42/120 Collins Street
Melbourne 3000

GPO Box 1472
Melbourne 3001

Telephone +613 8664 2664
Facsimile +613 8664 2666

www.bca.com.au

17 October 2008

Dr Ken Henry
Chairman
AFTS Panel
The Treasury
Langton Crescent
Parkes ACT 2600

Business Council of Australia

By email: AFTSubmissions@treasury.gov.au

Dear Dr Henry

BCA SUBMISSION TO THE AUSTRALIA'S FUTURE TAX SYSTEM REVIEW

Please find attached the BCA's initial submission to the Australia's Future Tax System Review.

The submission consists of a covering document, plus two attachments.

For further information in relation to the contents of this submission, please contact Allesandra Fabro, Director Policy, on (03) 8664 2664 or allesandra.fabro@bca.com.au.

Yours sincerely

Robert Milliner
Chair BCA Business Reform Task Force

Business Council of Australia

Submission to the
***Australia's Future Tax System* Review**

17 October 2008

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About the Business Council of Australia:

The Business Council of Australia (BCA) is an association of the CEOs of 100 of Australia's leading corporations, with a combined workforce of around one million people. It was established in 1983 as a forum for Australia's business leaders to contribute to public policy debates to build Australia as the best place in which to live, to learn, to work and do business.

BCA contact person:

For further information in relation to this submission, please contact Allesandra Fabro, Director Policy on (03) 8664 2664 or allesandra.fabro@bca.com.au.

The case for tax reform

It is time for Australia to invest in a new reform agenda.

After a decade of exceptional economic performance, significant challenges confront us. The global financial crisis has seen economic activity slow far more sharply than expected. While this has lessened the immediate capacity constraints that have hampered Australia's growth in recent times, it only serves to highlight the importance of positioning our economy to sustain strong growth over the longer term, including through investment in and improvements to productivity. Australia's demographic and environmental constraints will compound the challenges we face.

Focussing on the critical drivers of economic growth – labour, infrastructure and skills – is essential to lifting our productivity and preventing the gains of the last decade from slipping through our fingers. We must continually improve our international competitiveness to ensure that Australia remains an attractive place to invest and do business if we want to prosper, particularly in difficult economic times.

As the financial crisis has reminded us, markets are global. Policy settings must not only reflect this, but position us to take advantage of opportunities that enhance our competitiveness and build economic resilience.

This is as true in taxation as it is in all policy areas. As we develop a new tax architecture for Australia, we must recognise that taxpayers, particularly businesses with global reach, have a range of alternative investment locations available to them. Now, more than ever, Australia must set its policy frameworks with an eye towards long-term strategic growth and flexibility, so that we can benefit from our integration in global markets and economies.

The Business Council of Australia has set an aspirational goal for Australia to be the best place in the world to live, work, learn and do business. As part of this, the BCA believes Australia should aim to achieve a GDP per capita ranking among the top five countries in the world by 2012. In March 2008 similar goals were adopted by the economy stream of the 2020 Summit.

Reform of Australia's tax system is central to achieving these ambitions. The level and structure of taxes imposed fundamentally impact investment, saving and workforce participation – that is the decisions that shape our economic, social and environmental future. The revenues raised by the system can and should be used to strategically invest in future prosperity.

Getting the balance right, in terms of the amount of tax collected and the types of taxes imposed, is a key challenge for governments. Unnecessary taxes and costs should be minimised, and the tax system needs to enable high levels of investment, workforce participation, innovation and global engagement.

In its latest assessment of the Australian economy, the International Monetary Fund (IMF) encouraged Australian governments to use the benefits of recent growth to implement structural economic reforms aimed at lifting productivity and workforce participation – including tax reforms. In considering the case for structural reform of the Australian budget, the IMF also supported reducing the taxation of income over other tax bases. The IMF said that "a combination of lower labour and capital income taxes, along with increased public investment, will generate the largest economic gains".[1]

The Organisation for Economic Cooperation and Development (OECD) also endorses a shift away from income taxes towards less distortive taxes and improvements to tax design to better support growth.[2]

These recommendations are consistent with the approach to tax reform outlined by the BCA in June this year in *A Better Tax Return*. Rather than viewing tax as a regulatory burden, or simply as a means of revenue, we should consider the role tax can play in underpinning our national reform agenda in the critical areas that will deliver a more prosperous future. The notion of 'tax and spend' needs to become 'tax and invest.'

A Better Tax Return outlines a number of issues relating to Australia's tax system, and considers them in relation to five priority features. These issues and priorities accord in large part to the initial framing questions set out by the *Australia's Future Tax System Review* panel ('the Panel'):

1. What major challenges facing Australia need to be addressed through the tax-transfer system?

2. What features should the system have in order to respond to these challenges?

3. What are the problems with the current system?

4. What reforms do we need to address these problems?

This submission draws upon publically available research and the BCA's position on tax reform as outlined in *A Better Tax Return* to respond to these questions. A copy of *A Better Tax Return* is attached for the Panel's reference.

Because of the *Australia's Future Tax System Review's* forward-looking agenda, a copy of the BCA's submission to the Australia 2020 Summit, *Anticipating Success*, is also attached for the Panel's reference.

1. Australia's major challenges

The tax system is one of the foundations on which a strong economy is built. Because the tax system is so central to decision making by businesses and individuals, it has a fundamental role to play in addressing Australia's core economic challenges.

Boosting Australia's economic and social prosperity means addressing a range of challenges, including:

- declining productivity growth;
- increasing international competition;

[1] International Monetary Fund, Australia – 2008 Article IV Consultation, Concluding Statement, at http://www.imf.org/external/np/ms/2008/070108.htm

[2] OECD, Taxation and Economic Growth, Economics Department Working Paper no. 620, July 2008, p7

- demographic change;
- the risks associated with climate change; and
- more recently, global financial uncertainty.

Successfully tackling these challenges requires a range of reforms in key areas, each of which will need to be complemented by strategic reforms to the taxation system. To achieve the BCA's aspirational goals, Australia will need to sustain growth of rates of around 3-4 per cent over the longer term. This is an ambitious target, but an achievable one – provided we significantly lift productivity, participation, and competitiveness.

The BCA has for some time advocated reforms, in areas such as infrastructure, regulation, workplace flexibility, innovation, and education.[3] Sound tax policies can contribute to reform progress in each of these areas.

An additional challenge for Australia lies in the structure of the federal Budget. As highlighted in the BCA's 2008-09 Budget Submission, and acknowledged by the Review's *Architecture of Australia's Tax and Transfer System* paper ('the architecture paper'), Australia has become more sensitive to cyclical fluctuations in the economy due to a growing reliance on income taxes, particularly from companies.[4] A long term consideration of the structure of the tax system should establish tax bases that will support the objective of fiscal stability over time.

Getting our tax system right will be critical to successfully following a high growth trajectory over the coming years. In contrast, poorly framed tax policy will only add to our challenges and limit our growth. Against this background, the BCA considers that the decisions made as a consequence of the *Australia's Future Tax System Review* will be critical to our future prosperity.

2. The features of an effective tax system

The purpose of the tax system

The fundamental purpose of a taxation system is to support the necessary functions of government.[5]

However, if we are to respond effectively to the challenges Australia faces, we must ensure our taxation system raises these funds in a way that supports economic and social prosperity by driving participation, productivity and international competitiveness.

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[3] A more detailed description of these reforms can be found at p4 of *A Better Tax Return*. See also the BCA Submission to the Australia 2020 Summit, *Anticipating Success*. The BCA has also produced detailed plans of action in many of these areas: see www.bca.com.au.

[4] See *Budgeting for Prosperity: BCA Budget Submission 2008-09*, available at www.bca.com.au.

[5] The BCA notes that supporting the necessary functions of government also implies that attention should be paid to the level of Government expenditure (for a more detailed discussion of this, refer *Budgeting for Prosperity: BCA Budget Submission 2008-09*). Unnecessary or inefficient government expenditure adds to the overall taxation burden and diverts resources away from more productive uses.

As economies and businesses have become more globalised, the competitiveness of tax policy become has become more important and tax setting by governments more dynamic. International research shows that capital investment is highly responsive to relative tax settings across countries and that the competition for skilled labour across countries is increasing, with economic incentive an important factor in an individual's decision on where to live and work.[6]

According to the OECD, in open economies the design of the tax system "will need to consider the design of tax systems in other countries, since countries are increasingly using their tax systems to improve their ability to compete in global markets".[7]

Just as we are now reviewing our tax system, other governments are also considering how to structure taxes to support economic growth and give the companies and individuals operating within their jurisdictions a competitive edge in global markets. For example, by the time the *Australia's Future Tax System Review* is completed, an estimated ten countries in Europe will have cut their corporate tax rates.[8] This follows a long term trend in the OECD area where the unweighted average corporate tax rate has dropped from 47 per cent in 1981 to 26.6 per cent in 2008.[9] This means that the *Australia's Future Tax System Review* must seek to design a tax system that is flexible enough to withstand the challenges of a changing international environment.

Five features of an effective tax system

In *A Better Tax Return*, the BCA has set out five priority features that should be considered when developing an effective tax system for Australia:

1. **The tax system must support economic growth and productivity.**

   The tax system must encourage economic activity and decision making that grows national income in the long term, for example, through its influence over decisions made about:

   - the type, quality, and quantity of investment;
   - savings decisions;
   - innovation, including through collaboration domestically and overseas;
   - risk taking and entrepreneurship; and
   - the incentives for individuals to develop and apply skills and knowledge (including as they approach retirement).

[6] See, for example, National Bureau of Economic research, "The Effect of Corporate taxes on Investment and Entrepreneurship", Working Paper 13756, January 2008 and OECD, "The Global Competition for Talent: Mobility of the Highly Skilled", 2008.

[7] OECD, *ibid*, p.6

[8] Piatkowski, M and Jarmuzek, M, "Zero corporate income tax in Moldova: tax competition and its implications for Eastern Europe", IMF Working paper WP/08/203, August 2008, p4.

[9] OECD, *ibid*, p.15.

2. The tax system must support social prosperity.

The structure of the tax-transfer system is an integral part of Australia's social prosperity agenda. As Australia's economic prosperity increases, it is important that we find meaningful and sustainable ways to improve the opportunities and circumstances of people experiencing entrenched disadvantage. As part of this, we must take into account how the tax system interacts with transfer payments, the way that progressive taxation scales coupled with targeted welfare affects effective marginal tax rates, and, in particular, how we might be more creative in the delivery of benefits to ensure smoother transitions into the workforce.

3. The tax system must enhance our international competitiveness and engagement in the global economy.

Australia needs a tax system that contributes to its international competitiveness. To compete in a global environment, we need an economy that encourages both inbound and outbound investment.

As *A Better Tax Return* highlights, it is clear that globalisation presents additional challenges for tax systems. Governments are understandably concerned downward pressure on rates will erode revenue raising options. At the same time, running continually higher tax rates runs the risk of turning investment and skills away – or worse, driving the investment and skills we currently have elsewhere.

To prosper, our international focus must be similar to our domestic focus – encouraging economic growth and activity that expands our domestic tax base. This includes bringing greater foreign investment into Australia, and creating an environment that encourages internationally successful Australian companies to bring their profits, as well as the other benefits of global engagement, back home.[10]

Tax is an important component of a group of factors that determine international competitiveness, along with a skilled workforce, effective infrastructure, efficient government, strong research institutions and an environment that encourages and supports innovation.[11] To be most effective, tax must be seen as underpinning a comprehensive reform agenda, integral to all policy areas rather than approached in a stand alone manner.

The BCA considers tax competitiveness, particularly from the perspective of business, as an area warranting further research and in which we intend to provide the review panel with more detailed considerations throughout the review.

[10] For further discussion on enhancing our place in the global economy, see *A Better Tax Return*, pp 16-19

[11] The importance of the complete reform 'package' is frequently cited in the literature on international competitiveness; see for example M. Porter, The Microeconomic Foundations of Prosperity: Findings from the Business Competitiveness Index, in the Global Competitiveness Report 2007–08, World Economic Forum.

4. **The tax system must be simple and low cost.**

   We should aspire to being among the best performers on measures related to costs (both broader economic costs and the direct compliance costs on taxpayers) and simplicity. We must also aspire to a tax system that is administered efficiently and with regard for the intent of the law.

   Unnecessarily complex taxation systems increase deadweight costs and divert resources away from their most productive use. Complexity and inefficient administration also contribute to investment uncertainty, particularly when the tax impacts of a transaction are difficult to ascertain.

5. **The tax system must support fiscal stability.**

   The tax system must provide fiscal stability in a way that gives governments and others the confidence to undertake long-term planning and decision making. This implies both achieving a sustainable tax mix and, as noted above, rethinking of the role of government spending in the economy, particularly with regard to the effectiveness of some transfer payments.

Reform constraints

Maximum gains in each of these areas would flow from a comprehensive review of the tax system. Unfortunately the potential benefits of reform have been curtailed by limiting the terms of reference, in particular, the explicit exclusion of consideration of the GST.

In *A Better Tax Return*, the BCA argued for the inclusion of the GST on the grounds that it would have allowed for the most comprehensive discussion on the fundamental question how Australia structures its tax system in the most economically efficient way. It would have allowed us to consider the advice of the OECD and other policy experts that emphasise the benefits for economic growth of a shift from income taxes to less distorting taxes such as consumption taxes.[12] It remains the BCA's view that this is a discussion Australia will eventually need to have.

Nevertheless, the BCA understands the political circumstances in which the Review's terms of reference were set. It is the BCA's considered view that opportunity remains for significant and lasting reform to Australia's tax architecture, albeit more challenging to achieve.

[12] OECD, ibid, p7

3. Problems with the current tax system

Considering the current tax system in light of the five priority features identified by the BCA serves to highlight a number of concerns. Notwithstanding the structural reforms of the 1980s and late 1990s, further significant improvements could be made under each of the areas described.

BCA considers the following to be among the most important areas for improvement as part of the *Australia's Future Tax System Review*:

- The overall burden of taxation

  There has been a steady rise in the tax take over recent decades. Real federal revenue per capita has grown from $5,123 in 1992-93 to $12,153 in 2006-07. Federal taxes as a percentage of GDP have grown from around 20 per cent to 25 per cent over the same period.[13] Because taxation imposes deadweight costs, a tax system should be designed to collect the minimum revenue required to fund necessary government expenditure, not simply by the capacity of taxpayers to pay. As the BCA has previously argued, the overall burden of taxation in Australia must be permanently reduced.

- Over-reliance of taxation on income

  The architecture paper notes the total tax burden on capital is around 11 per cent, or the fourth highest in the OECD, compared to 12 per cent on labour (fourth lowest in the OECD) and 9 per cent on consumption (fourth lowest in the OECD). As mentioned earlier, in a competitive international economy, a high tax burden on the returns from capital can detract from a country's international competitiveness. As the Treasury paper points out, a growing body of literature also suggests that, in the longer run, the incidence of high effective corporate tax rates falls unexpectedly heavily on labour through lower productivity and wages. A consideration of the income tax burden must also consider the implications of Australia's personal income tax rates on Australia's attractiveness to skilled workers and incentives to work and to save.

- Declining international competitiveness

  It is no surprise that international tax settings are constantly changing. Our level of foreign engagement – in both investment and merchandise trade – has changed dramatically since the last major tax reform processes in 1985 and 1998.[14]

  As noted above, Australia's international competitiveness results from a range of factors including taxation. To be truly competitive, Australia must develop a tax system that employs the right taxes and rates, relative to the other factors that make it attractive as an investment destination, like infrastructure, education and a culture of innovation. Unfortunately, in many of these areas, Australia has underinvested in reform in recent years.

