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Commissioner Baxter and Commissioner Lindwall
Australian Government Productivity Commission
MELBOURNE VIC 3000

Business SA
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Working for your business.
Working for South Australia

Dear Commissioners

I write in response to the Productivity Commission's request for submissions to its Initial Report of the Transitioning Regional Economies study and to follow up on Business SA's comments made at your recent Adelaide workshop. This study has particular relevance for South Australia considering the pending shutdown of Holden's auto-manufacturing operations in October.

Executive Summary

- As South Australia transitions beyond traditional manufacturing, the environment needs to be conducive for all businesses to maintain viability and, where possible, expand. This will require every effort from Governments to reduce key input costs combined with appropriate tax settings which signal South Australia's, and indeed Australia's, position as a competitive place to do business.
- Business SA has long advocated for an independent infrastructure authority and South Australia's poor showing in Infrastructure Australia's 2017 priority list indicates that we can no longer wait for this reform. Transitioning an economy relies on having efficient economic infrastructure in place and in an age of limited Government funding, competing projects must be carefully weighed against each other based on thorough and independent cost/benefit analysis.
- Having broad State and Federal agreement on measures to put downward pressure on utility pricing, particularly a NEM wide emissions reduction scheme, is particularly critical in economies like South Australia's where the successful transition of our economy beyond auto-manufacturing will rely on other manufacturing sectors remaining viable and competitive in world markets.
- New product developments and innovations by businesses will be key to finding those niche opportunities in world markets which are central to the success of manufacturing in Australia and the tax system must be appropriately designed to encourage further collaborations between universities and small business, and not relying on the R&D incentive alone.

Should you require any further information or have questions, please contact me on (08) 8300 0000

Yours sincerely,

Andrew McKenna
Senior Policy Adviser

Why this matter is important to South Australian businesses

As South Australia's Chamber of Commerce and Industry, Business SA is the peak business membership organisation in the State. Our more than 3,500 members are affected by this matter in the following ways:

- The increase in electricity prices, particularly over the last two years, has had a devastating impact on South Australian business at a time when the State's economy is attempting to transition with the pending closure of Holden's manufacturing operations in October.
- South Australia currently has the lowest payroll tax threshold of all States and Territories and with payroll tax being the number one tax inhibiting job creation, it is important for this matter to be addressed.
- Transitioning businesses is very difficult at the best of times and all efforts need to be made to encourage collaborations on innovations and process improvements between universities and businesses, particularly small businesses.
- While the transition of South Australia's economy away from relying on auto-manufacturing has been underway for nearly four years, there is no doubt that this issue still requires the attention of both State and Federal Governments given the full realisation of outcomes will not be known until after Holden's shutdown in October.

Key Policy Points

1. Business SA has previously made submissions to both the Commission's Review of Australia's Automotive Manufacturing Industry and the Federal Government's Review of the Victorian and South Australian Economies in late 2013 into early 2014 when Holden and Toyota first announced their Australian auto-manufacturing exit would occur in 2017 following Ford's departure in 2016.

   Both our earlier submissions outlined policy recommendations required to most effectively transition South Australia's economy beyond local auto-manufacturing. At the time, Business SA's focus was to ensure that remaining component suppliers were more easily able to merge and diversify and that infrastructure investment supported the broader economy to allow for expansion of all industries, particularly to create job opportunities for displaced auto workers. Since 2013, the State Government has abolished stamp duty on business transfers in its 2015/16 Budget while introducing a phased abolition of commercial property stamp duty, which despite our advocacy to phase in sooner, will not be implemented in its totality until 1 July 2018.

   A key infrastructure recommendation of Business SA's in early 2014 was for the Northern Connector project to be fast tracked and we acknowledge the Federal Government for funding that project in 2015. Consequently, the Northern Connector is now likely to assist with new transport requirements for export orientated produce from the proposed Northern Adelaide Irrigation Scheme. It is important for the Commission to recognise that economic transitions of regions do take time but that strategically located economic infrastructure is critical to laying the foundations for a multitude of projects to be successful in future.

