INSURANCE COUNCIL OF AUSTRALIA

SUBMISSION TO THE VICTORIAN GOVERNMENT GREEN PAPER FIRE SERVICES AND THE NON INSURED

JULY 2010

INTRODUCTION

The Insurance Council is pleased to be able to provide this submission to the Victorian Government's Green Paper: "*Fire Services & the Non Insured*". The Insurance Council of Australia Limited (Insurance Council) is the representative body of the general insurance industry in Australia with members of the Insurance Council representing more than 90 percent of total premium income written by private sector general insurers. Insurance Council members provide insurance products ranging from those usually purchased by individuals and households (such as home/contents insurance and motor vehicle insurance) to those purchased by commercial entities both large and small (such as property, professional indemnity, product and public liability).

The Insurance Council submits that the presence and availability of general insurance is fundamental to the well being of individuals, business and communities alike. As the Green Paper itself suggests, nowhere has the value of general insurance been better demonstrated than in the aftermath of tragic Black Saturday bushfires in February 2009. Following the Black Saturday bushfires, the protection afforded by general insurance assisted affected communities to reconstruct and recover from their losses with some 10,280 claims made to a combined value of $1.1 billion. [1] The scale of this compensation post Black Saturday is a clear demonstration of the extent of assistance which may have otherwise been required to be funded by public finances in the absence of general insurance availability.

Mindful of the tragedy and the losses of Black Saturday, the Insurance Council welcomes the Victorian Government's initiative to commence a review of fire funding through the Green Paper process. Together with the Royal Commission into the Victorian Bushfires (scheduled to report at the end of July 2010) the Insurance Council believes it is appropriate for the Victorian community to reflect upon and evaluate existing Victorian fire funding systems and to consider whether existing arrangements remain adequate into the future. As this submission will outline, the Insurance Council contends that the current statutory contributions system for funding the Victorian fire services ill serves the Victorian community and should be replaced in its entirety with a funding system for the Victorian services which is more equitable and efficient. Moreover, the Insurance Council submits that a funding system built around a base of land/property offers the most efficient and equitable arrangement for funding what is, in effect, the public good of a comprehensive and indivisible fire service.

The Insurance Council also notes that the Green Paper process (and the Royal Commission) has coincided in timing with an extensive and wide ranging review of taxation undertaken as part of the Review of Australia's Future Tax System (AFTS or the "Henry Tax Review). The AFTS recommended the abolition of all taxation on insurance products, including fire services levies. The Insurance Council supports the findings and conclusion of the AFTS review which found that "*there is little justification for levying specific taxes on insurance products. Rather than correcting a market failure, insurance taxes can add to existing problems in the insurance market. The revenue from insurance taxes should be replaced by revenue from a more efficient and equitable tax*". [2] Furthermore, notwithstanding that the AFTS is a Commonwealth review of taxation, it should be noted that the findings of the AFTS are entirely consistent with those of Victorian government own State Tax Reviews, which advocated a similar recommendation on

[1] Source: Insurance Council

[2] See Australia's future tax system: *Report to the Treasurer: Part Two, Detailed Analysis* (2009) at page 472.

switching from insurance taxation to more stable and durable State tax bases.[3] Accordingly, the Insurance Council urges the Green Paper process to endorse the recommendations of the AFTS Review on insurance taxation and to begin a process that transitions the funding of fire services away from the use of insurance premium base to a more durable base, such as property/land.

The Insurance Council remarks that the Green Paper process also follows on from a former specific review into Fire Services Funding undertaken by the Department of Treasury and Finance. [4]As this submission will outline, the 2003 review recommended the retention of the contributions systems with some modifications to existing arrangements. The Insurance Council suggests that the 2003 Review arguably suffered from a limited terms of reference and in particular, an unwillingness to depart from the *ex ante* presumption that insurers are the major beneficiaries of the fire services. The Insurance Council contends that the current Green Paper process offers the opportunity to depart from this *ex ante* approach adopted in the 2003 Review and to design a fire funding system more equipped for the contemporary challenges of Victoria.

Lastly, the Insurance Council welcomes the inclusion of a feasibility study and the collection of specific data on insurance coverage and property status collected as part of the Green Paper process. [5] The Insurance Council believes the inclusion of this data will greatly enhance the quality and analytics of the Green Paper process setting it apart from the 2003 Review. Nevertheless, this submission, following the need to closely comply with the Green Paper public submission timetable, has been prepared in the immediate absence of such data. [6] The Insurance Council is currently making assessments of data provided by the Department of Treasury and Finance and where applicable, will seek to submit supplementary submissions as appropriate. The Insurance Council submits that the Green Paper process will be enhanced with the ongoing inclusion of quality data and policy development and in that regard, is looking to assist the Victorian Government with the provision of additional material as circumstances permit.

[3] See Victorian Department of Treasury & Finance State Business Tax Review Committee (2001) "*Review of State Business Taxes*"
[4] See Department of Treasury & Finance (2003) "*A Review of Victorian Fire Services Funding Arrangements*"
[5] Section 116 B of the *Victorian Tax Administration Act 1997* allowed the collection of data and the conduct of a feasibility study into insurance coverage as part of the Green Paper process.
[6] The Insurance Council received Department of Treasury & Finance data on Wednesday 30 June 2010. Public Submissions to the Green Paper close on 15 July 2010. See also Statement from the Victorian Treasurer "*Call for Policy Submissions on FSL*" 9 June 2010.

THE EFFICIENCY OF INSURANCE TAXATION

Starting from first principles - just what is an efficient tax?

An efficient tax is a tax that has minimal effect on the allocation of resources and therefore community wellbeing.

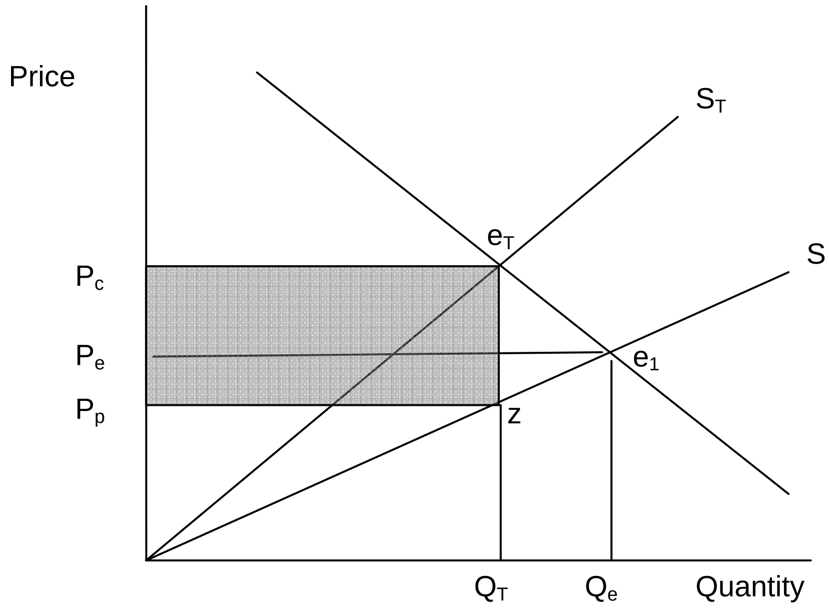
The discussion below provides a strong economic argument that land based taxes are the most efficient. A land/property based levy provides a viable alternative to the current insurance contributions/FSL model. The community well being and stability offered through such an option stands in stark contrast to the inefficiency of the current FSL insurance based model resulting in sub optimal allocation of resources and has a negative impact on the community more broadly.

Put simply, all taxes, irrespective of their incidence, distort the allocation of resources. Taxes serve to drive a wedge between the final price a consumer pays for a good or service and the final price a producer receives for supplying that good or service. This tax wedge directly impacts on consumer and investment decisions resulting in a suboptimal allocation of resources.[7]

The effect of a tax "wedge" can easily be demonstrated as shown in the diagram below. In the absence of a tax, the intersection of the demand (D) and supply (S) curves determines the equilibrium price (P_e) at output (Q_e). At this equilibrium point, the marginal benefit to the consumer equals the marginal cost to the producer.

However, the effects of a tax are demonstrated by the shift of the supply curve from S to S_T causing the point of intersection to shift from e_1 to e_T. The price paid by the consumer therefore rises from P_e to P_c while the price received by the supplier falls to P_p. Just as important as the change in price is the change in output, which declines from Q_e to Q_T – causing a shift in resources from the former and hence efficient, equilibrium to a less than optimal economic allocation of resources.

[7] An efficient market outcome may not coincide with a socially optimal outcome because the market does not account for positive or negative externalities in production or consumption. Where this form of market failure occurs taxes, user charges or subsidies can be used by Governments to shift the market outcome closer to a socially optimal outcome.



