SUBMISSION

Budget Submission 2020-21

Strong Budget, Strong Growth, Strong Australia

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EXECUTIVE SUMMARY

Our three priorities

This is the Business Council of Australia's budget submission for the 2020-21 budget.

After a decade of deficits, Australia has finally balanced its budget. However, economic growth is slow and the nation continues to face global uncertainties.

We, therefore, recommend the budget deal with three priorities:

- a balanced budget and return to surplus to pay for services and protect Australia from economic shocks
- an unprecedented focus from Commonwealth and state governments to accelerate the rate of economic growth, and
- a renewed focus on planning for the long term by reforming the Intergenerational Report and mapping out a course for long-term tax reform.

A strong budget

We believe a strong budget is vital for Australia's long-term prosperity.

The return to surplus has been a hard-fought achievement over 10 years.

A surplus, even a small one, is important and is much more than a bookkeeping exercise.

Balancing our budget protects the nation from economic shocks and gives us a crucial platform to grow the economy.

Absent an external shock, Australia cannot afford to casually slide into another decade of deficits. Ongoing deficits have serious consequences, and prevent us from getting on top of the interest payments needed to service debt. Australia's decade of deficits has led to net debt at its highest level as a share of GDP in 50 years.

We spent about $19 billion on interest payments last year which is money that could be spent on vital services such as world-class hospitals, schools and transport services, or to lower taxes.

Australia must have a strong budget to sustainably manage the challenges we face over the long-term, particularly the demand for services from an ageing population.

What needs to be done

- Maintain fiscal rules of:
  - a responsible tax-to-GDP cap (the federal government's tax cap is 23.9 per cent of GDP) which effectively hands back bracket creep and restricts government from expanding more rapidly than the economy
  - a real spending growth cap of 2 per cent per year which would, given current rates of population growth, still enable an increase in spending per person after inflation.

A strong economy

We believe strong growth and a strong budget go hand-in-hand.

An economy growing below 2 per cent will simply not deliver the jobs, higher wages, improved living standards, and the tax revenue to fund services that Australians expect.

The private sector has always been the main driver of economic growth but household consumption is slow, housing construction is down, and new business investment as a share of GDP is at its lowest level in more than 26 years.

Our focus must now turn to getting the private economy to work harder so it can do the heavy lifting and accelerate economic growth. This means the conditions for business investment must improve and the economy needs to be more competitive.

The underlying structural weakness in growth cannot be solved by short-term stimulus or rushed expenditure on projects.

A faster growing economy increases our ability to deliver what Australians rightly expect for themselves and their families: good jobs, more jobs, rising incomes, world class healthcare, liveable cities and regions, and support to look after our most vulnerable citizens.

If the economy was to grow at 3.4 per cent a year – the average annual growth rate over the past 60 years – the economy would be around $200 billion (in today's dollars) bigger in 2029 than if it grew at 2.6 per cent a year – the average over the past decade.

The consequences of low growth

The downsides of another period of low economic growth are very real. For example, if wages were to grow at 3.2 per cent (the average over the past 20 years) rather than 2.1 per cent (the average over the past 5 years), then this could translate into wages being around $11,000 higher per year (in today's dollars) from 2029 for a person working a full-time job with standard hours. The difference in these wages growth rates is similar to the difference in productivity growth rates over these periods.

The difference between an economy growing at 2.0 per cent instead of 3.4 per cent means generally fewer new jobs will be created and wages growth will be slower, leaving some households struggling to get ahead.

What are the drivers of low growth?

A slump in business investment has been driven by a lack of competitiveness, particularly in tax and the burden of unnecessary regulation, as well as increased uncertainty. This is driving lower productivity growth.

That productivity weakness is at the heart of Australia's slow economic growth and slow wages growth.

Labour productivity growth, which is a measure of our ability to constantly do things better, has been below the long-term average of 1.5 per cent for several years. It has fallen over the past year, and in eight of the past 13 quarters.

Productivity is the key driver of wages growth. Investment and innovation are crucial to improving the way goods and services are made, along with investing in the skills of employees.

When a business invests, it expects to increase revenues and profits (and taxes) which leads to employing more people and increases in what they produce. This allows higher wages to be paid.

Australia therefore needs to pull out all stops to kick-start stalled productivity growth to drive the conditions for sustained and faster economic growth and deliver higher wages growth.

There are no quick fixes, which is why our submission focuses on making Australia a more attractive investment destination and a more competitive nation.

Actions to grow the economy faster

We are calling for a focus on:

- Urgently creating a better environment for business investment by introducing a broad-based investment allowance to drive higher growth
- Overhauling and reducing unnecessary regulation which is stalling business investment
- Delivering infrastructure projects that make it easier to do business, export our products and reduce congestion

- Lifting Australia's performance on skills with a revamped skills system so Australians can secure high-paying and high-skilled jobs and also thrive as technology changes. A highly-skilled population works to attract the best companies in the world to operate and invest in Australia, and
- Introducing a new industry policy to build on our strengths and embrace new opportunities.

Tax incentives that drive investment

Australia needs to encourage more business investment to address the weakness in the private sector economy by ensuring we have a competitive tax system and efficient regulation. The move to a more competitive tax system should build on the government's Personal Income Tax Plan reforms.

This will ensure Australia is an easier place to do business so it can create more jobs, compete against the rest of the world, and deliver higher wages growth.

What needs to be done

▶ Introduce a broad-based, permanent investment allowance that would apply to all investment depreciable under current tax law in the absence of a reduction in the company tax rate for all companies.

▶ Enable the allowance to cover machinery and equipment, buildings and structures and intangible assets. It should also apply to energy assets and investments that improve energy efficiency.

- The benefit from the allowance could support:
  - developing new markets
  - building and expanding plants and structures
  - buying machinery and equipment
  - introducing new technologies to produce more goods and services more efficiently
  - investing in innovation
  - investing in the skills of employees, and
  - resource exploration and development.

▶ Implement the investment allowance as a bonus deduction on new investment.

- To illustrate, a 10 per cent investment allowance would allow companies to deduct an additional 10 per cent of the value of an asset in its first year. There would not be any change to the depreciation schedule of the asset.

- This could support medium-sized businesses like Farm Foods in Geelong to upgrade their meat processing equipment and ramp up production, or Manbulloo Mangoes to expand their business and explore new export markets.

▶ Progress tax integrity measures by continuing to support the OECD process on addressing the tax challenges of the digitalisation of the economy. This is the key multilateral forum for developing a coordinated international approach to global taxation issues.

Better regulation

We believe regulation is important but when it is poorly conceived or badly designed, the burden falls on consumers through higher costs, delays and fewer choices.

Unnecessary and inefficient regulation makes it harder to do business in Australia and makes the country less competitive and a less attractive place to invest.

The World Bank ranks Australia 103rd out of 189 countries for 'Ease of Trading Across Borders'.

Major project approvals times often take three years or longer. The net economic cost of a one-year delay in approving a major project of $500 million is $26 million to $59 million.

We believe the budget is an opportunity to reset Australia's regulatory environment so it works better for consumers and businesses. Efficient regulation streamlines project approvals, encourages investment, improves competitiveness, creates jobs, and provides new products and lower prices for consumers.

What needs to be done

▶ Rigorously assess the impact and cost of new regulations by state and federal governments through regulatory impact assessment processes to ensure efficient and effective regulation.

▶ Undertake regular stocktakes of the cumulative cost of regulation and work to reduce costs over time. This work should be done through the government's deregulation taskforce, which is an important new initiative.

▶ Give the Council of Australian Governments (COAG) control of reforming state-based regulation that focuses first on major project approvals, development approvals, retail trading hours and payroll tax compliance.

- This would identify the state or territory with the best approach to regulation in certain areas and reward other states for adopting these standards with productivity payments.

- Focus the government's deregulation taskforce efforts and COAG on reducing the burden of regulation to make it easier to: invest in Australia; export; approve projects and products; hire people; use infrastructure more efficiently; and pay small business suppliers quickly and on time. This submission details specific recommendations for each of these categories.
- Establish a small business register to better identify small businesses so policies that affect small businesses directly, such as paying them within 30 days under the Australian Supplier Payment Code, can be better targeted to them.
- Implement a one stop shop digital trade platform to reduce the duplication and complexity in customs and trade regulatory documents. This would reduce delays and unnecessary paperwork, making it easier for Australian businesses to export their goods and services.

Skilling up Australians

National Careers Institute and National Skills Commission

We believe Australians deserve a more responsive skills system that allows them to train and retrain quickly to adapt to the way the tasks that make up their jobs are changing with technology.

We also need to end the cultural and funding bias against vocational education and training and put the sector on an even footing with higher education.

The budget provides a chance to continue reforms to the skills system so Australians have the training they need to ensure the country can compete against the rest of the world as the global economy changes. Investing in the development of skills is a central element to improving Australia's productivity performance. It will also help attract the best companies to Australia.

What needs to be done

- Provide long-term funding to support the National Careers Institute (NCI) and the National Skills Commission (NSC) and ensure their operation beyond 2022-23. This would give these bodies the certainty to put in place meaningful reforms and build on their work.
- Establish the National Careers Institute as a 'go to' single online platform of information built around the learner detailing what post-secondary courses are available across vocational education and training (VET) and higher education (HE).
    - Information would include what to study, where to study, career options and salaries, course duration and cost.
    - This should be done through the NCI either via a website or app.

- Support this digital presence by building and trialling different tools such as online games and quizzes to assist people at different stages of their lives to identify the career paths best suited to their interests and skills.
- Create a national funding model for skills training through the NSC after undertaking a full costing exercise including benchmark costs and possible loadings for location and need, and the ratio of public and private benefit in qualifications.
  - The costing exercise will inform how much governments, individuals and employers should pay as a percentage share towards training costs and the information would be published. The first priority in this comprehensive costing exercise should be in areas that cut across both VET and HE, as well as high demand areas.

Skilling Australians Fund

We believe industry should have a bigger role in determining how the Skilling Australians Fund (SAF) is allocated, so that training is in areas of future skills shortage.

We believe the current structure of the fund is not the best solution for solving persistent skill shortages, nor has it contributed to better skills outcomes.

What needs to be done

- Give industry a bigger role in determining how the Skilling Australians Fund is allocated so training is targeted to areas of future skills shortage.
- Exempt businesses that spend directly on workforce training from paying the SAF levy. Recognise this spending as an effective means for reducing current and future skill shortages
- Make the levy refundable if a visa application is not successful and the applicant has acted reasonably throughout the process.
- Replace the levy over the longer term with alternative revenue sources that are more stable and less harmful to growth.

Temporary Skill Shortage visas

We believe skilled migrants bring ideas, innovation and new cultures, grow our trade and investment links and bring the capacity to train and skill their local co-workers.

A well-targeted skilled migration program complements the Australian-born workforce. In order to grow, Australia will need to continue to bring in highly skilled labour on a temporary basis under competitive migration settings when there are genuine skill shortages.

What needs to be done

- Assess current approval rates for the renewal of two-year Temporary Skill Shortage visas for occupations on the Short Term Skilled Occupation List. If the approval rate is high, consider returning to issuing a 4-year visa upfront for occupations on the list in the future.
- Make all occupations with total annual remuneration over $180,000 eligible for 4-year Temporary Skill Shortage visas.
- Create special categories of skills that are a national priority and eligible for the Temporary Skill Shortage visas, starting with cyber security skills from the Five Eyes countries, so we can quickly fill shortages with highly-skilled workers.

Better planning and infrastructure delivery

We believe better planning and infrastructure delivery are critical to ensuring our cities and regions are great places to live and work.

Building the right infrastructure at the right time in the right place is a key enabler of improved productivity and faster economic growth. It means better services can be delivered, Australians can enjoy a better lifestyle and get to and from work without congestion, and goods and services can be efficiently transported across the country and into export markets.

All governments should be encouraged to work together through COAG to agree on the extent and sequencing of planned public infrastructure investments.

What needs to be done

- Adopt a place-based approach to planning, sequencing and investing in infrastructure to drive growth and development through Infrastructure Australia prioritising a 20 to 30-year horizon.
  - This would identify and assess the net benefits of sets of interrelated projects within a key region or economic growth corridor. There needs to be a rethink in the way Australia plans and prioritises around key places that can make the greatest economic contribution to their regions, their states or territories, and the whole country.
- Start a place-based approach with ten places in addition to the existing city deals, and model it on the successful city deal framework.
- Use this approach to develop the Infrastructure Priority List and Australian Infrastructure Plan in 2020.

- Speed up planning approvals processes for major infrastructure projects by adopting a single application and single assessment model that makes an approval decision within 12 months.
- Reform workplace laws to enable ‘greenfields’ agreements for new projects to run for the life of the project to help deliver certainty and improve productivity.
- Speed up procurement processes and give bidders greater simplicity and transparency to increase competitive tendering and reduce bidding costs.
- Provide exemptions from local content provisions where Australian content is not available or fails to provide value for money.
- Seek private sector ideas for new investment in infrastructure via unsolicited proposals.
- Implement asset recycling schemes in federal, state and territory arenas to sell mature infrastructure businesses and use the proceeds to invest in new infrastructure projects.
- Assess the skills needed to deliver Australia’s investment pipeline and proactively tailor training programs and skilled migration lists to avoid skills gaps (for example engineers, electricians and project managers).
- Ask Infrastructure Australia for advice on the highest value opportunities to extend the current pipeline of infrastructure projects. The importance of rigorous, independent advice remains essential.

A new industry policy to build on our strengths and embrace new opportunities

We believe Australia needs greater purpose in how the nation generates the next wave of economic growth.

This will involve building on the things we are already good at as well as developing new strengths. This requires the nation to reimagine industry policy so it shifts from concentrating on individual industries to focusing on capabilities that cut across and contribute to multiple sectors of the economy.

Doing this will ensure Australia is playing to its strengths and concentrating its efforts on the areas that can grow, create jobs and contribute the most to growing the economy faster.

What needs to be done

- Undertake an immediate stocktake of spending on existing industry policy and programs to assess whether funding is strengthening our capabilities rather than targeting siloed industries.

- For example, government should undertake a stocktake and comprehensive evaluation of its $484 million Entrepreneur's Infrastructure Program, to see whether the Program's stated objectives and outcomes have been met.
- This will give us a starting point to better target funding and resources to areas with the best potential to contribute to faster economic growth.

