2011

Economic Structure and Performance of the Australian Retail Industry

National Retail Association Response to Draft Report

The National Retail Association is Australia's largest and most representative retail industry association. Its core constituency is the national retail chains, the majority of whom are members of NRA, but its membership also embraces many small and medium Australian family businesses.

This submission outlines NRA's response to the August draft report of the Commission.

NRA Response to Productivity Commission Draft Report

NRA's acknowledges the breadth of the Commission's draft report. NRA supports the Commissions recommendations in the areas of workplace regulation, retail trading hours regulation, retail tenancy leases, planning and zoning regulation, and ABS data collection.

The Commission now invites further submissions in response to its draft report.

REFORM OF THE TAX AND CUSTOMS REGIME

In NRA's view the most compelling issue requiring resolution is the reform of the current tax and customs regime as it applies to low value imports. Despite the breadth of the terms of reference for the Commissions Inquiry, we note that the dominant issue emerging from a review of submissions is the consideration of the current tax and customs regime. NRA has consistently articulated that this is the issue over which the Commission has the greatest control, or in respect of which it has the greatest capacity to influence outcomes. It is also the issue which requires urgent attention.

Key Considerations

1. An understanding of the design features of the GST and its underpinning principles, including competitive neutrality and equity, support the elimination of the threshold. The Productivity Commissions conclusions in its draft report endorse this in principle position.

2. In the terms of the application of the threshold, we note that compliance with Australian taxation and duty law appears discretionary depending on the operational business model. Some retailers are required to collect tax and pay duty while others are not. In this context it is not appropriate in our view for the beneficiaries of this inefficient business model to be asked, or relied on, to find an economic solution for the cost of collection of tax and duty unless the beneficiaries were asked to do so under highly specific and mandatory directions. NRA's view is that if collection of taxation and duty is expensive then that expense should be borne by the business operator (and ultimately their customers) not by the community. NRA strongly recommends that collection of tax and duty is mandatory and that the cost of collection, however it arises, should be paid for by the operators who benefit from the business operations. This will give the operators an incentive to search out the most efficient solution, it will ensure that tax and duty affect all competitors equally, it will increase the value of total tax and duty collection and will it reduce the need to compensate by greater collections from parties that pay tax and duty, and it will be at zero cost to the government if charges are applied that equal the cost of compliance.

3. Given that the Australian retail sector is predominantly an importing sector (excluding food), we cannot develop sustainable on line retail businesses in Australia unless there is a level customs and tax playing field in place. Retail is an intensively competitive sector whether viewed in a domestic or global context. No business model can survive in the face of an institutionalised price disadvantage in the order of 11% to 23%. Price is the key determinant in internet shopping in a process which greatly facilitates price comparison and product and supplier searches.

4. The longer Australian online retailers are required to contend with this price disadvantage, the greater the number of customers making purchasing decisions favouring foreign retailers and the greater the leakage of trade from the domestic retail sector. The high $A operating in conjunction with an unsustainable price difference will continue to drive changing consumer buying behaviour and add to the destabilisation of the Australian retail sector. The consequences of the shift of trade offshore are self evident and are already apparent in terms of store closures, business failures and a declining retail workforce.

5. The current tax and customs regime associated with low value imports is fostering the growth and profitability of foreign retailers at the expense of Australian businesses and Australian jobs.

6. The cross subsidization of customs fees and charges arising from the failure of individual importers to contribute to the customs and border protection costs of processing 40 million low value imports should be addressed immediately. Beyond all other disadvantages placed on Australian retailers by the current tax and customs regime, Australian retailers (among others) should not be required to pay not only their own entry costs but also the costs of processing the products of foreign retailers or individual consumers buying goods from foreign retailers. The Commission is asked to recommend the immediate imposition of a flat handling fee on all low value items imported into Australia. This fee should be collected by Customs and Border Protection from either Australia Post, CAPEC members, customs brokers or importers.