(Source: Insurance Council of Australia)

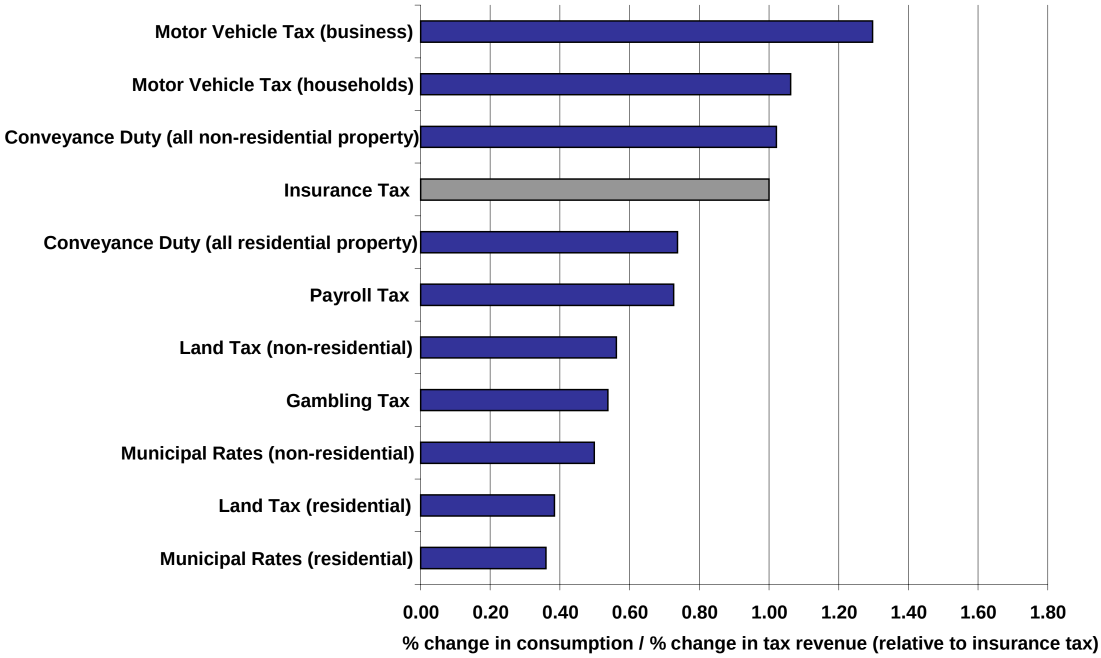
The imposition of the tax results in consumer surplus (a measure of consumer welfare) falling by the area P_c, e_T, e_1, P_e and producer surplus declining by P_e, e_1, z, P_p. The decline in both consumer and producer surplus comprises a tax revenue of P_c, e_T, z, P_p and a so called "dead weight" loss represented by the area e_T, e_1, z. This "dead weight" loss represents the cost of a tax to the community in terms of lost welfare.

The extent of reduced community welfare (or in other words the size of the dead weight loss) arising from a tax is dependent on the elasticity[8] of demand and supply of goods and services or their factors of production, such as land and labour. In general, for a given demand elasticity, the more inelastic is supply the smaller the negative welfare effect. Alternatively, for a given supply elasticity the more inelastic is demand the smaller the negative welfare effect. From this analysis, it is possible to conclude that the less efficient taxes are generally those that are imposed on products or factors that are elastic in supply while efficient taxes are imposed on goods or factors that are inelastic.

With these principles as their underpinning, Access Economics have been able to rank the efficiency of State taxes by measuring the size of the welfare losses as a net change in household consumption that is caused by raising a dollar of revenue from an indirect tax while decreasing lump-sum taxes by a dollar. The more efficient the tax, the smaller will be the change in consumption for a given dollar of extra revenue raised by the tax. If the tax is as efficient as the lump sum tax there will be no change in consumption.

The bar chart overleaf summarises the Access Economics tax efficiency analysis for Victorian State taxes

[8] In economics, demand elasticity is a measure of how the demand for a good or service responds to a change in its price. If a change in price has a relatively small effect on the demand for a product (e.g. a necessity like electricity), demand for the product is said to be 'inelastic'. If, say, an increase in the price of a product leads to a relatively large decrease in its demand (e.g. a luxury good), the product is said to have an 'elastic' demand. Elasticity of supply is a similar concept, except it measures the responsiveness of the supply of a product to a change in the price received by the producer.



Source: Access Economics, 2010

The taxes are ranked in descending order from the least to the most efficient, relative to insurance taxes which has an index value of 1. It should be noted that municipal rates are not levied by State and Territory governments but were included in the analysis for comparative reasons because the State and Territory governments assumed responsibility for funding local government as part of the IGA.

As can be seen from the chart, the more efficient taxes are those that apply to markets with relatively inelastic supply. For example, land, payroll and gaming taxes are more efficient than transaction style taxes.

Land based taxes are the most efficient as they tend to have low elasticities of demand and very low supply elasticities. (Land based taxes are effectively taxes on the rental price of immovable land). Gambling taxes are also relatively efficient taxes because the regulation of the number of gaming machines, casinos and other vendors makes the supply of legal gambling inelastic. In addition, the habit forming nature of gambling tends to make demand relatively inelastic.

Despite popular perceptions, payroll tax is a relatively efficient tax. The argument payroll tax is an inefficient tax because it is a tax on employment and encourages the substitution of capital for labour is misguided. In the short run, production processes limit the ability of firms to substitute labour for capital. In the initial phase, a payroll tax serves to increase the cost of employing labour thereby decreasing the demand for it. However, in a flexible market with relatively constant supply of labour, this fall in demand feeds through to lower wages, resulting in the cost of the tax being shared between the employer and employee. The less elastic is the supply of labour the greater will be the share borne by the employee, while the share borne by the employer can be shifted onto consumers as an increased price. [9]

[9] In other words, the economic effects of a broad-based payroll tax (with no exemptions) can therefore be likened to that of a broad-based consumption tax where the cost is passed onto consumers or to a personal income tax regime where the burden is passed through to employees in reduced incomes.

Given the relative efficiency of State payroll taxes, it is surprising that successive Victorian governments have sought to provide relief for payroll taxes at the expense of other more efficient taxes. As the table below demonstrates, the Victorian government, is "overweighted" to transaction taxes (such as insurance) vis a vis the national total at the same time as it is "underweighted" towards payroll taxes.

Table 1 summarises the tax proportions for each of the jurisdictions in 2007/08.

Table 1: Proportion of total taxation - 2007/08									
	NSW	Vic	Qld	SA	WA	Tas	ACT	NT	Total
Payroll	33.4%	29.9%	26.1%	25.3%	30.5%	30.1%	24.1%	35.7%	30.2%
Immovable property	10.9%	8.2%	9.2%	14.5%	10.1%	12.4%	23.4%	0.0%	10.2%
Other stamp duty	2.1%	0.1%	3.6%	2.3%	0.0%	1.7%	2.2%	0.3%	1.6%
Conveyance duty	21.2%	28.8%	30.5%	25.5%	37.1%	22.3%	27.1%	28.4%	27.1%
Gambling	8.5%	12.4%	9.3%	11.6%	2.6%	10.8%	5.0%	18.0%	9.1%
Insurance	9.9%	9.0%	4.7%	8.5%	5.9%	6.7%	4.4%	6.3%	8.0%
Motor vehicles	11.4%	10.4%	14.3%	11.9%	13.7%	14.8%	9.9%	11.1%	12.0%
Franchise taxes	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

(Source: Australian Bureau of Statistics)

Regrettably, it is common for commentators and the community to discredit efficient State taxes such as payroll, land and gambling as being "bad" or "poor" taxes. For any given budget or outlay, a reduction in the share of the more efficient taxes increases the need to fund budgets from the more inefficient State taxes (such as insurance) – thereby reducing overall economic welfare. In simple terms, the "cost" of reductions in efficient taxes is the opportunity cost of having to meet revenue shortfalls from the more inefficient State taxes.

Insurance taxes are widely recognised as being inefficient

In contrast to the more efficient taxes, less efficient taxes are found in markets with more elastic supply conditions. Taxes on movable capital such as motor vehicles exhibit a more elastic supply while financial services products such as insurance products can be considered to have near perfectly elastic supply conditions. These supply elasticities account for motor vehicle and insurance taxes being ranked as the least efficient taxes.

The inefficiency of insurance taxes has been very well articulated in numerous reviews, including those undertaken by Victorian policy makers themselves. There is now a widespread unanimity that taxation on insurance is highly inefficient and that taxes on insurance should be abolished. For example, the Victorian Treasurer has previously stated that "*everyone would identify the fire services levy as an inefficient tax*". [10] Similarly, the Victorian Competition & Efficiency Commission has remarked that "*many of the arguments against taxes on insurance are strongly based on efficiency grounds*" and the 2001 Victorian State Business Review (i.e. the so called Harvey review) urged the abolition of fire services levies and State transaction taxes, including duties on insurance. [11]

[10] See The Age (6 May 2009) "*Treasurer puts hand on heart: no poll war chest*"
[11] See Victorian Department of Treasury & Finance State Business Tax Review Committee (2001) "*Review of State Business Taxes*" and Victorian Competition & Efficiency Commission (2010) "*On Sound Commercial Terms: An Inquiry into Regulatory Impediments in the Financial Services Sector: A Draft Report for Further Consultation & Input*" at page 67

Elsewhere, the NSW Independent Pricing & Regulatory Tribunal (2008) found that insurance taxation was highly inefficient and created disincentives for the take up of insurance. The HIH Royal Commission (2003) recommended the abolition of the fire services levy in those States were applicable [12]. The Report of the Australian Financial Centre Forum (aka the "Johnson" Report, 2010) recommended the removal of State taxes and levies on insurance, [13] while the Western Australian State Tax Review (2007) also found that for an equivalent amount of taxation, available modelling ranked insurance taxation as amongst the most welfare destroying. [14]

The consensus of opinion on the need to abolish insurance taxation is most emphatically presented in the comprehensive Review of Australia's Future Tax System (AFTS) (2009) which has recommended that all specific taxes on insurance products, including the fire services levy, should be abolished. The AFTS Review goes on to recommend that insurance products should be treated no differently to other services consumed within Australia, and subjected to only the broad based consumption tax regime. As the AFTS states:

> "*There is little justification for levying specific taxes on insurance products. Rather than correcting market failure, insurance taxes can add to existing problems in the insurance market. The revenue from insurance taxes should be replaced by revenue from a more efficient and equitable tax".*[15]

Moreover, in a recent speech the Chair of the AFTS Review (2009) and Secretary of Commonwealth Treasury, Dr Ken Henry repeated the need for States to reform their narrow transaction taxes. Dr Henry stated:

> "*While most of our recommendations relate to the activities of the national government in this Australian federation, the panel was struck by the inefficiency of taxes currently relied upon by State and Territory governments. We found that narrow-based state taxes on insurance products, motor vehicles and real estate transfers are among the most inefficient in Australia".*

The Insurance Council concurs with the recommendation of the AFTS Review and the similar findings of the Harvey State Tax Review, HIH Royal Commission and the NSW IPART report. In particular, the Insurance Council reiterates its preferred policy prescription to reform/restructure State budgets away from transaction taxes to the "better" State taxes such as land and payroll.[16]

[12] See NSW Independent Pricing & Regulatory Tribunal (2008) "*Review of State Taxation: Report to the Treasurer*" and the HIH Royal Commission (2003) "*The Failure of HIH Insurance: Volume 1: A Corporate Collapse and its lessons*"
[13] See Australian Financial Centre Forum (2010) " *Australia as a financial centre: Building on our strengths*"
[14] See WA Department of Treasury & Finance (2007) "*State Tax Review: Final Report*"
[15] See Australia's Future Tax System: Report to the Treasurer (2009), Volume 2, at page 474
[16] See Insurance Council submissions to the Review of Australia's Future Tax System and submission to the Victorian Parliamentary Economic Development & Infrastructure Committee Inquiry into State Government Taxation & Debt available at www.insurancecouncil.com.au

THE EQUITY OF THE FIRE FUNDING SYSTEM

Starting from first principles - the Fire Services as public goods

Justifying the current Victorian statutory contributions system is the claim that insurers are the major "beneficiaries" of the Victorian fire services and accordingly, should fund the bulk of their costs. In simple terms, the argument presented is that insurers "benefit" directly from the extinguishment and containment of fires and ipso facto, this has a direct benefit to insurers in terms of lower claims costs.[17] This assertion informs a unique definition of a public good in the Victorian context as being those goods provided by the State where it is readily available to Victorian policy makers to "*trace the benefit to a particular individual or particular entity*". [18]

Despite the above, Victorian policy makers concede that insurance companies are not the *sole* beneficiaries of the fire services and that other parties (and the broader public), also benefit from the availability of the fire services. (For example, both the 2003 Review and the Green Paper clearly acknowledge that the fire services are also deployed in motor vehicle accidents and for the management of hazardous materials). [19] However, rather than settling that the fire services are pure public goods, the conclusion drawn by government from this evidence is that the fire services are "composite goods" with the 2003 DTF describing a "composite good" as "*providing benefits to the community generally but also to individual persons and entities*". [20] The Insurance Council contends that the above policy framework represents a clear ex post justification for funding the fire services through the statutory contributions model.

The difficulty of precisely defining what type of "good" the fire service is, is at the heart of what constitutes the most appropriate form of funding of the Victorian system. Typically, fire services are considered to be pure "public goods" to the extent that the use of the fire service by any one party does not (and should not) ration the availability of the service for another. [21] This understanding of the public good characteristics of the fire services is shared by the Review of Australia's Future Tax System which indicated that while applying cost recovery principles to fire services may appear appropriate for those individuals non insured, efforts to avoid such charges may result in avoidance of the fire service and hence risk to adjoining properties. As the ATFS Review states such risks "highlight the public good characteristics of fire services". [22]

Although discussion on whether the fire services are public goods or not can be reasoned on theoretical grounds alone, the extent to which the fire services more closely resemble public goods can also be tested empirically by examining the call out data from the Victorian fire services.

The table below, extracted from call out data for the period 1/01/09 – 13/12/09 from the Country Fire Authority, highlights the ownership of "fire incident" attended to by the Country Fire Authority. Examining the ownership of "fire incidents" attended by the CFA is relevant if one

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[17] See Department of Treasury & Finance (2003) "A *Review of Victorian Fire Services: Funding Arrangements*" at page 11.
[18] See Transcript of Proceedings, 2009 Victorian Bushfires Royal Commission, Wednesday 17 March, 2010 at 16282.
[19] See DTF (2003) and Victorian Government (2009) " Fire Services and the Non Insured: Green Paper" at page 5.
[20] See DTF (2003) at page 2. Note, in the economics literature, a composite good is not described as a private good sharing public good characteristics. Rather, a composite good is an abstraction used to describe opportunity cost under a budget constraint.
[21] A "public good" is described as a good where the use by one person does not reduce the consumption possibility for another. See Australia's Future Tax System (2009) "Report to the Treasurer: Part Two; Detailed Analysis, Volume 2: Glossary"
[22] See AFTS (2009) "Volume 2" at page 474

accepts the premise that the burden of funding of the fire services should fall predominately on private asset owners and their respective insurer.

Type of Structure	Number of Call Outs (exc vehicle fires)	% of Call Outs
Residential	4,572	32.2
Commercial	2,130	15.0
Religious Building	18	0.1
Government & Public	3,741	26.4
Medical/Hospital	111	0.8
Education	152	1.1
Agriculture	1181	8.3
Vehicle	1511	10.7
Other	761	5.4
Total	14,177	100
Source: Country Fire Authority, 1/01/09 -13/12/09		

The above table on call outs clearly demonstrates the key weakness in adopting a beneficiaries pay regime to the funding of a public good such as the Victorian Country Fire Authority. The table highlights that commercial and residential assets (assumed to be privately owned) comprise less than half of all call outs – notwithstanding that under current arrangements the CFA recoups 77.5% of their budget through private insurance contributions. Further, call outs to publicly owned assets, including medical and educational facilities, represent around 28% of all call outs - yet the State Government contributes only 22.5% of funding for the CFA. Arguably, the greatest "decoupling" of benefit and funding (again assuming that such an approach is appropriate) rests with vehicle drivers, who while assuming 11% of all CFA call outs, make no contribution to the funding of the CFA.[23] The Insurance Council maintains that insisting on a beneficiaries pay model yet excluding motor vehicles from such a regime, represents a fundamental contradiction in the Victorian fire funding system.[24]

Is Premium a good base to use – the proportion of premium attributable to fire claims

Concomitant with the assertion that insurers "benefit" from the provision of the fire services is the related suggestion that as a result of insurance premium reflecting the risk of fire, greater contributions are recovered from those with the highest risk (and hence propensity) to use the fire services. Such a framework permits the application of a "user pays" approach wherein the greater the risk, the greater the contribution to funding. As the Green Paper asserts:

> *"As the FSL is charged as a proportion of premiums, the contribution of individuals to the fire services is linked to fire risk and asset value. People who have more valuable assets in high fire risk areas contribute more to funding the fire services than those with low value assets or low fire risk".* [25]

According to this framework, the contributions system is fair and equitable as the fire services levy when applied to insurance premiums in an *ad valorem* manner, higher risk and higher

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[23] It should be noted that the Victorian Transport Accident Commission (TAC) contributes part funding to the Country Fire Authority. In the fiscal year, 2006 the TAC contributed $1.3 million to the CFA.

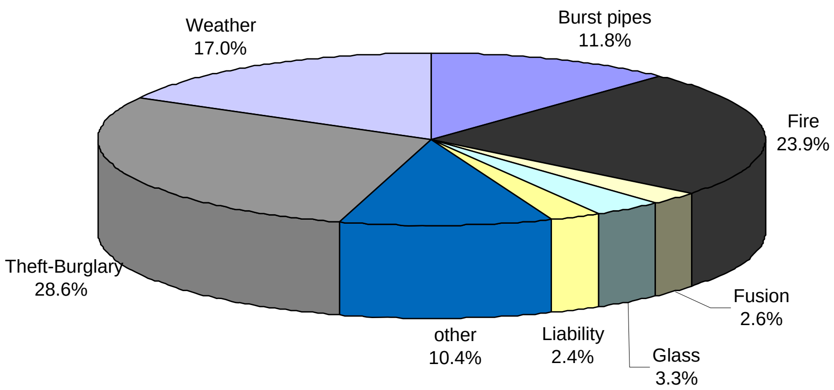
[24] It is noted however that the 2003 DTF Review of Victorian Fire Services Funding did recommend the introduction of a charge on motor vehicles attributable to the call outs from the fire services to vehicle related events. This recommendation was not adopted by the Victorian Government.

[25] See Victorian Government (2009) "*Fire Services and the Non Insured: Green Paper*" at page 9

value assets bear a greater burden of the cost of the fire services. The Insurance Council contends that such a framework breaks down once the assumption that premium reflects fire risk alone.

The Chart below shows the bulk of Victorian residential claims are completely unrelated to fire.

Average proportion of total claims cost Sept qtr 1988 to Mar qtr 2010



Source: Insurance Council of Australia

The Chart outlines the dollar value share of known perils to all claims for Victorian residential policies for the period September quarter 1988 and March 2010. The extended period for the claims analysis has been chosen to ensure that no single event distorts the claims profile.