▶ Evaluate and prioritise the capabilities with the greatest potential to accelerate economic growth, for example quantum computing or blockchain, and set up a new industry policy framework.

▶ Reallocate funding into projects with the greatest potential to contribute to growth and provide incentives to encourage private sector investment, with a focus on university and business collaboration.

Encouraging investment in research and development

As other countries become more attractive investment destinations, the risk is that the marginal R&D investment dollar moves overseas.

The value of R&D Tax Incentive claims processed by the ATO fell over $1 billion, or around a fifth, over the past two years – driven by a reduction in claims by larger companies. The number of claims processed also fell around 5 per cent over the same period.

Tax incentives for R&D have been changed, or changes have been proposed, multiple times in recent years – including both policy and administrative changes. This has created uncertainty and made it difficult for businesses to plan confidently, and likely limited the success of various schemes.

What needs to be done

▶ Repeal the R&D expenditure threshold (it is due to expire 1 July 2024), or at least increase it to $150 million.

▶ Ensure the scheme is administered consistently and predictably to avoid undermining confidence in it, and provide certainty.

▶ Simplify and reduce the administration and compliance costs.

▶ Introduce a collaboration premium of up to 20 per cent on non-refundable tax offsets to incentivise collaborations between industry and public research organisations and universities.

▶ Do not reduce the overall support or incentives for business expenditure on R&D, with consideration given to the balance between grants, tax incentives and business and university collaboration.

Longer term footing for success

Reform of the IGR

We believe that compiling a full picture of the long-term fiscal outlook of federal, state and territory governments is the best way to set Australia up for success over the decades to come. This is because it will help put current policy decisions in a long-term context and support the community in better assessing the merits of the fiscal choices made by governments.

We are calling for a revamp of the Intergenerational Report so it provides a national understanding of budgets across all levels of government and the major risks Australia faces.

This approach would improve the nation's combined policy responses to longer-term structural spending and economic pressures across the federation, particularly from an ageing population. It could also help pave the way for long-term and sustainable tax reform across the federation to better meet our challenges.

What needs to be done

- Create a national IGR – we need to understand the long-term budget position of the whole nation – federal, state and territory governments.
- Ensure IGRs are independent and non-partisan. The Parliamentary Budget Office is the most suitable authority to undertake the federal IGR.
- Consider releasing short updates of the main indicators in the IGR every one or two years while maintaining the current level of detail in the five-yearly report.
- States that do not produce IGRs should be encouraged to do so.
- The IGR should contain more analysis on the pressures, risks, adequacy and sustainability of the various taxes across the federation. This could help identify priority areas for reform.

Long term tax reform to drive growth

Australia must confront the need to move to a more modern, sensible mix of taxes that will best promote the wellbeing of the Australian community, provide incentives to work and better support job creation. An IGR that better considers the sustainability of the various taxes across the federation can help to identify the priorities for long-term tax reform. It could also help to keep track of personal tax and the effects of bracket creep.

The Australian economy faces immediate and long-term challenges and uncertainties, from its ageing population, shifting global economic forces and digital technologies.

Ultimately the current tax system must be fit-for-purpose to take on these challenges, which means addressing issues such as:

- the over-reliance on direct taxation
- the mismatch between federal and state taxes and spending
- the volatile and inefficient state tax base (notably stamp duties)
- a globally uncompetitive tax rate for larger companies, and
- fragmented payroll tax regimes.

What needs to be done

▶ Address the structural issues in Australia's tax system through broader tax reform:

- improve work incentives, especially around the tax/transfer interface for low income earners
- progressively lowering the company tax rate to 25 per cent to make all businesses more competitive in the global contest for investment
- better harmonise payroll tax bases
- more neutral tax treatment of savings income, such as capital gains, rental income and interest on savings deposits.

▶ Tax reform should not consider one tax, but the combination of taxes, and setting an overall tax mix that is most able to achieve the goal of growing the economy and creating jobs while funding vital government services. The tax system must also be equitable and support a better function federation.

Durable energy and climate change policy

Beyond the scope of this budget submission, it is critical that Australia has a long-term credible energy policy. We need an integrated, durable and bipartisan energy and climate change policy to drive investment in new generation supply, incentivise investment and innovation in new low-emissions technologies and finally put an end to the deadlock that has only resulted in higher power bills for consumers. Lifting moratoriums on gas ventures with evidence-based, project-by-project assessment is also critical.

MAIN REPORT

1. A STRONG BUDGET

Key points

The return to budget balance has been hard fought and its importance should not be underestimated. The underlying structural weakness in economic growth cannot be solved by short-term stimulus or rushed expenditure on projects.

A strong budget and low debt are more than bookkeeping exercises or ends in themselves. They provide the flexibility to respond to an economic shock, and fund the services the community expects and deserves.

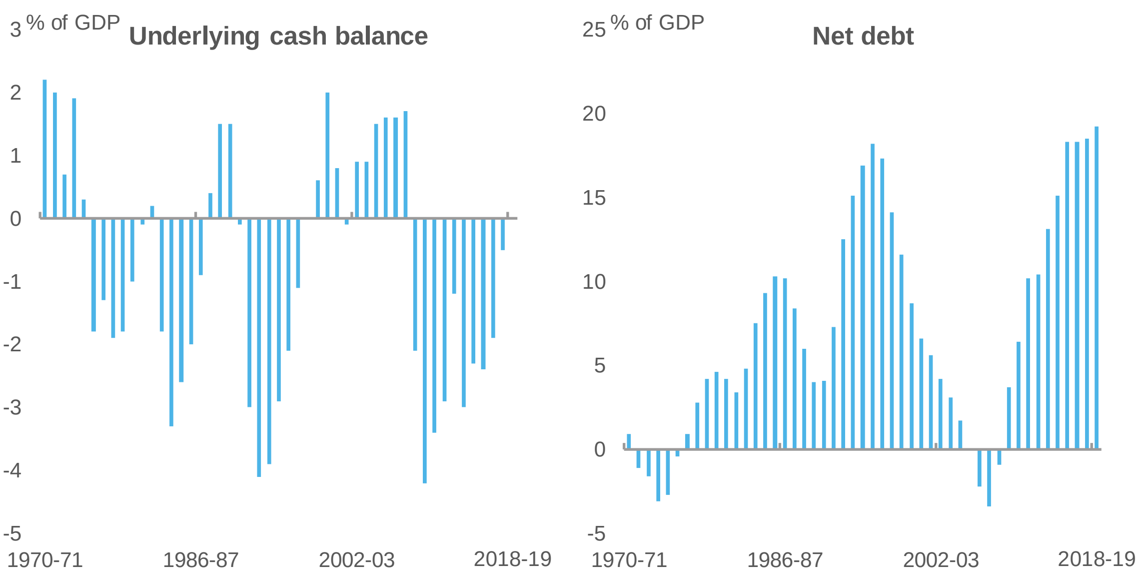
Maintaining a strong budget will require ongoing fiscal discipline as well as ensuring the community receives better value for the money the government spends on its behalf. The best way to get the budget into the black and keep it there is through strong economic growth. Strong growth and a strong budgetary position go hand in hand.

The fiscal backdrop

The federal budget returned to balance in 2018-19 following a decade of deficits. The decade of deficits has led to net debt at the federal level at its highest as a share of GDP in 50 years. A strong budget and low debt are more than bookkeeping exercises or ends in themselves. The real ends are:

- policy flexibility that a strong fiscal position provides if the global or domestic economy was to weaken
- budgetary strength that enables our need for quality schools, hospitals and a social safety net to be met now and into the future.

Figure 1: The budget is back in balance, but net debt is still high



Source: MYEFO 2019-20

The budget improvement in 2018-19 has been supported by spending discipline, a strong labour market and strength in commodity prices which have offset some of the weakness in the real economy. Indeed, Treasury's nominal GDP growth forecasts for 2018-19 were progressively revised up from the 2018 Budget, to the December 2018 MYEFO and again in the April 2019 Budget.

- Revenue is a full percentage point above its 30-year average, and is expected to rise moderately before returning below its 2018-19 level by the end of the forward estimates.
- Spending was below its 30-year average in 2018-19. It is expected to remain around this level over the forward estimates. Spending restraint has played an important role in the return to budget balance.

Real spending growth averaged 1.7 per cent a year over the past seven years, compared with 4.5 per cent a year for the preceding seven years.

The job is not done yet

Australia's budget challenge is far from over. Maintaining a strong budget will require ongoing fiscal discipline. The best way to get the budget into the black and keep it there is through strong economic growth.

The budget is at a better starting point compared with previous years, but the outlook beyond 2019-20 will be highly conditional on the strength of the domestic economy and downside risks (high consumer debt and high production costs), global risks (trade tensions and geopolitical issues) and commodity prices. The economy and budget will also continue to face several challenges over the long term, particularly from an ageing population.

The $19 billion of gross interest payments in 2018-19 was similar to the South Australian budget, or the ACT, Northern Territory and Tasmanian state budgets combined.

A strong budget provides the capacity to respond to a shock

Weakness in the real economy could undermine the expected improvement in the budget. A slower real economy will see an automatic easing of fiscal policy through the operation of the automatic stabilisers, such as slowing growth in tax revenues and increased social security spending. Much of the deterioration of the fiscal position during an economic downturn typically reflects the operation of these automatic stabilisers.

This is why a strong and disciplined budget matters. Uncertainty remains high, business and consumer confidence are weak, and the outlook remains risky. A strong budget provides the flexibility and capacity to respond to a domestic or global shock that can happen quickly. To illustrate, the global financial crisis triggered a $70 billion deterioration in the budget over just two years.

Key budget challenges remain

- Net debt is at its highest level as a share of GDP in 50 years. Debt is not costless – it restricts the fiscal flexibility of future generations and the interest bill means there is less money available today for more services or lower taxes.

A cumulative $96 billion has been spent paying interest on government debt since the budget went into deficit – more than enough to pay for Medicare, the pharmaceutical benefits scheme and all other federal government spending on health for a year.

- Australia's level of debt is low compared with a number of other countries. But Australia is also more exposed to the global economic cycle and commodity prices than most other countries. This has of course been to Australia's advantage, but it also means that the Australian economy can be subject to a wider range of shocks than most other developed economies. Therefore, a lower level of debt provides critical capacity to respond to any negative shocks.
- Federal, state and local governments spend over half a trillion dollars a year. Ultimately that needs to be paid for – either today through taxes or by future generations through higher debt. Australians therefore rightly expect this money will be spent well and that governments will be efficient and effective. Value for money does not mean fewer services, rather it means making sure services are delivered efficiently and effectively, without duplication. This is best achieved through careful redesign of programs and innovations in service delivery to drive better value and better outcomes.
  - Action must be taken to tackle entrenched disadvantage so Australians who are trapped in a cycle of poverty and welfare can get ahead. Too often, entrenched disadvantage reaches across generations. While a strong and growing economy provides a foundation to tackle the challenge of entrenched disadvantage, a comprehensive policy response is also needed to engage with the complexities and multiple dimensions of the issue. For this reason, we repeat our call for a Productivity Commission inquiry into entrenched disadvantage.
- Australia also remains reliant on borrowing from offshore. This means that losing Australia's AAA credit rating would have real economic consequences. It is critical for retaining financial strength and maintaining investor confidence. In addition, a loss of the rating would see higher borrowing costs for both banks and some levels of government. That in turn means more tax dollars would have to go to paying government interest bills and households would face higher mortgage interest rates.

- Underlying spending pressures will continue to build over the long term. The latest Intergenerational Report projects average annual real spending growth of 3.1 per cent over coming decades. Major spending drivers include new programs such as the NDIS and an ageing population. Off-budget projects such as the NBN also present budgetary risks.

On current projections, spending growth will exceed the IGR's long term average annual GDP growth projection of 2.8 per cent. This will generate an ever-growing and unsustainable fiscal gap and debt build up.

Fiscal rules

The Business Council continues to advocate for a series of fiscal rules to help drive efficiencies in government spending. These rules will not reduce the level of services available to Australians – indeed they provide for an increase in spending per person after inflation.

Fiscal rules are ultimately about ensuring taxpayer dollars are not wasted and taxes are kept as low as possible while still providing quality services and a safety net. They will help get – and keep – the budget in surplus. In turn, lower debt puts Australia in a stronger position to respond if something goes wrong down the track. Without fiscal rules, long term budget goals can be more easily deferred or fiscal discipline can be inconsistent. Put simply, without action the long run fiscal gap will grow wider until it requires a painful adjustment through a combination of cuts to services and higher taxes.

The fiscal rules the Business Council recommends are:

- a responsible tax-to-GDP cap (the federal government's tax cap is 23.9 per cent of GDP) which effectively hands back bracket creep and restricts government from continually expanding more rapidly than the economy
- a real spending growth cap of 2 per cent per year which would, given current rates of population growth, still enable an increase in spending per person after inflation.

Boosting confidence and certainty

It is critical that the budget sets out a coherent and credible long-term path for restoring the budget position progressively over time. Sticking to that path will provide a clear and consistent signal to business and the community for making decisions.

A loss of fiscal credibility ultimately impacts household and business confidence, increases uncertainty and works against a business environment conducive to investment and innovation.

Ad hoc policy changes each budget – be they tax increases or spending cuts – will mean business and the community begin to expect constant change in their financial affairs. It will also set an unstable platform for making decisions to work, save, invest and innovate.

2. A STRONG ECONOMY

WHAT IS THE STATE OF THE ECONOMY?

Key points

Economic growth has slowed to under 2 per cent over the year – but this is not as fast as it can be. The private sector has historically been the main driver of growth but household consumption, housing investment and business investment have been subdued.

