in South West Queensland – not only for food but for consumer prices generally. The main exception is housing costs, which depend on the balance of supply and demand in each town.

A fundamental feature of price indices is that they cover the same ‘basket of goods and services’ for each comparison. This is a bold assumption over time – new commodities are constantly entering consumers’ shopping trolleys and old items exiting – and it is an even bolder assumption when comparing places. Consumers in remote areas have different opportunities to those in the metropolitan areas – less choice, perhaps, but also some choices that are not available in metropolitan areas (a rodeo, perhaps?). Again, restricted choice itself has benefits: there’s no need to agonise over choice and maybe more time for simple entertainments, like yarning over a beer or playing participant sport. Some remote area residents have rejected the rat race, don’t have to keep up with the Joneses and consider that they pay less for a better life than they would have had in the cities. More generally, people confronted with different price patterns adjust to those patterns; they buy more of what’s relatively cheap and don’t agonise over what’s relatively expensive or not available. The resulting difficulties of measurement are known in economics as the ‘index number problem’, which means that comparisons apply to ‘typical’ people and not to those who have taken particular advantage of the opportunities available in different places or at different times. When metropolitan and remote areas are compared, the result regarding a ‘typical person’ is robust: the cost of living is indeed higher in remote areas.

Even so, the difficulties of measuring cost of living differentials and the lack of up-to-date evidence have caused people to appeal to an alternative differential – differences in access to government services – as a way of quantifying outback disadvantage. This does not mean that the cost of living argument has lost its force; rather it has been supplemented it with a related argument pointing in the same direction.

7. Isolation and services

In 1945 Zone Allowances were, in part, justified as compensation for isolation. This is a somewhat slippery concept. In so far as it was desirable to compensate for isolation so that it would be easier to recruit labour to the developmental task in the remote regions, the argument collapses back to populating the North, decentralisation and the exploitation of remote resources already discussed. However, the argument can take another tack: Zone rebates can be seen as (possibly token) compensation for the reduced range of government services available to the residents of remote regions and/or as partial compensation for the transport and telecommunications costs occasioned in accessing essential services. Here the appeal is to another of the classic principles of taxation – the Benefit Principle, which argues that taxes should be related to the value of benefits received. Remote area residents receive less benefit, therefore should pay less. Alternatively, the private (mainly transport) costs of accessing government services are greater and there should be compensation for this. Those who make this argument tend to assume that taxpayers receive the benefit of the rebate, but like cost compensation the argument can also be applied when the benefit is assumed to go to employers. The rebate then compensates employers for the extra wages they have to pay so that their employees can access services.

In 1981 it was argued that Zone rebates were an unfair way of compensating for service access costs because they were available only to taxpayers and not to people who fell below the tax threshold. This argument is no longer valid. The provision of Remote Area Allowances to social security recipients in 1984 meant that most remote-area residents now gain compensation.

Remote area residents have two main ways of dealing with the problems of service access. These are:

- bundling trips. Visits to service outlets, other than emergency visits, can be bundled together and satisfied in a single ‘trip to town’; and

- accepting a more limited range of choice and a concentration on the quality of local facilities. Thus metropolitan residents who disapprove of the education provided in their local high school send their children somewhere else. Residents of towns which are not large enough to support multiple schools are much more likely to campaign for an improvement in standards in their local school.

By contrast with the lack of recent work on cost of living differences, two studies on geographic differences in service provision have been published since the Cox inquiry.

In 1997 the Commonwealth Department of Health and Aged Care commissioned the National Key Centre for Social Applications of GIS to develop an accessibility/remoteness index for Australia. There are two main inputs to this calculation:

- a list of urban centres classified into five population groups: 1000<5000, 5000<18,000, 18,000<48,000, 48,000<250,000 and >250,000; and

- a matrix of road distances.

For each ‘populated locality’ in Australia, road distances are calculated to nearest urban centre in each of the five groups. This distance is divided by the average all-Australia distance for the category. The five scores thus obtained are added and used to define five ‘remoteness area classes’. (That there are five scores and five classes are coincidental – the researchers could have varied either number.) The remoteness area classes vary from ‘major city’ through ‘inner regional’, ‘outer regional’ and ‘remote’ to ‘very remote’. (Note the peculiar use of ‘regional’ in this nomenclature to mean neither metropolitan nor remote.) The ABS has adopted this index as a means of classifying the remoteness of localities throughout Australia.