The Chart highlights that fire related claims make up less than one quarter of the value of all residential claims during the period under examination. By far the bulk of all claims are for other perils such as theft/burglary and non fire weather related events. Notwithstanding the relatively modest share of fire related claims at 24%, the current Victorian fire funding system applies a "weight" of 40% for fire claims for the purposes of contributions determination.[26]

Further, evidence submitted by KPMG Actuaries to the Victorian Bushfire Royal Commission also challenges the suggestion that ad valorem insurance premiums represent a reasonable proxy for fire risk. Moreover, the work of KPMG Actuaries concluded that it remained impractical for individual insurers to risk rate individual properties according to pure fire risk.[27]

How Equitable is the Fire Services Levy – Non Insurance & Free Riders

In May 2007, the Insurance Council released a report on non insurance in the Australian community. The study "*The Non Insured: Who, Why and Trends*" detailed the take up of domestic home and contents insurance as well as examining the factors and influencers that

[26] See *Metropolitan Fire Brigades (Contributions) Regulations 2009 and Country Fire Authority (Contributions) Regulations 2009.*

[27] See Exhibit 779, 2009 Victorian Bushfires Royal Commission and Transcript of Proceedings, 2009 Victorian Bushfires Royal Commission (17 March 2010) at pages 16319 - 16337

impact on the take up of insurance. [28] The Non Insurance report also set out clearly the terms under which non insurance could be defined. That is, in the case of building non insurance, the relevant population to consider for non insurance in this segment were those owner occupied households residing in a dwelling that did not require the payment of body corporate fees. [29] Conversely, the market for contents insurance is potentially available to all households, resulting in the relevant population sample being all households in Victoria.

The Non Insurance report utilised the Australian Bureau of Statistics (ABS) Household Expenditure Survey (HES) to determine the extent of non insurance across Australia. Although the applicability and limitations of using the ABS HES data has been challenged by a number of policy makers and commentators [30], it remains the case that no other data set has been offered by way of an alternative to the HES or no other evidence has been presented to counter the evidence of non insurance secured through analysis of the ABS Household Expenditure Survey. In fact, the ABS HES data remains the only source of reliable data on non insurance in the Australian community and its applicability was sufficient for inclusion in the Review of Australia's Future Tax System. [31]

Detailed scrutiny and analysis of the Household Expenditure Survey data (including Confidential Unit Record Files) has allowed the Insurance Council to reveal the extent of non insurance according to key criteria, such as the level of non insurance by income quintile. The HES data has also allowed the Insurance Council to calculate the estimated value of assets at risk from non insurance.

The ABS HES data reveals that, in Victoria, there are approximately 51,000 owner occupied households (not paying body corporate fees) that do not purchase any form of building insurance. This represents a non insurance "rate" for this form of insurance (i.e. building insurance) of approximately 4%. [32] Conversely, approximately 490,000 households in Victoria do no not have contents insurance representing a non insurance "rate" for contents only insurance of approximately 26%. [33] Of the 51,000 owner occupied households not purchasing building insurance approximately 35,000 (i.e. 68%) reside in Melbourne with the balance in the remainder of the State. [34]

Table 5: Building Non Insurance By Income Quintile (Owner Occupiers Not Paying Body Corporate Fees)

Household Weekly Income	Number of Households	% of Total Non Insured Households
Income Quintile 1 – Less than $412	17,828	35%
Income Quintile 2 – Greater than $412 & less than $727	12,777	25%
Income Quintile 3 – Greater than $727 & less than $1,136	4,714	9%
Income Quintile 4 – Greater than $1,136 and less than $1,691	6,147	12%
Income Quintile 5 – Greater than $1,691	9,150	18%
Total	50,616	100%

[28] Insurance Council of Australia (2007) "*The Non Insured: Who, Why and Trends*" prepared by Dr Richard Tooth and Dr George Barker from the Australian National University, Centre for Law & Economics.
[29] In other words, excluded from the need for buying building insurance were those households that resided in apartments, flats etc where insurance cover for the building is part of the body corporate management fee.
[30] See for example, Transcript of Proceedings, 2009 Victorian Bushfires Royal Commission, Wednesday 17 March, 2010 at 16290 and Friday 16 April at 17918.
[31] See AFTS (2009) "Volume 2" Op Cit at page 473
[32] That is, 4% of the relevant population that being owner occupied Victorian households not paying body corporate fees.
[33] That is, 26% of the relevant population that being all households in Victoria.
[34] The ABS HES survey divides households as living in either the "Capital City" or the "Balance of the State"

Source: Australian Bureau of Statistics, Household Expenditure Survey (2003/04)

As the table above indicates, the vast bulk of those non insured for buildings only are lower income households. This presents an equity challenge for policy makers in maintaining a premium based system for funding of the fire services. The extent of non insurance in the lower income households suggests that there are significant numbers of low income households that place themselves at risk from an insurable event (such as fire) notwithstanding that their financial capacity for recovery after such an event may be very limited. In such circumstances, the State may be required to step in and provide assistance to such households in the event they were to suffer a significant loss. The Review of Australia's Future Tax System poses the question most elegantly when it states:

> "*As well as being inefficient by leading to under insurance and non insurance, insurance taxes can also be inequitable. Rates of non insurance (for building and contents insurance) generally decline with higher incomes, and non insurance can also be higher for certain demographic groups, such as retirees with mortgages and single parents (Tooth and Barker 2007). Because of their financial positions, people in these groups may be more vulnerable in the case of loss*".

Further, the above evidence suggests that some 9,000 households in the upper income quintile do not purchase any form of building cover thereby resulting in these households not making a contribution to fire funding. That is to say, that a significant number of high income households through their decision to self insure are "free riding" on the public fire services.

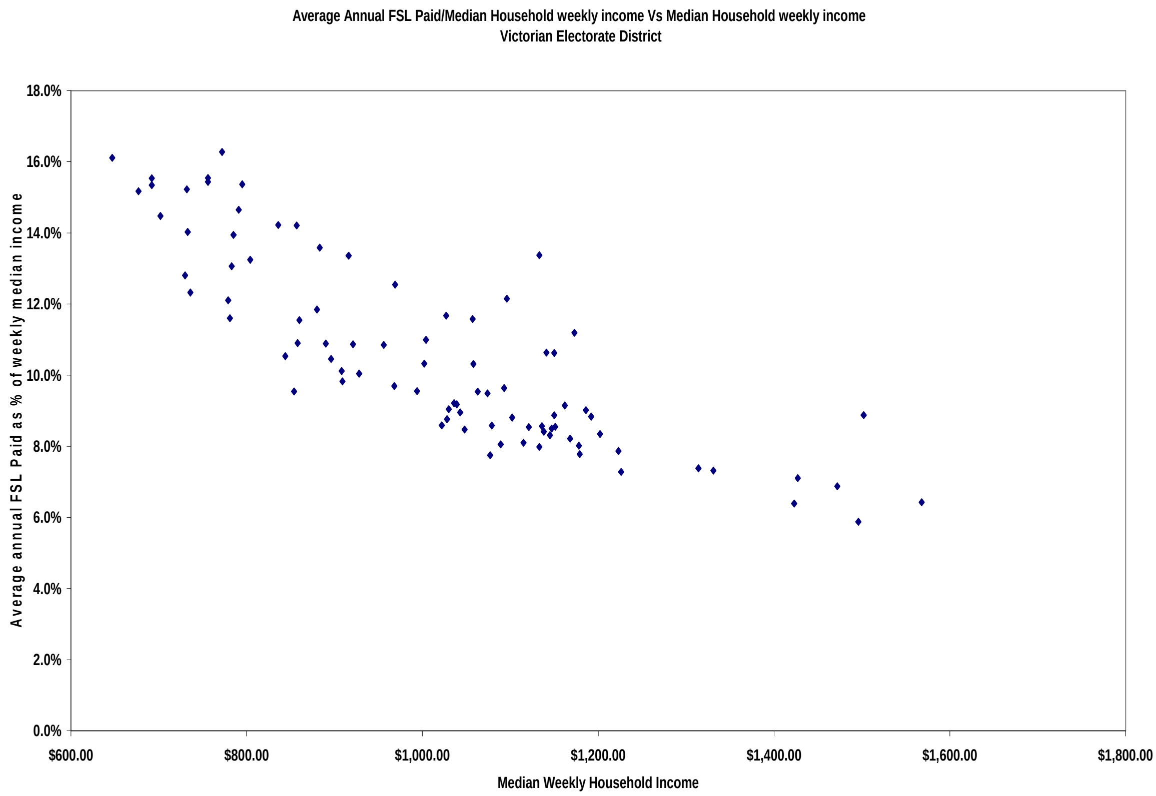
Where exactly does the burden of the fire services fall?