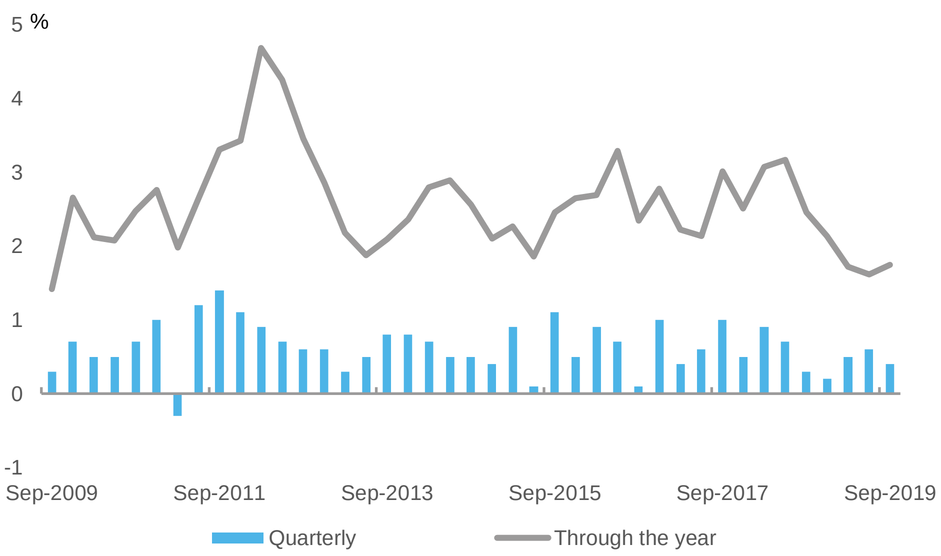
Growth improves our ability to deliver what Australians rightly expect for themselves and their families: good jobs, more jobs, rising incomes, world class healthcare, liveable cities and regions, and support to look after our most vulnerable citizens.

Australia has not had a recession in 28 years, and our level of debt is high by historical standards but low compared with many other countries. Growth in Australia has slowed over the past decade to an average of 2.6 per cent a year. This remains stronger than many other developed countries who have also experienced a slowdown in growth.

Australia has experienced 28 years of consecutive growth – a record for a developed nation. But economic growth is not as fast as it could be. The economy grew 1.7 per cent over the year to September 2019. Growth is expected to pick up in the near term, supported by personal income tax cuts, the Reserve Bank's three interest rate cuts and ongoing infrastructure spending.

The labour market remains robust with solid jobs growth over the year (mostly full-time jobs), an unemployment rate of 5.3 per cent in October and a participation rate around record levels. Wages growth is up 2.2 per cent over the year to September 2019 and is outstripping inflation of 1.7 per cent. A positive for households is that inflation growth in administered prices (which includes essential services such as utilities, health care and education) has slowed compared with recent years.

Figure 2: Economic growth



Source: ABS cat. no. 5206.0

Private sector growth is weak

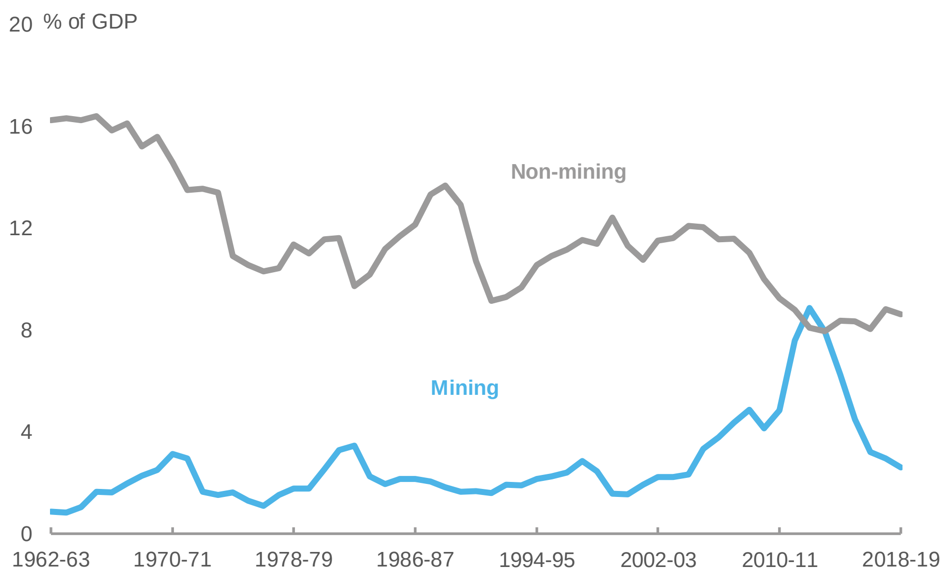
Historically, the private sector has been the main driver of Australia's economic growth and rising living standards. But private sector demand has been subdued the past six or so years. Over the last year alone:

- household consumption is growing at its slowest pace in over a decade
- housing construction is down 9.6 per cent
- new business investment fell 1.7 per cent and as a share of GDP is at its lowest level in over 26 years.

The weakness in business investment is not only related to the end of the mining boom, but also to weakness in non-mining investment. Non-mining investment averaged around 11 per cent of GDP from the mid-1970s to the onset of the global financial crisis. It fell to around 8 per cent of GDP in the years following the crisis and is yet to recover to its pre-crisis trend. This decline largely reflects falling investment intensity within industries, particularly between 2009-10 and 2012-13.

New business investment fell 1.7 per cent over the year and as a share of GDP is at its lowest level in over 26 years.

Figure 3: Private investment by industry



Source: ABS cat. no. 5204.0

In contrast, government spending is up around 5 per cent over the past year and was the largest contributor to growth over the past twelve months.

Australia's economic growth has slowed over the past decade

Although Australia has not had a recession in 28 years, there have been two distinct periods during that time. To illustrate, economic growth in the past decade has been slower than it was during the 1990s and the early 2000s.

There have also been times in the past 28 years when Australia's overall economic growth has been driven predominantly by strong population growth. While a growing population has many benefits, this has meant that growth in GDP per person (which tends to approximate increases in living standards over time) has on occasion been very weak or even negative.

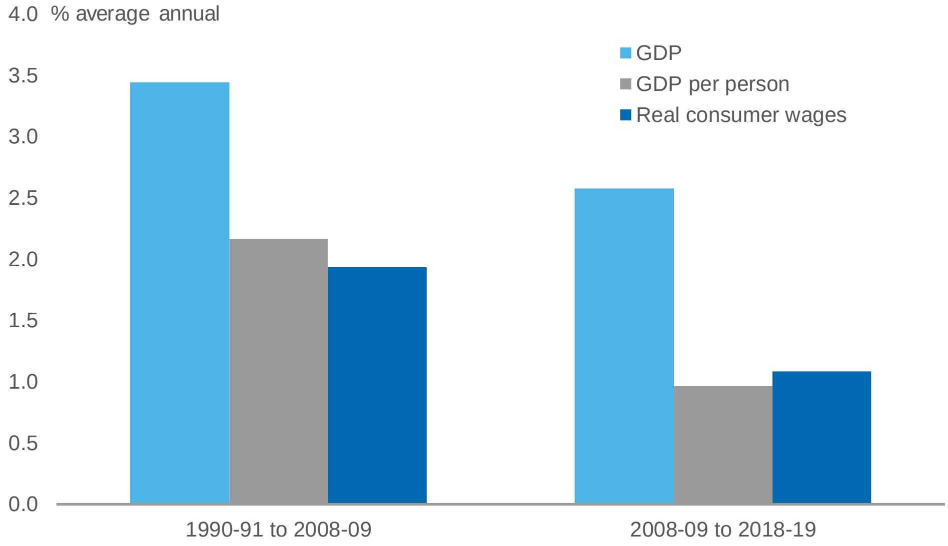
Between the recession in the early 1990s and the global financial crisis, real GDP expanded by an average of 3.4 per cent a year. That period ended with budget surpluses, a federal government with no net debt, greater community services and a mixture of tax reductions. Wages growth was well above inflation, with real consumer wages rising by an average of 1.9 per cent a year over that period.

The past decade has seen GDP growth average 2.6 per cent a year and the economy only grew 2.0 per cent in 2018-19, one of the slowest rates of growth in the past 28 years.

This result over the past decade is not as fast as we could have grown. As a result, we have had a run of federal budget deficits – although the budget is now in balance – and federal government debt now large by Australian standards. Reflective of a softer overall pace of economic growth, real consumer wages growth has averaged just 1.1 per cent a year. That's about a halving in the pace of real wages growth compared with the 1990s and the early 2000s.

Once population growth is accounted for, income growth per person remains weak. Real GDP per person has grown at an average of 1.0 per cent per year over the past decade and grew just 0.4 per cent in 2018-19, well below the long-run average of 1.8 per cent a year. Reflecting the ebb and flow of the terms of trade, average real net national disposable income took 7 years to exceed its last peak of $59,500 in 2011-12, rising to $60,300 in 2018-19.

Figure 4: Australia's core growth measures have weakened over the past decade



Source: ABS cat. no. 5206.0

WHAT ARE THE CONSEQUENCES OF A DECADE OF LOW GROWTH?

Key points

We must maximise our relatively strong starting position relative to other countries to deliver the economic gains of the past. But the Australian economy is not growing as fast as it should.

The impact of slower growth will be felt by Australians through slower wages growth and slower growth in living standards.

A difference of just a few percentage points in the rate of growth over a long time can make a big difference in the size of Australia's economy and our living standards.

Weak growth limits the options available to households, businesses and governments.

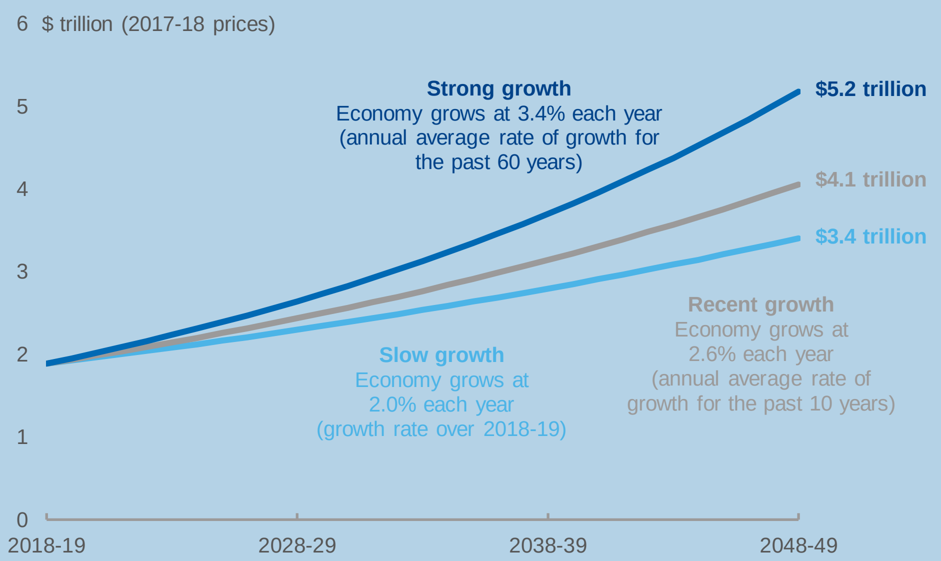
Australia has enjoyed decades of economic growth that have delivered higher living standards across the board. Real income per person has doubled over the past 40 years.

This remarkable achievement happened because of hard fought reforms by successive governments particularly in the 1980s and 1990s, the hard work of Australians and some lucky breaks. But, while the Australian economy has continued to grow, economic growth has slowed over the past 10 years compared with the 1990s and the early 2000s.

If Australia's slower growth was to continue for another 10 years, or even worsen, this would have clear real-world effects on people's lives, the choices they have and the decisions they make. The difference of just a few percentage points in the rate of growth in the economy over a long time can make a big difference in the size of Australia's economy and the opportunities available to people, businesses, government and the community.

The costs of (another) 10 years of low growth

Figure 5: A sustained increase in economic growth makes a big difference



Source: ABS cat. no. 5206.0 and Business Council calculation

- If economy were to grow 3.4 per cent a year – the average annual growth rate over the past 60 years – then the economy would be around $200 billion (in today's dollars) bigger in 2029 than if it grew at 2.6 per cent a year – the average over the past decade.
- If the economy were to grow at this faster rate, then tax revenue would be around $50 billion higher a decade from now (in today's dollars). This is a bit more than the government spent on the age pension in 2018-19.
- If wages were to grow at 3.2 per cent (the average over the past 20 years) rather than 2.1 per cent (the average over the last 5 years), then this could translate into wages being around $11,000 higher per year (in today's dollars) from 2029 for a person working a full-time job with standard hours. The difference in these wages growth rates is similar to the difference in productivity growth rates over these periods.
- If the economy was to grow at 2.0 per cent (the rate of growth over 2018-19) over the next 10 years, then the economy would be around $140 billion (in today's dollars) smaller than if the average growth rate over the last 10 years of 2.6 per cent continued.
- In this world of even slower growth, in 2029, the government would have around $35 billion less in tax revenue (in today's dollars). This is slightly more than the $31 billion the government spent on defence in 2018-19.

The difference between an economy growing by 2.0 per cent or 3.4 per cent may sound like a small difference to some. But this difference over a long time would have a big effect on the size of Australia's economy and weaker growth constrains the options available to households, businesses and governments.

- Generally, fewer new jobs will be created and wages growth will be slower, leaving households struggling to get ahead. (Recent modest labour productivity growth helps explain the recent coexistence of strong jobs growth and low wages growth. It suggests increases in labour supply are driving jobs growth, putting downward pressure on wages growth.)

- Businesses may worry about what's around the corner and hold off on hiring more people or investing in their business by buying new equipment, expanding to a new site or training staff in cutting edge skills.

- Slower wages, profits and consumption growth directly impacts the government's bottom line through slower growth in tax revenue leaving less money to spend on the services Australians want and need, including a safety net for the nation's most vulnerable people.

Slower economic growth may also force difficult decisions which may otherwise not need to be made. A person may put off investing in further education or skills training, because it might be harder to see the pay-off of getting a promotion or a better job. A business may need to pick between two different investments it thinks would be valuable or even not go ahead with either. And governments may face a deteriorating fiscal position or will need to make potentially rapid and blunt cuts in spending.

The real-world impacts of low growth are clear

There are clear real-world effects from slow economic growth on people's lives, the choices they have and the decisions they make.

If productivity growth over the past nine years was the same as it was through the 1990s, then it is fair to say that real incomes per person could be about $8,000 higher on average than they are today.

That extra money translates into less pressure on people – paying energy bills is a little easier, getting those back-to-school necessities is a little easier and putting that little bit away for a holiday is easier.

But what could happen in Australia if economic growth is just a bit lower than expected for a decade. Analysis commissioned by the Parliamentary Budget Office shows that if labour productivity grows at 1.35 per cent each year rather than at 1.6 per cent, then after 9 years, real GDP would be 2 per cent lower and 3.7 per cent lower after 16 years (or around $70 billion in today's dollars).