7. Any final consideration of the “administrative convenience” argument should take into account and measure, the damage caused to the domestic Australian economy by a failure to impose a level GST, duty and custom fees playing field, and the consequences of this failure, particularly given that retail generates one of the highest multiplier effects of any industry sector in the economy.

8. In considering the need for transitional arrangements associated with the elimination of the low value threshold, the Commission should take into account the global reach of CAPEC members and the extensive interface of these organisations with other jurisdictions where low value thresholds are at nominal levels. We note that, despite the clear relevance of such arrangements, the CAPEC submission was silent in this respect. The Productivity Commission is entitled to proceed on the basis that CAPEC members have the capacity to adapt within a reasonable period of time to a tax and customs regime in Australia which mirrors the regimes prevailing in the UK, the EU and Canada.

9. We note the Commissions concern with the capacity of Australia Post to adapt to an environment where the low value threshold did not exist. We also note that Australia Post has declined to make a public submission in this matter, and that this decision may give rise to a perception that the Commission processes lack transparency. Further the interests of the retail sector may be prejudiced in a process where there is not full disclosure of all competing arguments.

10. Illustrations of price differentials for particular products sold by Australian retailers, which are greater than the 11% to 23% attributable to the customs and tax arrangements, are not a reason for a failure to act. There are already significant price differentials between products sold within the Australian retail sector and the incidence of price differences will obviously be a significant feature of a global retail market. Price differentials in a global retail market may be attributable to a number of factors including:

- The dumping of distressed stock by US and UK wholesalers and retailers onto a global market reflects the recessionary conditions experienced in these sectors for some years

- The targeting of the Australian market by foreign websites anxious to exploit the current tax and customs benefits. Certain major foreign organisations have considerable expertise in this form of exploitation as reflected in their practices associated with the Channel Islands (circumventing UK regulations) and the US (avoidance of state based sales taxes).

We also note that it is not uncommon for consumers to compare wholesale prices or promotional prices offered by foreign websites with recommended retail prices for Australian products. This is not a fair comparison.

It is a flawed proposition to assert that the levelling of the playing field will not improve the competitiveness of the Australian retail sector.

The Draft Report

The draft confirmed the view articulated by retailers small and large over a long period of time that:

"there are strong in principle grounds for the low value threshold exemption for GST and duty on imported goods to be lowered significantly to promote tax neutrality with domestic sales" (Draft Recommendation 6.1);

and that:

"the GST as a broad based consumption tax should apply equally to all transactions. On these grounds, it would be preferable therefore to have no low value threshold and subject all imported goods to the payment of GST and duty." (Page 194 of the Draft Report)

The principal consideration remains the undertaking of activities which will bring about a dismantling of the current low value threshold and the consequential levelling of the playing field. In this regard the draft report canvasses a number of considerations which NRA will address in this submission and during the public hearing.

The Commission's initial view as disclosed by the draft report is to the effect that the cost of collection of revenue derived from an elimination of the threshold would be less than the cost of collection of the tax. There are a number of matters that NRA would like to further explore with the Commission arising from these views:

a. While the draft report does not disclose the reasoning underpinning the "de minimis" conclusion, the conclusion appears to have been arrived at without factoring in a consideration and measurement of a failure to act in a timely manner to level the playing field. This includes a measurement of the cost to the Australian economy, the cost to the Australian retail sector (both online retailing and bricks and mortar retailing), and the cost of business failures and job losses reasonably attributable to a measurable shift of trade to foreign retailers.

b. In NRA's primary submission to the Commission, NRA provided extensive modelling which showed that a price differential in the order of 11% to 23% would have severe and negative competitive impacts for the Australian online retailing and bricks and mortar sector. NRA's modelling did not measure the full impact of the price differential on the retail sector and the Australian economy, but it did establish that a leakage of retail trade from domestic retailers to foreign retailers in the order of 10% would result in a 7% contraction of the Australian labour force or 80,000 jobs. If an average retail job is measured at $40,000 per annum, then, in a simple analysis, the failure to allow domestic retailers to compete on level terms with foreign retailers will, at the relevant point, in time cost the economy $3.2Billion in lost wages each year.