As highlighted above, the fundamental problem with the fire services levy concerns itself with the "horizontal equity" of the levy. That is to say, those households/individuals that do not purchase insurance against fire make no contribution towards the funding of a service that remains available to them. As important as the horizontal equity arguments are, little attention has been paid to the "vertical equity" aspects of the fire service levy – the extent to which the burden of fire levy falls most heavily on those households/individuals of more limited means. This is notwithstanding the suggestion by some, that to the extent that the sum insured is a proxy for the value of a given property, and that the fire services levy is applied in an *ad valorem* way, the fire services levy represents a progressive tax. [35]

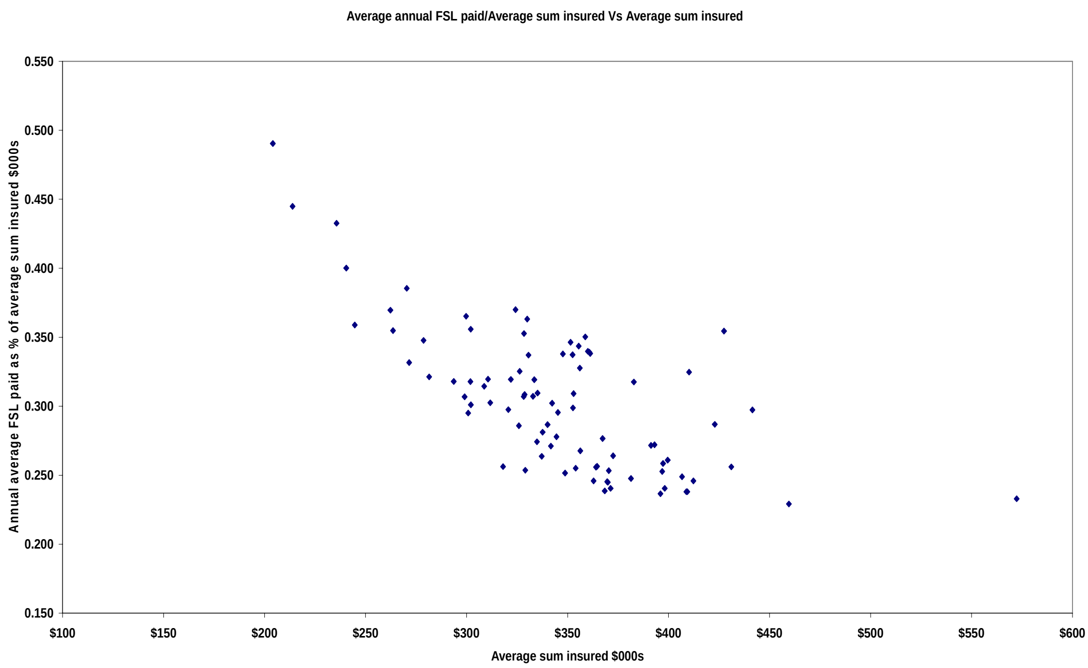
The Charts[36] below demonstrate that the burden of FSL payable falls most heavily on those households with lower median household incomes or lower sums insured. This evidence is consistent with the transactional nature of insurance taxation. The ability of wealthier individuals/households to appropriately "opt out" of a given level of insurance cover (and hence the applicable taxation obligations) is larger than for households of more limited means, given their greater access to ready substitutes, such as an increased capacity to self insure and/or increase their insurance deductible/excess.

[35] See Australia's future tax system (2009) "Part Two: Detailed Analysis: Volume 2" at page 474

[36] The graphs are based on a sample of 125,500 combined building and contents insurance policy holders and ABS census data



Source: Insurance Council of Australia



Source: Insurance Council of Australia

The Charts above indicate that, in many ways, that FSL displays the characteristics of a regressive tax – with the proportional burden of the tax falling most heavily on those of lower median household incomes and/or lower sums insured. Given that a major objection to the replacement of the fire services levy with a charge on property is the suggestion that such a change would be regressive, the Insurance Council submits that the current system already displays such features.

How transparent is the contributions system?

A key taxation principle is that, as best as possible, taxes should be transparent and visible to the public and community. In that regard, it is appropriate to review whether the Victorian fire funding system meets the test of transparency.

Funding arrangements for the Metropolitan Fire Brigade (MFB) and the Victorian Country Fire Authority (CFA) are governed by the *Metropolitan Fire Brigades Act 1958* (MFB Act) and the *Country Fire Authority Act 1958* (CFA Act) respectively. Section 37 of the MFB Act requires insurers against fire to meet 75% of the expenditure of the MFB, with the remaining proportion met equally from the Victorian government's consolidated fund and local authorities in the MFB district. Section 76 of the CFA Act requires insurers underwriting protection against fire to meet 77.5% of the expenditure of the Country Fire Authority with the balance payable from the consolidated fund.

Insurance company contributions to the Victorian fire services are subsequently recovered by insurers through a levy on insurance policy holders. Failure to recover insurance contributions to the fire services from individual policyholders would, other things being equal, require contributions to be paid from insurer capital, thereby potentially affecting the provision of insurance in these classes.

The requirement for insurers to recover from policy holders their statutory contributions can be demonstrated from the table below which uses APRA data on claims and premiums for the household and commercial property classes in Victoria. As the table demonstrates, in any given year the gap between premiums collected and claims payable for property classes varies according to the claims environment in a given year. [37] Assuming for a moment that insurance companies did not recover their insurance contributions from policy holders, then as the table demonstrates the gross "deficit" (i.e. the difference between gross claims and gross premium) can be as large as $243 million as it was for residential classes in the catastrophic year of 2009. Given the basic tenant of insurance is that those who purchase insurance are providing for their future contingencies themselves (rather than being reliant on other parties such as government), then the Insurance Council contends that it is not appropriate that the insurance claims pool can be used as a taxation base. In other words, the Insurance Council strongly challenges Victorian government assertions that insurance companies are not required to recover their contributions from policy holders. [38]

[37] For example, a "benign" claims environment would see a lower claims outlay for the industry while for a year of major catastrophes, the reverse would be true. The basic nature of insurance is that those who purchase insurance are providing for their future contingencies themselves, rather than being reliant on other parties (i.e. government).
[38] See for example, remarks from the Premier of Victoria on 16 April 2009 on Radio ABC Ballarat and remarks by the Premier recorded in Hansard, Victorian Legislative Council, 5 May 2009.

Gross Premium & Gross Claims (Victoria, $million)		
	Gross Premiums	Gross Claims
Residential Classes		
2009	1084	1327
2008	1003	618
2007	926	613
2006	873	457
2005	814	421
Fire/ISR (Commercial Classes)		
2009	822	506
2008	780	463
2007	675	589
2006	859	394
2005	682	220

Source: Australian Prudential & Regulatory Authority

The actual process of determining the appropriate recovery amount for fire contributions from policyholders is particularly complex. Given that contributions are sought in advance (leaving insurers with the task of forecasting the market going forward) and recoveries use insurance premium as their base, fluctuations in the insurer's market share (i.e. mix of business) and the actual premium levels attained (i.e. hardening or softening markets) results in insurance companies bearing all the collection risk for the fire services. In other words, while the State government bears no revenue risk for the insurer contributions it desires, the system is characterised by the inevitable potential of over and under collections for insurance companies themselves.

Moreover, for insured policy holders, the system is particularly opaque and results in considerable misunderstanding as consumers seek better information on what the recovery represents and with that, whether the levy is appropriate to their individual circumstances. The Insurance Council of Australia, using independent actuarial modelling, provides Fire Services Advisory Calculations to its members. However, the Insurance Council emphasises that the precise amount and timing of any recovery from insureds is, appropriately, a matter for individual insurance companies and can vary according to the commercial settings of the individual insurer.

It should be noted, that concerns over the transparency of the contributions system are well known to policy makers. [39] Largely as a result of concerns over transparency, the Victorian Government introduced amendments to the Victorian Fire Acts that allow the government to collect and report on both the amounts recovered by insurers from insureds for the purposes of contributions recovery and the specific contributions paid by insurers to the Fire Services themselves. [40] Unlike NSW however, the Victorian Fire Acts contain no specific legislative

[39] See for example, DTF Review (2003), op cit, at page viii and the NSW IPART (2008), op cit, at page 69 and the NSW Public Accounts Committee (2004) "*Review of Fire Services Funding: Report No 5/53 (148)*"
[40] Sections 45A and 42 (aa) of the MFB Act and Sections 81A and 79 (aa) of the CFA Act are the relevant provisions.

measure that requires insurance companies to disclose (to the insured) that amount of the insurance premium payable set aside for recovery for insurer contributions. [41]

At a fundamental level, the transparency of the contributions system is compromised by virtue of the fact that the insured policy holder's fire "levy" is a recovery of a contribution payable to the government via an "ad valorem" charge on premium. Irrespective of whether the insured is a business or a private consumer, price competition in insurance markets (together with the ready availability of substitutes), ensures that the economic incidence of the insurance contribution differs markedly from its legal incidence. This suggests that, despite all best intentions, measures that improve transparency designed to reduce the "wedge" between economic and legal incidence in the contributions system offer only second best policy making. The Insurance Council contends it is far more preferable to replace the contributions system with a taxation base that is fundamentally more transparent.

Detailed Consideration of the Green Paper Options

An Overview of the Options

The Government's Green Paper outlines six options for consideration by the community for funding of the Victorian fire services. Regrettably however, only one of those six options countenances an overhaul of the current contributions system and its replacement with an alternative funding structure. The remaining five options in the Green Paper retain the fabric of the contributions system while seeking to apply adjustments to the existing scheme. The Insurance Council contends that, to this extent, the Green Paper represents a continuation of the approach adopted in the 2003 Review which is to retain the current contributions system despite evidence of mounting pressures on the system and in the face of critique on the efficiency of insurance taxation. [42]

Nevertheless, regardless that the majority of the Green Paper options retain the essence of the contributions system, the Insurance Council has evaluated each Option on its individual merits including consideration of the key issues/questions raised for each Option in the Green Paper. A summation of the Insurance Council's evaluations of the Green Paper's options is presented in the table overleaf with a detailed evaluation of options two and six presented thereafter.

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[41] Section 80 of the NSW *Fire Brigades Act* 1989 is the relevant provision. It should also be noted that the 2003 DTF Review considered a "Section 80" style measure that would see insurance companies "*separately itemise the pass through of their statutory contribution (i.e. the FSL) on all insurance policy invoices*". See DTF (2003) at page 82.