Given the rates of economic growth seen recently, this is by no means a 'worst case' scenario.

Lower productivity growth flows through to every aspect of the economy. Business investment is projected to be 4.5 per cent lower after nine years and this grows to 6.4 per cent lower after 16 years (or around $14 billion in today's dollars). Compensation of employees (which includes wage levels and the number of people employed) is projected to be 1.9 per cent lower after nine years, extending to 3.4 per cent lower after 16 years (or around $30 billion in today's dollars).[1]

This illustrates how slower economic growth affects all Australians through lower wages, lower profits and therefore lower shareholder returns (including for the more than 15 million Australians with superannuation).

1. PBO, *2017–18 Budget medium-term projections: economic scenario analysis*, 2017; Murphy, *Economic impact of selected macroeconomic shocks: Report prepared for the PBO*, 2017.

Figure 6: Sustained low productivity growth flows through the whole economy

Source: PBO, 2017–18 Budget medium-term projections: economic scenario analysis, 2017; Murphy, Economic impact of selected macroeconomic shocks: Report prepared for the PBO, 2017.

Anything less than solid economic and productivity growth will have serious implications for the budget.

Over the longer term, the 2015 IGR assumed GDP growth of 2.8 per cent a year, which has only been achieved three times in the past 10 years. Even this rate of growth, which seems optimistic from today's standpoint, combined with longer-term spending pressures including from an ageing population led to a projection in the IGR of a widening fiscal gap approaching 6 per cent of GDP by 2054-55. And this does not include the fiscal position of state and territory governments.

The Business Council strongly supports the government including scenarios on the impact of both lower and higher economic growth not just on the government's fiscal position, but also living standards in the forthcoming intergenerational report (see Chapter 3 on reforming the IGR).

WHAT ARE THE DRIVERS OF LOW GROWTH?

Key points

In a structural sense, private sector weakness is tied to productivity growth – or the lack of it – which is at the heart of the weakness in economic growth, real incomes and real wages growth in Australia.

Labour productivity is the underlying driver of wages growth and rising living standards, but it has been weak in recent years. A key driver of the weakness in productivity growth is the weakness in business investment.

Therefore, the key to lifting productivity and wages is increasing investment.

The key to growth is investment to drive productivity

In a structural sense, the weakness in the private sector is tied to productivity growth – or the lack of it – which is at the heart of the weakness in GDP, real incomes and real wages growth in Australia.

An economy with greater productivity means the benefits can be shared by all Australians through lower prices, higher wages, higher profits and better shareholder returns. Better shareholder returns and higher profits also benefit the over 15 million Australians with superannuation accounts.

What is productivity?

Productivity is about investment and innovation – it is not about a cost cutting race to the bottom. Businesses will hire an extra person when the value of what that person produces at least matches the wage paid. When a business invests, they expect to increase revenues and profits (and taxes), which leads to employing more people and increases in output per worker. This allows higher wages to be paid.

- Investment means that there are more facilities and new equipment to be operated and goods and services to be produced
- Investment in developing new markets requires more workers and requires more products and services to be produced
- When a business invests in the skills of its employees, pay rates rise commensurately.

The overall effect of increased investment and increased demand for labour by individual businesses is for labour demand to rise across the economy. This translates to an increase in both the aggregate number of jobs and hours worked as well as the wages received by workers. Aggregate and average labour income increase.

We know that the only way to sustainably grow wages is through faster GDP and productivity growth. This relies on an ongoing process of improvement in our human and physical capital, and innovating to produce existing goods and services in a better way or developing new ones. It is also about allowing our resources to be allocated where they can create the most value.

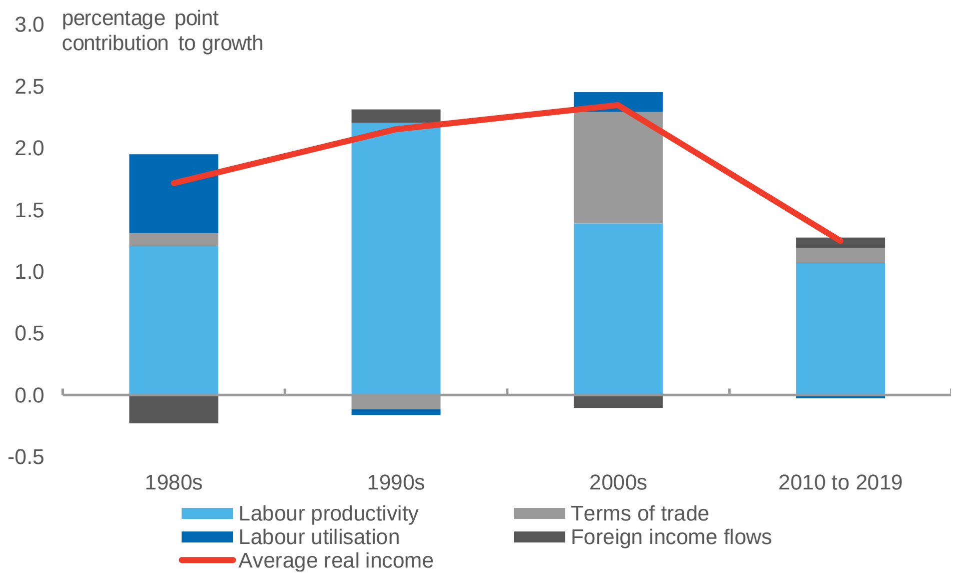
That in turn means lifting investment and making Australia a more competitive economy. It also means making sure our education and skills system is set up to help young people prepare for their future and for all workers to undertake life-long learning.

Australia has generated growth through different means over the past 40 years.

- Through the 1980s, growth in real incomes was generated by a combination of moderate growth in productivity and more people – predominately women – entering the workforce.
- The 1990s saw Australia reap the rewards of economic reform, with very strong productivity growth generating strong incomes and real wages growth.
- The 2000s was a different story, with productivity growth slowing but incomes growth was held up by surging commodity prices as China's economy boomed.
- This decade has seen real incomes growth almost halve with productivity growth also halving relative to the 1990s, while commodity prices have trended sideways.

Labour productivity has been by far the single most important driver of Australia's economic growth over the long term. It has accounted for 80 per cent of the improvement in average income growth over the past 40 years.

Figure 7: Contributions to growth in average real per capita incomes



Source: ABS cat. no. 5206.0

Productivity drives wages growth

Labour productivity increases the value of labour to businesses, driving up real wages (through higher nominal wages and lower consumer prices) and labour demand. This is borne out in the real world where growth in average real wages and labour productivity tracked closely over the 1990s, virtually one-for-one, reflecting the economic reforms of the 1980s and early 1990s.

Productivity growth slowed from the mid-2000s but wages growth held up due to booming commodity prices. Nominal wages grew at around four per cent a year and consumers benefited through lower prices driven by lower import prices. Businesses benefiting from high export prices could afford this as higher prices outstripped wage rises but this also meant that growth in wages ran well ahead of growth in productivity.

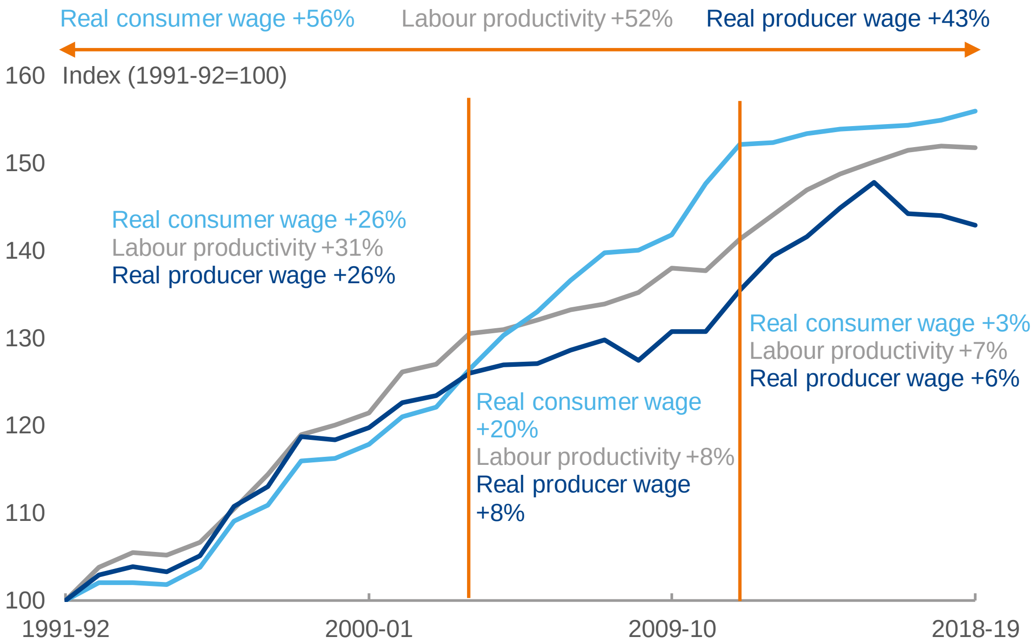
Treasury's confronting arithmetic shows that for real gross national income growth per person to return to its long-run average of 2 per cent per year, annual labour productivity growth will need to increase to around 2.5 per cent.[2]

The sharp drop in commodity prices in 2011-12 left producers with uncompetitively high wages and unit costs. Both consumer and producer real wages have had to realign with productivity growth and restoring the balance has taken some years, with slow labour productivity growth placing more of the adjustment burden on (slower) wages growth. But consumer real wages and producer real wages were converging to labour productivity growth, at least up until the more recent terms of trade spike over the past couple of years which again reduced the real producer wage.

- Real consumer wages mean wages after considering the impact of the rising cost of living and the number of hours worked in the economy. Real wages growth above zero means that wages are rising more than the cost of living.

[2] https://treasury.gov.au/sites/default/files/2019-03/p2017-t213722-Roundup_Productivity_trends_and_structural_change.pdf

Figure 8: Real wages and labour productivity growth since 1991-92



Source: ABS cat. no. 5206.0

The facts on wages

Wages continue to grow but at a slower rate compared with seven or so years ago.

- The total wages bill in the non-mining sector rose 4.7 per cent over the year to September 2019. This compares with non-mining profits growth of 2.2 per cent.
- The National Accounts measure of wages growth, which incorporates all payments to employees, is growing at its fastest pace in five years.
- WPI wages growth rose 2.2 per cent over the year to September 2019. After accounting for bonuses, WPI wages growth are up 2.8 per cent.
  - The fastest WPI wages growth is in the health and aged cared sector at 3.2 per cent over the year. This has been one of the fastest growing sectors of the labour market.
  - The slowest WPI wages growth is in the information media and telecommunications sector at 1.7 per cent over the year. This has been one of the slowest growing sectors of the labour market.
- Real wages grew 0.7 per cent in 2018-19 – the fastest growth in five years.
  - Real wages growth has averaged 0.4 per cent a year since the end of the mining boom.
  - Real wages growth averaged 2.1 per cent a year for the two decades up to the end of the mining investment boom (2011-12).
  - Average real wages growth over the past 40 years has been 1.3 per cent a year.
- For active, federally registered EBAs (with quantifiable wage increases), wage growth is relatively strong, growing at an average annualised rate of 2.7 per cent in the June quarter 2019. This is higher than the economy-wide average of 2.3 per cent over the year to June for all employees.
  - But the number of ‘active’ federal enterprise agreements is close to the lowest it has been in 20 years.

Investment is the missing link

Productivity has been the single most important driver of Australia's economic growth. And it is investment (capital deepening) and innovation (multifactor productivity) that drive productivity growth and create the basis for sustainable growth in real wages.

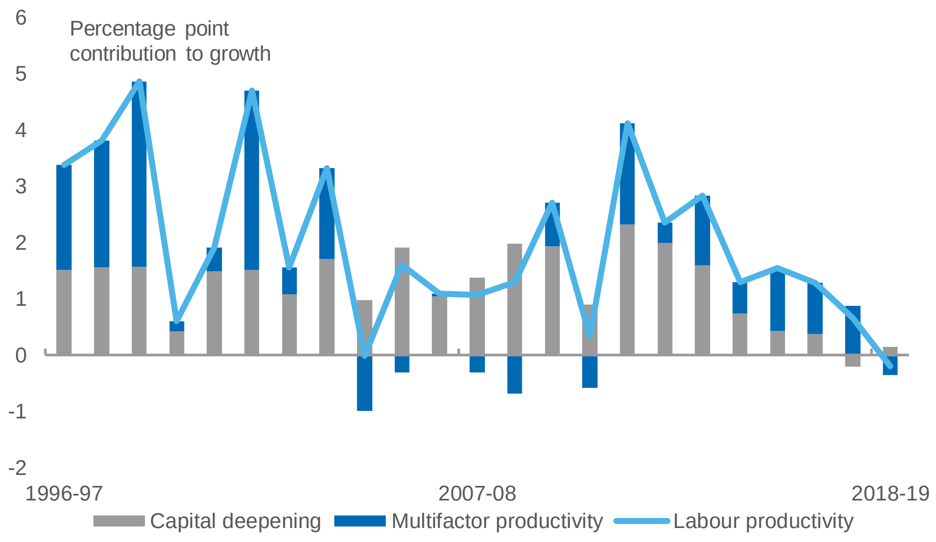
Both the Productivity Commission and the Treasury have recently noted the importance of investment – capital deepening – for Australia's long-run growth prospects. Capital deepening has been the largest contributor to labour productivity growth. However, as the Treasury recently noted: "Capital deepening has also softened, recently reaching the point of 'capital shallowing'. This has been broad-based and is not only related to the end of the mining-investment boom."

Labour productivity growth has been below the long-term average of 1.5 per cent for several years. It fell over the past year and has fallen in eight of the past thirteen quarters. When looking at the individual components:

- Capital deepening (i.e. how much companies invest) has declined as new business investment remains weak and as a share of GDP it is around the levels seen coming out of the 1990s recession.
- Multifactor productivity (i.e. how innovative companies are) has not grown since 2003-04, and fell in 2018-19 – the first fall since 2010-11.

This weakness in the core drivers of labour productivity growth and should therefore be of paramount concern.

Figure 9: Over time, business investment has been the main driver of labour productivity



Source: Business Council calculation using ABS cat. no. 5260.0.55.002. Note data are for market sector.

