

## **ANALYSIS OF THE TAXES AND ASSISTANCE IMPACTING THE TOURISM INDUSTRY**

This report was prepared for the National Tourism Alliance (NTA) by Econtech Pty Ltd with assistance from KPMG who prepared the Appendices

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Econtech was commissioned by the NTA to identify the taxes and assistance impacting on the tourism industry and to analyse the effect of these taxes and assistance on the tourism industry, related industries and the wider economy. This Report sets out Econtech's findings. Econtech makes no representations to, and accepts no liability for, reliance on this work by any person or organisation other than the NTA. Any person, other than the NTA, who uses this work does so at their own risk and agrees to indemnify Econtech for any loss or damage arising from such use.

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## CONTENTS

Executive Summary .....	i
1. Introduction.....	1
2. Definition of Tourism.....	3
3. Taxes on the Tourism Industry .....	4
3.1 General Taxes .....	4
3.2 Specific Taxes .....	5
3.3 Justified or Unjustified Taxes.....	8
4. Assistance Provided to the Industry.....	11
4.1 General Assistance.....	11
4.2 Specific Assistance.....	11
5. Economic Impacts .....	14
5.1 Methodology .....	14
5.2 Modelling Results .....	16
Appendix A – Tourism Industry Gross Value Added and Employment .....	20

## Executive Summary

The National Tourism Alliance has commissioned Econtech to identify the taxes and assistance impacting on the tourism industry and to analyse the effect of these taxes on the tourism industry, related industries and the wider economy.

The tourism industry is subject to a wide range of taxes, charges and levies under current government policies. For simplicity, these taxes, charges and levies are collectively referred to as “taxes” for the purposes of this report. For economic analysis, it is useful to classify these “taxes” into three groups: general taxes, specific justified taxes and specific unjustified taxes. These three groups are defined as follows.

- general taxes – are those that apply to industries generally, not just tourism, so their application to tourism is justified. The majority of the taxes that affect the tourism industry fall into this category.
- specific justified taxes – are those relating specifically to the tourism industry, but which may be justified on cost recovery grounds.
- unjustified specific taxes – are those relating specifically to the tourism industry, but which are not of a cost recovery nature, and therefore represent an unjustified tax on the tourism industry.

This report focuses on the unjustified specific taxes (including unjustified charges and levies) on the tourism industry. In this report, two “taxes” that fall into this category are identified. These are an unjustified component of the Passenger Movement Charge (PMC) and the Passenger Ticket Levy (Ansett Levy).

The PMC, which is levied on passengers departing Australia, is in part an unjustified tax. The PMC began as a cost recovery charge, but has since increased to the point that it now includes an unjustified component estimated at \$80 million in the 1999/00 financial year.

The Ansett Levy has applied to air travel originating in Australia, whether domestic or international, since 1 October 2001. It raised \$171 million in the 2002 calendar year. While the Ansett Levy may have been introduced by the government to recover certain government costs, those costs were not generated by the air travel on which the levy is now applied, and so the Ansett Levy cannot be justified in economic terms on cost recovery grounds.

More generally, the idea of cost recovery provides an economic justification for a specific tax on an industry only in two particular circumstances. The first circumstance is where the government provides a service to an industry player on a commercial basis, so that a specific tax based on the true cost of efficiently providing that service is justified as a user charge or fee. An example might be the Air Navigation and Rescue taxes levied by Airservices Australia. The second circumstance is where an industry generates adverse impacts on third parties who are not able to charge the industry for those adverse impacts, so that a specific tax is justified as an externality charge. An example might be the noise levy that covers the cost of noise abatement around Sydney and Adelaide airports.

This report also uses this same framework to analyse government assistance to the tourism industry. Just as general taxes that apply to industries generally can be regarded as justified when applied to the tourism industry, general assistance that applies to industries generally

can also be regarded as justified when applied to the tourism industry. For example, export market development grants are available to exporters generally, so their availability to the tourism industry is justified in that context.

The major example of assistance that is specific to the tourism industry is the funding of the Australian Tourist Commission (ATC) to promote Australia as an international tourism destination. The ATC, which was established in 1967, provides centralised international marketing for the tourism industry. This arrangement provides major economies of scale – it would be far more expensive if all tourism operators had to undertake their own international marketing, leading to much unnecessary duplication of effort. However, it is well established that it would be impractical to secure funding from industry operators for centralised marketing because of the “free rider” problem. This market failure justifies government funding of the ATC.

The economic modelling in this report focuses on the economy-wide effects of the unjustified specific taxes and assistance in the tourism industry. These are the Ansett Levy and the unjustified proportion of the PMC, there being no unjustified specific assistance. The results show that these unjustified taxes reduce real spending by foreign travellers in Australia by about \$120 million on an annual basis. The air transport industry also suffers, with a loss in annual output of around \$247 million.

## **Conclusion**

A component of the Passenger Movement Charge is not used for cost recovery purposes and is therefore considered unjustified. While the Ansett Levy may have been introduced by the government to recover certain government costs, those costs were not generated by the air travel on which the levy is now applied, and so the Ansett Levy cannot be justified in economic terms on cost recovery grounds.

All ongoing assistance that is currently available to the tourism industry is either not specific to the tourism industry or is justified on economic grounds by market failure due to the “free rider” problem.

The unjustified taxes have a negative impact on the tourism industry, with a loss in real spending by foreign travellers in Australia of about \$120 million on an annual basis, and a loss of \$247 million in the output of the air transport industry.

## 1. Introduction

The tourism industry has suffered significantly from adverse recent developments. Specifically, in September 2001 the terrorist attack in the US and the collapse of Ansett worsened conditions for the industry. Adding to these difficulties in the tourism industry is that taxes on tourism are substantial and continuing to rise. The World Travel & Tourism Council highlights this point in its Tax Barometer released in June 2002.

In response, the Commonwealth Government is developing a 10 Year Plan for tourism, including industry projections and new government policies. The first stage in this process was the release of a Discussion Paper in early 2002, which called for industry submissions. This is to be followed early in 2003 by a “Green Paper” containing a draft of the 10 Year Plan. Following the release of the Green Paper, formal consultations seeking feedback will be conducted, along with a regional tourism round-table. Finally, a “White Paper” containing the final plan will be put forward for consideration by the Government.