The fundamental assumption underlying the remoteness index is that service availability depends on town size and that increments in service availability occur at the five population thresholds used in the classification. Using the same general methodology, a different size classification would yield different patterns. Similarly, different weights could be awarded to the size categories. Work by NIEIR for the Farm Institute provides a check on these assumptions, since this work did not take urban centre size as a proxy for service availability but instead plotted actual locations of service delivery and estimated the distances residents would have to travel to visit the nearest outlet for a standard list of services, mainly in the education, health and welfare fields. For some services, the second-nearest and third-nearest (and so on) facilities were included at reduced weight, to allow a modicum of choice. Not surprisingly in view of the major differences between services provided in the heavily and sparsely populated regions, both the ABS and NIEIR studies supported two conclusions.

- The accessibility of services differs systematically between rural locations (defined as all settlements of less than a thousand population) and urban locations. The ABS has been understandably reluctant to publish remoteness indicators for other than very small geographic areas because the typical larger area, say a Local Government Area, contains a range of locations which often have significant differences in accessibility to services.

- The accessibility of services also differs systematically with distance from the major metropolitan areas. This differential is particularly marked if emphasis is placed on choice of service outlets – for example, only the metropolitan areas have multiple universities.

The NIEIR study distinguished between widespread and centralised services. The former are available locally in most country towns complete with a choice of service providers where this is appropriate (it is not appropriate, for example, for police services) while centralised services which are provided mainly in the metropolitan areas and not in the country. Centralised services include tertiary education and specialised health services, and also, surprisingly, secondary education, which is available in the typical country town but with very limited choice.

Judged by employment, centralised services account for roughly one-third of the public services provided in Australia. Because of their metropolitan concentration, they account for the way in which service accessibility declines with distance from the main cities. However, even if attention is confined to the widespread services and the micro-variation between towns and the countryside is averaged out, the NIEIR service accessibility index generates patterns which largely accord with the ABS remoteness index. According to the ABS the ‘very remote’ area comprises the Australian north coast from Shark Bay nearly to Cooktown, except around Darwin; the coast of the Great Australian Bight, and all the country between these two coasts except for the immediate surrounds of Alice Springs and Mt Isa, which are merely ‘remote’. In South West Queensland all places west of Mitchell are considered ‘very remote’ while the ‘remote’ area is a strip between the ‘very remote’ area and a line running from roughly Dirrinbandi to Miles.

The NIEIR study helps to place these patterns in context. According to this study a typical journey from a residence to the nearest outlet of a widespread service (or nearest several outlets in the case of services like GPs where choice is important) will take more or less the following times:

- 12 minutes in Brisbane;
- about 12 minutes in Dalby but more like 40 minutes in the rural parts of Western Downs;
- just under two hours in Roma (due to restricted choice in some services) and over two hours in the rest of Maranoa;
- just under three hours in Charleville (again mainly due to restricted local choice) and over three hours in the rest of Murweh and in Paroo; and
- nearly five hours for residents of Quilpie and Bulloo shires.

These estimates can be roughly translated into dollar costs. Without imputing any cost to residents' time, the typical metropolitan service access trip costs around $3. It costs less in towns like Bundaberg due to less congestion and lower car parking costs. At the other end of the distribution, the typical remote area trip costs around $50. As already pointed out, remote area residents manage these accessibility costs by restricting choice, by bundling trips and simply by doing without (e.g. by forgoing education).

To a large extent the superior accessibility of essential services in the metropolitan areas and provincial cities is due to the inexorable logic of economies of scale. An approach which emphasises economic efficiency narrowly defined would leave it at that: services are cheaper to provide in large centres and if citizens want good services they should shift to these centres. (Never mind if the shift causes congestion and increases land costs.) However, the Queensland government endeavours to guarantee equality of service access to all its citizens, if necessary by bearing transport costs and also by upholding service standards in remote areas to overcome the need for choice and duplication.

Given this policy, is there any need for Zone rebates and the complementary social security allowances as contributions towards service access costs?