Uncertainty has increased and is dampening investment

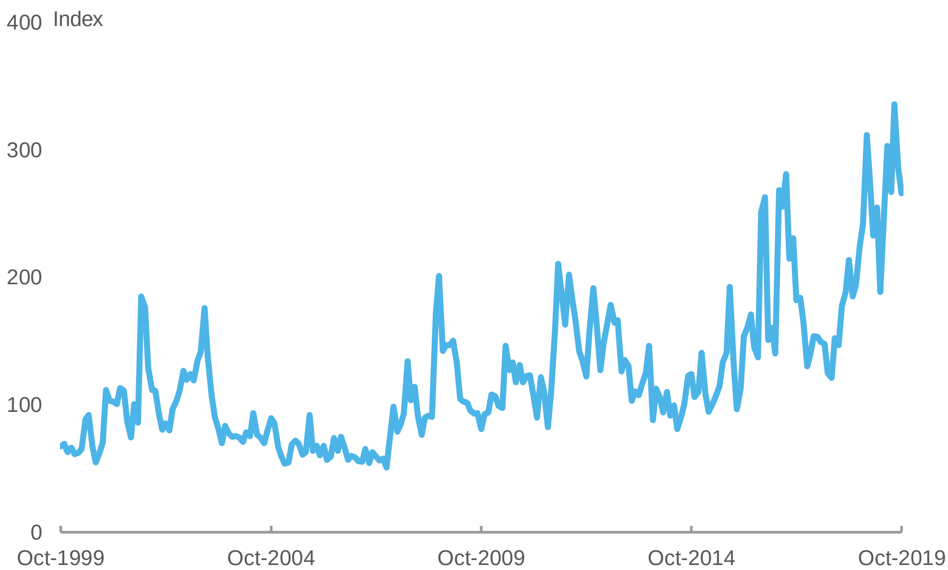
As an open economy dependent on trade and foreign investment, Australia is also exposed to global headwinds such as trade tensions and uncertainty. This was reflected in recent economic updates from the IMF and OECD. For example, the IMF expects that global growth in 2019 will be the slowest in a decade, driven by rising trade barriers, increased uncertainty around trade and geopolitics and the structural factors including low productivity growth and ageing populations in advanced economies.

Economic policy uncertainty has increased substantially since the beginning of 2018, and is above levels seen during the global financial crisis. Policy uncertainty is having a negative impact on the real economy and international perceptions of Australia. Uncertainty can cause:

- companies to delay decisions that are costly to reverse (such as major investments)
- the cost of capital to rise
- households to be more cautious and to increase savings, while reducing consumption.

The *Intergovernmental Review of Business Investment* noted that the choice by a firm to postpone investment in periods of heightened uncertainty 'is a rational business decision'.[3]

Figure 10: Global economy policy uncertainty index



Source: 'Measuring Economic Policy Uncertainty' by Scott Baker, Nicholas Bloom and Steven J. Davis at www.policyuncertainty.com

[3] The Australian Government and Heads of Treasuries, *Intergovernmental Review of Business Investment*, 2017.

Australia is in a global contest for investment

Australia is an open economy that depends on commerce with the rest of the world to generate higher living standards.

With a relatively small population, we do not save enough to finance all worthwhile investments, particularly in our capital-intensive export sectors. We have always relied on foreign investment to boost our own investment capacity.

Today, we are having to compete for funds in an increasingly contested global market. Investors have an array of choices about where next to invest their marginal dollar, and interest rates are at historic lows around the world. Australia is disadvantaged by scale and cost compared with Asian and North American markets.

Simply put, we must remain competitive to attract investment.

The company tax rate has stood still for 19 years for companies with turnover above $50 million. Other countries have continued to compete for capital by reducing their statutory and effective company tax rates over time.

But the case for investing in Australia has been made more difficult in recent years

Interest rates are low, but they are largely symptomatic of pervasive uncertainty in the global economy and, in this sense, are viewed by investors as offsetting higher risk premiums. The notion that Australian companies are overlooking profitable investment opportunities in a low interest rate environment because of rigid adherence to rule-of-thumb rate of return hurdles is not compelling. The likely and logical explanation is that the outlook is riskier.

Over the past decade or so, regulation and intervention are increasingly the first resort of policy makers to deal with a perceived market failure and cost-benefit assessments of new policies are either by-passed or given mere lip service by governments. Recent years have seen governments abruptly shift positions and even tear up contracts, increasing risk premiums for future projects. There has also been a long line of 'one-offs' which when taken together are increasing risk and chilling decisions to invest in Australia. All things considered, these actions undermine the incentives that drive businesses to invest and innovate in Australia, and are not conducive of rekindling confidence and animal spirits.

As the rest of the world moves to attract more investment, doing nothing does not mean nothing happens. We operate in a global economy and we cannot opt out. For example, KPMG Economics estimated that US tax reforms could permanently reduce Australia's GDP by at least 0.3 per cent (or $5.9 billion) and lead to around 25,500 fewer jobs.

Given the critical role that investment plays in delivering and sustaining strong productivity and GDP growth we need to kick-start investment spending and make Australia a 'first choice' investment destination.

Lifting business investment would respond to both the short-term weakness in demand and the longer-term weakness in productivity.

Are we missing out on investment?

Typically, there is no single reason why companies might choose not to invest in Australia. For some it is tax, for others the broader regulatory burden and the costs of operating in Australia, while for others it is the length of the approvals process for major projects. For many, it will be a combination of these factors.

These examples below show the cumulative impact that excessive regulation, a lack of competitiveness and high costs have on business in Australia. Of course, we do not know all the investment Australia may have missed out on as it is not typically broadcast.

CSL chose Switzerland over Australia in 2014 to locate a $500 million plant for manufacturing synthetic and enhanced versions of the body's own blood clotting agents, even with a large share of the foundation R&D undertaken in Australia.

CSL noted 'a range of factors, including for example, proximity to market, availability of staff with relevant regulatory and market experience and favourable industrial relations, influenced CSL's decision. But corporate tax rates were undoubtedly significant and the effective tax rate available in Switzerland is substantially lower than that of Australia.'

BlueScope announced a US$700 million steel plant expansion in the US in August 2019, in a move that will increase capacity around 40 per cent. The construction process will create hundreds of jobs, while in operation it will create 90 new full-time jobs, to go with the existing 400 jobs.

One of the main drivers of the expansion was that US energy costs are one-third of those in Australia, along with a robust manufacturing sector. BlueScope also noted that the tax benefits were attractive – both a lower company tax rate and accelerated depreciation. BlueScope helped build the mill in the mid-1990s through a joint venture, before fully acquiring it in 2015.

Incitec Pivot built a US$850 million world-scale ammonia plant in New Orleans over Australia. It noted the approvals process for a similar Australian project took some three years, about the same time that it took to construct the entire project in Louisiana (2013 to 2016). The cost of construction in Australia would have been 40 to 50 per cent more than what the plant cost in Louisiana and energy prices were more competitive.

Visy pledged US$2 billion of investment in the US over the decade from 2017. This represents a doubling of its rate of investment and would create an additional 5,000 manufacturing jobs.

A strong financial system is also critical for growth

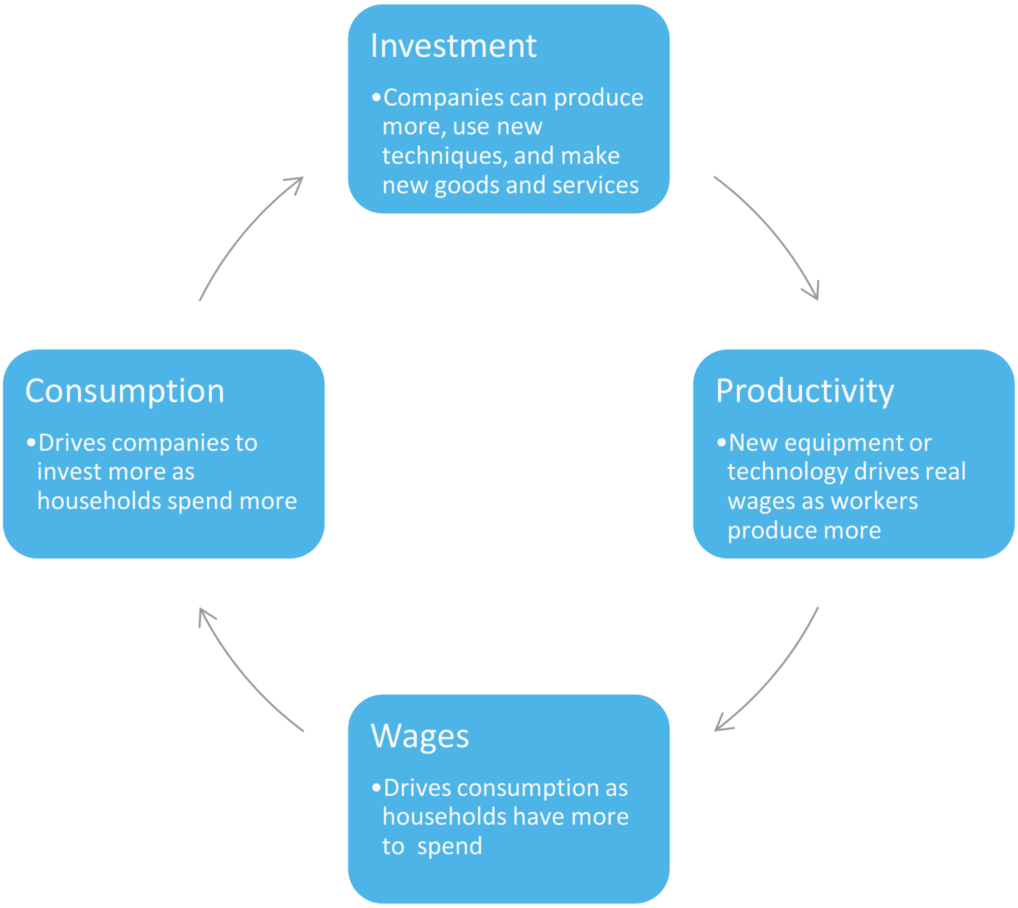
The financial system provides the lubrication for our economy. It helps to fund businesses and Australians to buy homes. Credit and measures of the money supply are, however, not growing at the rates required to generate and sustain a pickup in faster economic growth.

While demand for credit has moderated, financial sector regulation is an important setting for credit availability and, through that, macroeconomic growth.

Since the global financial crisis there has been a substantial reform agenda aimed at shoring up the foundations of the financial system. More recently, and particularly since the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, there has been a significant focus on consumer protections and the enforcement of those protections. These have been important developments that contribute to the stability and fairness of banking and finance.

As we look ahead, growth would better be served by a consolidation of the reform agenda and an open dialogue between government, regulators and stakeholders on the parameters of the existing laws. Where the law is unclear, confidence to lend is sapped. It is important that there are constructive approaches to regulatory uncertainty. This will help allay concerns that good faith attempts to comply with unclear laws will result in enforcement action. We would encourage a regulatory posture that supports the development of shared understandings of legal standards and thereby contribute to a stronger economy.

Figure 11: Generating income is paramount



ACTIONS TO GROW THE ECONOMY FASTER

Delivering strong economic growth lies at the heart of achieving our goals as a nation. Strong economic growth is not an end in itself, but the means to deliver on the policy flexibility that a strong fiscal position provides. It means we can provide for what we want as a nation – more jobs, rising incomes, quality schools, world class healthcare and support for those who are disadvantaged. Faster growth in real incomes per person can only be sustainably delivered by producing more output more person. This means deploying all our resources – natural, human and man-made – as effectively as possible.

This growth plan focuses on increasing productivity and making Australia a more attractive investment destination. This cannot be structurally solved with short-term fiscal stimulus, but rather kick-starting productivity growth (of which businesses investment is a key element) as the means to sustained, faster economic growth. Lifting business investment would respond to both the short-term weakness in demand and the longer-term weakness in productivity.

This growth plan outlines a series of actions to increase economic and wages growth by:

- lifting business investment by making Australia more attractive to investment and an easier place to do business through better regulation
- skilling up our people
- building the infrastructure to power a modern economy
- introducing a new industry policy to build on our strengths and embrace new opportunities.

A COMPETITIVE AUSTRALIA THAT IS OPEN FOR BUSINESS

Key points

Australia must be more attractive to investment and an easier country to do business to have a strong economy that creates jobs and rising wages. Our exporters need to be able to compete with the world's best. Commerce is increasingly borderless – from retailing to business to business services.

The way to unlock investment and help Australian businesses to compete with offshore rivals is through:

- a tax system that drives investment, and
- better regulation and greater regulatory certainty to enable investment decisions.

TAX INCENTIVES THAT DRIVE INVESTMENT

Key points

Australia is in a global contest for investment. Investors demand a globally competitive after-tax return on their investments in Australia, otherwise they will invest elsewhere.

Australia should introduce a broad-based, permanent investment allowance applicable to all investment depreciable under current tax law. This would respond to the short-term weakness in growth and the longer-term weakness in productivity.

An investment allowance is no substitute for a company tax cut, but doing nothing to turn around the weakness in business investment is not an option.

Australia must be a competitive investment destination

Investment is highly mobile globally and operates in an intensely competitive environment. Investors demand a globally competitive after-tax return on their investments in Australia, otherwise they will invest elsewhere. That takes jobs and investment that could have been in Australia and puts them somewhere else. Australia is also a net capital importer which means we rely on foreign investment to finance more investment here than our savings would otherwise allow.

A more competitive company tax system will expand the range of projects that will meet the after-tax rate of return required by investors. But Australia currently has the second highest effective marginal company tax rate in the OECD. Our competitors have both lower statutory corporate tax rates and business tax measures that are at least equivalent to, if not more favourable than, Australia. They include interest deductibility, accelerated depreciation and R&D tax incentives.

An investment allowance in the interim

In the absence of a reduction in the company tax rate for larger companies, Australia should introduce a broad-based, permanent investment allowance applicable to all investment depreciable under current tax law. This includes machinery and equipment, buildings and structures and intangible assets, and should also apply to energy assets and investments that improve energy efficiency.

Any investment allowance should capture the entire project to not distort investment and reflect the diverse nature of modern investment projects. For example, an investment project could:

- encompass a warehouse, that houses machinery used to produce goods, that are then transported by truck to consumers
- involve an autonomous truck which relies on software and radiofrequency spectrum to operate.

Who will benefit from an investment allowance?