In the current tight fiscal climate, there are indications that new government policies for the tourism industry may be funded by increases in revenue raised from the industry. For example, there has been an indication that one option may be to increase the Passenger Movement Charge. Before considering any proposal to increase taxes on the tourism industry, it is important to understand the effects of tourism taxes that are already in place.

Accordingly, the National Tourism Alliance has commissioned Econtech to analyse the economic effects of tourism industry taxes and assistance on the tourism industry. These economic effects include the effects on the tourism industry, as well as the effects on related industries and the wider economy. In this Phase 1 report, the effects of existing taxes and assistance are analysed. The effects of the government’s new proposals for the industry may be analysed in a Phase 2 report, once those new proposals have been unveiled in the Green Paper.

This Phase 1 report is structured as follows.

- Section 2 discusses the definition of the tourism industry.
- Section 3 outlines the taxes that are currently imposed on the tourism industry and analyses whether each tax can be justified.
- Section 4 sets out the assistance that is currently available to the tourism industry and analyses whether each form of assistance can be justified.
- Section 5 describes the methodology used in modelling the economy-wide effects of unjustified tourism taxes and assistance and presents the results of the economic modelling.

While all care, skill and consideration has been used in the preparation of this report, the scope of this report is based on the strict instructions of the NTA and it is designed to be used only for the specific purpose set out below. If you believe that your instructions are different from those set out below, or you wish to use this work or information contained within it for another purpose, please contact us.

The specific purpose of this Phase 1 report is to identify the taxes and assistance impacting on the tourism industry and to analyse the effect of these taxes and assistance on the tourism industry, related industries and the wider economy.

The findings in this report are subject to unavoidable statistical variation. While all care has been taken to ensure that the statistical variation is kept to a minimum, care should be taken whenever using this information. Should you require clarification of any material, please contact us.

## 2. Definition of Tourism

A number of definitions of tourism are available, however, some leave a number of questions unanswered. According to the Macquarie dictionary, tourism is “the provision of local services, such as entertainment, lodging, food etc. for tourists, someone who travels or goes on tours, especially for pleasure”. This dictionary definition clearly defines holidaymakers as tourists, but is unclear on whether a person who is travelling to visit relatives, or for business or to work is a tourist.

In Australia’s official tourism statistics, the Australian Bureau of Statistics (ABS) necessarily uses a more precise definition. It regards persons visiting relatives or on business as tourists, but not persons visiting a location to work. More precisely, the ABS defines a tourist as:

*“Any person travelling to and staying in places outside their usual environment for not more than one consecutive year for leisure, business and other purposes not related to the exercise of an activity remunerated from within the place visited.”*

In its Tourism Satellite Account, the ABS includes in the tourism industry the components of each industry that provide goods and services to tourists. For example, the restaurants industry can be divided into a tourism component and a non-tourism component, the tourism component representing the proportion of restaurant customers that are tourists. So the total tourism industry is made up of components of the wide range of industries that provide goods and services to tourists.

Appendix A shows tourism components of the key tourism industries. The first table shows value added while the second table shows employment. In particular, tourism accounts for 4.7 per cent of GDP and 6.0 per cent of national employment.

This report uses the ABS definition of the tourism industry.

### 3. Taxes on the Tourism Industry

The tourism industry is subject to a wide range of taxes, charges and levies under current government policies. For simplicity, these taxes, charges and levies are collectively referred to as “taxes” for the purposes of this report. For economic analysis, it is useful to classify these “taxes” into three groups: general taxes, specific justified taxes and specific unjustified taxes. These three groups are defined as follows.

- general taxes – are those that apply to industries generally, not just tourism. The majority of the taxes that affect the tourism industry fall into this category.
- specific justified taxes – are those relating specifically to the tourism industry, but which may be justified on cost recovery grounds, as explained further below.
- unjustified specific taxes – are those relating specifically to the tourism industry, but which are not of a cost recovery nature, and therefore represent an unjustified tax on the industry.

The economic modelling contained in section 5 of this report focuses on the economy-wide effects of the unjustified specific taxes. This is to show how these unjustified specific taxes affect the tourism industry and the economy generally. The other taxes are justified and so have not been modelled as this report does not propose any policy action in relation to them.

Section 3.1 below identifies general taxes affecting the tourism industry, section 3.2 identifies and quantifies specific taxes and then section 3.3 examines the reasons for whether the tax is considered justified or unjustified. Each of these taxes is discussed in more detail in the relevant Appendix (see Appendices 1-12).

#### 3.1 General Taxes

General taxes are imposed by the government as part of general revenue raising. While the tourism industry is impacted by these taxes, they are not specific to the industry and are not seen to affect the tourism industry more than any other industry. Therefore, this report will identify but not focus on any of the general taxes. Following is a list of general taxes that impact on the tourism industry:

- |  |  |
|--|--|
| ▪ GST (see Appendix 3)                 | ▪ Motor vehicles taxes                               |
| ▪ Fringe benefits tax (see Appendix 4) | ▪ Wine equalisation tax                              |
| ▪ Payroll tax                          | ▪ Excise (and customs) duties on alcohol and tobacco |
| ▪ Land tax                             | ▪ Stamp duty – conveyances                           |
| ▪ Personal income tax                  | ▪ Stamp duty – land rich provisions                  |
| ▪ Business tax                         | ▪ Stamp duty – hire equipment                        |
| ▪ Company tax                          | ▪ Other financial stamp duties                       |
| ▪ Entity tax                           | ▪ Thin capitalisation rules                          |
| ▪ Fuel tax                             | ▪ Stamp duty on car rentals                          |
| ▪ Capital gains tax                    | ▪ Vehicle registration fees                          |

Some commentators would query our inclusion of GST as a general tax that should apply to tourism on the basis that it applies to other industries. In particular, these commentators argue that all spending in Australia by foreign tourists should be GST-free, not just airfares and goods that are purchased in Australia and then taken out of Australia. Their argument for widening this exemption is that such spending is an export under standard economic and statistical definitions, and most other exports are GST-free.