c. In order to assist the Productivity Commission in its evaluation of the NRA modelling, and to enable further consideration of this matter in its final deliberations, NRA has commissioned Ernst & Young to complete independent modelling and research. The outcomes of this work will be submitted to the Productivity Commission no later than 16 September 2011. A description of the work to be undertaken by Ernst & Young is included as <u>Attachment A.</u>

d. Again, while the draft report does not disclose the Commissions reasoning around the "de minimis" calculation, it does not appear to have factored into its revenue calculation the potential application of a handling fee by Australia Post in the same way as such a fee is imposed by postal authorities in the UK and Canada, or the application of similar charges by CAPEC members. There is sufficient evidence available from other jurisdictions for the Commission to conclude the probability of the imposition of such a charge should the threshold be eliminated.

e. If an $8 fee were imposed by Australia Post and CAPEC members on low value imports, then at the current level of imports (approximately 40 million items), this fee would result in $320M in revenue being collected. We believe that the Productivity Commission should include this estimate in its determination of revenue to be collection if the low value threshold were eliminated.

f. The draft report does not detail the compliance activities and business processes of CAPEC members applicable in other jurisdictions including the UK, EU, Canada and New Zealand. Despite the unquestionable relevance of this information, the CAPEC submission was silent in these areas.

g. The draft report articulates concern at the capacity of Australia Post to manage a transition to a tax and customs regime which is absent a low value threshold. However no submission from Australia Post is available. The Commission has been asked to inquire into the economic structure and the performance of the Australian retail industry. The pivotal issue requiring determination by the Commission is the continued operation of the low value threshold. If the view of Australia Post is to be a substantive impediment to the delivery of an equitable customs and tax regime, these views must be published and made available to the retail industry for scrutiny and evaluation.

h. Additionally as with CAPEC members, Australia Post has considerable resources and must be familiar with the operation of postal services in jurisdictions such as the UK and Canada. Australia Post as a wholly owned Australian Government authority, has an obligation to the Australian retail sector to fully inform the Commission of the business processes and practices applied by postal services in these other jurisdictions relating to the operation of low value thresholds.

i. A review of the “de minimis” practice in other jurisdictions supports the elimination or substantial reduction of the threshold in Australia. These practices also establish the practicability of the proposed reduction in the threshold.

j. The draft report did not disclose whether the Commission, in estimating the cost of collection of the tax and duty, considered the probability that the number of low value inbound packages would substantially decrease if the threshold were eliminated. These estimates are relevant to any review of capacity considerations and logistics and infrastructure costs associated with an elimination of the threshold. We accept that the same consideration would have implications for the revenue estimates prepared by the Commission.

k. Proposed Task Force

The Commission proposes the establishment of a task force to oversee the reduction in the low value threshold. NRA has reservations about the taskforce process on a number of grounds:

- It delays the levelling of the playing field – a circumstance which is particularly relevant given the current state of the sector. The retail sector advocates for a more urgent conclusion of the Commissions processes and a quick implementation of outcomes. If the PC does not act decisively now it risks further destabilising the Australian retail sector as switching to foreign retailers becomes increasingly entrenched and the probability of switching back diminishes.

- The taskforce may not be necessary - it would be more effective in our view for the Commission to consider a more directive outcome in its final report. That is for it to say, for example, that, prima facie, there is no reason why Australia's tax and customs regime could not mirror practice in the UK and Canada, and to establish a timetable for the transition.

- It is a matter for CAPEC members and Australia Post to resolve how they must adapt to ensure compliance. The practicability of a low value threshold in the order of $20 is demonstrated by reference to practices in the UK and Canada. Additionally CAPEC members are intimately familiar with these jurisdictions and it is presumed that Australia Post is very familiar with the operations of UK Post and Canada Post. In practical terms it may be that the taskforce will not be able go much beyond a point of telling CAPEC members and Australia Post what they already know.