The additional investments from an investment allowance will span a wide array of industries, locations and activities. The tax benefit could support:

- developing new markets
- building and expanding plants and structures
- buying machinery and equipment
- introducing new technologies to produce more goods and services more efficiently
- investing in innovation
- investing in skills of employees
- resource exploration and development.

The impact on different industries will depend on factors such as how capital intensive production is, the rate at which capital is replenished, and the role of the sector in capital construction. An investment allowance will support many industries, such as mining; information media and telecommunications; utilities; rental, hiring and real estate services; agriculture and manufacturing. Of course, as capital-intensive industries respond to an investment allowance by investing more, this will support demand for inputs from other sectors. For example, an increase in mining investment would increase demand for construction services and professional, scientific and technical services.

Through the Business Council's Strong Australia program, we have seen an investment allowance could support companies like:

- Farm Foods in Geelong to upgrade their meat processing equipment and ramp up production
- Manbulloo Mangoes to expand their business and explore new export markets
- Humpty Doo Barramundi to continue to grow the business.

How does an investment allowance work?

In practice an investment allowance would work as a bonus deduction on new investment. The value of the bonus deduction would depend on the investment allowance rate. To illustrate, a 10 per cent investment allowance would allow companies to deduct an additional 10 per cent of the value of an asset in its first year. There would not be any change to the depreciation schedule of the asset.

Investment allowance example

Consider a manufacturer looking to invest in a new piece of machinery to expand its business. The machinery costs $1 million and can be depreciated over 10 years. With a 10 per cent investment allowance, the manufacturer receives a bonus deduction of 10 per cent of the asset value in the first year – equal to $100,000. With a 30 per cent company tax rate, the after-tax benefit of the investment allowance in this example is $30,000. That benefit can be used to invest further in the business.

In principle, an investment allowance and company tax cut both work in the same way by reducing tax payable on profits earned from investing. A company tax cut reduces tax payable for any taxable income, while an investment allowance reduces tax payable by reducing taxable income in the early years of an investment. Either way, the effect is to increase the after-tax return on investment. A higher expected after-tax return means that some projects that would otherwise not go ahead become viable.

An investment allowance responds to the short-term weakness in demand and the longer-term weakness in productivity. It would also maximise the benefits and minimise distortions relative to a temporary or narrow allowance. Its impact on after-tax returns will depend on its size (and scope). In turn, this will determine the budget impact and the effect on investment and jobs.

A broad-based investment allowance applicable to all investment under current tax law (Division 40 of the *Income Tax Assessment Act 1997*) should be:

- less likely to distort investment decisions between different types of assets
- less complex and costly to administer relative to a policy with carve-outs.

Other design elements of the investment allowance to consider:

- it applies to assets to be principally used in Australia for the principal purpose of carrying on a business
- it applies to new assets that have not been installed or ready for use by anyone before
- it applies to investment decisions made following the policy announcement, and this will typically be evidenced by a contract or agreement being entered from this date, including an amendment, variation or extension to an existing contract whereby it relates to the investment decision
- it be available from the first year the asset is installed and ready for use

- the bonus deduction is not refundable i.e. if a company is in a loss-making situation.

Some have called for any tax policy designed to boost investment be quarantined to additional investment that is over and above the level that would otherwise have occurred. But this would be infeasible to implement in practice. Simply put – we do not know what the marginal investment is.

An investment allowance is no substitute for a company tax cut

An investment allowance is not a substitute for a company tax cut, rather it should be an interim measure ahead of moving to a single company tax rate of 25 per cent for all companies. Absent an investment allowance, doing nothing to turn around the weakness in business investment is not an option.

A 25 per cent company tax rate for all companies will likely have a bigger benefit across the board than any investment allowance. If it had the same impact, then the fiscal impacts would broadly be the same. In addition, an investment allowance will not be able to capture all forms of investment, such as staff training which will be critical for a successful, knowledge-based 21st century economy. But not favouring one form of investment over another is an important advantage of an across-the-board rate cut.

Australia cannot stand still while other countries compete for investment – in 2019 alone there have been thirteen countries that have cut their company tax rate.[4] As other countries continue to compete for capital by reducing their statutory and effective company tax rates over time, Australia will need to do the same. Ultimately this means a reduction in the company tax rate for all companies.

A key element of tax reform is a progressive reduction in the company tax rate to make Australia more competitive in the global contest for investment. Today, Australia's company tax rate remains unchanged for companies with turnover above $50 million and there are no plans to reduce it. In contrast, almost 60 per cent of OECD economies have cut their company tax rates over the past decade or plan to do so in the future. The US, UK, Japan, India and Canada have already cut their company tax rate, with reductions planned for Argentina, Belgium, France, Netherlands and Sweden. Yet Australia has stood still for 19 years.

If broader tax reform is not possible, our 30 per cent company tax rate for large companies is globally uncompetitive and should be reduced to 25 per cent for all companies. This could be achieved through a modest, gradual reduction. The existing two-tier tax system increases complexity and potentially distorts investment by discouraging smaller businesses from expanding. This would move Australia's current uncompetitive company tax rate closer to the OECD average.

Tax system integrity

Australia's integrity measures, institutions and enforcement all contribute towards and complement a high level of compliance with our tax system. Treasury recently noted that,

[4] https://home.kpmg/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html

'Australia continues to have some of the most robust tax integrity rules in the world'.[5] At the same time, the tax system must ensure that the Australian economy, which is heavily reliant on trade and foreign investment, remains strong and continues to grow.

All companies must meet their tax obligations. Where arrangements do not keep pace with community norms, they should be reviewed. Many of Australia's integrity measures have been comprehensively amended over the past few years, including through the OECD's Base Erosion and Profit Shifting (BEPS) project. Treasury has observed that 'Australia has long been a strong and active supporter of the BEPS project and has been vigilant in implementing the BEPS recommendations. And … Australia has also gone further'.[6]

Australia is already either compliant or acting on the OECD's BEPS recommendations, and has also introduced other tax integrity reforms. They include the Multinational Anti-Avoidance Law, the Diverted Profits Tax, a doubling of penalties that apply to large companies who engage in tax avoidance, public disclosure of the tax information of large companies, the Tax Transparency Code, improved whistle blower protection, a hundredfold increase in penalties for large companies which do not adhere to tax disclosure obligations, changes to thin capitalisation, and a "good tax record" to access Commonwealth Government procurement.

Australia should continue to support the OECD as the key multilateral forum for progressing changes to global tax laws, including on taxation of the digital economy. There are more than 130 jurisdictions participating in the OECD process, and it provides the best opportunity to develop a consensus-based, credible and enduring solution to global tax issues. If Australia acts outside this process, it risks unintended consequences such as double taxation, reducing competitiveness or deterring vital investment.

Tax Commissioner Chris Jordan has said company tax compliance in Australia 'is around global best practice and many countries aspire to this level of compliance'.[7] The ATO has measured the tax gap for individuals not in business to be $8.4 billion (or 6.4 per cent) in 2015-16, for small business to be around $11.1 billion (or 12.5 per cent) in 2015-16 and for large companies to be $2.0 billion (or 4.0 per cent) in 2016-17.[8]

[5] Tax integrity source: The Australian Government the Treasury (2018), *The Digital Economy and Australia's Corporate Tax System*, Treasury Discussion Paper, October 2018.

[6] Ibid.

[7] https://www.ato.gov.au/Media-centre/Speeches/Commissioner/Commissioner-s-address-to-the-National-Press-Club/

[8] https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Australian-tax-gaps-overview/?anchor=Summaryfindings#Summaryfindings

BETTER REGULATION

Key points

We believe regulation is important but when it is poorly thought through or designed, the burden falls on consumers through higher costs, delays and fewer choices.

More efficient regulatory settings across Australia will deliver needed protections while enhancing the environment for business investment and jobs growth.

All governments should commit to best practice regulation making, and to reducing the cumulative cost burden of poorly designed regulation, which ultimately falls on workers and consumers.

The work of the federal government's deregulation taskforce should be complemented by the establishment of a COAG regulation reform agenda to drive jurisdictions towards best practice.

Better regulation means less unnecessary red tape and more productive businesses. It supports more job creation, better products and lower prices for consumers.

The cost of regulation

In its 2007 research report 'Performance Benchmarking of Australian Business Regulation', the Productivity Commission divided regulatory costs into the following three categories:

Direct costs	Compliance costs	Indirect costs
Licence and permit fees	Paperwork, record keeping, auditing and provision of information	Restrictions to competition
Government fines	Training and accreditation costs	Reduced innovation and entrepreneurship
Government charges	Installation of plant and equipment	Reduced business flexibility
	Capital holding costs	Limiting choice of products and services to consumers
	Time spent meeting regulatory requirements	Delays to development
	Changes to production processes	Business uncertainty
	Procurement and contracts	Transition costs of people moving

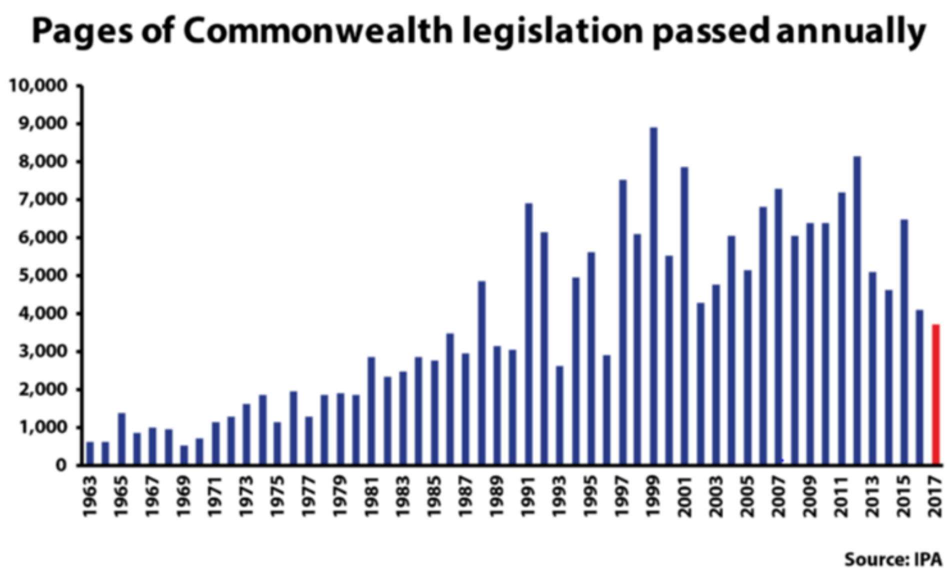
Some examples of costs imposed by poor regulation across Australia include:

- The federal government's Environment Protection and Biodiversity Conservation Act 1999 requires the applicant to provide multiple hard copies of EIS' at physical locations for public perusal. These documents can be over 4000 pages and electronic copies would be better.

- For major resource projects, the average approval timeframe is now between three to six years (MCA).
  - The Wallarah 2 coal mine in New South Wales has been subjected to repeated assessment over a 16-year period.
- It is cheaper to produce some items in Europe and ship them back to Australia than produce them in Australia.
- It can cost more to ship products to Tasmania than Hong Kong.
- You can't buy light bulbs in major retail stores before 11 am in Western Australia.
- A panel beater that is registered in the Australian Capital Territory, must apply to have their licence recognised before they can start working 3km away in Queanbeyan, New South Wales.
- Fire exit signs can have 'Exit' or the running man symbol, but not a mix of both – which forced one business to replace 40 per cent of their signs at significant cost.

Australia's record run of economic growth was built on the economic reform of the 1980s and 1990s, which had a key focus on reducing restrictive and costly regulation.

Since then, the tide has changed and Australian jurisdictions have created a multitude of new regulations. As recently documented by the Institute of Public Affairs (IPA), between 2007 and 2016 federal parliament passed 61,615 pages of new legislation, an average of 6,162 pages per year (see figure below)



While each regulation on its own may be considered to impose manageable costs on business and society, it is the increase in the *cumulative burden* of regulation that is now acting as a brake on economic growth and productivity.

- Deloitte Access Economics estimated that Federal, State and local government rules and regulations cost $27 billion a year to administer and $67 billion a year to comply with (2014).

- The Institute of Public Affairs estimated that the economic costs of red tape in Australia is at least $176 billion per annum (11 per cent of GDP). This translated into red tape costs of about $19,300 per Australian household (2016).
- The World Economic Forum's 2019 Global Competitiveness Index found Australia ranked 16th in overall competitiveness, but ranked 80th in the 'burden of government regulation' category.

In an increasingly globalised economy, good regulation can be a competitive strength, but poor or excessive regulation weakens competitiveness, and poses the risk of business being done elsewhere. We cannot rely on good fortune and we must acknowledge that the complexity of Australia's regulatory framework is deterring private business investment and undermining competitiveness.

The costs of poor regulation are ultimately borne by consumers though higher prices or less product choice, or by employees through lower employment and wages outcomes.

Efforts to reduce the regulatory burden need to be centred on:

- Committing to best practice regulation making and impact measurement
- Making regulation reform a top priority for COAG's agenda
- Getting behind the federal government's deregulation taskforce
- Investing in Regtech solutions to reduce compliance costs.

The regulation making process

The best way to avoid the imposition of unnecessary regulatory compliance costs is to prevent the creation of poorly designed regulation in the first place.

All governments should properly assess the impact and cost of new regulations by state and federal governments through Regulatory Impact Assessment processes, to ensure efficient and effective regulation.

Governments should also undertake regular stocktakes of the cumulative cost of regulation within their jurisdictions and work to reduce costs over time. This work should be led through the government's deregulation taskforce.

The Federal Government has recently made some positive changes to the Regulatory Impact Assessment process – including requiring a stronger focus on evaluating broader cost impacts, streamlining RIS documents and limiting the use of independent reviews as a substitute for proper RIS analysis.

Further, practical recommendations for improving the RIA process should be undertaken:

- All new regulation should be subject to regulation impact assessment in accordance with the government's new 'good practice' and 'exemplary practice' standards.
  - The problem should be clearly identified and the proposed regulation is demonstrated to be the best solution using cost-benefit analysis.