However, there are persuasive arguments in favour of the current GST arrangements for foreign tourists. First, it is generally not practical to provide foreign tourists, but not Australian residents, with a special GST exemption. Second, Australia's approach is similar to practice in most other countries.

On balance, this report accepts the arguments for the current GST treatment in Australia of spending by foreign tourists. So GST is regarded as a general tax that is applied appropriately to the tourism industry.

### 3.2 Specific Taxes

This section identifies and describes taxes that are applied specifically to the tourism industry. A brief discussion of eight specific taxes follows. Section 3.3 will then classify each of these taxes as justified or unjustified. As mentioned at the outset, in this report the term "taxes" is used collectively to cover taxes, charges and levies – so taxes, charges and levies are all discussed below.

#### *Passenger Movement Charge (PMC)*

The PMC was introduced in January 1995 to replace the departure tax. It was intended that this charge simply recoup the costs of customs, immigration and quarantine processing of passengers and the cost of issuing short term visitor visas. The PMC is a tax which is levied on purchasers of tickets for travel leaving Australia for an overseas destination. It is collected by regular passenger transport (RPT) airlines, charter airlines and shipping companies as part of their ticketing arrangements. RPT airlines remit approximately 98% of all PMC revenue. The PMC is administered by the Australian Customs Service (see *Appendix 7* for more details).

When the PMC was first introduced it was charged at \$27 per passenger leaving Australia. The level of the tax was increased on 1 January 1999 to \$30 to cover the additional costs associated with the large number of passengers coming in to Australia for the Sydney Olympic Games and extra funding for advertising to attract visitors to Australia during the Games. The tax was further increased to \$38 on 1 July 2001 to cover the cost of improvements to the quarantine facilities associated with foot and mouth disease. The PMC currently remains at \$38 per passenger leaving Australia. During the 2001/2002 financial year the Australian Customs Service collected \$281.3 million from the PMC. (Source: Australian Customs Service)

#### *Passenger Ticket Levy (Ansett Levy)*

The government introduced the Passenger Ticket Levy on air passenger tickets purchased after 1 October 2001 to cover the basic entitlements of Ansett employees. The levy is a tax which is charged at \$10 per ticket for all flights originating in Australia. The government

has so far (from 1 October 2001 to 31 December 2002) collected \$182.3 million from the Ansett Levy. On an annual basis, collections amounted to \$171.3 million in 2002. As at 2003, the government had paid out \$332 million to fund the entitlements of Ansett employees. (Source: DoTARS) (See *Appendix 5* for more details.)

### *Aircraft Noise Levy*

The Aircraft Noise Levy came into place from 1 October 1995 for all jet aircraft landings at Sydney Airport. The levy is a tax which was designed to recoup the costs associated with the acoustic insulation works in the vicinity of the airport. The government has not placed any restrictions on how the operators recover the cost, however, in most cases the airlines operating jet aircraft into Sydney Airport are imposing a charge of \$3.40 per passenger landing. The government raised revenue of \$35.9 million from the Sydney Aircraft Noise Levy in the 2001/02 financial year.

The levy was extended to cover Adelaide Airport from 1 May 2001 to cover the cost of acoustic insulation works for areas surrounding that airport. The government raised revenue of \$6.8 million in the 2001/02 financial year from the Adelaide Aircraft Noise Levy. (Source: DoTARS) (See *Appendix 6* for more details.)

### *Aviation Fuel Excise*

Excise duty (or customs duty) is payable on domestic aviation turbine fuel (AVTUR) and aviation gasoline (AVGAS). The aviation fuel excise has been established as a cost recovery mechanism for the provision of a range of civil aviation safety services currently provided by the Civil Aviation Safety Authority (CASA). The revenue raised under the aviation fuel excises is paid into Consolidated Revenue and then paid to CASA under a special appropriation.

CASA is an independent statutory authority established on 6 July 1995. CASA's objective is to maintain, enhance and promote civil aviation safety by undertaking the following four key functions:

- develop and implement aviation safety standards and practices;
- secure compliance with safety standards and procedures through surveillance and enforcement
- provide information and educative standards, practices and compliance; and
- process application and handling of regulatory requests.

The FY01 Budget increased the rate of excise (and customs duty) on AVTUR to recover the ACCC's costs of regulating airports. The ACCC's regulatory activities include administering airport access arrangements, assessing compliance with airport caps, monitoring the prices of aeronautical related services at airports and monitoring the quality of service. The ACCC is forecast to receive approximately \$1m per year from the rate increase.

Aviation fuel excise raised \$56 million in the 2001/02 financial year. Of this total amount, Qantas (with its regional airlines) estimated that it paid \$35.4 million. (Source: Productivity Commission 2001 and Qantas) (See *Appendix 8* for more details.)

### ***Environmental Management Charge***

The Environmental Management Charge came into effect from 1 July 1993 to fund research, management and information programs within the Great Barrier Reef Marine Park. The charge is levied on tourist operators at \$4 per passenger per day and raised \$6.6m for the financial year 2001/02. All funds raised from this charge are used by the Great Barrier Reef Marine Park Authority, with a major proportion of the funds being allocated to the Cooperative Research Centre for the Ecologically Sustainable Development of the Great Barrier Reef in Townsville. (Source: Great Barrier Reef Marine Park Authority) (See *Appendix 9* for more details.)

### ***Air Navigation and Rescue Charges***

Air Navigation and Rescue Charges are designed to cover air traffic management, terminal navigation, enroute navigation and aviation rescue and fire fighting services in Australia. These services are provided by Airservices Australia. Airservices Australia was established on 6 July 1995 as a Government Business Enterprise. Two of the fees used to fund Airservices Australia, which directly affect the tourism industry, are:

- Terminal and rescue service fees: based on the Maximum Take-Off Weight (MTOW) of aircraft; and
- En route navigation fees: based on a combination of the square root of aircraft MTOW and distance (kms)/100.

The airlines recover these fees in the price of passenger tickets. (Source: Productivity Commission 2001 and QANTAS) (See *Appendix 10* for more details.)