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[13] BCA Budget Submission 2008-09, p18

[14] See, for example, Table 1 "Australia's changing international circumstances", p17, *A Better Tax Return.*

As *A Better Tax Return* outlines, this underinvestment means Australia cannot afford to be complacent when it comes to the competitiveness of its tax system. On the investment side, for example, international research suggests that low tax rates, particularly corporate and personal tax rates, help alleviate some of the disincentive effects caused by Australia's relatively small domestic economy, geographically dispersed population, and distance from world markets.[15]

Yet, as the architecture paper confirms, while Australia's top personal rate is now around the OECD average, the corporate tax rate is increasingly out of step. Since 2001, the unweighted average corporate tax rate for OECD countries has decreased by around 6 percentage points to 26.6 per cent. Australia's company tax rate at 30 per cent is now above the OECD average – and Australia has moved from 9th lowest, to 21st. Such differences contribute to concerns about the international competitiveness of Australia's tax system and in particular, the dampening effect these concerns may have on business investment decisions.

If Australia's tax system is to genuinely enhance our engagement in the international economy, measures that contribute to our international competitiveness should be a key focus of the review, including a reduction in the corporate tax rate.

- Complexity and the costs of administration and compliance

  As the architecture paper notes, there are at least 125 taxes paid by Australians – yet ten taxes collect 90 per cent of the revenue. Similarly, the BCA's *Tax Nation* report identified 56 separate taxes borne or collected by business: 21 federal taxes, 33 state taxes and 2 local taxes.[16] The number of taxes raising small amounts of revenue raises legitimate questions about whether they cost more to collect then they raise for the public purse, particularly when taxpayer compliance costs are considered.

  The transfer system is also complex, with around 40 cash transfer payments paid by the Australian government to Australians. This level of complexity is unnecessary and imposes additional compliance costs on the Australian economy. The architecture paper notes that 'there are no reliable estimates of the complexity or operating costs of the tax-transfer system but there is a strong sense in the community that they are too high'. It is time that these costs were estimated, reported and monitored and reduced.

- Inefficiency and economic costs

  In addition to direct compliance costs, Australia's large number of taxes includes many that are narrowly applied and which impose unnecessary economic (or deadweight) costs. Many state taxes, in particular, fall into this category, and their inefficiency is compounded by the fact that they are applied differently in different states. As the BCA's *Tax Nation* report highlighted, there is considerable scope to rationalise, reduce, or eradicate many of these taxes.

  The BCA agrees with the review team's finding that 'the nature of our federation' is intrinsic to this review and that 'coordinated action across governments is imperative'. Removing inefficient, distorting taxes, particularly at the state level, should be a priority for the review.

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[15] BCA, *A Better Tax Return*, p 16-19

[16] BCA, *Tax Nation: Business taxes and the Federal-State Divide*, Melbourne, April 2007.

- Tax-welfare churn

  As noted in *A Better Tax Return*, approximately half of Australia's welfare spending is returned to the people who paid the tax to fund it in the first place. Given the size of the welfare system, this generates extraordinary additional costs to the economy for no net benefit to taxpayers. Removing churn from the personal tax system should be a priority. An analysis of the interactions between tax and welfare should also consider the complexities caused by a welfare system that is calculated on a family basis and a tax system that operates on an individual level.[17]

- Risks to fiscal stability

  As identified earlier, the federal Budget has become increasingly subject to the economic cycle. Research conducted for the BCA by Access Economics found that virtually all of the revenue side of the Budget is now sensitive to the economy, whereas little more than one in every $25 on the spending side is similarly sensitive.[18]

  A significant element of this cyclical sensitivity comes from the Budget's growing reliance on income taxes, particularly on the corporate side. The substantial increase in total tax revenue over the last decade has been underpinned by a sharp rise in corporate income tax: from $27 billion in 2000, to a projected $73.5 billion in 2008–09. Over this time, the share of corporate taxes in overall revenue has increased from 9.6 per cent in 1985 to 24.4 per cent in 2006–07, making it one of the fastest growing sources of revenue for the government.

  Providing fiscal stability requires both achieving a sustainable tax mix, and rethinking the role of government spending in the economy.

4. Addressing the problems of the current tax system

The *Australia's Future Tax System Review* is as ambitious and complex as it is essential. We know Australia is likely to reap substantial benefits by reforming the broader structures of the tax framework. Consideration must be given to the impacts of tax across the economy and community, and to how those impacts relate to future risks and challenges.

If we are to use the tax system to promote economic growth and productivity, support social prosperity, enhance our engagement in the global economy, and underpin fiscal stability, we must be confident that unnecessary costs are minimised, and that the incentives (or disincentives) created by taxation enable the outcomes needed to achieve our ambitions.

This means we must seek to address the key challenges outlined above.

[17] There has been much discussion of the issues around the tax/welfare churn and its resulting costs; see for example P. Saunders (ed.), Taxploitation: The Case for Income Tax Reform, Centre for Independent Studies, 2006; and the BCA submission to the 2008–09 Budget, Budgeting for Prosperity, February 2008.

[18] BCA, 2008-09 Budget Submission, February 2008, p 21.

Over the next twelve months, the BCA will seek to assist the Review Panel by providing further information in relation to aspects of the five priority features and the challenges the current system presents before they can be achieved.

In particular, the BCA will seek to provide specific additional information on the impacts of the current business taxation system on:

- the hiring and investment decisions of Australian businesses;
- the ability of Australian businesses to expand and compete internationally;
- economic growth and productivity;
- domestic and international competitiveness; and
- Australia's budgetary position.

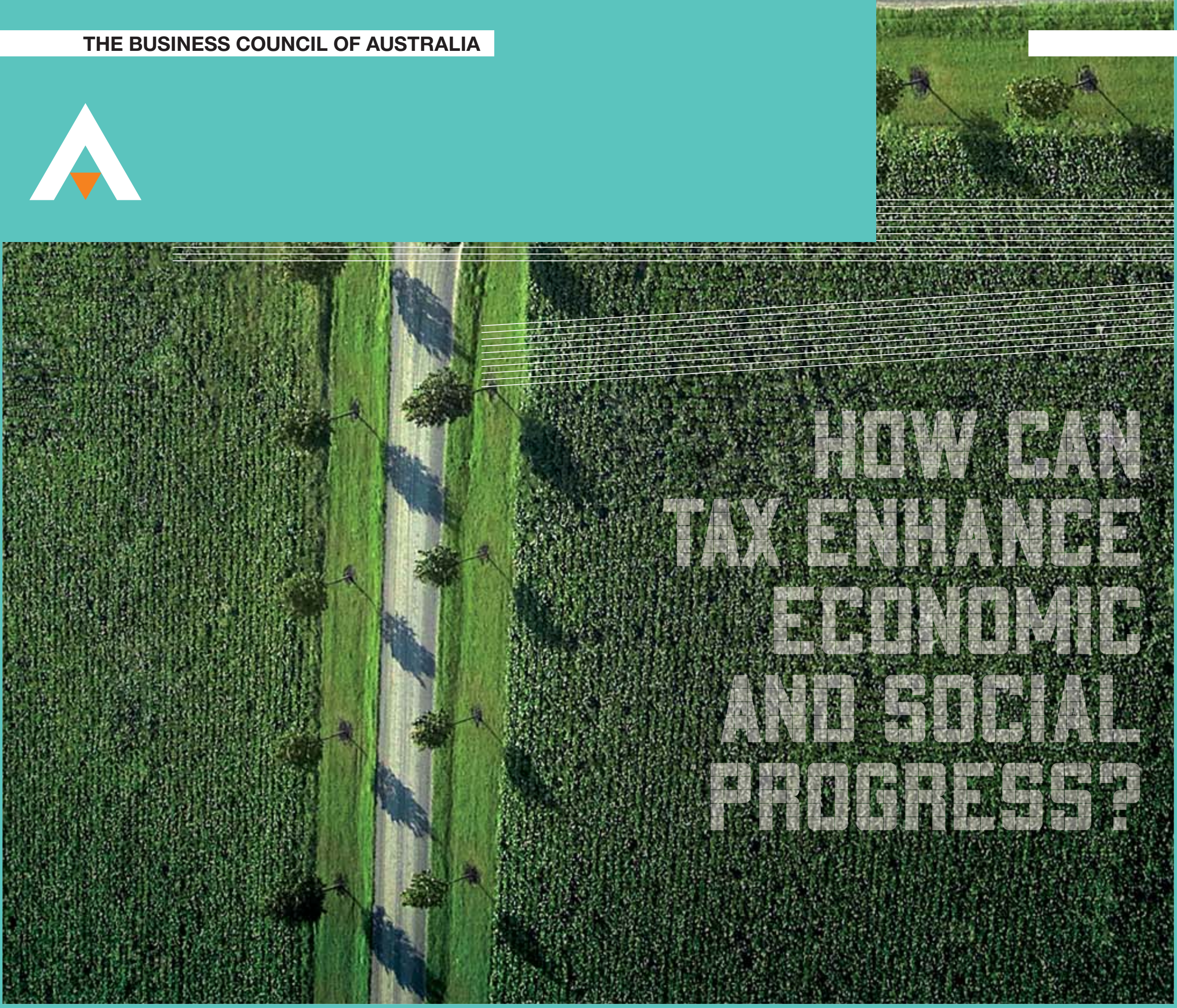
A Better Tax Return argues that the overarching aim of reforms should be to enable Australia to move into the top-five band of countries with the world's highest living standards by 2012, and ultimately become the best place in the world in which to live and work. But such aims will not be achieved in the absence of real change, or without seeing those changes through to implementation.

The BCA considers Australia must seize every opportunity to position itself to deliver sustained economic growth and strong social and environmental outcomes into the future. The *Australia's Future Tax System Review* has a critical role to play in securing the country's future prosperity.

A BETTER TAX RETURN

RECONSIDERING THE ROLE OF AUSTRALIA'S TAX SYSTEM

THE BUSINESS COUNCIL OF AUSTRALIA



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INTRODUCTION
LOOKING TO THE FUTURE

Australia has been a standout economic performer for well over a decade, but it is facing new challenges. Few countries so clearly demonstrate the characteristics of a supply-constrained economy. By failing to invest substantively in a new reform agenda and in the critical inputs of economic growth – labour, infrastructure and skills – there is a risk that the strong growth of recent years will become the very thing that holds the nation back in the decades ahead.

Compounding domestic supply side constraints, deeper global integration and technological advances are heightening the immediacy and impacts of global competition.

While the rapidly growing economies of China and India are underpinning demand for resources and rising incomes, Australia's strengthening currency is raising the bar for other sectors as they seek to compete.

Population ageing and responding to the risks associated with climate change add further challenges and complexity to the policy environment in Australia.

The simple fact is that we have over-consumed the benefits of past reform and underinvested in the foundations of future growth and prosperity. Now is the time to change tack.

We must seize every opportunity to respond effectively to these risks and position Australia to deliver sustained economic growth and strong social and environmental outcomes into the future. Reform of Australia's tax system has a critical role to play in achieving these ambitions.

BUSINESS COUNCIL OF AUSTRALIA BUSINESS REFORM TASK FORCE

Mr Robert Milliner (Chairman)	Mallesons Stephen Jaques
Mr Michael Andrew	KPMG
Mr Mark Chellew	Adelaide Brighton Ltd
Mr Stephen Creese	Rio Tinto – Australia
Mr David Deverall	Perpetual Limited
Mr David Fagan	Clayton Utz
Mr John Gaskell	ABB Australia Pty Limited
Mr Chris Jenkins	Thales Australia
Ms Katie Lahey	Business Council of Australia
Mr James Millar	Ernst & Young Australia
Mr Stephen Roberts	Citi Australia and New Zealand

RATHER THAN SEEING TAX SIMPLY AS A NECESSARY BURDEN, WE MUST SEE IT AS AN ENABLER OF GROWTH AND PROSPERITY.

ACHIEVING THE 2020 AMBITION

A PROSPEROUS AUSTRALIA REQUIRES AN AMBITIOUS VISION.

The economy stream of the Australia 2020 Summit agreed that Australia should be the world's top place in which to live and do business. It also agreed on the need to set national economic goals in areas in which all Australians share, including full employment, low inflation, and a GDP per capita ranking in the top five countries in the world.[1]

The Business Council of Australia (BCA) strongly supports this ambition. Achieving it requires the implementation of wide-ranging reforms that are not just comprehensive, but coordinated and prioritised (see Exhibit 1).

Each area of policy – infrastructure, education, regulation, competition, trade, innovation and others – needs to pull its own weight but also complement and reinforce the direction and impact of other reforms.

This is where tax reform must play its part.

The tax system is one of the foundations on which a strong economy is built.

The level and structure of taxes imposed fundamentally impact the decisions – such as investment, saving and workforce participation – that shape our economic, social and environmental future. The revenues raised by the system can be used to strategically invest in future prosperity.

Getting the balance right, in terms of the amount of tax collected and the types of taxes imposed, is a key challenge for governments. All taxes change incentives and impose costs. If the tax system is to support the goals outlined above, we must be confident that unnecessary taxes and costs are minimised, and that the incentives or disincentives created by taxation enable the actions and outcomes needed to achieve our ambitions.

We must change our mindset about tax. Rather than viewing tax as a regulatory burden, or simply as a means of revenue, we should consider the role tax can play in underpinning our national reform agenda in the critical areas that will deliver a more prosperous future. Rather than seeing tax simply as a necessary burden, we must see it as an enabler of growth and prosperity. 'Tax and spend' needs to become 'tax and invest'.

EXHIBIT 1
STRATEGIC PRIORITIES FOR ECONOMIC AND SOCIAL PROSPERITY

The BCA has identified a number of necessary reforms to increase productivity, competitiveness, and participation, and therefore national prosperity. Changes to the taxation system should complement these broader reforms.

Boosting economic prosperity requires a long-term, strategic approach to developing a competitive and dynamic business sector that ensures resources are directed to their best use and used as efficiently as possible, and that entrepreneurship and risk taking are supported. Priority reforms include:

Infrastructure, including the establishment of genuine national markets, competition, and market-based pricing, with greater accountability.

Regulation, and in particular, the creation of a seamless economy for business regulation by 2010, and better regulation-making processes.

Workplace flexibility characterised by a wide range of enterprise-based options for agreeing employment terms and conditions.

Innovation, involving the implementation of a national innovation framework encouraging greater linkages and collaboration between business, research institutions and universities.

Workforce participation, including improved employability skills, more flexible job design, and improved childcare options.

Education, involving increased investment, greater focus on improving outcomes and performance across all sectors, and encouraging greater diversity and specialisation among universities.

Trade, involving strengthening the focus on and performance of services sector trade and investment to better capture new and emerging global opportunities.

To lift Australia's levels of social prosperity, including by addressing core issues relating to the sustained marginalisation of certain groups, reforms are needed in:

Education, through greater focus on the quality and consistency of educational outcomes, and increased attention at the primary/early intervention level.

Welfare and support programs, by ensuring adequate and appropriate support is given to those with genuine need (whether transitory or entrenched).

Health, by reforming the health sector to better target prevention, improving service delivery and encouraging greater personal accountability for health.

Boosting our national prosperity also means positioning Australia to deal appropriately with growing environmental risks and issues, particularly in regard to water and climate change including through the development and implementation of an emissions trading scheme.

Source: *Anticipating Success: BCA Submission to the Australia 2020 Summit*. The BCA has also produced detailed plans of action in many of these areas; see www.bca.com.au.

LEARNING FROM THE PAST

BECAUSE TAXES IMPACT EVERY ASPECT OF THE ECONOMY, TAX REFORM, ESPECIALLY COMPREHENSIVE REFORM, IS HARD WORK.