- Set a minimum period of consultation that allows stakeholders to properly understand a proposed regulation and fully assess its impact.
- Co-design regulation with industry, or encourage self-regulation where it can be effective in achieving desired outcomes at least cost.
- Adequate resources and training so that agencies can accurately measure the costs of new regulation and undertake genuine cost-benefit analysis of all options. In doing so, agencies should assess how the cost of the proposed regulation will interact with existing regulation to affect the *cumulative burden* on business.
- Use sunset periods and commit to post-implementation reviews to assess and monitor the impact of new regulatory initiatives.
- The Terms of Reference for any future economic policy-related enquiries should include these requirements:
  - the reviewing agency to identify deregulation opportunities
  - any recommendations arising from the enquiry that increase regulation are accompanied by estimates of the cost impacts and the benefits.

Better measurement of the cumulative costs of regulation, or the ‘stock of regulation’, should complement the RIA process. For instance, the Federal Government assessed the total cost of regulation under its control at $70 billion in 2014 and used this estimate to set targets for future reductions in regulatory cost.

Monitoring the stock of regulation will enable all governments to assess the ongoing impact on the competitiveness of their economies and set targets for a reduction in the cumulative burden.

The Productivity Commission should be tasked with developing robust methodologies that can be used by all jurisdictions (federal, state and territory) to carry out and publish:

- a stocktake of the total cost of regulation (every five years)
- an annual, consolidated regulatory performance report that provides information on: approval times; fees and charges; investigations, enforcement actions and penalties (e.g. fines paid); regulator budgets; and additions and removals to the stock of regulation through the year (the ‘flow’).

COAG agenda

Regulation reform should be a top priority for the Council of Australian Governments (COAG).

This would identify the state or territory with the best approach to regulation in certain areas and reward other states for adopting these standards with productivity payments.

The patchwork of regulation that exists across Australia serves to create costs on the economy due to:

- regulatory inconsistency and duplication that adds significant costs for businesses operating across multiple jurisdictions

- regulation of varying quality, in terms of its costs and timeliness and delivery of positive outcomes for society.

There is a major opportunity in 2020 for COAG to commit to a regulatory reform program where governments are encouraged to reform their regulations in line with the best performing jurisdiction.

Previous efforts to harmonise state and territory laws under the Seamless National Economy initiative and elsewhere have had limited success due to difficulties in getting all jurisdictions to agree to a common set of laws.

COAG should switch from seeking harmonisation to identifying the jurisdiction with the best approach to each area of regulation and encouraging all jurisdictions to move to that standard.

The Business Council, with A.T. Kearney, has undertaken research that is soon-to-be-released on best practice in several key areas of state and territory-based business regulation. The preliminary results find there would be benefits if, for instance, all states and territories adopted the main elements of the payroll tax regime in New South Wales, retail trading laws in the ACT and Northern Territory, and the approach to major project approvals reporting in Western Australia.

COAG should be given control of reforming state-based regulation that focuses first on major project approvals, development approvals, retail trading hours and payroll tax compliance. Once success has been demonstrated, reforms using this methodology in other common areas of regulation should follow suit.

To share the dividends of economic reform from this process, the Commonwealth should continue to explore productivity payments to reward states that deliver pro-competitive reforms that ultimately provide benefits for the wider community.

COAG should ask the question, why can’t all jurisdictions design and administer regulation as well as the best performer? Following this practical process would deliver better regulation, lower costs and a more productive and growing economy.

Deregulation taskforce

The Federal Government’s deregulation agenda is crucial for turning the tide of the creeping burden of regulation.

The federal government is working effectively with business and other stakeholders to identify deregulation priorities. The Prime Minister has announced the first set of initiatives with regard to small business employment, major project approvals and consolidating business registries. There is much more work to be done.

Business is committed to assisting the taskforce to conduct deep dives into the impact of regulation on key sectors and economic activities to identify better ways of doing things.

The taskforce needs to be effective in delivering deregulation across Australia so as to offset the costs of recently introduced and planned new business regulation. The deregulation taskforce should move quickly to identify unnecessary regulation and have it reformed or repealed.

Key areas of focus, as detailed below, should be on regulatory reforms that make it easier to do the following things without diminishing protections or regulatory standards:

- make it easier to employ people
- invest in Australia
- export goods and services
- get products and projects approved
- make more efficient use of infrastructure
- enable access to goods and services for consumers
- small business suppliers to get paid more quickly and on time.

In addition to removing and reforming regulation, the taskforce should identify where further government investment in more efficient regulatory platforms will make it much easier to do businesses. The digitisation of Australia's regulatory system will provide significant efficiency benefits to all stakeholders – such as the online portals and information offered by Service NSW – but it will require greater public investment in Australia's regulatory infrastructure.

This submission identifies two particular initiatives that should be considered for government investment that would reduce regulatory costs and deliver benefits for the economy:

- a small business register to better identify small businesses and deliver targeted policies and programs
- a one stop shop digital trade platform, to reduce the duplication and complexity in customs and trade regulatory documents.

Regulatory reform priorities

A suggested set of priority reforms for governments to adopt via the COAG reform initiative or the deregulation taskforce is set out below – this is by no means an exhaustive list.

Make it easier to employ people

- Reduce differences between Payroll Tax Regimes.
  - Jurisdictions should utilise the same small business exemption thresholds, calculation methods and exemptions. This would mean that businesses that operate in multiple jurisdictions across Australia would avoid unnecessary compliance costs when adhering to their payroll tax obligations across multiple jurisdictions.
  - Jurisdictions should look to consolidate their eight, separate payroll tax online platforms into a single national payroll tax online platform. This would simplify the compliance process for businesses that operate across multiple jurisdictions.
- Mutual recognition of occupational and professional licensing.
  - Revive and complete the Council of the Australian Federation (CAF) process supporting mutual recognition of occupational and professional licensing, and refer to

  COAG if progress is not made by CAF – as per the Productivity Commission's report on mutual recognition.
  - Remove occupational and professional licensing requirements that restrict competition and do not lower health, safety and other risks. Priorities sectors are legal, construction, veterinary and architecture.

- Reduce unnecessary overlap and complexity in labour hire licensing regimes across Australia.

- Project-length agreements: extend the life of 'greenfields' agreements to cover the life of new projects.

- Annualised salaries – prevent employers being subject to onerous new red tape under proposed new award terms.

- Enterprise bargaining – reduce complexity in bargaining and approval processes by the Fair Work Commission to encourage business and workers to replace existing expired agreements.

- Expand the new online checklist that supports employers in employing their first person, to support employers in employing more staff. It can be a single point of information on wages for small business.

Making it easier to invest in Australia

- All state and territory governments should reform their major project approvals systems by adopting the Business Council's best practice model, which is based upon:
  - greater use of strategic plans to determine permissible land use
  - a lead agency framework
  - single application, single assessment and single approval, within a legislated 12-month maximum timeframe
  - streamlined compliance and performance monitoring with respect to conditions of approval
  - judicial review only, and only for directly affected parties.

- Make amendments to the Environment Protection and Biodiversity Act 1999
  - Implement bilateral approvals agreements under the EPBC Act, to allow the Commonwealth to delegate project approvals to the state and territory governments.
  - Implement the recommendation of the 2017 Independent Review of the Water Trigger legislation to review the adequacy of state regulatory systems, practice and policy to meet the requirements of the water trigger, and recommend any changes needed to expand bilateral approval agreements with the Commonwealth.
  - Repeal third party appeal rights under section 487 of the EPBC Act to prevent frivolous or vexatious appeals of ministerial decisions. (Removing the section would not affect judicial review appeal rights for persons directly affected by a decision and project proponents). Improve the robustness of decision-making processes under the EPBC Act and reduce the likelihood of administration errors that can give rise to judicial review.

- Make changes to the FIRB process.
  - Review fee structures for FIRB applications to ensure they are not acting as a revenue raising mechanism but instead reflect the true costs of assessing applications.
  - To ensure FIRB applications are acted upon within mandated time periods, introduce a "default approved" approach for low risk projects, under which the proposed investment is automatically approved if the FIRB does not respond within stipulated time frames.

- Reduce the paperwork and reporting requirements for private investors under the Commonwealth Government's Australian Industry Participation requirements.

In addition, all governments need to be aware of the harmful impacts on long term investment when key policy settings are changed suddenly that impact negatively on investment returns or raise concerns about sovereign risk.

Making it easier to export

- Introduce a one-stop-shop digital trade platform to facilitate lower costs for exporters. Consult with industry and the Productivity Commission to identify the most cost-effective approach to introducing the platform.
  - The digital trade platform was a 2016 election commitment of the Federal Government (under the 'Single Window' policy), however progress to date has been slow.
  - The Single Window trade system will provide a central location for cross-border traders to submit regulatory documents like customs declarations and trading invoices, rather than having to deal with multiple regulations and government agencies.
  - The Federal Government should convene a roundtable including business and government representatives to identify interim milestones for the progress of the Single Window trade platform.
  - The Productivity Commission should undertake a study as to the benefits for large and small importers and exporters and recommend the most cost effective and fastest ways to proceed towards introducing a single window, bearing in mind the desirability of building a system that can interface electronically with platforms of other countries.

Make more efficient use of infrastructure

- Implement the Productivity Commission's recommendations with regard to operating restrictions at Sydney Airport:
  - Airlines can use any peak-period slot for flights servicing regional New South Wales.
  - Measure actual aircraft movements once (rather than four times) an hour to achieve the intended 80 movements an hour.
  - Allow alternative types of freight aircraft to operate during the curfew, so long as aircraft noise and the number of movements are not increased above current levels.

- Streamline coastal shipping regulations by allowing a temporary licence for a single voyage, reducing voyage notification requirements, extending the loading dates tolerance and extending or removing volume tolerances. In time, remove the contestability (cabotage) restrictions in the Coastal Trading Act.

Make it easier to get new products approved

- Reinvigorate the process of identifying trusted international product standards and removing unnecessary duplication of approval processes through the establishment of regular, cross-government reporting on standards adoption (potentially through the annual deregulation report process). Priority reform areas include:
  - Medical devices: Introduce a risk-based approach in relation to the audit of medical devices by the Therapeutic Goods Administration to reduce the high number of devices subjected to the more costly and time-consuming Level 2 audit process.
  - Agricultural and veterinary chemicals: Investigate the benefits of co-regulation with major technology-development countries, such as Canada and the United States, to leverage international approval processes and expand market access.
  - Second hand motor vehicles: Progressively relax the restrictions on importing second-hand vehicles into Australia and continue to align Australia's vehicle standards with major manufacturing markets like the USA, Japan and Europe.

Make it easier for consumers to access goods and services

- Remove retail trading restrictions in South Australia, Western Australia and Queensland, estimated by the Productivity Commission to impose costs of approximately $600 million per year. This will drive greater competition for the benefit of consumers and grow employment.

- Remove unwarranted competition restrictions in the pharmacy sector.
  - Amend section 90 of the National Health Act 1953 and the Pharmacy Location Rules. The rules set out the location-based criteria which must be met for the Australian Community Pharmacy Authority to recommend approval of a pharmacist to supply PBS medicines. This regulatory mechanism limits the potential for new pharmacies to open and existing pharmacies to relocate.
  - Review state and territory legislation, which place various restrictions on the ownership pharmacies.

Small business suppliers to get paid more quickly and on time

- The government should invest in the establishment of a small business register. The register would be regularly updated and provide a look-up table for parties wishing to verify the small business status of a business (using the suggested definition of annual turnover up to $10 million).
  - Signatories to the Australian Supplier Payment Code commit to pay small business suppliers within 30 days of receipt of a correct invoice. However, validating the small business status of a supplier can be difficult and resource intensive. Similar problems are expected to impact the government's proposed reporting framework for payment times to small businesses. The register would reduce compliance costs associated with all small business-targeted policies and programs (e.g. education and information campaigns, small business procurement targets, industry

participation plans, tax concessions, etc.) and would help to drive convergence around a single definition of small business.

- Government should consider how it can support small businesses to move to e-invoicing as the e-invoicing 'Peppol' standards are implemented in Australia and New Zealand. E-invoicing replaces paper and e-mail-based invoicing and enables faster processing times and fewer errors. Options for support include: information and education programs; government committing to faster payment times for suppliers using e-invoicing, or temporary, targeted tax benefits to reward companies that invest in IT systems or training.

SKILLING UP AUSTRALIANS

Key points

The best way to ensure Australians have the right jobs at the right time is giving them the skills and training they need for all stages of their working lives.

Australia needs an education and skills system that is not one-size fits all. One that recognises that learners should be placed at the centre of the system, so their individual skill development needs are met to enable them to meet their full potential.

Future growth in productivity and wages will best be achieved by ensuring that Australian workers have skills that are fit-for-purpose. This will increasingly mean they have greater scope to improve their skills at various stages during their careers. Australia's workplace relations system also needs to be able to accommodate the changing nature of work in various sectors of the economy.

Building such a system will not happen overnight. It will require significant policy work and deep intergovernmental collaboration, but the Commonwealth Government's skills package announced in April, *Delivering Skills for Today and Tomorrow* is an important first step in building such a system.

The establishment of a National Careers Institute (NCI) and the National Skills Commission (NSC) is vital foundational infrastructure on which Australia's future education and skills system can be built.

It will take at least five years for these institutions to become an integral part of the education and skills system, so sequencing the work will be important.

National Careers Institute

The NCI should be established as a common market information platform across VET and higher education, providing the right kind of information and guidance to help learners, workers and employers make the best decision for their future.

As part of this budget, the Business Council believes the government should commit and provide appropriate funding to:

1. Establish the NCI as the single integrator of the multitude of information and data about courses (including micro-credentials), careers, salaries and the labour market.
2. Establish a strong digital presence, either through a website or app, that becomes the 'go-to' location for all Australians, including professionals such as careers counsellors, looking for information.
3. Ensure the NCI is built around and supports the learner and how they make decisions, starting with the questions of 'what am I good at?' and 'what do I like?'.
4. Build and trial tools as part of the digital presence, including with gamification, to assist different cohorts of learners and workers to identify the industries relevant to their interests and skills.

National Skills Commission

The Business Council regards the establishment of the NSC as the first step in establishing a single funding model across VET and higher education that is sector-neutral.

As part of this budget, the Business Council believes the government should commit and provide appropriate funding to support the NSC to:

1. Undertake a costing exercise to determine benchmark costs, including loadings or something similar to account for locational and student need variations.

    - This should be done starting with relevant state and territory data, and the methodology should be agreed with all jurisdictions.