### ***Safety and Security Charges (S&SC)***

The Safety and Security Charge (S&SC) is charged by airlines to passengers to recover the cost of a range of safety and security measures at Australian airports. This safety and security measures are required by the Commonwealth Government. The safety requirements include the Counter Terrorism First Response capability supplied by the Australian Protective Services, passenger screening for domestic airports, and additional checked bag screening at international airports. The S&SC is included in this report because it is a direct result of the policies of the Commonwealth Government.

The amount of the S&SC varies between airlines and airports. Qantas has estimated that the additional security requirements will cost around \$80 million in the financial year 2002/03 for all airlines operating within Australia. (Source: QANTAS) (See *Appendix 11* for more details.)

### ***Visa charges***

A visitor visa or electronic travel authority (ETA) is required by tourists visiting Australia. The Commonwealth Government does not charge for ETA's, however, visas do attract a fee. The Commonwealth Government collected revenue of \$224.9 million from general visas in the 2001/2002 financial year. (Source: DIMIA) (See *Appendix 7* for details of the fees payable for short stay visitor visas.)

### 3.3 Justified or Unjustified Taxes

The purpose of this section is to determine whether each of the eight tourism taxes that have been discussed above is justified or unjustified. The economic effects of the tourism taxes that are identified as unjustified are then modelled in section 5.

The principle of cost recovery provides an economic justification for a specific tax on an industry in two particular circumstances.

1. Services are provided by the government to an industry player on a commercial basis, so that a specific tax based on the true cost of efficiently providing that service is justified as a user charge. An example might be the Air Navigation and Rescue charges levied by Airservices Australia.
2. The second circumstance is where an industry generates adverse impacts on third parties, so that a specific tax is justified as an externality charge. An example might be the noise levy that covers the cost of noise abatement around Sydney and Adelaide airports.

Unjustified taxes either should be removed or accepted as a justification for industry assistance of an equal amount. As mentioned above, the economic effects of the unjustified taxes are modelled in section 5. (See *Appendix 2* for a discussion of the new Cost Recovery Guidelines and review processes adopted by the Government.)

The eight specific taxes described in the preceding section are now assessed in turn. As mentioned earlier, the term “taxes” is used collectively to cover taxes, charges and levies – so taxes, charges and levies are all discussed below.

#### *Passenger Movement Charge (PMC)*

The PMC contains both a user charge and an unjustified component. The user charge or cost recovery component covers the various costs identified earlier, including passenger processing and the cost of issuing short-term visas. Collections from the PMC exceed these costs, and it is the amount of over-collection that represents an unjustified tax.

The over-collection in 1999/00 was officially estimated at \$80 million by Lionel Woodward (Australian Customs Service) in the Senate Hansard. This estimate is used in the modelling in section 5. Senator Ludwig asked at the end of last year for this estimate to be updated but no new official estimate is yet available. (See Appendices 7.1 and 7.2 for detailed unofficial estimates of the over collection in 2000/01 and 2001/02.)

As mentioned earlier, there was an increase of \$3 per passenger in the PMC at the beginning of 1999 to cover the additional expenses associated with the Sydney Olympic Games. The justification for this additional funding has now passed but the extra revenue continues to be collected, adding to the amount of over-collection.

### ***Passenger Ticket Levy (Ansett Levy)***

The proceeds of this levy will be used to fund the basic entitlements of Ansett employees. While the Ansett Levy may have been introduced by the government to recover certain costs, those costs were not generated by the air travel on which the levy is now applied, and so the Ansett Levy cannot be justified in economic terms in terms of negative externalities or other cost recovery grounds. Therefore, this levy is unjustified and is included in the modelling of unjustified taxes in section 5.

### ***Aircraft Noise Levy***

One of the consequences of flying is that noise will result from that flight, which will affect those in the vicinity of the airport – this represents a negative externality of flying. To minimise the impact of the noise of the aircraft, the Commonwealth Government has implemented an acoustic insulation program for residential and public buildings in the proximity of both the Sydney and Adelaide airports. This is on the basis those who are creating that noise should pay for the cost associated with minimising the effects of it. Therefore, the Aircraft Noise Levy is considered justified as a charge for a negative externality and will not be included in the modelling of unjustified taxes in section 5.

### ***Aviation Fuel Excises***

Aviation Fuel Excises are used to recover the cost of services to the airline industry. Therefore, these taxes are considered justified as a user charge and are not included in the economic modelling. However, there have been arguments from the airlines questioning the appropriateness, efficiency and transparency of the aviation fuel excises as a cost recovery mechanism. (See *Appendix 8* for a summary of these arguments.)

### ***Environmental Management Charge***

Tourists visiting the Great Barrier Reef can have a negative impact on the environment – a negative externality. To preserve the Reef, research, management and information programs need to be implemented. Therefore, the Environmental Management Charge is considered justified as a charge for a negative externality and will not be included in the modelling process.

### ***Air Navigation and Rescue Charges***

The air navigation and rescue charges are used to cover the cost of government services provided to the industry. These charges are therefore considered justified as a user charge and will not be included in the economic modelling. However, the airlines argue that there is increasing evidence to suggest that Airservices Australia's current charging structure may not accurately reflect the cost of providing a given service and that it does not promote efficient new investment in aircraft technology. (See *Appendix 10* for a further discussion of these issues)

### ***Safety and Security Charges***

The Safety and Security Charge (S&SC) is a commercial cost recovery charge which is considered justified. Airports and airlines are required by the Commonwealth Government

to maintain a minimum standard of security for the benefit of passengers, who pay for this security through the S&SC.

### *Visa charges*

There is a cost associated with the issuing of visitor visas by the government. This implies that the government is providing a service in a commercial arrangement for which it should be paid. Therefore, the visitor visa charge is considered justified.

## 4. Assistance Provided to the Industry

This report uses the same framework to analyse government assistance to the tourism industry as was used to analyse government taxes impacting the tourism industry. Just as general taxes that apply to industries generally can be regarded as justified when applied to the tourism industry, general assistance that applies to industries generally can also be regarded as justified when applied to the tourism industry. Specific justified assistance is assistance that is specific to the tourism industry, but which may be justified on economic grounds. Specific unjustified assistance is that relating specifically to the tourism industry, but which cannot be justified on economic grounds, and therefore represents an unjustified assistance to the tourism industry.