   The Northern Adelaide Irrigation Scheme could be a transformational infrastructure project for South Australia's northern suburbs should it be developed to its full potential. The original plan to develop the project to its full 20 gigalitre (GL) capacity as announced by the State Government last September was forecast to create up to 5,000 jobs over hundreds of hectares of high-tech greenhouses. This original proposal, backed by an international consortium, has now been pared back to 12

GL based on a purported constraint on Federal Government funding available through the Water Infrastructure Development Fund. Now that the project is being scaled back, it will be important that the remaining 12 GL is allocated to optimise the returns to both SA Water customers and the to ensure the greatest economic growth and jobs outcomes for the State more broadly.

2. In Business SA's member survey to inform our *2014 Charter for a More Prosperous South Australia*, 78% of respondents supported an independent infrastructure authority to advise the State Government on infrastructure priorities. South Australia's infrastructure needs must be determined by objective cost-benefit analysis of specific project proposals without the influence of electoral boundaries or any incumbent Governments' political priorities of the day.

   It is now clear that all States are moving towards this model. Independent infrastructure authorities already exist in New South Wales, Queensland and Victoria and one will now be established in Western Australia following the recent change in Government.

   In Infrastructure Australia's 2017 priority list released in February, Business SA notes that South Australia had:

   - **Not one high priority project** (ie where business case completed) – 7 for country
   - **Two priority projects out of 11** being the Adelaide–Tarcoola Rail Upgrade Acceleration and an Eyre Peninsula deep sea port which would be contingent on the Iron Road mining proposal
   - **Only one high priority initiative out of 20** state based initiatives being the Gawler Line rail upgrade, not an economic infrastructure project; and
   - **Eight priority initiatives out of 55** state based initiatives including Adelink, remaining North-South corridor upgrades, Gawler Craton rail access, a Melbourne/Adelaide/Perth rail upgrade, the Northern Adelaide Irrigation Scheme, Truro bypass, SA regional mineral port development and the Strzelecki Track upgrade.

   Notwithstanding the State Government will ultimately control the projects it funds either solely or in conjunction with the Federal Government, having an independent statutory authority govern the assessment of infrastructure proposals will provide an improved level of public transparency over how projects are ranked and would also encourage private sector proponents to advance projects independently of the State Government. Business SA acknowledges the recently established Infrastructure Victoria has a strategic focus on soliciting project proposals from both the private and public sectors. Business SA is not suggesting the State Government cannot advance good infrastructure proposals, and in fact we have strongly supported the Northern Adelaide Irrigation Scheme, but the Government is not and should not be the sole purveyor of infrastructure project proposals in an increasingly dynamic world where funding of projects requires more complex models to attract private capital, particularly from the superannuation sector.

   In terms of transitioning economies, adequate infrastructure to support the economy more broadly is critical to lay the foundation for businesses to grow, particularly for States like South Australia where the economy is already lagging. Over 2015/16, South Australia's Gross State Product grew by 1.9% against Victoria's 3.3%[1] which highlights the demand differences in each economy and the likelihood that auto-related firms and employees in Victoria are likely to more easily diversify and transition in a relatively stronger economy. Anecdotal evidence to date from Ford's Geelong closure seems to support this proposition.

   South Australia can transition successfully beyond auto-manufacturing but it will only happen when limited resources from both a State and Federal Government are invested in infrastructure with the highest sustainable returns.

[1] ABS, National Accounts – State Accounts, 2015-16, GSP Chain Volume Measures

3. The Finkel Review primarily originated from the severe price pressure placed on South Australian consumers, particularly businesses, which became evident after South Australia lost its last coal-fired power station and the impact that had on competition to provide firm contracts to business which fell to fewer and higher priced gas-fired generators. While it took both gas shortages & retail price hikes in mid-2016, and finally the State-wide blackout to generate the political will for the Council of Australian Governments (COAG) to actually implement the independent Finkel Review, the reality of the situation was that alarm bells had been ringing for South Australian businesses since mid-2015. In fact, just prior to the blackout, Business SA led a coalition of South Australian representative organisations to lobby for an independent review of the transition of the electricity market to low carbon while protecting the long term interests of consumers with respect to price, quality, reliability and safety. Even then, there was broad concern about the impact high wholesale prices were having on the community and economy and what future costs might eventuate in the absence of transparent and evidence based policy decisions.