The costs of change, be they financial, administrative, or compliance costs, are felt almost immediately and present a significant challenge. This is compounded by the fact that the costs are often individualised, with intense scrutiny of who stands to 'lose' or miss out, or who may 'benefit' less than others. In contrast, the benefits of tax reform can be diffuse, longer in coming, and more difficult to articulate.

If past reform efforts tell us anything, it is that the costs of tax reform dominate public and political debate, turning it into a discussion about who will lose in the immediate term. This is usually to the detriment of good policy outcomes.

Without broader goals that can be articulated and understood by all, the tax system is too readily subject to the constraints of the electoral cycle, vested interests, and the needs of the next budget.

The difficult nature of tax reform means that governments are often prepared to examine the issues and develop recommendations, but far more reluctant to implement change. While there have undoubtedly been some notable achievements in tax reform, the gains that could have been made are often stymied by the limited scope afforded to reforms in practice and the piecemeal way in which those reforms are implemented.

EXHIBIT 2
A BRIEF HISTORY OF RECENT TAX REFORM IN AUSTRALIA

Over the past forty years Australia has seen a series of major tax system reviews with a mixed record of success.

Tax reform emerged as a major public policy issue in the 1970s largely in response to the rise of inflation and its effects on income tax under a progressive tax system, but also because of concerns about tax evasion and the integrity of the tax base. The consensus was that the tax system was not suited to an inflationary environment or one of growing international competition.

In 1972 the McMahon Government set up the Asprey Taxation Review Committee, the first comprehensive review since 1934. The review was independent, with broad terms of reference that provided a significant degree of scope, but was limited to Commonwealth taxes. The findings (reported in the 1974–75 Commonwealth Budget) recommended a substantial change to the tax mix, particularly greater reliance on indirect taxes on consumption, and proposed a value added tax. It also recommended lowering income taxes but broadening the base through the introduction of a capital gains tax. There was little community support for the recommendations and no significant reforms were implemented.

As inflation continued to climb, the Mathews Inquiry into Taxation and Inflation was announced in late 1974 with more specific terms of reference to examine the effects of inflation on tax paid by individuals and companies.

The inquiry's recommendations in the following year included indexation of income tax brackets and, for companies, the indexation of trading stock values.

The recommendations appeared to enjoy widespread support, but the indexation measures were opposed by Treasury. Implementation was limited, although personal income tax indexation was introduced by the Fraser Government in 1976–77, but full indexation lasted only twelve months before being scaled back and then abandoned altogether.

By 1984 taxpayers on average earnings faced a marginal tax rate of 46 per cent, and the growing concern over the increasing burden along with increasing levels of tax avoidance led to renewed calls for reform. In 1984 the Hawke Government announced it would hold a National Taxation Summit the following year, and in the lead-up Treasury produced a draft white paper that argued for the broadening of Australia's direct and indirect tax bases to improve economic efficiency and reduce tax evasion. The proposals included a 12.5 per cent broad-based consumption tax. The consumption tax failed to get key stakeholder support and was not implemented. But the process did lead to the introduction several key reforms first canvassed as far back as Asprey, including a capital gains tax and a dividend imputation scheme. It also resulted in the introduction of a fringe benefits tax.

In 1998, after a year of consultations, the Howard Government released details of its A New Tax System (ANTS) package, which included proposals for a 10 per cent goods and services tax to replace the wholesale sales tax and a raft of smaller state taxes, increases in personal tax thresholds and a lowering of rates, a broadening of the fringe benefits tax base, and changes to tax administration.

However, a number of compromises, most notably to the scope of the GST through the exclusion of food, were necessary to secure passage of the changes through parliament.

Alongside the ANTS package, the Howard Government announced a Review of Business Taxation to examine taxation in relation to business entities and business investments. The terms of reference required reforms to be revenue neutral. Its findings advocated a reduction in the company tax rate to 30 per cent, changes to capital gains tax, removing deductions for accelerated depreciation and further broadening of the business tax base, and a consolidations regime for company reporting.

Some further recommendations, including the introduction of a 'Tax Value Method' (TVM) system of determining assessable business income, were not implemented following lengthy community consultation.

In response to the Review of Business Taxation recommendation that there be an examination of Australia's international tax regime, in early 2006 the Howard Government commissioned its Review of International Taxes. The report, prepared by the Board of Taxation, was restricted to international tax issues and made a number of recommendations, including in relation to the treatment of controlled foreign companies and foreign investment funds. A recommendation to reduce the double taxation of income on offshore corporate earnings through a limited expansion of the imputation regime was rejected.

Source: Information in this exhibit comes from a variety of sources including R. Eccleston, *The Thirty Year Problem: The Politics of Australian Tax Reform*, Research Study 42, Australian Tax Research Foundation, 2004.

BUILDING PROSPERITY THROUGH BETTER TAXATION

'Only a strategic, structured, transparent and comprehensive plan, properly implemented, will achieve the growth needed for Australia's future prosperity.'

Business Council of Australia, *Keeping a Permanent Watch on Australia's Tax System*, 2006.

The Australia's Future Tax System review gives us a chance to make far better use of one of the most important tools of economic policy. We need to see this review not in terms of potential short-term costs, but rather in terms of the longer-term benefits and opportunities that will flow from comprehensive reform.

We should see this review as an opportunity to better support growth and prosperity through the development and maintenance of a truly world-class tax system.

An opportunity to better enable workforce participation, skill development, long-term investment, innovation, risk taking, and competitiveness. An opportunity to improve the interaction of welfare benefits and the taxation system. And an opportunity to fundamentally address federal–state tax and fiscal arrangements.

Reform on this scale is not undertaken often. For the first time in decades, we are approaching tax reform not in isolation, but at a time when there is active public support for vital reforms in other areas. This represents a unique opportunity to align the most important economic policy levers towards achieving the goals agreed by the Australia 2020 Summit.

THE STARTING POINT

What is achieved with this review, what we are bold enough to tackle, will have a very significant bearing on whether or not we achieve the aspirations set out by the 2020 Summit. That is, to climb the global league tables and become the best place in the world in which to live and do business.

We know that Australia is likely to reap substantial benefits by reforming the broader structures of the tax framework.

We also know the gains will be proportional to the scope of the review, which means that the review should be as broad as possible. Unfortunately, politics has already curtailed the benefits of potential reform by significantly limiting the terms of reference. In particular, the explicit exclusion of consideration of the GST – either base broadening or changes to the rate – is a fundamental weakness.

It is difficult to see how the Australia's Future Tax System review can fundamentally address core issues such as the balance of taxes on work, investment and consumption, without taking into account the key consumption tax. Political compromises made in order to secure the introduction of the GST have already undermined the efficiency gains of the tax and greatly increased its administrative complexity.

Refusing to examine the GST as part of a comprehensive review is all the more concerning given that demographic trends mean the proportion of income taxpayers in our total population is set to decline.

Likewise, it is difficult to see how the review can seek to simplify and reform taxation across state and federal jurisdictions while failing to consider the scope for possible changes to one of the key channels through which revenues are collected and transferred from the federal government to the states.

The extent of this shortcoming cannot be overstated. As a matter of priority, the government should reconsider the exclusion of the GST from the review.

The review is also likely to be constrained by an implicit assumption or goal of revenue neutrality. This again unnecessarily limits options. Revenues and spending have grown strongly in real and per capita terms. Now is the time to question whether these trends and settings are appropriate. While the 2008–09 Budget made a positive start to reining in spending, a more comprehensive consideration of what and where spending genuinely adds to future prosperity is warranted.

The review should explicitly consider the scope for a sustained reduction in the overall tax burden and how this might be achieved.

HEADLINE PRIORITIES

Consideration must be given to the impacts of tax across the economy and community and how those impacts relate to current and future risks and challenges. A summary of the BCA's key priorities in this context follows.

Economic growth and productivity

Capacity constraints, skill shortages and declining productivity make it clear that the review should focus on how the tax system can better enable economic growth and productivity. Important issues for consideration must include the impact of the tax system on:

- the type, quality, and quantity of investment;
- savings decisions;
- innovation, including through collaboration domestically and overseas;
- risk taking and entrepreneurship; and
- the incentives for individuals to develop and apply skills and knowledge (including as they approach retirement).

Supporting social prosperity

Many of the broader social gains we desire are only possible through sustained economic and employment growth. But broader economic growth, and the current tax and benefits system, are failing to deliver improved outcomes for some in our community. We must do better on this front.

Reforming transfer payments (and broader support programs) is fundamentally important, but we must also take into account how the tax system interacts with those payments, and more specifically, their withdrawal.

Progressive taxation scales coupled with targeted welfare mean that there will always be high effective marginal tax rates at some point in the system. The challenge is to ensure that we minimise their impact when and where they have the most significant influence on decisions related to workforce participation.

Given current high levels of participation and employment and the extent to which personal income tax rates have come down, an important issue for consideration is how we might be more creative in the delivery of benefits. More specifically, are there ways in which we can taper the withdrawal of benefits (or payment of taxes) or stagger these over time to ensure smoother transitions into the workforce – particularly for those that have been out of it for some time, or who face more significant barriers to ongoing participation?

A clearer understanding of the part tax plays in reaching broader goals – both in terms of design and the uses to which revenue is put – should contribute to the development of a system that is simpler and more equitable, rather than one that is too easily politicised for short-term gain.

Enhancing our engagement in the global economy

If we are to meet the challenges of globalisation head-on we must ensure the tax system supports businesses and individuals looking to capture new opportunities in global markets. In other words, our tax system must be competitive.

This is not an argument for always having the lowest tax rates or tax burden. It is an argument for understanding how the tax system impacts Australia's productivity performance and our ability to attract and retain investment, skills, and ideas. It is also about ensuring that we do not create or maintain tax barriers that undermine the capacity of businesses to expand into overseas markets, including through investment.

Simplicity and low cost

The Australian tax system is complex and costly. Tax reforms to date have tended to increase rather than reduce this problem and there is plenty of scope for improvement on this front.

The plethora of taxes imposes excessive administrative costs and creates uncertainty. To highlight this point, the BCA's *Tax Nation* report identified 56 business taxes in Australia: 21 federal taxes, 33 state taxes and 2 local taxes.[2] The report highlighted that the costs of tax compliance continued to be a significant burden in Australia, particularly on the business community. We should aspire to being among the best performers on measures related to cost and simplicity.

Providing fiscal stability

Last, but by no means least, the tax system must provide fiscal stability in a way that gives governments and others certainty to undertake long-term planning and decision making. This implies both achieving a sustainable tax mix and, as argued above, rethinking of the role of government spending in the economy.

REFORM ADVOCACY

Developing a tax system that meets the criteria outlined above is a tall order. Reform on this scale cannot be delivered effectively in the short term. Significant research and consultation is needed and in all likelihood tax changes will need to be phased in over time. It will take even more time for the real benefits to flow.

Against this background, reforms must be prioritised and clearly explained so that the public can understand the reasons for and benefits of change.

The BCA does not underestimate the size of the challenge, or the political realities that such a reform effort faces. That's why a clear ambition and vision about what can be achieved is so important. The BCA will seek to communicate and advocate not only its priorities but also the broad and long-term benefits that can flow from ambitious reforms.

CHARTING OUR COURSE

'Australia needs a tax system that supports the global competitiveness of our economy, provides incentives, minimises distortions, and supports fiscal responsibility.'

Australian Government, *Australia 2020 Summit: Initial Summit Report.*

SUPPORTING ECONOMIC PROSPERITY

Taxation impacts on almost every area of the economy and economic decision-making. Australia's federal, state and local tax systems collect the equivalent of around one-third of annual national income. In various forms we tax incomes, expenditures, capital transactions and some aspects of wealth.

'An alternative and significantly more ambitious approach would be to transform the tax system in concert with other major public policy reforms to open up the possibility of shifting Australia onto a higher economic growth path.'

BCA *Taxation Action Plan for Future Prosperity,* 2005.

The tax system affects consumption decisions, workforce participation, saving and investment decisions, business structures and business operations. Some taxes are specifically designed to influence outcomes.

Taxes are used to discourage some activities, like gambling and smoking, or to encourage others, like retirement savings.

In other cases, taxes can inadvertently create perverse incentives, like the imposition of multiple taxes on insurance policies that make insurance less affordable, or reductions in fringe benefits tax that encourage people to drive cars more amid rising concerns over greenhouse gas emissions.

Taxes create a gap between the prices paid and the prices received for goods, and between wages earned and wages 'taken home.' They create a gap between profits earned and profits able to be distributed to shareholders or re-invested in business growth.

In many cases, the person (or entity) who technically bears the tax is different to the person who actually ends up paying it, once the full effects of the tax have worked their way through the economy. Who ultimately bears the cost of a tax will depend on the type of tax and the activities it applies to, but there is always a cost.

The size of this distortion or 'wedge,' and where and how it falls, can have very profound impacts on the behaviours and decisions that underpin economic growth.

Taxes therefore have significant bearing on many of the drivers that contribute to improved productivity, participation and population, as described using the so-called '3Ps' framework.

Tax and the 3Ps

Sustaining economic growth at 3 to 4 per cent per annum will be essential if Australia is to move into the top-five band of countries with the world's highest living standards by 2012.

To achieve such a strong growth rate in the face of current supply constraints, we must adjust policy levers towards improving productivity, higher rates of labour force participation, and population growth (including through immigration).

Tax and productivity

Australia's productivity growth has slowed sharply. Multifactor productivity – essentially the additional output from the more efficient use of capital and labour – declined by 0.6 per cent in 2006–07 (see Figure 1).

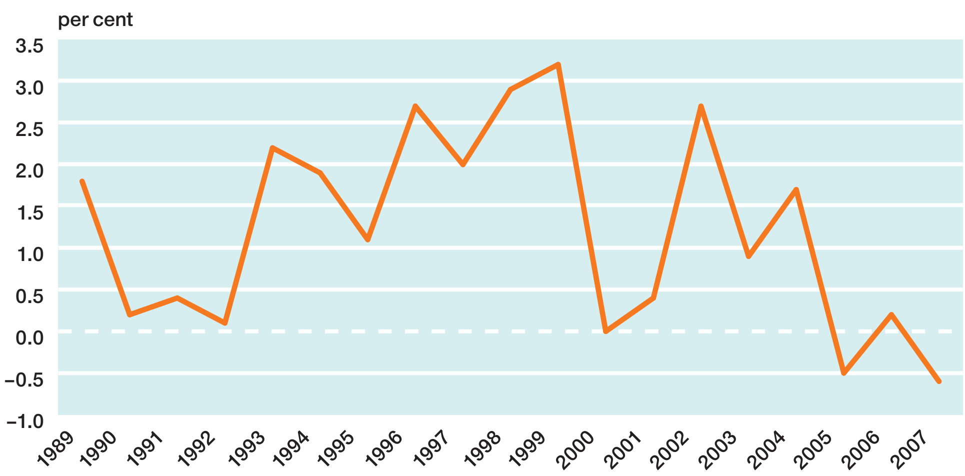
Turning this performance around will be fundamental to lifting competitiveness. If Australia is to sustain real annual economic growth in the range of 3 to 4 per cent, productivity growth will need to consistently sit in the range of 2 to 3 per cent per annum.[3]

Increasing productivity requires lifting investment levels and the availability of capital, improving the quality of investment – including through effective innovation, raising skill levels, maximising the application of skills in production – and enhancing production processes through innovation and adaptation.

A fundamental issue underpinning these drivers of future productivity is the incentive to take measured risks, and it is here that the taxation system comes into play. For example, does the tax system work in favour of, or against, individuals deferring current income to invest in the acquisition of education and skills? Does the system work against or in favour of companies seeking to invest in growing operations in new overseas markets from an Australian base? Does the tax system inhibit or enable collaboration on research and development? Does the tax system work against or in favour of overseas investors investing in Australian companies and markets? These are the kinds of questions we must ask in determining how our tax policy settings can better assist productivity growth.