Any unjustified assistance would be used to offset the unjustified taxes in the economic modelling in section 5 of this report. The other assistance is justified and so has not been modelled.

Section 4.1 below identifies general assistance available to the tourism industry and section 4.2 identifies and quantifies specific taxes and examines the reasons for whether the assistance is considered justified or unjustified.

### 4.1 General Assistance

General assistance is provided by the Commonwealth Government to help all industries. These will not be covered in detail because, while the industry does benefit from this assistance, they are not specific to the industry and are not seen to benefit the tourism industry more than any other industry. Therefore, this report will identify but not focus on any of the general assistance. Following is a list of general assistance that benefits the tourism industry:

- Depreciation
- Tourist refund scheme (TRS)
- Principle of mutuality (for clubs)
- Regional Headquarters (incentives, and tax holidays for some firms provided by some State governments)
- Duty and tax free shopping (accepted under international agreement)
- Export marketing development grants (EMDG) scheme
- Heritage conservation tax incentive
- Regional development funding (“Regional Solutions”)

### 4.2 Specific Assistance

The main form of Commonwealth Government assistance received by the tourism industry is through the Australian Tourist Commission (ATC). The ATC received \$98 million for the 2001/02 financial year, while the See Australia Marketing campaign and the Regional Tourism Program will each receive \$8 million over four years and the Travel Compensation fund received a maximum of \$5m. Therefore, this section will focus mainly on Commonwealth Government funding of the ATC.

### *Commonwealth Government assistance to the Australian Tourist Commission (ATC)*

The ATC is an Australian Government Statutory Authority, established in 1967 to provide centralised international marketing for the tourism industry. It is the major assistance specific to the tourism industry designed to promote Australia as an international tourism destination.

The ATC was established to take advantage of the economies of scale in international marketing for Australian tourism operators. It would be far more expensive if all tourism operators had to undertake their own international marketing, leading to much unnecessary duplication of effort. So the most efficient arrangement was to establish a single marketing authority – the ATC – to take maximum advantage of the economies of scale.

The ATC necessarily relies mainly on government funding because of market failure for private funding. An individual tourism operator receives little benefit from any contribution that he or she makes because it is unlikely to significantly change the size of the total funding pool for the ATC. So each operator has an incentive to not contribute and instead “free ride” on the contributions of other operators. If each tourism operator “free rides” in this way, then no industry contributions to the funding pool will be forthcoming. To overcome the market failure from the “free rider” problem, the ATC has always relied mainly on government funding.

The ATC received government funding of \$98 million for the financial year 2001/02, with \$109 million forecast in the 2002/03 budget. This funding is justified in economic terms by the market failure from the free rider problem and so is not included in the modelling of unjustified taxes and unjustified assistance. (Source: ATC and the 2002/03 Budget) (See *Appendix 13* for more details on the forms of direct budgetary assistance provided to the tourism industry.)

### *See Australia Marketing*

The See Australia marketing campaign is a domestic tourism initiative designed to encourage travellers to regional areas of Australia. The campaign is managed by a private company but is funded jointly by the Commonwealth Government, State governments and industry. The program also involves research and development to assist the marketing campaign. The Commonwealth Government will provide funding to the See Australia program of \$8 million over four years. The See Australia Marketing scheme is also in place to offset market failure for marketing in the tourism industry and to benefit from the economies of scale. Therefore, this assistance is considered justified and is not incorporated into the economic modelling. (Source: Prime Minister News Release, November 2001)

### *Regional Tourism Program*

The Regional Tourism Program provides funding for the development of tourism attractions and facilities, special interest markets, cultural and heritage attractions in regional Australia. The program aims to help boost the capacity of businesses and organisations to deliver high quality tourism attractions, products and services in regional Australia. The Commonwealth Government provided \$8 million in assistance over 4 years to fund the program. The Regional Tourism Program is aimed more at regional development rather than assistance for

the tourism industry. As described on the Department of Industry, Tourism and Resources website, this program is designed to fund tourism that complements regional industries, boosts local economies and creates employment, particularly for young Australians. As this assistance appears to be aimed at the broader regional economies, the assistance is considered justified and will not be incorporated in the modelling. (Source: DITR website and Prime Minister News Release, November 2001)

#### *Travel Compensation Fund (TCF)*

The TCF compensates consumers who have suffered financial loss by a travel agent's failure to account for monies paid to the agent for travel arrangements. Following the collapse of Ansett/Traveland in September 2001, the number of claims made to the TCF substantially increased. In order to assist with these additional claims, the Commonwealth Government offered a one off assistance package to the TCF. The contribution to the TCF recognised the exceptional circumstances of the collapse of Ansett/Traveland and the downturn in tourism. The Commonwealth Government provided \$5 million in assistance in the year following September 2001 to the TCF. This was a one off contribution that has now finished. As a result, this assistance will not be included in the modelling. (Source: Prime Minister News Release, November 2001 and TCF)

Each form of assistance is justified on an individual basis. Therefore, no unjustified assistance will be included in the modelling in section 5.

## 5. Economic Impacts

### 5.1 Methodology

This section of the report describes the modelling assumptions used in the analysis of the economic impacts of the unjustified taxes on tourism. In particular, this section provides an explanation of the main features of MM600+ that are important for understanding the modelling results. It then explains the steps undertaken in modelling the economic impacts of the unjustified taxes on tourism.

The economic modelling in this report was conducted using Econtech's MM600+ model. MM600+ is a highly detailed model of the Australian economy. It distinguishes the prices of 672 different products, making it six times more detailed than comparable models.

MM600+ has many features that make it well suited for this analysis as follows:

- it is a Computable General Equilibrium (CGE) model that estimates long term effects on costs, prices and volume of economic reforms;
- it fully incorporates the New Tax System (NTS), making it unique among Australian CGE models;
- it separately identifies air passenger transport and air freight transport services, which is important for modelling the effect of air passenger transport taxes;
- it includes a detailed representation of Australian trade in tourism, including both travel imports and exports; and
- it produces results for key economic aggregates such as gross domestic product (GDP).