   In June 2015, the wholesale electricity futures price for the South Australian NEM jurisdiction doubled upon news that Alinta was going to close its Northern Power Station in 2016. This was nearly 12 months before the power station actually shut down and while the spot market maintained similar levels, only a very small percentage of large market customers are directly exposed to the spot market (the most volatile commodity market in the world) so most were directly impacted by the futures market when they needed to lock in their next contract. At the time, peak energy rates for large market customers (went from 7 cents to 14 cents). Since then, while there has been some fluctuations, the peak energy price being contracted now by most large market businesses is around 20 cents, with short term rates even higher and the spot price has also increased substantially, particularly since the closure of Victoria's Hazelwood coal fired power station.

   Given wholesale energy can represent between half and three quarters of total bills for large market customers, depending on their level of consumption, this has mean bills for South Australian businesses have increased by between 50% to 150% over the past two years, depending on when individual businesses came out of their multi-year contracts. SA's small market customers, which include most small businesses, have also been caught up in the energy crisis and although the impacts have been delayed due to nature of annual price reviews, last year bill increases were approximately 10% on average, depending on the retailer, and small businesses have been hit again this year with circa 20% bill increases effective from 1 July 2017.

   In December 2016, the State Government announced it would provide $31 million through its Energy Productivity Program to assist large energy using businesses to manage their electricity costs. While Business SA welcomed this initiative to ease the cost pressure on South Australian businesses, unfortunately, many of those same businesses have also had to contend with a more than doubling of the wholesale price of gas in the past four years with some paying contract gas prices of up to $18 / gigajoule. This has been predominantly driven by the establishment of Australia's LNG export market and increasing levels of gas moratoria interstate which have prevented new supply coming on stream to meet the structural shift in demand.

   For South Australia to effectively transition its economy, businesses must have affordable electricity and gas and the current impasse on a State/Federal agreement on an emissions trading scheme for the NEM, despite having the independent Finkel Review recommend it, must be addressed as soon as possible.

4. Business SA acknowledges the Commission's statement that 'in the past, regional adjustment assistance has often been costly and ineffective in facilitating a region's adaptation to changing economic circumstances'[2]. Accordingly, the Commission's focus should be on how to improve the cost competitiveness of regions undergoing transition, rather than just how tailored funding packages can help the businesses most directly impacted.

   The Commission also states that 'diversification for its own sake is not always better – regions should focus on producing goods or services that can earn them the highest income'. Again, this statement aligns with Business SA's overarching recommendation that the emphasis of support for transitioning economies must be on how the whole regional economy can be more competitive, which starts with a competitive cost base and access to efficient economic infrastructure, particularly for export orientated freight.

5. The historical roots of Horizontal Fiscal Equalisation (HFE) can be traced to pre-federation when the colonies combined to form a political model, fundamentally underpinned by equal distribution of power and resources. The new federation introduced a national aged pension in 1909 and established the Commonwealth Grants Commission (CGC) in 1933 to assess claims by the States for financial assistance. In 1976 the Federal and State Governments agreed that the fiscal capacities of States and Territories should be made equal and the CGC was given responsibility to make recommendations for how general revenue could be distributed accordingly.

   Prior to the introduction of the GST in 2000, all States agreed with the current system whereby GST distributions provide each State with the capacity to provide its citizens with a comparable level of government services. Again in 2008, under the Inter-Governmental Agreement of Federal Financial Relations, the Federal, State and Territory Governments reaffirmed that GST distributions should achieve HFE.

   Since the early 2000s Western Australia has experienced an unprecedented mining boom enabling 14 consecutive Budget surpluses up until 2014/15 and resulting in a ten-fold increase in mining royalty revenue which the Commission needs to consider in the context of why it would recommend any permanent changes to the current HFE system.

   While Business SA acknowledges that issues of lag should be addressed within the current HFE system to assist mining dependent States like Western Australia, fundamentally changing the notion of equalisation amongst States and Territories will have long term ramifications for how regional economies transition in the face of economic shocks.