FIGURE 1: ANNUAL GROWTH IN MULTIFACTOR PRODUCTIVITY

Multifactor productivity – hours worked



Source: ABS Catalogue No. 5204.0, *Australian System of National Accounts 2006–07*, p. 12.

Tax and participation

Australia faces a skills shortage. Participation rates have risen steadily over the past decade, reaching 65.2 per cent in May this year. As workers become harder to obtain, it is important that policy settings aim to maintain and build on this success.

The structure of the tax system, and importantly how it interacts with welfare benefits, has a significant impact on participation decisions. As our population ages, the way the tax system interacts with and impacts on superannuation, and hence retirement decisions, is also increasingly important.

While the 'participation' decision is often thought of in the context of 'to work or not', it also relates to decisions about how many hours to work, whether to take a promotion, or whether to invest in further education or training.

One of the biggest challenges for the forthcoming review will be to better understand and explain the impact of marginal tax rates and their interaction with the benefits system, in terms of how they affect the behaviours and decisions of different individuals and households.

In other words, how responsive are different groups to effective marginal tax rates? Do the different elements – tax rates versus benefit withdrawal – have the same influence on participation decisions and outcomes for different kinds of taxpayers?

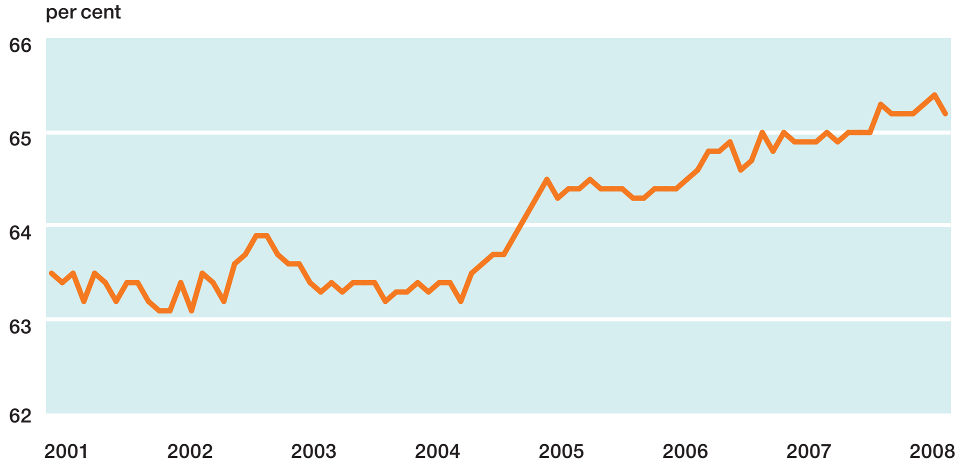
Tax and population

Australia's demographic profile and the skills mix of its workforce underlie its productive capacity. We know that population ageing is set to weigh on our ability to sustain strong economic growth as the proportion of non-workers to workers continues to rise (see Figure 3).

Ensuring that population developments have as positive an impact as possible is therefore important. While tax might, at the margin, impact decisions on whether or when to have children, the bigger driver of Australia's population future is net migration. Australia has benefited from strong net migration in the past and must continue to do so, particularly from skilled migrants.

We must also avoid discouraging Australians who leave to seek international opportunities from returning.

FIGURE 2: AUSTRALIA'S PARTICIPATION RATE



Source: ABS Catalogue No. 6202.0, *Labour Force, Australia*, May 2008. The participation rate measures the labour force (employed and unemployed) as a percentage of all citizens aged 15 and over.

The effect of marginal tax rates on the location decisions of Australia's skilled workforce have been hotly contested, but it is safe to say that global competition for labour will intensify, and Australia must ensure that its tax system does not create an obstacle to both attracting and retaining the best and brightest to our shores.

SUPPORTING SOCIAL PROSPERITY

'A more efficient, growing economy is likely to improve the chances of achieving a more equitable society.'

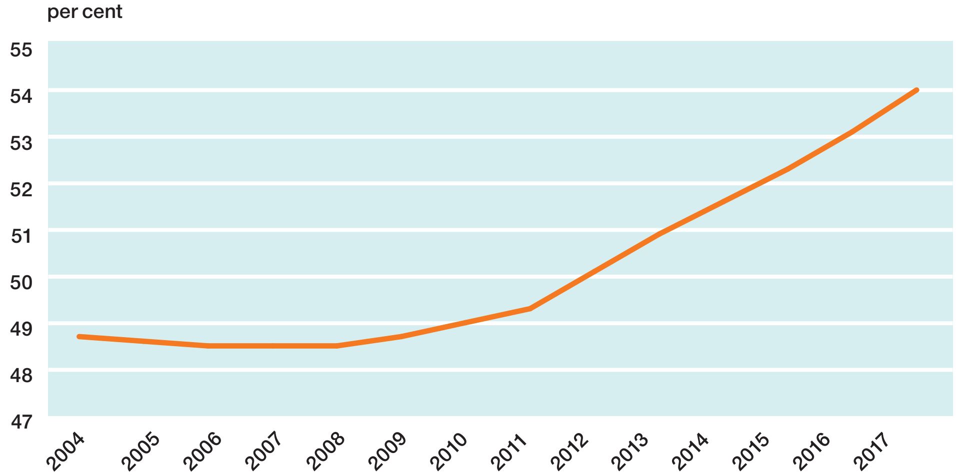
Australian Government, Commonwealth Budget 2008–09, Budget Paper No. 1.

Supporting social prosperity is critical to a nation that wants to count itself as among the best in the world. As Australia's economic prosperity has increased, it is important that we find meaningful and sustainable ways to improve the opportunities and circumstances of people experiencing entrenched disadvantage.

The tax system is integral to addressing some of these issues, particularly as it impacts on the participation and education decisions highlighted above. But the tax system by itself cannot be seen as the solution to all social ills. Introducing tax incentives without the requisite improvements to the education and welfare systems more broadly – or the federal–state reforms that are needed to facilitate them – will have a limited effect. Both business and government must begin to seek more creative solutions in this regard.

FIGURE 3: THE DEPENDENCY RATIO

Population aged 0–14 and 65+ as a percentage of population of working age (15–64)



Source: ABS Catalogue No. 3222.0, *Population Projections, Australia, 2004 to 2101*.

Equity

Equity in the tax system is critically important. However, as a relative concept, it means different things to different taxpayers and can be difficult to define. It is also emotive, which means objective debate can be easily distorted, particularly in the political context.

A culture of taxing for opinion polls is not only short-sighted, it increases complexity and creates division in the community. Rather than fostering an understanding of the benefits that economic growth can bring to society as a whole, it distracts the genuine reform debate with trite arguments about who is paying the 'fairest' share, and encourages Australians to believe that tax is a zero-sum game: if somebody else gains, they must lose as a result.

All too often, this rhetoric is used to disguise the fact that the reforms being offered are not really reforms at all, but a series of short-term measures whose benefits will be eroded within a few years – such as adjustments to tax bracket thresholds that do little more than return bracket creep.

An equitable tax system should encompass genuine incentives to participate, minimising disincentives created by effective marginal tax rates for people returning to the workforce and ensuring those already there have an incentive to stay longer. It should also remove the potential disincentive effects of tax rates at higher income levels, and attempt to alleviate their role in discouraging people to increase their productivity or upgrade their skills.

An assessment of the level of equity in the tax system is not possible without an analysis of the taxes being returned through the welfare system. Approximately half of Australia's welfare spending is returned to the people who paid the tax to fund it in the first place.[4]

Given the size of the welfare system, this generates extraordinary additional costs to the economy for no net benefit to taxpayers. Removing churn from the personal tax system should be a priority. It is better government spending, not more, that supports improved social prosperity.

An analysis of the interactions between tax and welfare should also consider the complexities caused by a welfare system that is calculated on a family basis and a tax system that operates on an individual level.

If comprehensive tax reform is to be accepted by all, there needs to be a clear explanation of the changes and their intention. Careful consideration should also be given to appropriate sequencing of changes and transitional arrangements.

Enhancing our place in the global economy

Globalisation presents additional challenges for tax systems. The ease and speed with which businesses, people, ideas and capital can move around the globe make revenue authorities understandably nervous. Concerns relate to the potential for tax evasion, and fears that downward competition on rates will erode revenue raising options.[5] At the same time, running continually higher tax rates runs the risk of turning investment and skills away, or worse, driving the investment and skills we currently have elsewhere.

We cannot change the reality of globalisation. Indeed, if the growth in our engagement since the last two tax reform processes is any guide, these international pressures will only increase (see Table 1). This means we have to seek a new approach in order to deal with them.

TABLE 1: AUSTRALIA'S CHANGING INTERNATIONAL CIRCUMSTANCES

	1985 Review of the Australian Tax System	1998 A New Tax System/Review of Business Taxation	2007
Level of Australian investment abroad (original)	$33b	$290b	$884b
Level of foreign investment in Australia (original)	$112b	$587b	$1,621b
Exports to GDP ratio	16.3%	20.3%	20.8%
Imports to GDP ratio	16.8%	20.3%	21.6%

Source: ABS Catalogue No. 5302.0, *Balance of Payments and International Investment Position*, Australia, December 2007.

AUSTRALIA NEEDS TO EMBRACE THE TAXATION IMPLICATIONS OF GLOBALISATION.

The increasing internationalisation of Australian business means increasing amounts of business income will not be earned within Australia and many 'Australian' activities will not be taxable here. In taxation, as in other policy areas, globalisation is a two-way street (see Exhibit 3).

This means that our international focus must be similar to our domestic focus: encouraging economic growth and activity that expands our domestic tax base. This includes bringing greater foreign investment into Australia, and creating an environment that encourages internationally successful Australian companies to bring their profits, as well as the other benefits of global engagement, back home.

Australia does not need the lowest tax rates in order to be internationally competitive. It needs to have the right taxes and rates, relative to the other factors that make it attractive as an investment destination.

In other words, we need to focus on our competitive advantages of the whole package, not a comparative advantage on rates alone.

This does not mean Australia can afford high rates. We all know Australia's inherent disadvantages as an investment location: a relatively small economy, a geographically dispersed population, situated a considerable distance from world markets. International research tells us that low tax rates – particularly corporate and personal income tax rates – are clearly important to making up for some of these concerns.[6] In and of themselves, however, they will not be enough to sustain the levels of growth Australia is looking for.

We cannot ignore the need to have well-positioned rates, but with proper planning and investment in the appropriate infrastructure to attract investment we should not have to compare ourselves to countries who have little else to offer. The dilemma for Australia is that, because we have neglected reforms in a number of these key areas, we have made ourselves more reliant on cutting tax rates in order to compete.

Long-term competitive growth needs to be supported with a skilled workforce, effective infrastructure, efficient government, strong research institutions and high levels of innovation – in fact, the very things the BCA has been advocating as part of its strategic priorities.[7]

Government has an inescapable role in creating this environment by setting the right rules and incentives and overseeing the appropriate level of public investment needed. In the modern environment, it is no longer enough for governments to simply avoid being a barrier to growth – they must actively seek ways to encourage the upgrading of competitiveness.[8]

The tax system can contribute to improvements in the competitiveness of Australia's business environment, by increasing the attractiveness of Australia as a location for investment and decreasing the cost of capital for business investment in Australia. It can also increase the level and efficiency of investment within Australia, whether in housing, physical business assets, infrastructure, human capital or the other intangible assets that play the major role in a modern knowledge-intense economy. All of these things can contribute to productivity growth over the longer term.

EXHIBIT 3
THE INTERNATIONAL GROWTH OF AUSTRALIAN BUSINESS

Australian businesses earn increasing amounts offshore. In the 2007 financial year, the offshore earnings of Australia's 100 most globalised companies (companies with the most foreign revenue) hit $218.9 billion – an increase of more than 15 per cent.

Although recent turmoil on global financial markets may slow growth in some sectors, it is clear that Australia's small domestic market means the internationalisation of business can only continue.

Sector	Foreign Revenues $b
Mining	92.3
Services, other	45.1
Manufacturing	40.9
Services, financial	36.0
Agribusiness	4.4

'Overseas trade is a necessity. Australia is the fifteenth largest economy in the world, but accounts for only 1.6 per cent of world GDP. As such, foreign markets offer Australian firms huge growth potential (and the Australian consumer access to the best products). Although Australia has experienced significant globalisation more needs to be done. With only 21 million geographically dispersed people, Australia cannot match world's best practice in the production of every good and service that the market demands. It must trade. Countries of a similar structure tend to export at least 25 per cent of GDP.'

Source: *The Diplomat*, May/June 2008.

An internationally competitive economy is also better able to manage the risks associated with imbalances in the economy, such as future fiscal pressures, a shortfall in national savings, or excessive reliance by any sector on debt.

Building stronger domestic foundations, including through a world-leading tax system, will better position Australian businesses to compete in global markets.

The tax system also improves incentives for Australians to save and invest in Australia and contributes to the drive to grow the population, by increasing Australia's attractiveness to internationally mobile skilled labour.

Simplicity and low cost

Simplicity is regularly identified as a goal of taxation but all too rarely achieved. Complex regimes reduce voluntary compliance, increase taxpayer (and government) error, increase taxpayer perceptions that the system is unfair, and increase the economic drag of the system, diverting resources away from their most productive uses.[9]

One of the chief contributors of complexity in a tax system is the lack of a guiding plan with clearly articulated objectives. The absence of a plan leads to piecemeal changes and uncoordinated reforms, increasing the risk of unintended consequences. It also makes it more difficult for governments to resist calls for special concessions that simply do not fit longer-term priorities.

Complexity also results from the sheer number of taxes, many of which raise relatively little revenue.

As the BCA's *Tax Nation* report identified, there were 56 separate taxes borne or collected by business in 2006.

Significantly, of the $27.5 billion in tax borne by the businesses in the survey, 66 per cent ($18.1 billion) was income tax. It took 50 other taxes to raise the remaining 34 per cent ($9.4 billion). The number of taxes raising small amounts of revenue raises legitimate questions about whether they cost more to collect then they raise for the public purse.

The 'deadweight costs' of taxation are now well known.[10] Taxes impose direct and indirect administrative, compliance and other decision-making costs on the economy. These transaction costs reduce the share of the income available for investment and consumption. A tax system must be economically efficient both in terms of compliance costs for taxpayers and government collection costs.

A key priority for the reform should be to reduce the number of taxes currently levied.

Providing fiscal stability

The tax system must be capable of providing a reliable source of funds to enable the appropriate level of government activity, for the benefit of all Australians.

In recent years, both the stability and size of the revenue base have become growing sources of concern. Unfortunately, scope for reform in both of these areas has already been constrained through the review terms of reference – by removing elements of the tax base from consideration (the goods and services tax, tax-free superannuation), and by assuming a constant, rather than reduced, level of government spending.

Stability and sustainability

The stability and sustainability of budget revenues is a key consideration for fiscal policy. Table 2 provides a snapshot of federal government revenues at the time of each of the two most recent major tax reviews. Real federal revenue per capita has grown from $7,166 to $12,153 over that period.

While revenue levels are increasing, research shows that the federal Budget has become increasingly subject to the economic cycle. Virtually all of the revenue side of the Budget is now sensitive to the economy, whereas little more than one in every $25 on the spending side is similarly sensitive.[11]

This means that when growth slows, the federal Budget will deteriorate markedly and quickly, unless offsetting decisions are made to curtail spending or raise taxes. As the BCA submission to the 2008–09 Budget highlighted, given the political difficulties of cutting spending, the likely fallbacks are higher taxes (which in turn would weigh against competitiveness and longer-term growth prospects), or larger fiscal deficits.