MM600+ models a long-run equilibrium. Some of the key assumptions involved are as follows.

- *labour market equilibrium*: employment in MM600+ is fixed, which means that in the long run the labour market is assumed to attain equilibrium, so that an economic shock has no lasting effect on total employment. This assumption is implemented by fixing the level of total employment. This means that direct job losses in a particular industry or region will be exactly balanced by job gains in other industries or regions.
- *external balance*: in MM600+, the balance of trade is at a sustainable level. Specifically, a trade surplus is run equal to the amount required to service foreign-owned capital. The real exchange rate needed to achieve this trade surplus is determined by MM600+. Thus shocks to international trade affect the real exchange rate, not the trade surplus.
- *budget balance*: the government budget is assumed to be in balance. Labour income tax is used as the swing fiscal instrument to balance out the effects on the government budget of any shock to the budget, such as increased taxation on airfares.
- *private saving*: the level of private sector saving and associated asset accumulation are sustainable in the long run. Private saving is held constant in MM600+ by fixing the quantity of capital that is owned locally, and changes in capital are only in the foreign-owned portion.

The economic modelling in this report focuses on the economy-wide effects of the unjustified specific taxes and assistance in the tourism industry. These unjustified taxes were identified in the earlier parts of this report. Specifically, there are two current unjustified taxes on tourism and these are both taxes that are levied on passenger air transport. These two taxes are the Ansett Levy and the unjustified proportion of the PMC. There is currently no unjustified specific assistance that has been identified.

The current level of unjustified taxes was estimated in Section 3.3 at around \$251 million on an annual basis. The \$251 million is made up of the unjustified proportion of the PMC, estimated at \$80 million per year, and the Ansett Levy, estimated at \$171 million per year. This \$251 million dollars of unjustified taxes on airfares can be thought of as an over collection of taxes on air travel.

Once the level of this over collection is identified, it is then necessary to represent it in MM600+. In the MM600+ model, the unjustified taxes on airfares affect two types of air travel:

- i. air travel by Australians; and
- ii. air travel by foreigners on Australian-based airlines.

The Ansett Levy is a tax on air travel that originates in Australia and therefore falls almost exclusively in Australians. Thus it applies to the first category of air travel. The PMC is a tax on international travel from Australia (i.e. departures). So it affects both foreigners visiting Australia as well as Australians visiting overseas. This means that it applies to both categories of air travel to some degree.

Taking both the Ansett Levy and the unjustified component of the PMC into account, it is possible to calculate, for both types of air travel, corresponding tax rates representing the unjustified taxes. The unjustified component of the tax rate for air travel by Australians was estimated at 8.7 per cent of airfares. The unjustified component of the tax rate for air travel by foreigners on Australian-based airlines was estimated at 2.9 per cent.

Therefore analysis for this report was undertaken using two model scenarios:

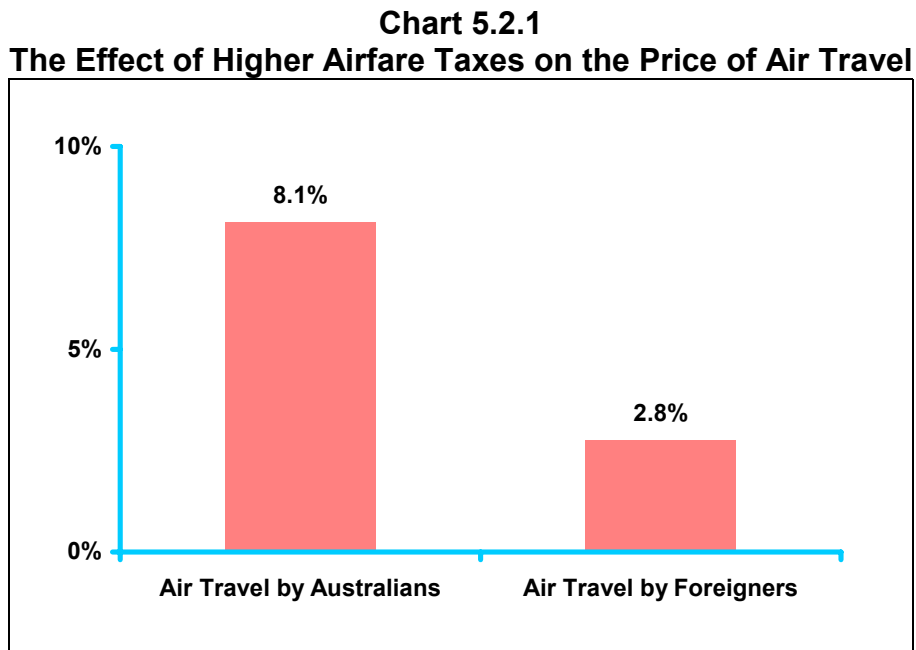
- Baseline Scenario. This scenario models the Australian economy without the current over collection of taxes.
- Over-collection Scenario. Under this scenario, the two unjustified tax rates described above are applied to air travel.

The Over-collection scenario was compared with the Baseline Scenario to estimate the effects of the current over collection of taxes on the tourism industry. The results also estimate the flow on effect of this over collection of taxes on production and employment in other industries.

## 5.2 Modelling Results

As discussed in the previous section, the model examined two scenarios: one without the over collection of taxes on air travel and one with the over collection of taxes on air travel. The estimated effect of the over collection of taxes on air travel is calculated by examining the differences between the two scenarios.

By increasing the taxes on airfares, the price of air travel will rise. The chart below shows the estimated rise in the price of air travel as a result of introducing a tax on airfares that is equivalent to the current over collection.