- Whatever the good intentions of the state governments, remote area residents bear significant service access costs which have to be met from their own pockets.
- The Zone rebates can be interpreted as a contribution towards the basic mobility, e.g. car ownership, assumed by service providers.
- Accessibility costs for essential services can be taken as proxy for accessibility disadvantages more generally – those which we have already considered as cost of living disadvantages or, more broadly, the costs of a minimum level of engagement with society as a whole – those costs which, in the broad social welfare literature, are called the costs of belonging.

The Cox inquiry argued that poor service accessibility and high costs of living together provided an equity argument for Zone allowances. At the very least, accessibility calculations help to identify the affected areas and the size of the disability.

Given that the prime purpose of Social Security is to provide minimum incomes to people who have no other income source, equity arguments apply particularly strongly to the recipients of Remote Area Allowances, but also apply to income earners in general.

8. Zone boundaries

When the system was inaugurated in 1945, the then Treasurer, Mr Chifley, said that the zone boundaries took into account latitude, rainfall, distance from centres of population, density of population, predominant industries, rail and road services and the cost of food and groceries. Unfortunately the exact criteria used in the demarcation (if there were any) have been lost.

The only general change to date in the Zone boundaries occurred in 1955 when the boundary of Zone A was extended south to the 26th parallel, so conveniently including the whole of the Northern Territory within Zone A. As noted above, Special Zones were introduced in 1981.

A comparison of the current Zone map with the ABS remoteness/accessibility index broadly mapped, and similarly with the NIEIR/Farm Institute service accessibility index, shows several major divergences. We consider first the Zone A/Zone B differential.

- Though Darwin is somewhat disadvantaged (according to the ABS it ranks as 'outer regional') its level of remoteness is well short of that in the typical Zone A location. It might be added that Darwin has now developed a broad industry structure and is no longer dependent on the prosperity of a limited number of export industries exposed to fluctuating world prices.

- Similar considerations apply to the Queensland coast between Mackay and Cairns, which is included in Zone B despite 'outer regional' status.

- There is essentially no difference in remoteness between Zone A and Zone B locations either side of the 26th parallel, nor does any remoteness gradient run along this line, nor is there any noticeable difference in industry composition either side (though it is roughly the northern limit for sheep).

- Apart from Darwin and the Queensland coast, Zone A and Zone B taken together are remarkably similar to 'Very Remote Australia' as defined by the ABS and confirmed by NIEIR. This applies whether remoteness is defined in terms of distance from services, distances from towns, or thin industry structure arising from a lack of arable land.

By contrast, apart from Mt Isa, Alice Springs, Kalgoorlie and Esperance, the Special Zones are not recognisable in the ABS remoteness map, nor are they to be found in the NIEIR calculations. For example, in Queensland Charleville and Longreach are each responsible for large circles in which residents are not entitled to Special Zone allowances, but in both instances the typical trip to access a widespread service from within the town is rated at around two hours and from within the excluded circle is closer to three hours. Among the isolated centres in Queensland, only Mt Isa is large enough, and has a sufficient range of services, to produce a significant improvement in accessibility. This suggests two conclusions:

- a town population of 2500 is too low to produce significant improvements in accessibility in an otherwise remote area. Judging by the populations of Alice Springs, Mt Isa and Kalgoorlie, the cut-off appears to be more like 15,000; and

- the radius of 250 road km is too long. Accessibility drops rapidly with distance from urban centres.

There is a strong case for redefining the Zones to take these findings into account. The exclusion of Darwin, Mackay, Townsville and Cairns and the adjacent coast, plus an extension of the eligibility period from six to ten months, would go a long way towards financing the re-drawing of Zone boundaries. An outback Zone could be based on ‘very remote’ Australia as defined by the ABS. A new fringe outback Zone could serve as a transition area and also accommodate towns of 15,000 plus population which would otherwise be located within the outback Zone. The Special Zones would be abolished. It is suggested that the rebate for the outback Zone would be the current Special Zone rebate, updated, while the rebate for the marginally outback Zone would be the current Zone A rebate, updated. The Social Security Remote Area allowance would be available to permanent residents of the outback Zone and possibly, at reduced rates, to permanent residents of the marginal outback.