A significant element of this cyclical sensitivity comes from the Budget's growing reliance on income taxes, particularly on the corporate side (see Table 2). The substantial increase in total tax revenue over the last decade has been underpinned by a sharp rise in corporate income tax: from $27 billion in 2000, to a projected $73.5 billion in 2008–09.[12]

Over this time, the share of corporate taxes in overall revenue has increased from 9.6 per cent in 1985 at the time of the Review of the Australian Tax System reforms, to 24.4 per cent in 2006–07, making it one of the fastest growing sources of revenue for the government.[13]

This level of reliance is not common. According to the OECD, Australia has the second highest reliance on corporate taxation as a percentage of total tax revenue. In 2004, the unweighted average across the OECD was just 9.1 per cent.[14]

In the context of an ageing population (see Exhibit 4), and the future reductions in Australia's working-age population, our reliance on personal income tax is also a significant concern.

A stable revenue supply is one that relies on a range of taxes, raised from a varying and broad base. If Australia is serious about long-term reform, we need to consider the entire tax mix, including the GST.

Alongside this heightened instability are questions of the sustainability of the total tax take. All taxes carry an economic cost, and while higher taxes might meet immediate adequacy goals, they may also reduce future adequacy by damaging growth prospects. The review should explicitly consider how a sustained reduction in the total tax burden can be achieved.

TABLE 2: REVENUE TRENDS

	1985 Review of the Australian Tax System	1998 A New Tax System/Review of Business Taxation	2007
Total federal revenue (original)	$58b	$133b	$278b
Reliance of federal budget on corporate taxes (companies, superannuation and PRRT)	9.6%	17.6%	24.4%
Federal revenue to GDP ratio (including GST)	22%	23%	25% (2005–06)
Federal revenue per person (in today's dollars)	$7,166	$8,828	$12,153

Source: ABS Catalogue No. 5302.0, *Balance of Payments and International Investment Position*, Australia, December 2007 and BCA 2008–09 Budget Submission.

EXHIBIT 4
TAX IMPLICATIONS OF AN AGEING AUSTRALIA

The fiscal implications of population ageing have been well articulated in the federal government's Intergenerational Report and more recently by the Productivity Commission.

This work confirms that population ageing will result in a significant fiscal burden or gap emerging in coming decades. This reflects the adverse impact of slower economic growth on revenues and increasing expenditures associated with health, aged care and pensions.

In particular, the Productivity Commission noted the following:

- While taxation revenue will largely track GDP growth, government expenditure is likely to rise more rapidly, placing budgets under considerable pressure.
- Although education and some welfare payments are projected to increase more slowly than GDP, government spending on health, aged care and pensions will grow at a faster rate.
- The major source of budgetary pressure is health care costs, which are projected to rise by about 4.5 percentage points of GDP by 2044–45, with ageing accounting for nearly one-half of this.
- In the absence of policy responses, the aggregate fiscal gap will be around 6.4 percentage points of GDP by 2044–45, with an accumulated value over the forty years of around $2200 billion in 2002–03 prices.
- On past trends, much of this could be expected to be borne by the federal government, but there are also significant potential burdens faced by state and territory governments.

These conclusions point to growing tensions between state and federal governments in regard to revenue and spending responsibilities, and draw into question the ability to effectively sustain current revenue-sharing arrangements. These tensions could be exacerbated by a reduction in GST revenues as a result of increased spending on GST-exempt items (namely health).

The analysis concludes that 'the shift towards consumption of tax-exempt items that accompanies ageing is most likely to reduce long-run GST revenues lightly as a share of GDP.' While its current estimates are for a modest reduction of GST revenues, against the backdrop of increased spending demands, even modest shifts are likely to cause friction in current revenue-sharing arrangements.

Based on past experience, there is concern that the most likely 'default' outcome will be a reliance on higher taxes. This will weigh on growth and make it harder to meet spending obligations.

Source: Productivity Commission, *Economic Implications of an Ageing Australia*, Research Report, Canberra, 2005.

The role of government

'A reduction in today's tax burden without addressing spending is at the expense of future taxpayers who must service or repay the debt. This is a particularly inequitable strategy in the context of the higher tax burdens on those taxpayers already likely to result from the increasing age dependency ratio.'

Business Council of Australia, *Taxation Action Plan for Future Prosperity*, 2005.

The role of a taxation system is to support the necessary functions of government. Tax and spending decisions should be driven by clearly stated and assessed needs and objectives, not simply by a 'capacity to pay' as revenues increase. The welfare system, in particular, should not be expanded for its own sake or for the sake of political expediency.[15]

Unfortunately, over recent years government expenditure has continued to grow with little apparent regard for whether this intervention contributes meaningfully to prosperity. This has seen a rapid increase in assorted benefits and payments, even as concerns are raised about future pressures on the Budget as a result of Australia's ageing population.

All areas of spending – including business support programs – should be regularly reviewed to determine their effectiveness and net benefit. The BCA has also proposed a Charter of Budget Quality to promote greater transparency and accountability for new spending programs.[16]

The reluctance to discuss the appropriate levels of government expenditure has put constraints on past tax reforms, as governments insist on maintaining current revenues in the immediate term at the expense of what could be wider-reaching reforms that bring greater benefits in future years. At a time when reforms to federal–state relations are also firmly on the agenda, there is no better opportunity to address the size – and efficiency – of government.

If we are serious about lifting Australia's long-term productivity, we should seek to reduce Australia's tax to GDP take, and maintain it at a reduced level.

Tax and intergovernmental relations

There is currently broad support for efforts to modernise the Australian federation, to improve accountability and service delivery across the board, and reduce the economic and social costs that arise from the current level of duplication and overlap in regulatory regimes.

The tax system is a necessary part of reforms to improve the operation of our federation. When taxes are imposed by all layers of government, the overall competitiveness of a tax environment hinges on an effective interrelationship between the tax systems of often competing jurisdictions.

As noted earlier, the BCA's *Tax Nation* report found that businesses operating across state borders bear or collect up to 56 separate taxes. This results in a system that is overly complex, opaque, and costly for both business and government to administer. These costs weigh on the competitiveness of the business sector – and other parts of the community.

It is clear that reforming the tax system will raise important questions about revenue-raising and sharing arrangements.

As the BCA highlighted in *Budgeting for Prosperity*, a significant part of the fiscal tensions that exist across state and federal jurisdictions stem from the imbalance between spending responsibilities and the capacity to raise revenue.

Clarifying roles and responsibilities in service delivery and fixing fiscal arrangements are fundamental steps to any improvement in the federal system. As fiscal pressures associated with population ageing mount, there will be an impetus for governments at all levels to seek greater revenues, and the complexity of the current system both increases opportunities for, and decreases the transparency of, revenue raising initiatives.

The introduction of the GST made the first serious attempt in many years to reform some of the unnecessary complexities and inefficiencies in state taxation. The outcome in reality involved political compromises and repeated delays in the removal of state taxes under the Intergovernmental Agreement. As a result, business has been left frustrated and disillusioned by the lack of progress in reducing the number of taxes and genuinely addressing complexity and compliance costs.

This is despite the fact that these so-called 'deadweight' costs have been repeatedly shown to reduce business investment levels and discourage employment.

An in-depth understanding of the strengths and weaknesses of the state and territory tax systems, how they impact on costs, and how they might be reformed to maintain a competitive business sector and improve long-term revenue security, will be integral to better federal–state relations.

Tax implications of emissions trading

The introduction of an emissions trading scheme has the potential to deliver significant revenue to the government. The size and predictability of this revenue stream in the near term and over time, and how it should be used and allocated, will have a very important bearing on future growth and prosperity and is a crucial area of consideration for the review. Obviously these considerations and the design of other changes to the tax system should take into account the overriding objective of an emissions trading scheme, which is to reduce greenhouse gas emissions at least cost. It is critical that other policy measures – be they tax, spending or regulatory in nature – do not work against this.

CONCLUSION

Taxes play a fundamental role in economic and social prosperity. Because the tax system influences almost every aspect of economic decision making, tax reform must be treated as an integral part of Australia's broader reform agenda, working in concert with other key reforms.

The Australia's Future Tax System review presents an opportunity for a fundamental change in mindset about tax. Rather than seeing tax as a necessary burden, we must see it as an enhancer of a more prosperous future – a way to underpin national reform in key areas such as federal–state relations, infrastructure, education, workplace flexibility, trade and innovation.

A comprehensive review of the taxation system is as ambitious and complex as it is essential. We know Australia is likely to reap substantial benefits by reforming the broader structures of the tax framework. Consideration must be given to the impacts of tax across the economy and community, and to how those impacts relate to future risks and challenges. If we are to use the tax system to promote economic growth and productivity, support social prosperity, enhance our engagement in the global economy, and underpin fiscal stability, we must be confident that unnecessary costs are minimised, and that the incentives (or disincentives) created by taxation enable the outcomes needed to achieve our ambitions.

Fundamental reform is not easy. Getting the balance right, in terms of the amount of tax collected and the types of taxes imposed, will be a challenge for policymakers. If we are to be confident the review will be successful in laying long-term foundations for growth and prosperity, we must be confident that it is conducted with a long-term vision for Australia's prosperity.

This paper argues that the overarching aim of reforms should be to enable Australia to move into the top-five band of countries with the world's highest living standards by 2012, and ultimately become the best place in the world in which to live and work. But such aims will not be achieved in the absence of real change, or without seeing those changes through to implementation.

We must seize every opportunity to position Australia to deliver sustained economic growth and strong social and environmental outcomes into the future. Reform of Australia's tax system has a critical role to play in securing the country's future prosperity.

NOTES

1 Department of Prime Minister and Cabinet, *Australia 2020 Summit*, Final Report, Canberra, 2008, p. 38.

2 BCA, *Tax Nation: Business Taxes and the Federal–State Divide*, Melbourne, April 2007.

3 *Anticipating Success: BCA Submission to the Australia 2020 Summit,* Business Council of Australia, April 2008, p. 12.

4 There has been much discussion of the issues around the tax/welfare churn and its resulting costs; see for example P. Saunders (ed.), *Taxploitation: The Case for Income Tax Reform*, Centre for Independent Studies, 2006; and the BCA submission to the 2008–09 Budget, *Budgeting for Prosperity*, February 2008.

5 These concerns are discussed in the OECD 2007 publication, *Fundamental Reform of Corporate Income Tax* (p. 76).

6 There is a large body of international tax research to suggest that low tax rates, particularly corporate tax rates, have a significant 'head-turning' effect and encourage greater levels of foreign investment.

7 The importance of the complete reform 'package' is discussed time and time again in the literature on international competitiveness; see for example M. Porter, *The Microeconomic Foundations of Prosperity: Findings from the Business Competitiveness Index*, in the Global Competitiveness Report 2007–08, World Economic Forum.

8 ibid., p. 59.

9 See for example American Institute of Certified Public Accountants, *Guiding Principles for Tax Simplification*, New York, 2002.

10 For a thorough discussion see the BCA *Taxation Action Plan for Future Prosperity*, April 2005, p.11.

11 See p. 21 and Paper 2 of the BCA *Budgeting for Prosperity* submission.

12 Australian Government, Commonwealth Budget Paper No. 1.

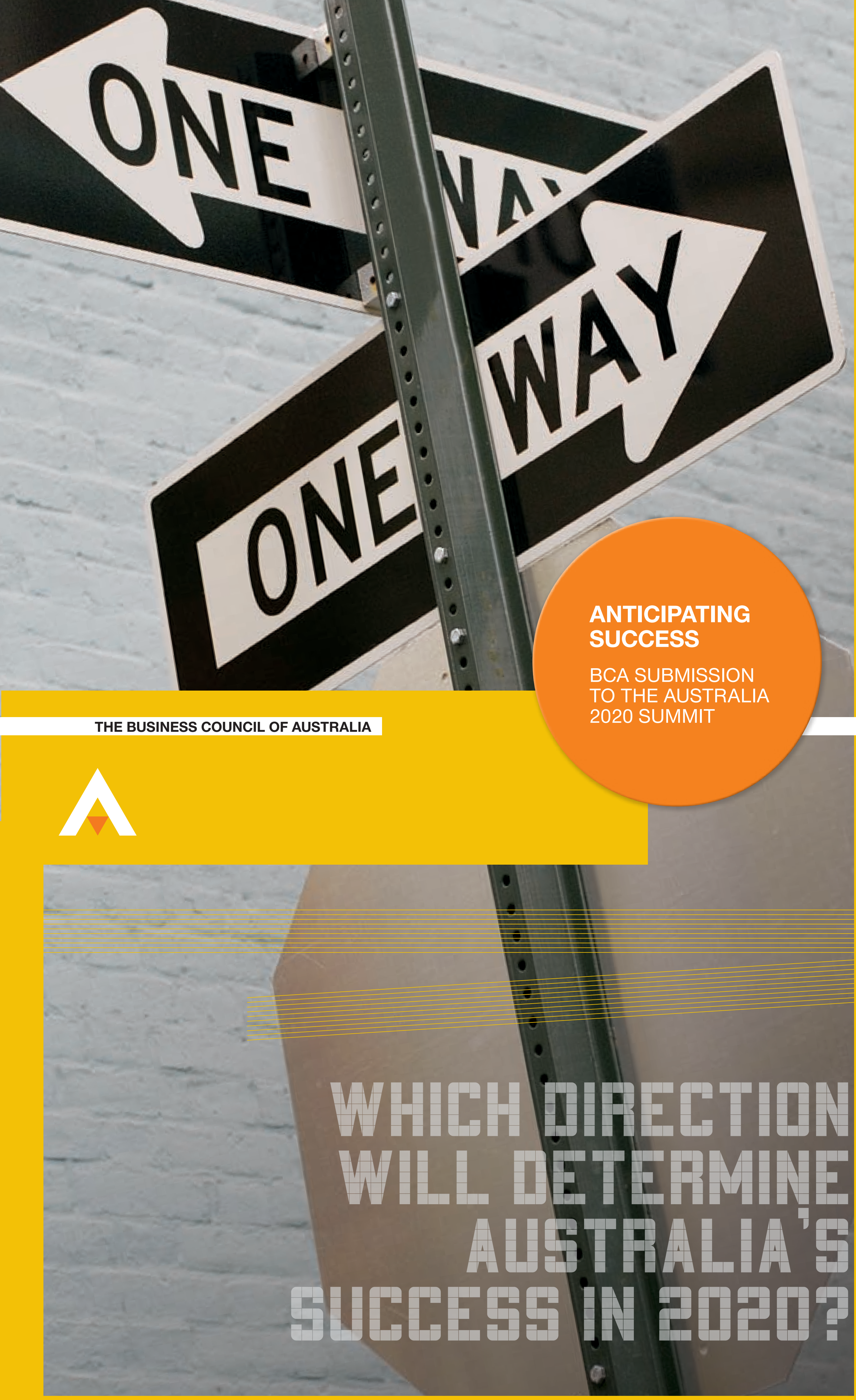
13 Corporate taxes include company tax, superannuation taxes and resource rent taxes.

14 OECD, *Fundamental Reform of Income Tax*, Tax Policy Studies No. 16, 2007, p. 31.

15 For a discussion of the need to better assess the size and priorities of Australia's welfare system, see P. Saunders, *Australia's Welfare Habit and How to Kick It*, Duffey & Snellgrove, 2004; and P. Saunders and B. Maley, 'Tax Reform to Make Work Pay' in P. Saunders (ed.), *Taxploitation: The Case for Income Tax Reform*, Centre for Independent Studies, 2006.

16 For an examination of the need to reconsider Australia's spending priorities and the size of government intervention, see the BCA submission to the 2008–09 Budget, *Budgeting for Prosperity*.