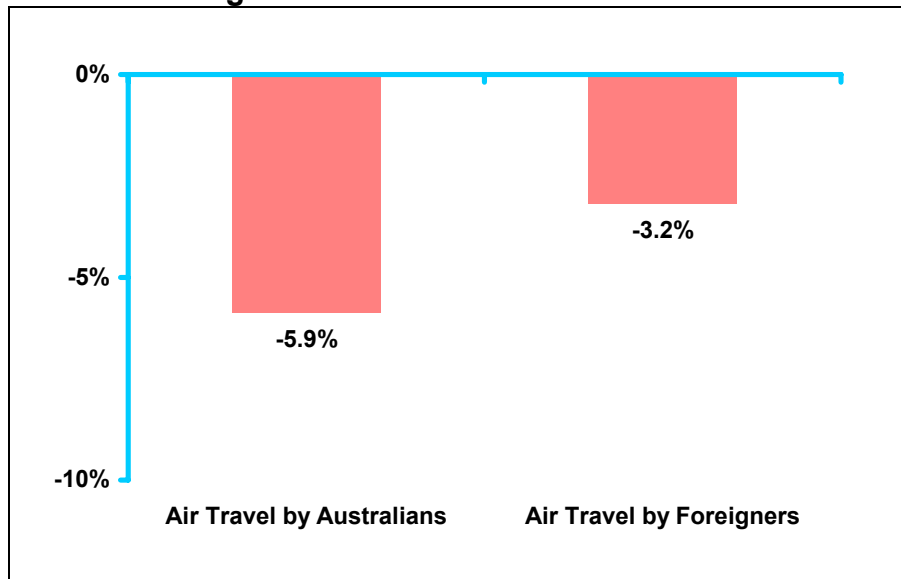


The increase in the price of airfares is more pronounced for air travel by Australians. This is because these airfares include both the Ansett Levy and the PMC (on overseas travel). This boots the price on air travel by Australians by 8.1 per cent.

The price of airfares purchased by foreigners is less pronounced, as it is only affected by the PMC. The chart above shows the price of airfares purchased by foreigners increasing by 2.8 per cent.

The increase in the price of airfares is expected to reduce the demand for air travel. The chart below shows the change in the consumption of the two types of air travel. Consumption of air travel by Australians is expected to fall by 5.9 per cent, while consumption of air travel by foreigners on Australian-based airlines is expected to fall by 3.2 per cent.

**Chart 5.2.2**  
**The Effect of Higher Airfare Taxes on the Volume of Air Travel**



The reduction in the demand for air travel will flow through to changes in production in the air transport industry. Further, production in other industries will also respond to the change in air transport activity, with industries that service tourists particularly affected.

#### *Tourism Industry Effects*

Chart 5.2.3 shows the estimated long-term effects of the increase in the price of airfares on the tourism industry. The 2.1 per cent reduction in Australian spending by foreign travellers is the result of the increase in the cost of airfares purchased by foreign travellers. The increase in the price of airfares purchased by foreigners of 2.8 per cent, this flows through to a significant reduction in Australian spending by foreign travellers.

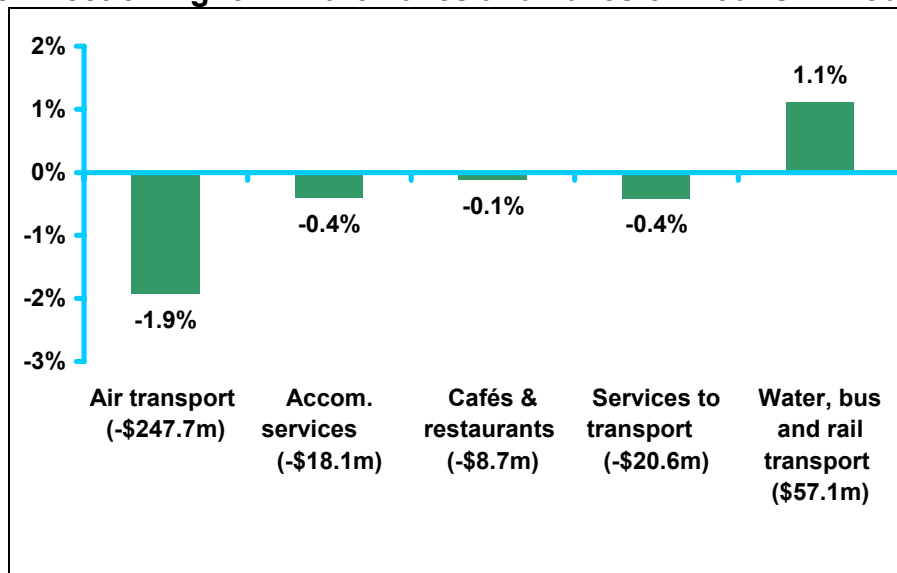
**Chart 5.2.3**  
**The Effect of Higher Airfare Taxes on Travel Exports**



As mentioned above, introducing additional taxes on airfares will directly increase the cost of airfares. The increase in the cost of air travel will affect the level of spending in Australia by foreign travellers in two ways. First, raising the cost of airfares to Australia will reduce the demand for air travel to Australia. With a reduction in the number of people flying to Australia, there will be less money spent in Australia by foreign travellers. Second, some of the foreign travellers who still decide to travel to Australia will have less money to spend once they arrive here. Overall, introducing an additional tax on airfares will lead to a reduction in the level of spending in Australia by foreign travellers.

The chart above shows that this reduction in Australian spending by foreign travellers is estimated at around 2.1 per cent. In 1998/99 it is estimated that international visitors consumed \$5.8 billion worth of goods and services produced by the Australian economy. Thus a fall in this consumption of 2.1 per cent would represent a loss of over \$120 million. This reduction in spending in Australia by foreign travellers tends to be more concentrated in the tourism sector. Chart 5.2.4 shows the effects of the unjustified taxes on products in the Tourism Industry.