[42] See DTF (2003) "Review of Victorian Fire Services Funding Arrangements" and Australia's Future Tax System: Report to the Treasurer (2009).

Green Paper Option	Green Paper Identified Questions for Consideration	Insurance Council Response
Option One – Retention of existing approach	*Is the lack of parity in fire services funding created by the level of non-insurance and under-insurance significant enough to warrant a change to the current arrangements?* *Does the increased fire effort put too much strain on insurers who along with Government are having to meet this cost?*	The Insurance Council supports the recommendation of the Review of Australia's Future Tax System that "*all specific taxes on insurance products, including the fire services levy, should be abolished*". Further, the Insurance Council notes and supports the AFTS Review in its remarks on the fire service levy wherein its states "*the higher tax on insurance generally leads to a reduction in the number of insured and will spread the burden of funding such a service over less people than desirable*".
Option Two – Charging a levy on non insured and under insured property owners	*Is the option outlined above an appropriate way to target non insured and under insured property owners, to ensure their contribution corresponds with the level of benefit they receive?* *The factors that influence insurance take up involve a number of socio economic triggers. Are there any social policy issues that would need to be considered if implementing this proposal? For example, should there be concessions through exemptions or subsidies for low income groups and how could these be bundled?*	Noting the Insurance Council's fundamental objection to the current contribution system *per se,* the implementation of such a proposal faces very practical challenges. These are: Such a proposal would be administratively burdensome (i.e. in terms of privacy, compliance, enforcement etc) for both insurers and government. The expected administrative costs of such a proposal would exceed any likely benefits, including the amount of additional contributions or improvements to the "equity" of the system. Such a system raises legitimate concerns around any "rational" decision to self insure. Such a measure is likely to result in extensive exemption regime for disadvantaged/fixed income populations. The beneficial "gains" from such a proposal to the contributions pool are likely to be very marginal relative to the size of the overall contributions pool. Consequently, the Insurance Council contends that the marginal gains arising from the reform are unlikely to provide significant relief to existing contributors and/or justify the added administrative burden that such a system will necessitate. Furthermore, the Insurance Council contends that such a levy will necessarily use private land as the basis in which to issue/base the levy and that such a levy would be non risk rated. In that regard, the Insurance Council contends it would be preferable to apply the use of the land based systems to fundamentally reform the contributions system.
Option Three – Status Quo plus mandating banks to issue compulsory insurance	*How would this option address the question of equity outside of properties that are mortgaged?*	As outlined in the Green Paper itself, the Insurance Council contends that this measure would not capture homeowners without a mortgage or renters of properrties. Further, the Insurance Council challenges the extent that such a measure can be enforced as the responsibility to implement the proposal and to impose the compulsory insurance purchase would fall on private banks. The Insurance Council also notes that this proposal would require Federal cooperation to the extent that banking is Commonwealth regulated and that it would need to be accompanied by definitions of what constitutes the appropriate minimum cover.

Green Paper Option	Green Paper Identified Questions for Consideration	Insurance Council Response
Option Four – Introduce compulsory fire services insurance	*Is this option an appropriate way to target non insured and under insured property owners to ensure their contribution to fire services corresponds with the level of benefit they receive?* *Does the compulsory nature of this proposal raise Charter of Human Rights concerns?* *The factors that influence insurance take-up involve a number of socio economic triggers. Are there any social policy issues that would need to be considered when implementing this proposal? For example, should there be concessions by way of exemptions or subsidies for low income groups and how could these be funded?* *Does this option discriminate between fires and other natural disasters (e.g. flood)? Should the levy be applied to cover all natural disasters, e.g. an emergency services levy as opposed to a fire services levy?*	The Insurance Council submits there are several fundamental issues associated with this proposal. These include: Statutory compulsory insurance schemes are extensively regulated and arise due to evidence of market failure in key insurance markets. (For example, in compulsory third party bodily protection insurance, issues arise with adverse selection). It is not clear what the insurance market failure issues are associated with insurance against fire or indeed other property perils. The key demarcation/difference between protection against the peril of fire and what is understood to be the Green Paper Option of fire "services" insurance. It is unclear what the public interest is in introducing compulsory "fire services" insurance. Further, the Insurance Council reiterates that it is inefficient to use insurance premiums as the basis to fund hitherto public goods, such as the emergency services. The Insurance Council would again draw attention to the recommendations of the Review of Australia's Future Tax System.
Option Five – Introduce compulsory property insurance	*Is this option an appropriate way to target non insured and under insured property owners to ensure their contribution to fire services corresponds with the level of benefit they receive?* *Does the compulsory nature of this proposal raise Charter of Human Rights concerns?* *The factors that influence insurance take-up involve a number of socio economic triggers. Are there any social policy issues that would need to be considered when implementing this proposal? For example, should there be concessions by way of exemptions or subsidies for low income groups and how could these be funded?*	The Insurance Council submits that the issues with Option Five are similar in nature to that of Option Four. In particular, the Insurance Council contends that prior to the introduction of compulsory statutory schemes it is fundamental that an *ex ante* case for market failure be established. As highlighted above, there is no evidence of market failure with respect to property insurance and accordingly, it is not considered necessary to introduce compulsion measures.

Consideration of Option Two – Introducing a Levy for the Non Insured

The Green Paper introduces the proposal to retain the existing contributions system and to manage the issue of free riders (essentially the non insured and under insured policy holders) by imposing a "levy" which would serve to "nudge" such asset owners to take out prudent levels of insurance. It is suggested that such a proposal would improve the "equity" of the contributions system by enlarging the available contributions pool (or limiting leakage) and thereby relieving the pressure on existing contributors.

Disappointingly, Option Two in the Green Paper bears a close resemblance to the methods adopted in the 2003 DTF Review of Fire Funding. That is to say, the 2003 Review recommended the maintenance of the current contributions system but with modifications designed to improve the "equity" of the system. Subsequent to the DTF Review, measures were introduced into the *Metropolitan Fire Brigades Act 1958* and the *Country Fire Authority Act 1958* which adjusted premium calculations to take into account the practice of "net rating". [43]. The Insurance Council maintains that, just as the measures adopted post the 2003 Review have failed to materially alter the fundamental weaknesses in the contributions system, Option Two in the Green Paper is also likely to be of limited value. Indeed, Option Two is expected to introduce considerable additional administrative and compliance complexity to the system, including (but not limited to) the following:

- The need to maintain and support administrative and data collections systems between the insurance industry and the regulator/administrator of the scheme.

- The need to ensure that data collections are contemporaneous and up to date so as to limit the risk of error in the issuance of such levies.

- The need to establish "back office" customer information, appeal and response arrangements for those cases of error and/or where consumers seek appeal/relief.

- The need to establish a regulatory framework for determinations of what constitutes prudent level of insurance for a given asset or conversely, the trigger for a determination of underinsurance.

- The need to establish a policing, enforcement and penalty regime which ensures the system is not "gamed" or evaded. [44]

The Insurance Council contends that these administrative challenges are formidable and fundamentally alter the cost/benefit ratio of the Option Two proposal. Further, the Insurance Council suggests that, given the proposed levy is likely to be generated from property data (whether municipal or State Revenue Office), then it is more efficacious to apply such administrative processes to a broadly based property levy that funds the entirety of the Victorian Fire Services.

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[43] See for example, Section 44A Parts 3C and 3D of the MFB Act and Section 80A. Parts #C and 3D of the CFA Act deal with net rating. A further measure to bring to account deductibles into premium calculations for the purposes of premium calculations was subsequently abandoned by the Victorian government due to the administrative complexity involved.

[44] For example, cooling off and periodic payment provisions available for general insurance may see insurance purchased to avoid penalty, and then subsequently rescinded.

Consideration of Option Six – A Property Based Charge

As the Green Paper refers, only NSW, Victoria (and to a lesser extent Tasmania) retain statutory contributions funding systems for the funding of the fire services. In recent times, most other State administrations have transitioned to systems where fire and emergency services levies are collected through charges on property value rather than on insurance premiums. [45] An outline of the key features of the fire and emergency services systems across Australia is outlined in Box 1 below.