BUSINESS COUNCIL OF AUSTRALIA
42/120 COLLINS STREET MELBOURNE 3000 T 03 8664 2664 F 03 8664 2666 www.bca.com.au



ANTICIPATING SUCCESS

BCA SUBMISSION TO THE AUSTRALIA 2020 SUMMIT

THE BUSINESS COUNCIL OF AUSTRALIA

WHICH DIRECTION WILL DETERMINE AUSTRALIA'S SUCCESS IN 2020?

ABOUT THIS SUBMISSION

THIS SUBMISSION PROPOSES AN ASPIRATIONAL AND ACHIEVABLE VISION FOR A PROSPEROUS AUSTRALIA IN THE YEAR 2020.

It outlines the reforms and adjustments required to successfully negotiate the next 12 years and secure Australia's position within the top five countries in the world. The submission anticipates a number of future challenges and identifies solutions to those challenges. In a number of areas it projects some outcomes which we might aspire to achieve by 2020. These specific examples are intended to provoke consideration of where we are heading and what an alternative future could look like. The overriding intention is to help stimulate and guide the thinking of decision makers and participants involved in the Australia 2020 Summit in April 2008.

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FROM CURRENT FOUNDATIONS WE CAN BUILD AUSTRALIA AS THE BEST PLACE IN THE WORLD IN WHICH TO LIVE, LEARN, WORK AND DO BUSINESS.

1. AUSTRALIA 2008: THE ONLY CERTAINTY IS CHANGE

As we approach the second decade of a new century, the one certainty Australia faces is continuing change.

The nation has faced major challenges and uncertainties in the past, and has prospered. Although the challenges Australia now faces are unique to the fast-paced, 21st-century globalised world, there are some important similarities with those encountered previously.

After a long period of prosperity in the 1960s and early 1970s, cracks in our economy and social fabric emerged. Rising inflation and unemployment, together with declining competitiveness in those industries we traditionally relied on for growth, began to intrude into the comfort zone Australia had inhabited for many years. Left largely unaddressed, these cracks developed into structural problems that began to erode our living standards, limiting individual opportunity and significantly curtailing Australia's prospects for future success.

Policymakers recognised the extent of the problem and resolved to make major changes to the way we lived, worked, learned and did business. Many of the changes, such as floating the Australian dollar, reducing tariffs and other barriers to the international economy, and freeing up our workplaces, seemed at the time too long a line of hurdles to negotiate. These were, after all, the foundations on which Australia's previous successes had been anchored.

But Australia rose to those challenges and put in place the major changes – supported by an emerging, proactive community mindset – that fundamentally changed our economy and society for the better. Those changes provided the foundation for 16 years of continuous economic growth and widespread individual prosperity, and enabled Australia to successfully negotiate significant shocks and challenges (see Exhibit 1).

EXHIBIT 1
THE FUTURE IS NEVER AS WE EXPECT IT

In 1996, who would have expected some of the events, challenges and changes that lay ahead:

- The oil price falling to below $15 per barrel (with some predicting $5 per barrel), only to see it rise to $100 today
- The $A heading below $US0.50 only to approach $US1.00
- The Asian financial crisis on our doorstep
- SARS
- A global credit crunch associated with the collapse of Long Term Capital Management
- September 11
- Wars in Afghanistan and Iraq

Our comfort zone is again under threat. The turbulence on global financial markets, rising interest rates, an ageing population, managing environmental risks, and major changes on our doorstep as emerging markets develop into major new sources of competition, collectively place Australia at a new crossroads (see Exhibit 2).

Australia again has a choice. We can let these new challenges and uncertainties accumulate, and in the process, do little to arrest emerging threats to our prosperity. Or we can rise to the challenge again and make the decisions and reforms that will set Australia on the path to a prosperous future.

EXHIBIT 2

FUTURE TRENDS AND CHALLENGES

A wealthier older population

This will present challenges in terms of future labour supply and potential growth, changing consumer demands and preferences, and increased demand for government services in important areas like health.

It is important to recognise that population ageing is a global phenomenon. The elderly are projected to be more than three times as many in number in 2050 as today, and to comprise nearly 17 per cent of the global population, compared with 7 per cent in 2002.[a]

Geographic isolation and dispersed domestic markets

Australia will continue to be challenged by its distance from global markets and relatively small and dispersed domestic markets (i.e. lack of scale).

Technology

Rapid technological advances highlight the importance of innovation and underpin strong demand for skills. Sources of comparative advantage will continue to change rapidly. While advances in information and communication technology (ICT) will help to offset geographic isolation, distance from global sources of innovation and technological advances will limit the potential 'spillover' benefits Australia may be able to capture.

> 'Technology is to a substantial degree local, not global, as benefits from spillovers are declining with distance. The distance from which the amount of spillovers is halved is about 1200 kilometres.'
>
> Wolfgang Keller, *American Economic Review*, 2002.

Global growth and competition

Advances in ICT and the scope for further policy liberalisation should continue to support the increased mobility of capital, goods, services and people/skills around the world. This brings new opportunities and markets, but also new sources of competition.

The growing influence of emerging markets in Asia, particularly China and India, looks set to continue. China and India are estimated to grow to populations of 1.4 and 1.3 billion respectively by 2020.[b]

China's economy is projected to be the second largest in the world by 2020, and India will have overtaken, or be in the process of overtaking, the major European economies. This is likely to sustain strong demand for energy and natural resources, and (at least in trend terms) raises the prospect of the terms of trade and $A remaining higher on average in the next decade than in the past decade, which in turn presents new competitive challenges for Australian producers.

Other fast-growing major countries such as Brazil, Russia and Indonesia will assume a more prominent position in the global economy, alongside the traditional power centres of the United States, Europe and Japan.

Growth in developing countries will create new and more disparate sources of economic opportunity. The World Bank estimates that average incomes in developing countries will more than double in real terms from $1,300 in 2001 to $2,800 in 2020 (and to nearly $4,000 by 2030).[d]

POPULATION TRENDS: TOP 15 LARGEST COUNTRIES BY POPULATION

	2005 Country	millions	2050 Country	millions
1	China	1316	India	1593
2	India	1103	China	1392
3	United States of America	298	United States of America	395
4	Indonesia	223	Pakistan	305
5	Brazil	186	Indonesia	285
6	Pakistan	158	Nigeria	258
7	Russian Federation	143	Brazil	253
8	Bangladesh	142	Bangladesh	243
9	Nigeria	132	Democratic Republic of the Congo	177
10	Japan	128	Ethiopia	170
11	Mexico	107	Mexico	139
12	Viet Nam	84	Philippines	127
13	Philippines	83	Uganda	127
14	Germany	83	Egypt	126
15	Ethiopia	77	Viet Nam	117

Figures published by the United Nations.[c]

Environmental sustainability

Sustained economic and population growth will contribute to pressures on the environment unless properly planned for and managed. The need for frameworks and markets to reflect the value of environmental resources will become increasingly important.

Climate change

Managing the potential risks associated with climate change will be a long-term challenge for Australia and the world.

Engaging with developing countries will become increasingly important. It has been estimated that China has already passed the United States in terms of carbon emissions, and that China's consumption of coal could increase from 2 billion tons at present to 4 billion tons by 2016.[e]

Security

The threats stemming from terrorism and the instability associated with failed states and intra- and inter-state conflict are likely to remain part of the geopolitical landscape in the decade ahead.

Sources: (a) United States Census Bureau, *Global Population at a Glance: 2002 and Beyond*, 2004; (b) *Mapping the Global Future*, Report of the National Intelligence Council's 2020 Project, 2004; (c) United Nations Global Population Projections; (d) World Bank, *Global Economic Prospects 2008*, 2008; (e) United Nations Millennium Project, *State of the Future 2007.*

2. AIM OF THE SUBMISSION: ANTICIPATING AUSTRALIA'S SUCCESS

Drawing on a number of recent reports released under the BCA agenda, this submission proposes an aspirational and achievable vision for a prosperous Australia in 2020. It outlines the reforms and changes that will allow us to successfully negotiate the challenges Australia faces at the end of the first decade of the 21st century and, by the end of the second decade, attain the mantle of the best country in the world in which to live, learn, work and do business. In other words, the submission anticipates success – in terms of a comprehensive reform agenda, and therefore also in terms of achieving future growth and prosperity.

The purpose of the submission is to help guide the thinking of decision makers and participants involved in the Australia 2020 Summit about the detail of the challenges we face and the solutions needed to meet them.

Like in the 1980s, achieving sustained economic and social prosperity will require fundamental change. Like in the 1980s, many of these changes will seem too difficult, and to some, unthinkable. They include:

- New approaches, roles and systems of government, including more strategic and productive partnerships with business, which will make the public sector a facilitator of (and not a barrier to) continuing economic and social prosperity.
- Fundamental renewal of the basic building blocks of the economy, including transport, water and energy infrastructure, tax, business regulation and workforce participation.
- Major readjustments to the economy to better deal with climate change and other pressing environmental risks.
- Matching or exceeding the performance of global leaders in those areas of our economy and society, including education, innovation and services exports, that will be increasingly vital to a prosperous, 21st-century Australia.

The good news is that this time, we start from a much stronger position. Despite current challenges, our economy remains strong. We have the financial resources to invest in the adjustments and reforms needed to lay the foundations for a new era of long-term prosperity. Australians are now more willing and able than they were 25 years ago to recognise, and make the most of, the opportunities the globalised world offers. We have the benefit of having successfully risen to the challenge before, which involved rethinking existing ways of doing things and charting new pathways to prosperity.

If we are to embark on new pathways to prosperity, it is important that we share a collective vision for our future. A shared national vision can serve many useful purposes. It can excite and motivate our community. It can guide debate and policy evolution. It can highlight the costs of inaction. And it can provide an anchor in turbulent times. If the Australia 2020 Summit does nothing more than spark discussion about such a vision, then it will have been worthwhile.

Our vision starts from an aspirational picture of Australia in the year 2020. We have the benefit of having successfully risen to the challenge before, which involved rethinking existing ways of doing things and charting new pathways to prosperity.

3. LET'S IMAGINE … A 2020 VISION

In 2020, Australia's performance in terms of rising economic growth and prosperity over the preceding two decades has been remarkable and the envy of most.

Australia is now a $2.2 trillion economy, and is in its 29th consecutive year of economic growth, with a population approaching 25 million. Since March 1992, when Australia last recorded two consecutive quarters of negative economic activity, GDP growth has averaged between 3 and 4 per cent per annum. Productivity has grown on average by over 2 per cent a year since 2010 and the unemployment rate has fallen to 3 per cent. The share of the population in employment, despite a decline in the proportion of individuals in the population of 'traditional' working age, is at record highs.

To the surprise of many, Australia has well and truly broken out of the tradition of past cycles, which had seen prosperity rise, only to fall away again.

We are now ranked in the top five economies in the OECD (a greatly expanded club of nations since 2008) in terms of GDP per capita (see Exhibit 3). Against broader benchmarks relating to environmental and social prosperity, Australia's performance is also exceptional.

TABLE 1
AUSTRALIA: THEN AND NOW

	2008	2020
GDP (nominal)	$1 trillion	$2.2 trillion
Population	21 million	24½ million
Unemployment rate	4 per cent	3 per cent
Employment-to-population rate	50 per cent	53 per cent
GDP per capita (nominal)	$50,000	$90,000
Population: traditional working age (15–64)	67 per cent	64 per cent

Note: The estimates provided for the year 2020 in this table (and in Exhibits 5 and 6) are notional only. They are not projections, but a set of potential, realistic indicators of Australia's economy in the year 2020. They have been drawn, where possible, from BCA research on the benefits of sustaining strong economic growth.

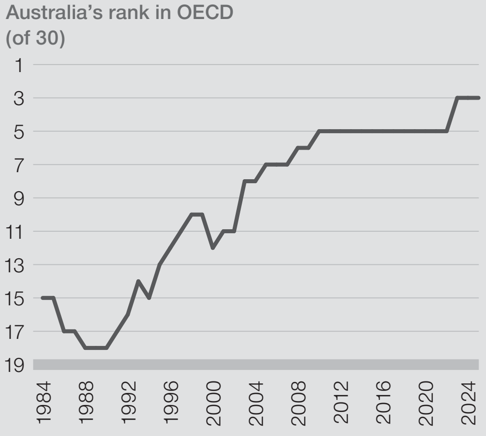
EXHIBIT 3

LIVING STANDARDS: AUSTRALIA IN THE TOP FIVE IN THE OECD

In its submission to the 2007–08 federal Budget, the BCA set a goal for Australia to lift its living standards into the top-five band of the world's developed economies by 2012 and in the process, provide additional opportunities and the means to pass on prosperity to future generations.

By embracing a new national reform agenda, Australia was able to reach this goal in 2012 and maintain it throughout the following decade, which in turn provided the foundations for broader success and prosperity.

GDP PER CAPITA RANKINGS



Source: Business Council of Australia, *Locking in or Losing Prosperity: Australia's Choice*, August 2005.

In the year 2020, according to a comprehensive range of measures analysed by the BCA, taking into account issues such as health and wellbeing, the quality of the natural and built environment, business competitiveness, education outcomes, and the performance of government, Australia can justifiably claim to be the best place in the world in which to live, work, learn and do business.

Australia's performance is all the more remarkable because it was achieved against the backdrop of significant structural change and external shocks, some of which we knew to expect and could plan for – such as population ageing and the risks related to climate change – but others that we could never have predicted.

4. LOOKING BACK ON SUCCESS FROM THE YEAR 2020

How did Australia arrive at this point?

Perhaps ironically, at a time when the economy was facing significant capacity constraints and rising concerns about the relationship between economic activity, the environment and the risks associated with climate change, the newly elected federal government adopted an ambitious, multi-year, ‘growing the future’ strategy.

The strategy committed the government to aim and plan for average annual economic growth of between 3 and 4 per cent through to the year 2020.

This ambitious goal acted as a catalyst for the development and implementation of a broader reform agenda – similar in scale to that embarked on in the mid-1980s – to lay the foundations for strong growth, achieved in a way that carried ongoing electoral support.

The ‘growing the future’ agenda comprised four broad elements:

- Identifying the contribution that each of the key drivers of economic growth would need to make to sustaining growth at 3 to 4 per cent per annum.
- Long-term planning and policies to ensure that growth is sustainable from an environmental perspective and also built on, and capable of generating, broader improvements in social prosperity.
- Confirmation of Australia’s policy of openness to global markets and deeper global engagement.
- Refocusing the contribution of government in achieving sustainable growth.

These elements are discussed in greater detail below (including Exhibit 4).

> ‘The most successful societies are notable for their unity, for the cooperative quality of all their relationships ...’
>
> Paul Keating, ‘Ministerial Statement: One Nation’, February 1992.

The success of the ‘growing the future’ strategy was also predicated on the responsiveness of the business sector and wider community to changing incentives, institutions and opportunities. Business responded positively to the changes implemented by governments to the year 2020 (see Section 10).

EXHIBIT 4

POLICY INVESTMENTS TO GROW THE FUTURE

2007	2020s
Segmented infrastructure markets	National infrastructure markets
Regulated prices for infrastructure use	Market-based prices for infrastructure use
Segmented infrastructure investment	Nationally coordinated and planned infrastructure investment
Poor federal–state collaboration	Institutionalised federal–state cooperation
Duplication and overlap in service delivery across federal, state and territory governments	Streamlined service delivery and accountability
No carbon pricing or emissions trading scheme	National emissions trading scheme
Inconsistent business regulation across jurisdictions	Nationally consistent business regulation
Environmental management is fragmented and rules-based	Environmental management based on national markets
Annual migration targets	Long-term population strategy
Education policy focused on inputs	Education policy focused on quality outcomes
Expensive, fragmented and reactive health policy and health system	Transparent, integrated, efficient, prevention-based health policy and health system

Permanent Policies

- Macroeconomic stability, anchored by credible policies and targets
- Open markets and low barriers to the movement of people, capital, goods and services
- Strong competition policy
- Floating exchange rate
- Decentralised labour market

5. BUILDING A PLATFORM FOR STRONG GROWTH

In order to ensure its growth target was credible, the federal government built its reform agenda around the drivers of economic growth, the so-called 3Ps: population, productivity, and participation.