**Chart 5.2.4**  
**The Effect of Higher Airfare Taxes and Taxes on Tourism Products**



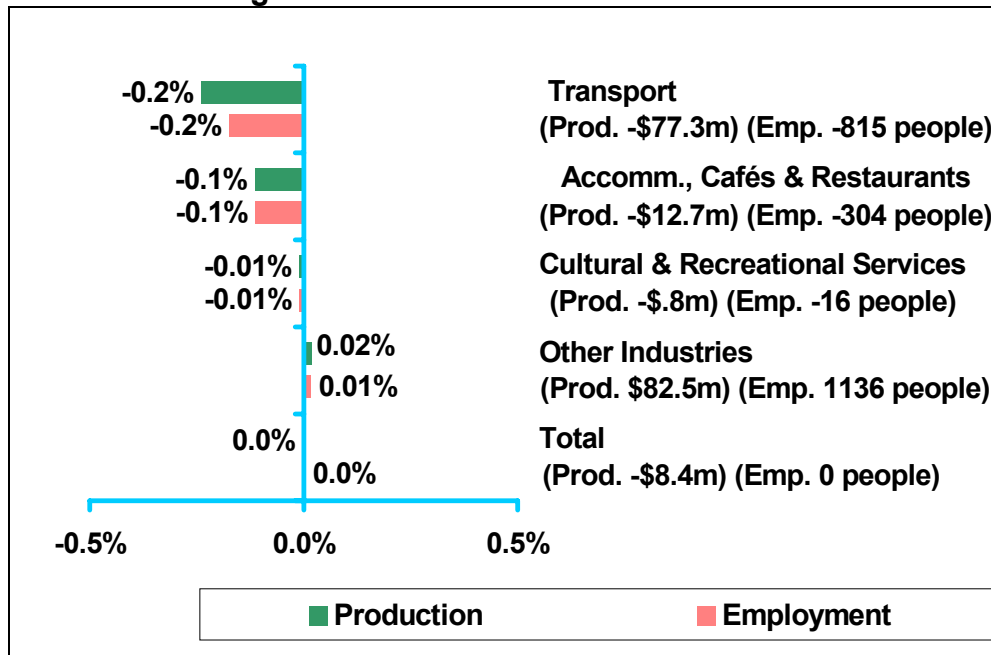
The volume effect shown in Chart 5.2.2 contributes to the 1.9 per cent reduction in the level of air transport services. This reduction in air travel means that less people are travelling and, as such, less money is being spent on services for travellers. These services include accommodation, cafés and restaurants, and services to transport. The chart shows these services reducing by between 0.1 and 0.4 per cent.

With the increase in the cost of air travel, some travellers will substitute air travel with other forms of transport. This type of substitution will generally be on the domestic legs, with travellers using train or bus services instead. Because they are substituting domestic air travel, these effects are largely being driven by the Ansett Levy, rather than the PMC (which is applied to international departures). The chart above shows other transport services increasing by 1.1 per cent.

### Wider Industry Effects

The change in activity in air travel is expected to affect activity in other industries. Chart 5.2.5 shows the main effects on other industries. The industries that are the most affected by the higher taxes on airfares are those industries that service travellers.

**Chart 5.2.5**  
**The Effect of Higher Airfare Taxes and Taxes on Other Industries**



As discussed earlier, the higher airfare taxes increase the price of air transport, which leads to a long-term reduction in demand for air transport services. While this is partly offset by the substitution of other forms of transport, the overall level of transport services are expected to reduce. The chart above shows a reduction in the transport services of around 0.2 per cent or about \$77 million. This flows through to a similar fall in employment in this industry.

The other broad industry that is affected by the higher airfare taxes is the Accommodation, Cafés and Restaurants industry. The detailed effects on some of the products and services within this industry were shown in Chart 5.2.4. The overall impact on the Accommodation, Cafés and Restaurants industry is an average fall of 0.1 per cent in activity, as seen in Chart 5.2.5.

For the economy as a whole, the over collection of airfare taxes do not lead to any significant growth to total production (GDP). The over collection of taxes reduces tourism related activity. As such, some resources shift to other industries, increasing the activity in these industries. However, this increased activity is only enough to offset the loss of activity in the tourism sector, it does not bring any significant long-term benefits to the economy through increased GDP. Similarly, there is no change in the level of employment in the economy. As explained in Section 5.1, national employment is assumed to be unchanged as a standard long-term modelling assumption. Under this assumption, the job losses in the tourism industry will be balanced by job gains in other industries or regions.

## Appendix A – Tourism Industry Gross Value Added and Employment

### Tourism Industry Gross Value Added

	2000-01(a)
	\$m
Tourism characteristic industries	
Travel agency and tour operator services	978
Taxi transport	221
Air and water transport	3910
Motor Vehicle Hiring	281
Accommodation	2765
Cafes, restaurants and takeaway food outlets	2504
Total tourism characteristic industries	10659
Tourism connected industries	
Clubs, pubs, taverns and bars	1228
Other road transport	716
Rail transport	439
Food manufacturing	767
Beverage manufacturing	468
Transport equipment manufacturing	221
Other manufacturing	1564
Automotive fuel retailing	180
Other retail trade	2288
Casinos and other gambling services	195
Libraries, museums and arts	435
Other entertainment services	763
Education	1053
Ownership of dwellings	1605
Total tourism connected industries	11923
All other industries	3702
Total	26284
Net taxes on tourism products	5529
<b>Tourism GDP</b>	<b>31814</b>
Total GDP	669907
<b>Tourism share of GDP (%)</b>	<b>4.7</b>

(a) Estimates for 2000-01 are preliminary due to delays in the availability of the International Visitor Survey for the that year.

**Tourism Employed Persons (a), By Industry**

	2000-01 '000
Tourism characteristic and connected industries (b)	
Travel agency and tour operator services	23.7
Road transport and motor vehicle hiring	23.3
Air and water transport	36.0
Accommodation	99.0
Cafes and restaurants	50.9
Clubs, pubs, taverns and bars	29.4
Rail transport	3.7
Manufacturing	38.8
Retail trade	143.6
Casinos and other gambling services	2.1
Libraries, museums and arts	11.0
Other entertainment services	15.4
Education	18.8
Total characteristic and connected industries	495.7
All other industries	55.3
Total tourism employed persons	551.0
Total employed persons	9123.0
Tourism share of total employment (%)	6.0

(a) Tourism employed persons is derived by multiplying the number of employed persons in the industry by the proportion of total value added of the industry which is related to tourism.

(b) The industries shown in the employment tables are at a more aggregated level than that shown in the monetary tables.

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