9. Value of the allowance/rebate

When introduced the Zone A allowance was set at £40 but in 1947 it was increased to £120, a considerable concession at a time when workers were typically paid around £500 a year (average earnings per railway employee were £477 in 1948-49). In conjunction with the schedule of marginal rates, this increased disposable incomes by 3 to 4 per cent compared with charging the full income tax to workers in Zone A. The Zone A deduction was indexed sporadically and in 1958-9, after an increase, produced increases in disposable income of the order of 6 per cent for workers on average weekly earnings. The additional deductions for dependants meant that the proportion was broadly similar for taxpayers with and without dependants. From 1959, however, there was a pronounced reluctance to index the allowances, later rebates, for inflation.

The Cox Inquiry failed to produce any indexation of the rebates but its recommendations to raise the loading for dependants and introduce Special Zones were implemented. As a result, in the 1981-82 tax year Zone rebates produced the following increases in real incomes (calculated, for convenience, on the assumption that the allowance benefits the taxpayer rather than the employer):

- taxpayer on average weekly earnings living in Zone A, an increase in disposable income of approximately 1.8 per cent. Due to the dependant allowances, this increase was roughly the same for all levels of dependants;

- taxpayer on the minimum wage living in Zone A, an increase in disposable income of approximately 2.7 per cent. Increases for taxpayers with dependants were somewhat less because they ran out of tax to offset the rebate against; and

- taxpayer on average weekly earnings living in a Special Zone: an increase in disposable income of 6.3 per cent (9.4 per cent for a taxpayer on the minimum wage).

The two dissenting members of the Cox committee would both have made more generous allowances available.

- Mr Kerr, a rebate sufficient to raise the disposable incomes of taxpayers earning average weekly earnings in the Special Zone by 12.6 per cent (18.8 per cent if on the minimum wage).

- Mr Slater, a rebate sufficient to raise the disposable incomes of taxpayers earning average weekly earnings in a revised Zone A by 16.8 per cent (22.2 per cent if on the minimum wage).

The rebates were increased in 1984, 1985, 1992 and 1993, but since then the Zone A rebate has remained at $338 plus a 50% loading on dependant rebates. Due to growth in earnings and lack of indexation of the rebate, its value has now been eroded to an increase of 0.8 per cent the in disposable income of a Zone A resident without dependants receiving average weekly earnings. The value of the rebate for a taxpayer without dependants working in the Special Zone now stands at an increase in disposable income of 2.7 per cent.

The value of the remote area allowance for social security recipients now (September 2011) stands at an increase of 2.6 per cent in the disposable income of a single pensioner and 3 per cent in the disposable income of a couple.

The real value of Zone rebates has been falling since 1993, which accords with Treasury's preference for removing concessional tax offsets. Indeed, the failure to review the Zone rebate may indicate satisfaction with the current non-indexed benefit – from Treasury's point of view there is a risk that a review might defend the rebate and recommend that it be raised. The present paper has shown that there are indeed strong arguments for retaining and increasing the rebate.

10. Conclusion

It is now two years since the release of the Henry Report into Australian taxation and its recommendation that remote area tax offsets be reviewed. The review has not taken place and in the meantime Zone rebates continue to decline in real value.

There remain three arguments for the continuation and updating of Zone rebates, including the related social security Remote Area Allowances.

- Support for remote-area economic development. Zone rebates provide partial compensation for the reduction in the competitiveness of remote-area export industries which has occurred as an unintended side-effect of the market-determination of the exchange rate coupled with heavy reliance on monetary policy to counter inflation. Zone rebates also assist in the provision of local infrastructure and support services in the remote areas. This infrastructure is important for the export industries, for defence and for the future of remote indigenous communities. (In discussions of public finance, this is essentially an economic efficiency argument.)

- Compensation for the higher prices of necessities in the remote areas, particularly food. This is particularly important for social security recipients. (In discussions of public finance, this is essentially an ability-to-pay argument.)

- Partial compensation for the costs of accessing government services from the remote areas. Though the primary responsibility here lies with service providers, the Zone rebates recognise that remote area residents bear a share of these costs. (In discussions of public finance, this is essentially a benefit principle argument.)

This paper provides a preliminary discussion of each of these topics and shows that Zone rebates can be justified by arguments invoking each of the major principles of taxation. Following through from these arguments, the paper also suggests that the Zones should be updated and the levels of rebate revised.

Zone rebates have not been reviewed for three decades. This paper has shown that there is a strong case for updating the rebates, subject to a review of eligibility. It is time that the review recommended in the Henry report took place.

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