A national population policy

Against the backdrop of the outlook for slower population growth and for population ageing, the federal government established a long-term national population policy aimed at sustaining population growth at between 1 and 1½ per cent per annum. This policy comprised three elements: permanent migration, temporary migration and natural increase.

Permanent migration

The government committed to a strong permanent migration intake to offset slower domestic population growth and the emigration of Australians. The program was targeted towards skilled migrants to maximise the contribution to economic growth.

Temporary migration

A strong temporary migration program to support the skills needs of business was retained. In addition to enabling businesses to quickly and efficiently access world-class skills, the program proved to be an effective source of candidates for permanent migration.

Natural increase

Migration policies were complemented by policies to support individual fertility aspirations, with a strong focus on supporting the availability of, and access to, high-quality, flexible child care and the implementation of a government-funded, national paid maternity leave policy that worked in conjunction with paid maternity leave schemes provided by business.

A long-term productivity agenda

Sustaining economic growth at rates of more than 3 per cent required a commitment to achieving 2 to 2½ per cent productivity increases per annum as well as consistent population growth.

The second pillar of the government's growth platform therefore was the implementation of a comprehensive reform agenda aimed at enabling improved productivity in both the business and government sectors.

The federal government recognised that sustained strong productivity growth would not happen without a competitive and dynamic business sector, well-placed and equipped to respond effectively to challenges and opportunities. This meant developing an economic and business environment that:

- ensured resources were directed to their best use and used as efficiently as possible;
- enabled innovation and technology diffusion;
- rewarded entrepreneurship and measured risk taking; and
- supported business investment.

Likewise, strong aggregate productivity growth could not be achieved if governments at all levels did not tightly focus their activities and policies so as to avoid misallocation of resources and distorting business decision making and competitiveness.

The reform agenda was designed around a number of key elements to support productivity:

- Infrastructure
- Regulation
- Business tax reform
- Flexibility in the workplace
- Better support for innovation
- Education

Infrastructure

In 2008, Australia was at a crossroads in terms of addressing its existing infrastructure needs and developing sufficient infrastructure capacity to meet future growth. The problems that existed in 2008 stemmed from poor governance, a failure to plan for the future, poor policy choices, complex and inconsistent planning regimes and inadequate financing options.

The federal government embarked on a reform agenda to alleviate constraints and to meet the needs of a growing economy and population. This agenda sought to embed an effective, transparent and cooperative approach to determine national infrastructure priorities. It also sought to introduce efficient and nationally consistent planning and approval systems, which were important in underpinning confidence in public and private infrastructure investment processes and their capacity to anticipate the needs of a growing economy and population.

The federal government prioritised the following reform agenda, which together with state and territory governments (through COAG, the Council of Australian Governments), was implemented by 2010.

- The establishment of effective national (not state-based) infrastructure markets, involving national regulation.

- The adoption of market-based prices for infrastructure use that appropriately reflect externalities, and send accurate signals to influence demand and supply (such as covering long-run marginal costs and reflecting time of use).
- The introduction of effective competition in all contestable (non-network) market segments.
- The use of private ownership of infrastructure in all contestable market segments.
- Ensuring that regulation of infrastructure did not discourage investment seeking to meet expected demand.
- Ensuring public and private financing options were considered transparently on their merits.
- The preparation and publication of regular and transparent audits addressing the state of existing infrastructure and risks.

The federal government also moved quickly to establish Infrastructure Australia in 2008. Infrastructure Australia became the organisation through which transparent assessment of nationally prioritised infrastructure investment was achieved in line with projected economic and population growth and the potential risks associated with climate change.

A coordinated and consistent approach to infrastructure planning between governments was at the core of this achievement, and supported the broader development of better collaboration between private and public infrastructure interests, including appropriate arrangements to share risk and rewards. Effective, nationally consistent regulatory frameworks reduced the costs associated with major infrastructure projects.

Finally, the federal government prioritised the development of a quality broadband network with effective third-party access to facilitate competition and stimulate roll-out to achieve a comprehensive rate of take-up across business and households by 2010.

Regulation

Deeper integration of world markets provides a wider range of opportunities for business expansion, but also presents competitive challenges and makes it easier for businesses and individuals to seek out jurisdictions more favourable to capacity building and innovation.

Australia's distance from global markets, and its dispersed domestic markets, makes it difficult to match the productivity performance of the most competitive economies in the world. Additional domestic barriers to the interstate mobility of people, goods and services serve only to exacerbate these existing structural challenges.

Against this background, a regulatory system that strengthened our competitive position, rather than undermining it, was critical to sustained success.

As a key feature of its productivity agenda, the federal government with the states (again through COAG), established a 'seamless' economy for business regulation. In general terms, this has allowed business to operate within a single set of rules anywhere in Australia.

The first important step towards a seamless economy involved the harmonisation of priority areas of regulation highlighted by business, the so-called 'hotspots', by 2009.

After accelerating progress on the 'hotspots', governments implemented the remaining recommendations of the 2006 Banks Review, establishing a seamless economy for business regulation by 2010.

While greater consistency and harmonisation of domestic regulatory arrangements was a key priority, where practicable, the federal government also sought to minimise unnecessary or unduly costly discrepancies between domestic regulations and legislation and that applying in key markets overseas.

In addition to creating a seamless economy for business regulation, the federal government adhered to policies that strengthened regulatory and legislative processes including:

- Requiring a clear and strong case for action and for regulation as the best response to be developed prior to any legislation being introduced.
- Subjecting all federal regulation and legislation to thorough and transparent cost–benefit analysis.
- The incorporation of a full regulatory impact statement in all federal regulation and legislation.
- Procedures to ensure timely and transparent consultation with business regarding the likely costs and benefits of proposed legislation and regulation.
- The provision of clear and public guidance to regulators and stakeholders regarding the intent of regulation.
- Regular review of new regulation to assess effectiveness and costs in practice.

Between 2008 and 2020 the federal government undertook three reviews of the existing stock of regulation as a means of driving the elimination of redundant and ineffective regulation. These reviews focused not only on new developments in Australia, but also incorporated evidence emerging from international experience and best practice.

Business tax reform

Following a request from the new federal government, the Productivity Commission completed a review of the cost and effectiveness of the business tax regime across state and federal levels in 2009.

Based on this review, the federal government initiated a longer-term business tax reform agenda aimed at reducing the total tax burden on business, enhancing the effectiveness of the system, and securing a stable, long-term revenue stream.

This reform agenda involved the abolition of a significant number of state taxes that were found to cost as much to administer as they raised in revenue, and the consolidation of a series of state taxes levied on broader, more effective tax bases.

This overall reduction in the number of state taxes was supported by the federal government taking over a number of spending responsibilities. All together, this enabled the number of state taxes to be almost halved, with little impact on the effective financial positions of states, resulting in a significant reduction in the unnecessary burden associated with business taxation in Australia.

Surveys conducted in 2020 found that business tax compliance costs had effectively halved during the preceding 10-year period. Government costs incurred in revenue collection and administration were also shown to have been reduced significantly during that time.

The federal government also established a tax advisory council comprising representatives from businesses with significant overseas operations. The 'Tax Competitiveness Council' was created to advise government on the implications of greater capital mobility for the structure of business tax in Australia and movements in effective corporate tax rates in Australia relative to key competitors.

Flexibility in the Workplace

Companies increasingly rely on diverse skilled labour input and innovation as new sources of competitive advantage. Competitive companies must continually evolve and adapt methods, patterns and processes of production.

In this environment, productivity in the workplace depends on businesses having flexibility in terms of how they employ their workforce, structure their operations, and are able to reward employees for contribution and effort.

Importantly, while undertaking significant reforms to workplace relations, the federal government maintained:

- Enterprise-based agreement making as the core of the workplace relations system.
- A wide range of options for agreeing employment terms and conditions.
- A national system of workplace relations regulation.

Better support for innovation

Innovation is key to lifting productivity, competitiveness and living standards. Recognising this, the federal government implemented a national innovation framework and established a new central body, the 'Australian Innovation Council', by 2010. Within this context, support for public and business research and development focused on improving innovation capabilities (including through greater linkages and collaboration for the business, university and research sectors) was significantly increased.

A strategy to turn Australia into a world leader in both collaboration and knowledge diffusion was implemented. It focused on building international linkages and developing collaboration as a discipline in Australia through a new centre for collaboration research and teaching. Under the strategy, updated best practice in knowledge diffusion is made available through information technology and networks such as Enterprise Connect.

The federal government also invested in the development of education and training systems providing people with the capabilities to contribute to innovation success. This involved a greater focus on:

- Skills related to the management of knowledge and innovation, including communication, teamwork, problem solving and entrepreneurship.
- Strengthening the acquisition of underlying skills relevant to innovation capabilities, including by increasing the number of students doing maths and science in senior secondary school years, and increasing the level of participation in post-Year-12 education and training and the attainment of higher-level skills.
- Improving flexibility in the provision of post-Year-12 education and training, and enhanced recognition of skills.

Education

Improving the outcomes from the school education system was a key priority for the new federal government in 2008. In addition to ensuring access to the best available technology to assist learning for all students, the federal government identified a series of reforms, to be undertaken through COAG, targeted at improving the quality and consistency of educational outcomes.

The key priority was improving the quality of teaching through recruitment of the right people, keeping the best teachers in the classroom, and supporting teachers to continually improve their teaching skills. Greater flexibility in remuneration structures allowed the best teachers to be rewarded for excellence. New governance and leadership frameworks were introduced that provided principals with greater autonomy to select teaching personnel.

State and federal governments agreed to a nationally consistent, engaging and flexible curriculum that was able to be customised to the individual learning requirements of students.

Each of these steps was underpinned by greater investment in education and training.

Similar measures were introduced to generate improved performance in vocational education and training, including in regard to recruitment of the best available staff. An additional priority was achieving greater flexibility in the delivery of training. Improved workplace delivery, using the best available information and communications technology and enabling better recognition of the components of qualifications in their own right, were important developments in this regard. More effective engagement with employers enhanced the content of training programs, and reduced regulatory requirements for training organisations also played a part. Finally, significant attention was paid to improving linkages and recognition of qualifications between vocational education and training and universities.

In terms of higher education, as a result of reforms adopted by the federal government aimed at improving outcomes in education and research, in 2020 three of Australia's universities are ranked among the best in the world. The key reforms implemented included the following.

- University academics were better supported to continue to improve their teaching skills, including through better recognition and reward for quality teaching.
- Greater diversity was encouraged, with each university allowed to specialise and develop world-class capabilities in specific areas of teaching or research.
- Regulatory and governance requirements were reformed to provide universities with greater flexibility and freedom to make decisions consistent with their individual missions.
- Universities were supported in their efforts to increase revenue from private sources.
- The federal government increased its investment in the higher education system in return for reforms that strengthened the quality of teaching and the quality and practical uses of research undertaken.
- Working with the higher education sector, the federal government developed policies to better support and invest in Australia's participation in international education.

Workforce Participation

In addition to securing labour supply through increased migration, the federal government set a goal of lifting workforce participation rates to levels achieved by the top performers in the OECD. As a result, aggregate participation rates in 2020 stand at 67 per cent, rather than around 59 per cent, which is where they would have been without this policy intervention.[1]

This result was achieved through a combination of personal income tax reform to reduce barriers to participation for those earning lower incomes, and education and training (including programs undertaken in collaboration with business) to better support the development of genuine employability skills.

Businesses also demonstrated far greater innovation in job design, including through the proactive use of ICT to better support participation. This was accompanied by the development of workplace policies and strategies enabling employees and employers to effectively accommodate more individualised solutions.

The federal government invested in more flexible, quality childcare facilities and introduced a means-tested payment to cover costs associated with caring for the elderly or disabled. This was in response to the increasing challenges for many individuals juggling employment while also looking after aged or disabled family members.

6. EMBRACING GLOBALISATION

Despite the clear benefits that globalisation had historically delivered to Australia, enthusiasm for further liberalisation appeared to be waning in 2008. In large part this reflected the impact of a sustained stronger Australian currency (on the back of then booming commodity prices) and associated concerns about Australia's ability to compete in such an environment (highlighted by a record current account deficit).

The decision by car manufacturer Mitsubishi to close its Australian operations, little progress in multilateral trade negotiations, the rise of sovereign wealth funds and the adverse impact of the global credit crunch flowing from the US sub-prime mortgage market all added fuel to protectionist sentiment.

To its credit, the federal government took stock of those developments, but also looked beyond them, taking into account that:

- The likelihood that strong growth in India and China in particular would underpin demand for Australia's resources.
- Globalisation is a two-way street; Australia could not seek to continue to benefit from a 'long boom' in commodities and simultaneously deny other exporters the opportunity to sell their goods into the Australian market.
- Australia would be unlikely to sustain strong economic growth domestically if it closed itself (even at the margins) to the benefits of global markets for exports and competitive imports.
- Technological advances were likely to make it increasingly difficult to prevent the freer movement of goods, services, ideas and skills.
- Open and flexible markets proved successful in overcoming earlier economic challenges (for example, the Asian financial crisis of 1997 and the 'tech wreck' of 2001).

The government realised that agreed tariff reductions and the pursuit of further trade and investment liberalisation through multilateral and strategic comprehensive free trade agreements were in Australia's best interests.

Rather than trying to lift external barriers, the federal government directed its efforts to highlighting the benefits of its broader reform agenda to export competitiveness and initiated a comprehensive review of trade policies and programs. Among other things, the review prompted a radical repositioning of trade policy and support programs. In particular, the government redirected resources to remove barriers and build capabilities in the export of services, and used the review as a platform to drive a broader, cross-portfolio reform agenda targeting:

- improved productivity and innovation in services industries;
- the development of a better understanding of the role of inward and outward investment to growing services trade opportunities; and
- improved access to global services markets.

The government also used its economic credentials and track record to aggressively promote the benefits of domestic economic reforms throughout the Asia–Pacific Economic Cooperation (APEC) group. This laid the groundwork for a greater preparedness among developing countries in the region to genuinely open their domestic markets to competition, including from overseas service providers.

By 2020, Australia's services export performance had been transformed. Based on growth over the period from 2015 to 2020, Australia ranked among the top-three countries in the world in terms of relative growth in services exports, surpassing the performance of China, India and Ireland, who were among the leading performers in the early 2000s.

7. INVESTMENTS IN SOCIAL PROSPERITY

By 2008, Australia was already enjoying its 16th consecutive year of economic growth. But significant groups continued to be marginalised, such as Indigenous Australians, some migrant groups, and children in jobless or single parent households.

This served as an important reminder that a strong, competitive and globally engaged economy can deliver higher living standards for many, but not everyone benefits directly. Some are challenged by rapid changes in competitive advantages and employment opportunities, and others simply fail to engage at all.

Against this background, the new government correctly determined that a further round of bold economic reforms would only attract support from the wider community if it was accompanied by a clear investment in improved social prosperity. Once again, a multifaceted approach was adopted.

> ‘An additional year of education may raise the level of productivity by between 3 and 6 per cent for a country with Australia’s current average education level.’
>
> OECD, 2003

Education: early intervention

The greatest emphasis was placed on strengthening education and training opportunities and outcomes to provide as many people as possible with the capabilities to benefit from the opportunities created by growth and technological advancements. Particular attention was given to the following.