[2] Productivity Commission, Transitioning Regional Economies Initial Report, April 2017, page 29

6. Prior to the 2017/18 State Budget when the pre-existing temporary 50% small business payroll tax rebate was made permanent, there had been no change to the payroll tax threshold or rate since 2009. On 1 July 2009, the rate was reduced from 5% to 4.95% and the threshold raised from $552,000 to $600,000.

Over the past eight years, every other State and Territory has increased their payroll tax threshold, while others have also reduced their rate:

State / Territory	Payroll Tax Rate			Payroll Tax Threshold		
	2009 Rate	Current Rate	Difference	2009 Threshold	Current Threshold	Difference
New South Wales	5.75%	5.45%	0.30%	$ 638,000	$ 750,000	$112,000
Victoria	4.95%	3.65% to 4.85%	varies on location	$ 550,000	$ 650,000	$100,000
Queensland	4.75%	4.75%	0.00%	$1,000,000	$1,100,000	$100,000
Western Australia	5.50%	5.50%	0.00%	$ 750,000	$ 850,000	$100,000
Tasmania	6.10%	6.10%	0.00%	$1,010,000	$1,250,000	$240,000
Australian Capital Territory	6.85%	6.85%	0.00%	$1,500,000	$2,000,000	$500,000
Northern Territory	5.90%	5.50%	0.40%	$1,250,000	$1,500,000	$250,000
South Australia	4.95%	2.5% to 4.95%	varies on size	$ 600,000	$ 600,000	$ -

For South Australia to successfully transition beyond auto-manufacturing, there needs to be much more substantive reform to the number one jobs inhibitor for business, payroll tax.

7. In Business SA's submission to the Tax White Paper process, we argued that the R&D incentive did not necessarily promote increased collaboration between industry and universities and we called for specific tax incentives to help small businesses innovate, including deduction benefits for university collaborations.

Compliance costs invariably have a much higher relative burden on small businesses who do not typically have specific employees to manage their compliance workload. Feedback provided to Business SA suggests the application process for the R&D tax incentive could be improved to better facilitate small business access. Businesses have also expressed frustration at delays with refunds through the R&D Tax Incentive and all efforts need to be made to ensure that Government processes support the cashflow requirements of businesses, particularly small to medium sized businesses.

In the South Australian component sector, there have been significant efforts made by the Universities and the State Government to increase collaborations for new products to assist the diversification of businesses, most notably the partnership between the University of South Australia and SMR Automotive to develop the world's first fully plastic automotive mirror for export to the United States. While such product developments do take time, the underlying tax system needs to be appropriately structured to provide incentives for future collaborations of this nature which are critical to helping transition economies which have typically relied on large scale manufacturing anchored by multi-nationals.

8. As per the latest figures available, South Australia's public sector remains of disproportionate size to other States and Business SA has previously called on the State Government to investigate all options to improve its efficiency:

Size of State public sectors as at June 2016[3]

State	Employed full-time (total)	General Public Sector FTEs	Percentage of total full-time employed
SA	519,800	81,305	15.6%
TAS	154,400	22,135	14.3%
NSW	2.6 Million	326,706	12.4%
QLD	1.6 million	212,132	13.0%
VIC	2 million	222,507	11.1%
WA	916,097	107,809	11.8%
National Average of States	1.3 million	163,266	12.4%

If the Commission is considering how best to transition regional economies, it must consider the efficiency of the public sector and how the cost of excess bureaucracy inhibits the ability of regional governments to lower the taxes which actually incentivise the businesses needed to achieve the economic transition in the first place.

9. Despite recent improvements after the introduction of the current *Return to Work Act* in 2015, South Australia's latest average workcover premium of 1.8%[4] still sits well above the average of the mainland States, 1.38%[5]. Again, when the Productivity Commission is assessing factors inhibiting the transition of regional economies, costs of doing business which cut across the entire economy, such as workcover premiums, also need to be considered.

[3] General Public Sector Data compiled from various Government sources within respective States, Employment data from ABS, Labour Force January 2017
[4] Return to Work SA website
[5] Safe Work Australia, Comparison of workers' compensation arrangements in Australia and New Zealand, October 2016, page 14