BOX 1 : OUTLINE OF FIRE FUNDING MODELS ACROSS AUSTRALIA	
Western Australia	Property based system with emergency service levy applied on the gross rental value of all immobile properties. No levy imposed on motor vehicles. State is divided into fire levy categories according to level of service (i.e. extent of emergency service provision and access) with Category 1 (i.e. Perth) through to Category 5 (remote WA). Minimum charge of $43 with maximum levy payable by households of $225 and commercial property owners $130,000. Levy collected by local government.
South Australia	System introduced in 1999. Emergency Service Levy levied on capital values for fixed property and also on motor vehicles and other mobile capital. Levy on fixed property is a fixed fee ($50) plus a variable component. Variable component derived from capital value, an "area factor", land use "factor" and the levy rate. For motor vehicles a fixed fee applies (e.g. $24 for cars and large capacity motor cycles). The SA Transport Authority collects the levy from motor vehicles while the SA State Revenue Office collects the levies from properties. Concessions for seniors apply.
Queensland	Queensland Fire & Rescue Service funded through an Urban Fire Levy on properties. Urban Fire Levy contributes 73% of funding with State government and user charges making up the remaining proportion. Amount of levy is dependent on the "class" of the urban district (i.e. where the property is situated); the activity carried out on the property or the use to which the land is used and the size and nature of any improvements on the land (using the local government guide to classification of properties). The latter two factors determine the fire levy "group". Once the appropriate fire levy group and urban class is determined, the amount payable is set out under Schedule 2 "*Annual Contributions of Owners of Prescribed Properties", Qld Fire & Rescue Service Regulation 2001*.
NSW	Statutory contributions system. *NSW Fire Brigades Act* 1989, *Rural Fire Services Act 1997* and *State Emergency Services Act 1989* requires insurers to contribute 73.7% of funding, with local government paying 11.7% and State government 14.6%. Schedules to the Acts provide a weighting of 50% to domestic premiums and 80% for other property insurances, insuring against fire. (i.e. that for domestic policies 50% of premium is subject to contributions and for any other insurance against fire, 80% of premium is subject to contribution)
Tasmania	Statutory levy model. Levy on insurance of 28% of gross premium for all commercial insurances against fire, including contractors all risk. For marine and cargo insurance levy is 2% of gross premium and for aviation 14% of gross premium. Local government levies assessed on annual value of properties with minims charge applicable. Charge on motor vehicles of $14. Concessions available to pensioners.
ACT	Property based system. Residential and rural properties $91.20 with commercial properties levied on the basis of the average unimproved land value over three years.

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[45] For example, in June 2002 the Western Australia government announced reforms to emergency services funding stating " *for too long there has been an unfair and inequitable situation with as many as one in three homes either not insured or under-insured, but still receiving emergency protection*" See Western Australia Government Media Office, Ministerial Statements (12 June 2002) statement by WA Emergency Services Minister "*New funding system to assist the State's volunteer emergency services*"

As evidenced from the above table, although each State retains private land as the principal base for the emergency services levy, there remain differences in approach. These differences can be summarised as follows:

- The basis under which the emergency service is calculated. For example, in the case of Queensland, the emergency services levy incorporates a risk factor based on the activity carried out on the property with these risk factors set out in the regulations. In the case of Western Australia, the emergency service levy is a function of service levels with minimum payments and maximum caps in place. South Australia employs a land use factor for its emergency service calculation.

- The extent to which mobile property, such as for motor vehicles, is included in the levy net. In the case of South Australia, a fee is imposed on motor vehicles for purpose of emergency services funding.

Internationally too, there a number of models/approaches used to fund the fire services although by far, property based systems and direct grants to the fire and emergency services are the most common form of funding. For example, the London Fire Brigade (an arm of the London Fire & Emergency Planning Authority (LFEPA)) secures the bulk of its funding from central government funding and the remainder from London boroughs primarily though taxes on property. [46] Similarly, in the United States although local governments use a variety of methods to enhance the funding of the professional fire services, the most common taxes supporting fire and emergency services remain property taxes usually levied at a set rate per dollar of assessed value.[47]

An outline of a range of international approaches to funding fire and emergency services is set out in Box 2 overleaf.

[46] See London Fire Brigade "Statement of Accounts, 2007/08" at http://www.london-fire.gov.uk/CorporatePublications.asp and Victorian Department of Treasury & Finance (July 2003) "*A Review of Victorian Fire Services: Funding Arrangements*" at pages 104 - 105
[47] See US Federal Emergency Management Agency; US Fire Administration "*Funding Alternatives for Fire & Emergency Services*" available at http://www.usfa.dhs.gov/downloads/pdf/publications/fa-141.pdf

BOX 2: OUTLINE OF INTERNATIONAL FIRE & EMERGENCY SERVICE FUNDING MODELS	
United States	States and local governments in the United States use a variety of methods to fund the professional fire services. The most common taxes supporting fire and emergency services in the US are property taxes usually levied at a set rate per dollar of assessed value. However, local authorities also adopt innovative measures such as Howland, Ohio which has implemented a "bed tax" to generate revenue for the Howland Fire Department. In the State of Washington, fire districts are authorised to utilise a service charge based on measurable benefits to property with the "benefit" charge a function of the type of occupancy, insurance reduction, fire flow requirements and distance from fire stations. Other local authorities utilise specific user charges to meet demand for fire services and at the same time dissuade foolish behaviour such as driving through flood zones. Casper, Wyoming charges a fee for hazardous material call outs. Ventura, California has established guidelines for recovering the costs of certain "preventable" fire events such as discharging a firearm that results in a fire; inadequate control of open burning; juveniles playing with fire and the misuse of alcohol or controlled substances that lead to fire and emergency call outs.
United Kingdom	The London Fire Brigade is an arm of the London Fire & Emergency Planning Authority (LFEPA) with all 17 members of the LFEPA appointed by the Mayor of London. In 2007/08, the London Fire Brigade was funded by a combination of grants from central government (£ 254.4 m) and the remainder from funding from London boroughs (£ 137.0 m) primarily through taxes on property.
Canada	There are approximately 3,500 Fire Departments in Canada of which around 3% are full time and 91% volunteers. Of the 108,000 estimated fire services personnel 22% are full time and the remainder volunteers. Primary responsibility for fire and emergency services is the responsibility of cities and municipalities. For example, fire services and emergency services in the City of Toronto is coordinated by the Office of Emergency Management. The Toronto Fire Services provides "all hazard" assistance and is funded and mandated by the City of Toronto. 40% of the City of Toronto is funded by property taxes, with federal and provincial subsidies making up an additional 25% of funding. The Vancouver Fire & Rescue Service is a department of the City of Vancouver and was funded to the amount of $88 million by the City. The City of Vancouver recovers the bulk of its revenue from taxes on property.
New Zealand	The New Zealand Fire Service is funded through the imposition of a fire service levy on insurance policies to the value of 7.6 cents per $100 of insured value for residential, commercial and personal property (with a cap of $100,000 for residential property insurance, $20,000 for personal property and no cap for commercial). Motor vehicles under 3.5 tonnes are levied a flat rate of $6.08 per vehicle.

It is clear from the above national and international comparisons that land based charges are by far the preferred means through which governments recover the costs of emergency services. This preference is attributable to a number of reasons, such as:

- Land remains a highly efficient taxation base. As both Access Economics and the Henry Tax Review efficiency rankings emphasise, broadly based taxation on land (whether represented by land taxes or municipal rates) are amongst the most efficient of all taxes – whether State, Local or Federal. It is the efficiency of land as a taxation base (i.e land taxes impose less distortions to the efficient allocation of resources vis a vis other taxation sources) that has informed the Henry Review, the Victorian Review of State Business Taxes and the NSW Independent Pricing & Regulatory Tribunal (IPART) in urging the replacement of inefficient taxes (such as insurance) and their replacement with land based charges.[48]

- As outlined above, emergency services are public goods to the extent that the use of such services are non discriminatory and available to all, irrespective of whether they have purchased insurance. Given the pure public good characteristics of emergency services, in most jurisdictions of Australia and internationally, policy makers have deemed it appropriate to meet the cost of such services using the broadest means available. Recovering the cost of emergency services through land taxation bases, ensures the absence of "free riders".

- Transparent charges on property, hypothecated or earmarked for a specific use can assist in promoting agency accountability and efficiency. In the case of a fire and emergency service levy, a hypothecated tax regime assists in ensuring that the revenue raised fully funds program expenditures and in the reverse, expenditures are constrained to the amount of revenue raised. A key strength of the South Australian, Western Australian and Queensland systems are their ability to transparently align expenditure on emergency services with community and taxpayer obligations.

Accordingly, the Insurance Council maintains that a move to a property based system to replace the statutory contributions formula is the preferred policy change with respect to fire services funding. In pursuing this position, the Insurance Council is clearly cognisant of Victorian government remarks that such a model is inappropriate as it would represent a "flat tax" on all Victorian households.[49] The Insurance Council clearly recognises that government policy held since the 2004 DTF review (and subsequently reiterated in the Green Paper) is that a move to a property based system would "decouple" the relationship between "risk" and funding contribution. Nevertheless, notwithstanding the material sighted elsewhere in this submission suggesting that the pure relationship between final insurance premium and fire risk is tenuous at best, the Insurance Council contends a property based fire funding system can be built which goes beyond a "flat tax" approach and with appropriate regulation incorporates risk. Indeed, just such a system is in existence today in Queensland and is available for policy makers to consider and replicate.

The Insurance Council contends that a transition to a risk based property system is particularly feasible in Victoria today given existing policy development on integrated fire planning in Victoria. The Insurance Council is aware of the development of an "Urban Risk Profiling Tool" (URPT) under the auspices of the State Fire Management Strategy managed by the Victorian Integrated Fire Management Planning Agency. The Urban Risk Profiling Tool provides the means through which Victoria, if desired, can apply a risk factor to a property based fire services funding system.

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[48] For example, the Review of State Business Taxes, aka the "Harvey Review" recommended that fire services levies be replaced by a charge on property. See Review of State Business Taxes (2001) "*Summary Report*" at page xi. Similarly, the NSW IPART recommended that statutory contributions by insurance companies to fund fire services should be replaced by a corresponding increase in contributions from local government. See NSW IPART "*Review of State Taxation: Report to the Treasurer*" (2008) at page 7.

[49] See remarks from the Victorian Premier, the Hon. John Brumby MP to ABC Radio Mildura on 15 June 2010.