Early intervention programs sought to identify potential learning problems before they became entrenched and more difficult to address. Particular attention was paid to early childhood development and the establishment of a coordinated, national, whole-of-government approach to early childhood education and care. Routine assessments to identify and address learning difficulties in early childhood helped to minimise the number of children slipping through cracks in the system.

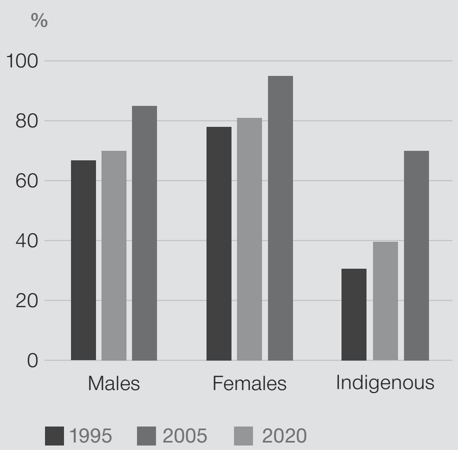
The number of young people achieving only minimal standards of schooling (and dropping out before Year 12 or its vocational equivalent) was substantially reduced (see Exhibit 5). This was supported by the provision of a broader range of pathways for students (including vocational education and training pathways in secondary school years). Business has proactively contributed to the improvement and development of graduates’ skill formation, including in terms of employability skills.

EXHIBIT 5

ASPIRING TO BETTER SCHOOL OUTCOMES

Early intervention programs and a focus on improved school outcomes saw the number of young people achieving 12 years of education (or equivalent training) steadily rise. Targeted intervention also delivered significant benefits in terms of outcomes for Indigenous young people.

YEAR 12 RETENTION RATES



Source: Business Council of Australia.

Note: Includes Year 12 and its vocational education equivalents.

> ‘Women who complete Year 12 are 14 per cent more likely to be employed, other things being equal, than those who do not, and to earn, on average, 8 per cent more.’
>
> Breusch and Gray, 2004

Welfare and social support

The government reviewed the effectiveness of its social support and welfare programs, taking into account the fact that, for many, the need for assistance is likely to be ‘transitory’, while for a smaller group, disadvantage remains deeply entrenched and often intergenerational.

This review led to:

- A restructuring of tax and benefits policies to minimise the impact of high effective marginal tax rates on very low-income earners, including improved tapering of some benefits (such as access to health care cards).
- The introduction of intensive assistance programs, developed and delivered locally, to high-risk individuals and their families, with business and community engagement from the outset.
- The streamlining of compliance and administrative requirements for those delivering assistance programs, particularly in smaller communities.
- Regular and transparent reviews of the effectiveness of these programs.

Additional measures designed to deepen social inclusion included improvements in migrant settlement programs and other community-building initiatives.

Health

The federal government recognised that a key determinant of individual wellbeing and broader social prosperity would be the capacity of the health system to deliver high-quality services in support of improved health outcomes over time.

In collaboration with the states, the federal government undertook wholesale reform of the health sector. These reforms first and foremost focused on increased transparency and accountability. This was achieved by more clearly defining responsibility for outcomes and spending across state and federal jurisdictions, by better benchmarking those outcomes, and by better highlighting the role and contribution of private sector providers. Secondly, a greater share of spending was targeted towards preventative measures. And finally, improved incentives were incorporated to encourage individuals to become more responsible for their own health outcomes (see Exhibit 6).

The development of best practice in service delivery had the added benefit of underpinning the strong growth in health services exports. A key enabling factor was the use of e-health technologies to offer real-time services in the Asia–Pacific region.

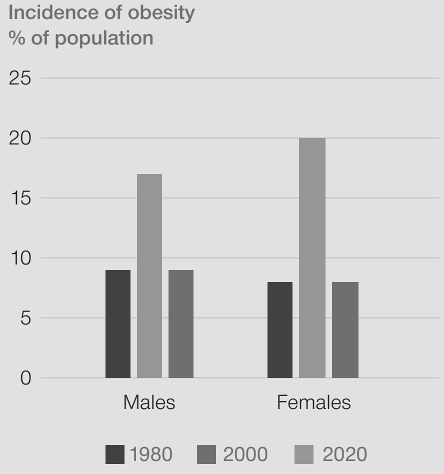
Despite these improvements, health care spending as a share of total government spending and GDP continued to rise. Further advances in medical technology, coupled with rising expectations, meant the pressure on spending remained significant, resulting in difficult decisions in terms of prioritisation and access to resources and treatments.

EXHIBIT 6

ASPIRING TO BETTER HEALTH OUTCOMES

Incentives supporting greater personal accountability for health outcomes delivered significant results. For example, by 2020 the incidence of obesity returned to levels recorded in the early 1980s.

GREATER PERSONAL RESPONSIBILITY DELIVERS RESULTS



Source: Business Council of Australia.

8. BETTER VALUING THE ENVIRONMENT

Environmental management and economic growth are fundamentally linked, but the relationship is not the straightforward negative one that many assume, in which stronger growth necessarily equates to poor environmental management.

On the contrary, a strong economy and sound institutional and policy frameworks provide the basis for ensuring effective long-term management of natural resources, including the adoption of new technologies that facilitate more efficient resource use over time. A strong economy also underpins ongoing community support for the prioritisation of sound environmental management.

Likewise, the standard of living of present and future generations is dependent on meeting the needs of (and not destroying) the environment, which sustains growth over the longer term.

In order to secure ongoing community support for sustained strong economic and population growth, governments around Australia recognised the need to manage well Australia's environmental capital, but in a way that did not undermine growth and investment in the future.

In 2008, the approach to managing the environment generally involved separating environmental matters from the market and broader tools of economic management. This approach neither recognised nor rewarded reduced environmental degradation or improved environmental practices. In addition, regulatory approaches normally require specific outcomes to be achieved irrespective of cost, which often creates few incentives to innovate, resulting in an economically inefficient outcome.[2]

The challenge centred upon the development of better signals to guide both consumption and investment in a manner consistent with sustainable growth. In other words, the challenge lay in ensuring that the prices of goods and services reflected the environmental impacts associated with their production and consumption.

Ensuring the market provides the signals to reinforce sustainable growth was acknowledged as an increasingly important objective, both in a domestic and international context. As a result, governments prioritised the development of systems and strategies to better value and monitor Australia's environmental capital.

> ‘Well-trained economists would recognise that there is a real flaw in the argument that says development can only come at the costs of destruction of what we presently have. If we are not clever enough as policy makers to find ways of securing economic development without trashing what we have already got, then we really should be questioned.’
>
> Ken Henry quoted in article titled ‘Saving Grace of Treasury Boss’, *The Australian*, 26 January 2007.

This agenda ran parallel to the federal government’s broader infrastructure agenda and focused on creating national markets, the use of market-based prices to guide consumption and investment, regulation that did not act as a barrier to investments to meet future demand, and the provision of more (and better) information to guide consumers.

Water: not a problem of scarcity

Water was an example of a ‘touchstone’ concern for the community in 2008. By 2020 this concern had effectively been ameliorated through better management and planning.

In the case of urban water, water utilities were disaggregated into their monopoly (pipes) and competitive (supply and retail) components in the major cities and in major regional centres. By 2020, appropriate third-party access to water pipes and other relevant monopoly infrastructure, and water quality, is governed by national regulation.

Planning for future urban and rural water needs, recognising the required health of Australia’s river and groundwater systems, and taking into consideration population growth and industry location, is ongoing – and transparent – with all options for supply considered on their economic and environmental merits.

The Productivity Commission completed a review of water pricing policies and recommended a national approach that addressed the cost of additional supplies and provided consumers with the discretion to purchase water as they required.

Competition was introduced into water supply to facilitate cost-effective provision of additional supplies of water, and regulatory inhibitors to recycling and other sources of water were reviewed and removed.

A market for water trading, including between urban and rural water, was made fully operational and where necessary structural assistance enabled the most effective utilisation of water resources.

In the year 2020, water restrictions are more or less considered as a thing of the past.

Climate change

The government introduced major reforms aimed at 'internalising' environmental costs and risks, most notably in regard to greenhouse gas emissions and the risks associated with climate change.

An internationally linkable, national emissions trading scheme was established in 2010 to facilitate the achievement of least-cost emissions reduction. This scheme was underpinned by institutional and governance arrangements ensuring a transparent and informed market and a minimisation of government intervention.

The trading scheme covers most industry sectors, and where a sector has not been included it faces policies with equivalent impacts. As there is still no global price on emissions, the government implemented the scheme in a manner to address both competitiveness risks and carbon leakage in the interim period prior to a global price. Appropriate transitional arrangements ensured that Australia has not lost businesses to other markets that will remain competitive once a fully global carbon market and price is in place. The scheme recognised the disproportionate loss on industries through a one-off adjustment.

The substantial revenues that resulted from the introduction of the scheme have been used strategically to:

- Support investment in 'first of a kind' low-emissions research and development and technology.
- Deliver tax reform that addressed the needs of businesses and low-income households related to the introduction of emissions trading.

Federal and state governments rationalised and ended a range of regulations, programs and policies that had the potential to adversely impact on the emissions trading scheme and lead to higher-than-required energy prices.

As part of the longer-term risk management strategies of the government, extensive work is underway on adaptation policies including future land use.

Energy efficiency remains a key priority, and federal and state governments worked cooperatively to identify a national approach to building standards, fuel standards and other mechanisms to support emissions reduction.

As part of the national focus on infrastructure prioritisation and development there is a renewed commitment to public transport development and better urban planning and design.

9. REDEFINING THE ROLE AND CONTRIBUTION OF GOVERNMENT

The role of government was fundamentally reshaped by reforms in the 12 years between 2008 and 2020.

This did not reflect the outcome of an overtly philosophical debate or policy shift, but rather the ongoing evolution of the contribution of government consistent with changing circumstances and expectations. Examples of some of the key sources of this trend follow.

First, the extent of capacity constraints apparent in 2008 focused the federal government's attention on the need to ensure that its activities did not 'crowd out' or distort private decisions and investments. Likewise, the costs imposed on the economy as a result of a rising tax take, a substantial amount of which was being 'churned' back to the taxpayers from whom it came, had also become increasingly apparent.

Second, population ageing contributed to rising expectations from an older, wealthier population, precisely as an increasing share of the population moved from being income earners/taxpayers to 'dependants', at least in terms of the government purse. This, in turn, required better prioritisation of spending consistent with ongoing fiscal responsibility – a key plank in maintaining macroeconomic stability and resilience.

Third, it had become increasingly apparent that significant amounts of social security and welfare were not producing substantially improved outcomes, at least in terms of the most disadvantaged in the community. This prompted reform of the structure of assistance and its delivery.

Fourth, the costs of duplication and overlap across state and federal jurisdictions, and the lack of an effective means of collaboration across governments, were weighing heavily on economic performance.

The federal government addressed these issues in three ways.

It substantially reformed its own budget, and the processes underpinning it, to better align fiscal policy with the determinants of future prosperity.

All budget programs were reviewed in terms of their need and effectiveness. This underpinned a significant and sustained refocussing and reduction in spending. A 'Charter of Budget Quality' was adopted to ensure that all spending measures passed a rigorous cost–benefit test before being implemented, and the government instituted full-scale audits of the budget every five years.

> '... Our real concern should be the rights and needs, not as, say, Queenslanders or Tasmanians, but as Australians ... How sensible is it to shrink what is already a relatively small Australian market into separate state markets?'
>
> Bob Hawke, 'Towards a Closer Partnership', speech to the National Press Club, 1990.

One of the most challenging but productive reforms was in federal–state relations. Federal and state governments signalled their intent to reform Australia's century-old system of government by signing a 'Charter for New Federalism', which strengthened and embedded COAG as the means to deliver national reform. This commitment has since underpinned an impressive list of achievements in national collaboration, many of which have already been summarised above.

Reaching new standards in accountability, the Prime Minister established the practice of delivering, at the end of each year, an annual report to the nation on the federal government's achievements over the preceding 12 months and priorities for the year ahead. The report includes the Prime Minister's assessment of how COAG performed in delivering its commitments for the year.

Perhaps most surprisingly, federal, state and local governments made bold progress in rationalising service delivery across jurisdictions. For all intents and purposes, one layer of government is now largely accountable for most of the key areas of service delivery. In large part the driving principle underpinning this rationalisation has been that the level of government 'closest' to the issue has taken responsibility, the exception being where national interests override local needs and/or where significant economies of scale have existed. In the latter circumstances, accountability has been centralised to the federal government.

The end result has been significant one-off savings flowing from the abolition of unnecessary duplication, and ongoing savings due to greater efficiency and innovation associated with clear ownership of outcomes.

More broadly, government engagement has shifted from a model based on how to manage or regulate issues, to how its actions can better enable positive outcomes over the long term.

10. THE ROLE AND CONTRIBUTION OF BUSINESS

The role of business continues to evolve to meet the changing expectations of the community. In response to growing expectations from investors and the community that business growth must be environmentally and socially sustainable, assessment of business 'success' continues to develop beyond singular definitions of commercial profit. Business balance sheets and reporting standards increasingly reflect the trend to multidimensional reporting as companies seek to develop competitive advantage among customers and consumers through continual development of best practice corporate social and environmental responsibility practices.

As the economy continues to expand and internationalise, prosperity and opportunity for individual Australians becomes increasingly intertwined with that of the business sector. The relationship between business and government has also become more interactive, with both sectors drawing on each other's experience and expertise to create more collaborative and supportive models of service delivery and infrastructure provision. Where government wound back its activities in response to fiscal and electorate pressures to focus on genuine benefits and 'returns' to investment, the government and community increasingly looked to business to make sure funds were spent effectively and within a strategic framework enabling all parties to invest in future growth.

Business, in particular, has become increasingly enmeshed in education, contributing to a better understanding among education providers and curriculum developers of emerging and evolving employability skills, and in facilitating ongoing training that keeps Australia at the forefront of education and skills development. The barriers that previously inhibited active linkages in innovation between business, government and higher education providers have been significantly dismantled, and collaboration between business and innovators now represents world's best practice.

In response to the ageing of the population and structural labour shortages, business also works proactively with government to contribute to effective solutions for the long-term disadvantaged, including through the enabling of training and employment opportunities. Business also invested heavily in improving job design to increase flexibility and diversity in the workplace and hence higher rates of staff retention and participation.

Finally, in return for government heeding business calls for less heavy-handed regulation, business raised the standard of its own transparency and reporting, particularly around the management of risks – financial and non-financial – and executive salaries and performance.

11. CONCLUSION

Australia's performance in terms of rising economic growth and prosperity over the two decades to 2008 has been the envy of many. This provides the foundation from which we can now, as a nation, set our sights higher in order to capture and create new and better opportunities for Australians now and into the future.

The BCA's vision is that from current foundations we can build Australia as the best place in the world in which to live, learn, work and do business.

This submission promotes something of a 'perfect wave' scenario. There is no doubt that in reality Australia will confront more 'swings and roundabouts' than this scenario suggests. But that reality does not undermine the central message, which is that an intentional and comprehensively scoped reform agenda is needed to pave the way for future success and prosperity.

The simple fact is that what we collectively achieve over the next 3 to 5 years will determine what our nation becomes by 2020.

NOTES

1 Source: Access Economics, 'The Speed Limit: 2005–2025', paper prepared for the Business Council of Australia and incorporated as part of the BCA publication, *Locking in or Losing Prosperity: Australia's Choice*, August 2005.

2 Commonwealth of Australia, *Intergenerational Report 2007*, p. 71.

BUSINESS COUNCIL OF AUSTRALIA
42/120 COLLINS STREET MELBOURNE 3000 T 03 8664 2664 F 03 8664 2666 www.bca.com.au