- While we understand that members of the taskforce will be independent, the profile of the independent members is not disclosed. It is difficult to evaluate the effectiveness of the taskforce without some indication of the resume of the persons who may comprise the taskforce. We also have significant reservations about the functioning of a taskforce which is to be advised by Customs, Australia Post and CAPEC members. We presume, but do not know, that Australia Post is making representations to the Commission in support of the retention of the $1000 threshold. We know that CAPEC has been unequivocal in its representations about the retention of the threshold. As currently informed, it is difficult for the retail sector to entertain a view that a task force operating under the proposed arrangements will be focussed on delivering an expeditious reform of the tax and customs regime which will benefit the retail sector.

Attachment A

Independent economic analysis of the impact of the online retail sector under the current GST/duty regime on the national economy, as well as the impact of potential taxation reform scenarios going forward.

Key Objectives

The key objectives of the analysis are:

- Quantifying the impact of online retail on the overall Australian retail industry going forward.
- Quantifying the impact of potential reforms to the GST/duty regime on Australian retailing, including the likely extent of customer switching between domestic and foreign businesses
- Quantifying the wider economic impact (GDP and jobs) of potential reforms.

Scope of works

The key tasks are as follows:

- Literature review of the size and scope of and trends in online retail in Australia (as well as internationally), as well as the behaviour of online shoppers

- Economic impact analysis of potential reforms to the current taxation and duty regimes applicable to the online retail sectors. The economic impact analysis will involve the comparison of base and reform scenarios -

    - *Base case scenario (current regime)* –Australian retail demand segmented by traditional bricks and mortar, domestic online and foreign online retail under the current regime where the GST duty exemption threshold remains at $1000

    - *Reform scenario A (no duty exemption threshold, no compliance costs)* - Australian retail demand segmented by traditional bricks and mortar, domestic online and foreign online under a new regime where the GST duty exemption threshold is removed. In the first scenario, no incremental compliance cost associated is assumed with collecting this tax.

    - *Reform scenario B (no duty exemption threshold, compliance costs)* – As with Reform Scenario A above, but with the inclusion of a compliance cost (which has been estimated at $1.6 billion). This scenario would also consider who would bear these costs (i.e. overseas producers versus domestic consumers).

The difference between the base case and the reform scenarios will represent the net economic impact of the change.

In completing this project, the intent would be to further consider and develop the information already contained in the Productivity Commission draft report by the completion of further research and analysis along with expanded economic analysis.

It is therefore expected that the output would further contribute to the current online retailing debate and provide the Productivity Commission with further information to assist with its deliberations.

Economic modelling

The economic modelling will involve two steps:

- *Scenario analysis* – based on a literature review, as well as (econometric) time series analysis of retail trends to date (using ABS retail data) we would develop scenarios of retail demand over the next 5 years, taking into account:
  - Overall retail growth, including by subsector
  - Market segmentation by bricks and mortar, domestic online and foreign online, including assumptions on the degree of switching under the various scenarios
  - Changes in compliance costs
- *Wider economic impact analysis using econometric analysis* – based on the above scenario analysis, this will be fed into a structural time series based econometric model to predict:
  - Wider economic impacts (GDP and employment)
  - Impacts by industry
  - GST impacts

Structural time series analysis allows for the identification of robust components including trends and cycles embedded in retail data. The introduction of time varying parameters allows for those components to be robustly forecast into the future. Furthermore, the model framework allows for the inclusion of Bayesian priors. Existing panel information published by the Australian Bureau of Statistics (for example, catalogue number 8146) which provides insight into consumer choice regarding online shopping across a range of demographic cohorts and geographic areas can also be fully reflected in the framework.

The uses of existing models, in particular Computable General Equilibrium models, make less efficient use of the most up to date information available in the public domain. In most cases these existing models are reliant on input-output tables which reflect an updated representation of the economy. Furthermore, unless the parameters of these models have been derived via robust econometric estimation and are time-varying, they will tend to produce less than reliable forecasts. This is important in the calculation of elasticities which is an important aspect of this assignment.