As the "Fact Sheet" outlining the purpose of the Urban Risk Profiling Tool states"

> *" The tool calculates the "cost to community" of a number of risk environments (e.g. industrial, residential, infrastructure) using the past three years of incident data. The 'cost to the community' considers injuries, fatalities, damage and indirect costs of fire.*
>
> *The tool then uses the Valuer General's data to identify where risk environments exist translating this data to identify areas of high risk graphically on a map of the area.*
>
> *When dealing with residential fire risk environment, the tool compares the postcode area's average number of house fires over the past three years with the metropolitan wide average to influence the risk value, rather than the density of houses. This approach allows the user to identify the drivers of fire risk, such as socio economic status".*[50]

There are considerable advantages in integrating the Urban Risk Profiling Tool into a wider project of fire services funding reform. In particular, the risk elements identified by the URPT tool can achieve the Green Paper objective of "aligning" risk and property replacing the "proxy" of insurance premiums as an indicator of risk of which the current contributions system is based. The Insurance Council submits also that the unique property value system in Victoria which utilised Capital Improved Value (CIV) provides further scope to develop a viable property based system. [51] Simply put, existing Victorian systems (such as the CIV and the URPT) allow for the development of a property based fire services system in Victoria akin to that in operation in Queensland – that is, a property based system that applies differential levies according to property types and uses. Moreover, flexibility in a property based system can be introduced that allows adjustment in the property charges to reflect the ongoing development and refinement of the URPT information.

Alternative Funding Models – Further options beyond those mentioned in the Green Paper

While a property based system (irrespective of the form in which it takes) is clearly the most preferred form of funding fire and emergency services in alternate jurisdictions, the Insurance Council clearly acknowledges that public statements from the Victorian government suggesting that property based funding models are not the current preference of the government.[52] The Insurance Council laments such comments given the Green Paper process includes a property based charge as an Option for consideration during the consultation phase.

The Insurance Council submits that it is entirely feasible to fund the Victorian Fire Services from revenue alternatives that extend beyond existing insurance contributions and/or property based frameworks. For example, the Insurance Council contends that one such option is funding the Victorian Fire Services through a direct grant from Consolidated Revenue and then to bridge the cost of this grant from existing State taxes as appropriate. Although this approach to funding of the fire services challenges existing models of funding (and with it existing Government policy frameworks) the Insurance Council contends that the Green Paper process would be enhanced with the introduction of such Options into its deliberations.

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[50] See Victorian Government Integrated Fire Management Planning "*Fact Sheet: Urban Risk Profiling Tool*" and Victorian Government Integrated Fire Management Planning (2009) " *State Fire Management Strategy*"
[51] For example, the Capital Improved Value system allows for accounting of the structure value of buildings.
[52] See, Transcript of Interview, the Premier, the Hon John Brumby MP, ABC Mildura/Swan Hill, 15 June 2010 at 10.30 am

With this in mind, the Insurance Council has modelled options to the statutory contribution system that extend beyond property based system alternatives. Although these options are not specifically included in the Green Paper, given public remarks that the Victorian government is adverse to property based alternatives, the Insurance Council contends that there exists considerable merit in drawing the Government's attention to such alternatives as part of the Green Paper process.

The Options evaluated by the Insurance Council for funding the Victorian Fire Services include:

- A broad based municipal levy [53]
- Funding the Fire Services through a direct grant to the services from Consolidated Revenue.
- Funding the Fire Services through a direct grant to the services and raising the revenue from the application of more efficient State taxes.
- Funding the Fire Services through the introduction of a lump sum tax on electricity retail distribution similar to the hitherto NSW Energy Distributors levy and the Queensland ambulance charge.

The Insurance Council, using the Access Economics General Equilibrium model, has sought to estimate the welfare benefits of these options and test their relative efficiency. The results of this modelling are reproduced below:

Funding Option	Net Improvement to Welfare (%, Victoria)
Introduction of a municipal levy (revenue neutral)	0.29
A grants based system funded from the Consolidated Fund at a cost to revenue (i.e. not revenue neutral)	0.94
A grants based system funded from the Consolidated Fund on a revenue neutral basis using existing payroll taxes and with current exemptions in place	0.21
A grants based system funded from the Consolidated Fund on a revenue neutral basis using gaming taxes	0.22
A grants based system funded from the Consolidated Fund on a revenue neutral basis by removing payroll exemptions and adjusting the rate to match revenue requirements	0.24
A lump sum tax on electricity retail distribution akin to the NSW Energy Distribution Levy and the Qld Ambulance Charge	0.26

Source: Access Economics, 2010

There are a number of key observations that can be made about the above modelling analysis. These include:

- Broadly speaking, the Access Economics modelling results confirm existing analysis [54]on which State taxes are "better" (i.e. more efficient and less distorting). Again, taxes which are broadly based and that are relatively inelastic in supply, such as land and payroll are more efficient. Hence, a State tax mix "switch" away from transaction style taxes (such as on insurance) and towards broad based taxes would result in a net improvement to economic welfare.

[53] Note, this is essentially the broad based property charge mentioned as Option Six in the Green Paper.
[54] See for example, the tax efficiency rankings in the Review of Australia's Future Tax System on Page 13 of the *Overview Report* and analysis in the NSW Independent Pricing & Regulatory Tribunal (2008) "*Review of State Taxation*".

- The largest improvement to economic welfare in Victoria would be for the Victorian Fire Services to be funded directly from the Consolidated Fund at a cost to revenue. However, the Insurance Council concedes that such an approach would impact on government outlays in other areas, although the extent of such impacts would be a function of the capacity of the Victorian Government to administer widespread savings to fund the opportunity cost to outlays.

- Of all the Options under consideration, the most efficient remains the introduction of a municipal tax to replace the current statutory contributions system. Conversely, the least efficient way to fund the revenue needs of the Victorian Fire Services is through the imposition of higher stamp duties on general insurance.

- The Option to introduce a charge on energy distribution to fund the fire services akin to the hitherto NSW energy distribution charge and/or the Queensland ambulance charge would see an improvement in economic welfare similar in scale to the introduction of a municipal based tax. An appraisal of this Option is outlined further below.

The Insurance Council submits that it is in the interest of the Green Paper process to consider the Options presented above together with the Options mentioned in the Green Paper. In particular, the analysis above suggests that it is welfare enhancing to fund the Victorian Fire Brigades directly from the Consolidated Fund and to recover such outlays through a greater reliance on more efficient State taxes – such as payroll, land and gaming.[55] Although this Option is not included in the Green Paper, the Insurance Council maintains that it is entirely open to the Victorian Government to restructure its budgetary settings to allow such a reform to take place.

The Insurance Council also believes that there is considerable merit in examining the Option to fund reform of the Victorian Fire Services Funding through the imposition of a lump sum charge on retail energy distribution. Such a charge on the retail "wires" business would be "passed through" to customer accounts and be included as a legitimate network cost for energy retail businesses in their regulated prices. A proposal of this kind has precedence with the NSW Government introducing such an energy distribution levy in its 1997/98 Budget [56] and the Queensland Ambulance Service securing its funding via the Community Ambulance Cover levy which is applied to every supply point of electricity unless exempted.

Arguably, the advantage of an energy retail distribution charge is that the potential for "free riders" is dramatically reduced, given all energy supply points would be subject to the levy. The broadness of the levy would also ensure that all dwellings, irrespective of ownership, would incur the charge.[57] Similarly, commercial buildings with multiple tenancies (and hence multiple supply points) would see the charge allocated to individual tenancies directly. [58] Nevertheless, the Insurance Council is cognisant that a reform of this nature has particular equity effects to the extent that occupants of all buildings, irrespective of their ownership and/or relationship to the building structure, would be subject to a electricity distributors levy. Further, the Insurance Council recognises that such a funding proposal represents a significant departure from existing

[55] Such an approach would be both revenue and outlay neutral.
[56] See NSW Treasury, Office of Financial Management Research & Information Paper (Sept 1998), "*Electricity Distribution Levy; TRP 98 -7*" available at http://www.treasury.nsw.gov.au/__data/assets/pdf_file/0019/6661/trp98-7.pdf
[57] The caveat to this assumption would be those dwellings not connected at all to a retail electricity grid.
[58] This is opposed to a lump sum property charge on the owner of the land/property which is then passed through in rents to individual tenancies.

Victorian fire funding policy frameworks and in that regard, may require additional community consultation beyond that of the Green Paper process.

CONCLUSION

The Insurance Council welcomes the Green Paper process of the Victorian Government and the government's commitment to review the future funding of the Victorian Fire Services. The Insurance Council contends that the Green Paper process offers the opportunity for the Victorian Government to replace the statutory contributions system with a land/property based system which is by far more equitable and efficient. Moreover, the Insurance Council believes that existing arrangements in Victoria facilitate the development and design of a land/property based system and that the Victorian government is well served by the understandings available from such systems in other States.

This Insurance Council submission provides the fundamental case for change to the existing contributions system. In particular, the submission highlights the inequity of current arrangements as well as demonstrating the inefficiency of insurance taxation. The approach taken to this analysis by the Insurance Council follows well settled understandings on insurance taxation and which has been reflected in several taxation reviews, including most recently the Review of Australia's Future Tax System. The Insurance Council can only concur with this body of work which has consistently and demonstrably concluded that there is little to justifiably support taxation on insurance, including fire services levies.

Lastly, during the ongoing course of the Green Paper assessment/process, the Insurance Council will be considering additional data and information on the contributions system, insurance coverage and property classes, including that provided to the Insurance Council from the Department of Treasury & Finance. In order to ensure the Green Paper is continually advanced, the Insurance Council will look to provide additional contributions to the Green Paper process as appropriate and as material becomes available.