    - The costing exercise could be trialled in industry clusters that cut across VET and higher education such as engineering or nursing to enable a broader understanding of the different cost structures.

2. Develop a methodology to identify the ratio of public and private benefit in qualifications. The NSC should then use that methodology to create a national funding model that allocates the percentage share of training costs between governments, individuals and employers, and publish the information.

Good governance is essential for the NCI and the NSC

In establishing these two important institutions, the Business Council urges the government to get the governance model right from the beginning including:

- **Learner-centric** – one of the key concerns about the current education and skills system is that the leaner is not at the centre of the system. As two new institutions, it will be important that the design work of the NSC and NCI begins with the learner at the centre.
- **A broad scope** – while acknowledging that the work of both institutions will need to be phased and will start with the VET sector, do not limit the scope of the institutions, and ensure both institutions can cover VET, HE and the labour market more broadly.
- **Genuine national arrangements** – consistent with the government's commitment to negotiate the design of the model with states and territories, establish the institutions as national not commonwealth bodies, recognising that post-secondary education and skills is a shared responsibility.
- **Industry participation** – ensure industry, including national peak industry bodies, are part of the formal governance arrangements and have a genuine role to play.
- **Implementation** – the initial work of the NSC to establish a costing framework, and the NCI to build a usable platform of information for learners, will likely take at least two years of development and testing before anything can be publicly launched. Establishing a clear implementation schedule from the outset will manage community and sector expectations, as well as providing key milestones that can be reported against.

National Careers Institute

Developing a market information platform through the National Careers Institute

- The NCI is a unique opportunity to establish a common market information platform across both VET and higher education.
- The Business Council believes this should be the beginning of a single-source platform of market information that provides the right kind of information and guidance to help learners, workers and employers make the best decision for their future.
- It is crucial that the NCI extend beyond VET to encompass higher education and the broader labour market. It must provide holistic source of information for learners looking to navigate the post-secondary education and skills system.

Key actions for government in establishing the NCI:

- Any market information platform should start with the proposition – "what do I like, and what am I good at?" This will allow the learner to identify what they are good at, as well as potential career pathways.
- The NCI must be a one-stop show for information – it should consider data across the entire post-secondary education and skills system, and not be siloed to VET or higher education providers.
- As a starting point, the NCI should integrate the following data:
  - MySkills for VET, which allows the user to search for courses and includes some information on potential jobs and income
  - Quality Indicators for Teaching and Learning (QILT), which has some quality data indicators for higher education providers
  - JobOutlook, a federal government website that has quizzes to help people identify potential careers, and provides information on potential jobs and income
  - the federal government's Jobs and Education Data Infrastructure Project (JEDI), an online tool that will allow education providers design courses and training to cater for emerging skills, identify skills mismatches, and tailor their courses to meet demand
  - industry-led tools, such as the Business Council's guide "*The Modern Worker: a guide to what employers want"*, which sets out the minimum expectations employers have of workers across the labour market
  - data from the Australian Taxation Office, including median salaries for occupations across the labour market, and HECS-HELP loans accrued by learners for higher education.
- Market information cuts across both federal and state and territory governments, and the only way to create a platform that encourages informed decision-making is a collaborative approach.
- Industry involvement is critical and must be integrated into the design-thinking process.

Exhibit source: Business Council of Australia, Future-Proof: Protecting Australians through Education and Skills (2017).

Reforming the Skilling Australians Fund

Industry should have a bigger role in determining how the Skilling Australians Fund (SAF) is allocated, so that training is in areas of future skills shortage. The Business Council believes the Fund is not the best solution for solving the persistence of skill shortages, nor has it contributed to better skills outcomes.

Consideration should also be given to replacing the SAF levy with alternative revenue sources that are more stable and less harmful to growth on completion of the current 4-year partnership arrangement with the States and Territories. The levy is a cost impost on businesses that are trying to innovate, grow and expand employment opportunities in Australia, but need skilled migrants to do so due to skill shortages that are no fault of their own. The cost is particularly significant for SMEs.

Alternatively, changes to the levy should be made to provide more relief for small and medium sized businesses and to exempt businesses that spend directly on workforce training. That spending should be recognised as an effective means for reducing current and future skill shortages.

Changes to SAF Levy

- The revenue from the SAF levy should be used in a more targeted way to close the skill shortage gap.
- Industry should have a bigger role in determining how the Skilling Australians Fund is allocated, so that training is in areas of future skills shortage.
- Exempt businesses that spend directly on workforce training from paying the SAF levy.
  - Recognise this spending as an effective means for reducing current and future skill shortages.
- Make the Skilling Australians Fund Levy refundable if a visa application is not successful and the applicant has acted reasonably throughout the process.
- Prioritise the administration of refunds and commit to refund within 20 days of application (matching the government's 20-day payment commitments).

Changes to Temporary Skill Shortage visas

In order to grow, Australia will need to continue to bring in skilled labour on a temporary basis to fill skill shortages, especially where there are emerging, niche highly skilled roles. Temporary migrants enable business activity to proceed in Australia that grows employment opportunities for Australians and skills and knowledge transfer. The temporary skilled visa program is also an important conduit to the permanent skilled migration program.

Safeguards under the temporary migration program require migrants to meet certain criteria relating to desirability, capability and security, and that suitable Australian workers have an opportunity to fill a role before a temporary visa is issued. In an increasingly competitive global market for talent, it is essential that these safeguards are applied efficiently and that the overall program supports growing Australia's attractiveness as a destination for talent.

We recommend the following changes to Temporary Skill Shortage (TSS) visas:

- Improve the efficiency of labour market testing (and reduce costs on business and migrants) by greater use of departmental discretion where:

- minor errors in the advertising may require a role to be re-advertised, but there is an existing job-holder or preferred candidate who is adversely affected and may have to go offshore as a result
- a redundancy has occurred in another state or territory and it is unrealistic to expect the redundant individual to move or be considered for the role
- remove the requirement to publish salary.

- The government should review and publish data on the approval rate for renewals of the two-year TSS visa (that is, the issuance of a 2-year visa for occupations on the STSOL, plus the option of another 2-years). A high approval rate should lead to consideration of returning to issuing a 4-year visa upfront for occupations on the STSOL.
  - Occupations on the Short-term Skilled Occupation List (STSOL) are currently eligible for a two-year TSS visa, which can be renewed once at the end of that period for a further two-years. That is, the visa can be made valid for four years in total.
  - The feedback from industry is that the uncertainty associated with requiring approval for renewal after two-years is a major disincentive for highly skilled migrants to move to Australia and makes workforce planning difficult for businesses needing to fill roles of greater than two-years duration.
  - Since these changes were introduced in 2017, the first batch of two -year visas is now coming up for renewal. If the practice is for most renewals to be granted, then to reduce cost and uncertainty for all parties the government should consider reverting to issuing 4-year visas for occupations on the STSOL.
  - Other distinctions between the STSOL and the Medium and Long-term Strategic Skills List could be retained. That is, only occupations on the MLTSSL would have access to the pathway to permanent residency and the option of further renewals beyond the initial 4-year period.

- Make all occupations with remuneration over $180,000 p.a. eligible for the 4-year TSS visa, recognising they reflect highly skilled workers and roles.

- Create special categories of skills that are a national priority and eligible for the TSS visa, starting with cyber security skills workers from trusted countries.

DELIVERING INFRASTRUCTURE AND A PLACE-BASED APPROACH

Key points

Infrastructure is key to making our fast-growing cities and regional centres more productive, more liveable and less congested. We must continue to build the infrastructure to power a modern economy.

Too often the problem plaguing Australia is not a lack of infrastructure spending, but the wrong projects at the wrong time and for the wrong price. We can build it by fundamentally rethinking the way we plan and prioritise infrastructure, create jobs and provide services in all the places of Australia.

A place-based approach

A place-based approach should be applied to identifying and assessing the net benefits of sets of interrelated projects within a key region or economic growth corridor. There needs to be a rethink in the way Australia plans and prioritises around key places that can make the greatest economic contribution to their regions, their states or territories, and the whole country. Some initial criteria could include places that:

- have nearby gateway infrastructure such as an airport or major transport routes
- are home to one or two existing and successful industries and have the capacity to attract more investment
- are strategically important, such as Darwin and Cairns
- are close to major power grids
- have a university and a TAFE that will need to work together to drive the new skills agenda
- have quality health services that can support an expanding population
- have the capacity to increase the supply of housing and industrial land
- have an appetite for more people to take pressure and congestion off the major cities and in doing so create economic activity in their region.

This should start with ten places in addition to the existing city deals, and be modelled on the successful city deal framework. All evaluation and prioritisation must be supported by transparent cost-benefit analysis that identifies the growth opportunities of regions, the industries they could attract and long-run infrastructure needs.

This would create a pipeline of infrastructure projects from where the role of private, state and federal funding could be then explored. Further consideration should be given to using innovative funding and financing models for all new infrastructure.

Delivering infrastructure

Infrastructure should be well-planned and integrated, with projects prioritised for public funding independently assessed (by Infrastructure Australia and the relevant independent state and territory agencies) as providing the highest value to the community. We also need to make more productive use of our existing infrastructure though better regulation and application of technology.

The federal government's contribution to infrastructure investment is primarily through grants to state and territory-led projects. The federal government also invests directly in some major projects such as inland rail, Western Sydney International Airport and the National Broadband Network.

There is a substantial $339 billion of committed infrastructure funding in all government budgets that needs to be delivered efficiently. This represents the federal government's commitment to spend $100 billion over 10 years plus $239 billion over 4 years in state and territory budgets.

The Business Council's 2019 report *Australia's Infrastructure System* discusses the challenges with planning, delivering and operating the nation's infrastructure and calls on all stakeholders to manage infrastructure as a well-functioning system, rather than a collection of projects.

The infrastructure system needs to interact seamlessly with the planning system and systems for skills development, skilled migration, materials supply, security, and so on. Getting this right will avoid project delays and shortages in skilled labour and materials that push up project costs.

The 2020-21 budget can best support a well-functioning infrastructure system by providing:

▶ stable long-term infrastructure funding and a long-term infrastructure pipeline – this will provide assurances to the community that long-term infrastructure needs will be met and help minimise the boom/bust cycle which can lead to higher costs and unproductive delays in infrastructure delivery

▶ discretionary infrastructure funding measures – spending on infrastructure is acknowledged as a good way to stimulate growth, and this would be best done by accelerating maintenance spending and bringing forward smaller capital projects where industry capacity exists.

Infrastructure Australia has called the elevated level of spending in the years ahead as the new normal and that it will need to be continued into the future.

So, what is the role of the budget and public policy? All governments should work together through COAG to agree on the extent and sequencing of planned public infrastructure investments and agree on the future investment pipeline that will maintain a consistent level of spending over time. All governments should also agree to adopt policies that will support the efficient delivery and use of infrastructure and ensure value for investments by taxpayers. Specific actions should include:

- Ask Infrastructure Australia for advice on the highest value opportunities to extend the current pipeline of infrastructure projects. The importance of rigorous, independent advice remains essential.

- Speed up planning approvals processes for infrastructure projects (see the regulation section).
- Reform workplace laws to enable 'greenfields' agreements for new projects to run for the life of the project.
- Speed up procurement processes and provide greater procedural simplicity and transparency for bidders. Exemptions from local content provisions should apply where Australian content is not available or fails to provide value for money.
- Seek private sector ideas for new investment in infrastructure via unsolicited proposal processes in the states and territories.
- Implement a new asset recycling scheme to encourage the states to sell mature infrastructure businesses and use the proceeds to invest in new infrastructure projects. Seek the ACCC's advice on appropriate economic regulation to ensure privatisation of infrastructure assets is consistent with economic efficiency and results in higher consumer welfare.
- Assess the skills needed to deliver the investment pipeline and use the assessment to inform the setting of skilled migration lists and training programs to avoid skill shortages (for example engineers, electricians and project managers). Ensure permanent and temporary skilled migration programs are responsive to employers' needs (see regulation).

A NEW INDUSTRY POLICY TO BUILD ON OUR STRENGTHS AND EMBRACE NEW OPPORTUNITIES

Key points

Australia needs the policy settings to unleash the next wave of economic growth by removing barriers that prevent new and emerging industries succeeding or that hold back our existing industries and prevent them from expanding.

To achieve this, Australia needs to move from industry policy that focuses on individual industries, to a focus on capabilities that cut across and contribute to multiple sectors in the economy.

Government should also design a modern industry policy framework to ensure industry policy programs are effective, efficient and deliver maximum value for taxpayers. This includes ensuring the R&D Tax Incentive better supports and retains R&D investment in Australia.

Creating the conditions for Australia to return to our long-term growth rate of 3.4 per cent each year must be at the forefront of government decision making.

A more rapidly growing economy gives Australians greater capacity to provide for their families, communities and for the future.

Australia's economy has many strengths, but the nation must build on these solid foundations to unleash the next wave of economic growth.

Barriers that prevent new and emerging industries from locating in Australia or staying in Australia need to be removed. We also need to remove barriers that hold back our existing industries and prevent them from expanding.

Australia needs to do more to lower the barriers and hurdles to adopting the innovation of others in our workplaces and homes; as well as doing a better job at commercialising our own research and development. On tax, given the importance of innovation to economic development, our tax system ought to drive greater domestic investment in research and development.

Australia's capabilities

Industry policy must move from a focus on individual industries, to a focus on capabilities that cut across and contribute to multiple sectors in the economy.

A capability is the capacity, knowledge or skill to achieve a desired outcome. Capabilities are more than niche talents, or outlier activities. They are the demonstrated ability to produce high-value products or services, supported by evidence.

A reimagined industry policy should be focused on the capabilities that will allow Australia to be competitive in the global economy. This involves building on our natural advantages and developing innovative, high-value products and services that target niche areas of global value chains.

The Business Council has broadly defined and categorised Australia's capabilities into two tiers: traditional, and emerging and frontier. For Australia to be successful and grow these capabilities, it must act with purpose to secure opportunities that build on our natural advantages.

Traditional capabilities

Traditional capabilities are capabilities where Australia is already a market leader and has traditionally led and developed market innovation, like natural resource extraction and agricultural exports.

Traditional capabilities stem from Australia's natural advantages and are focused mostly in 'upstream' activities (capabilities that produce goods or services at the beginning of the global value chain).

While these capabilities underpin some of Australia's oldest sectors, they do not belong to the old economy. These sectors are constantly adopting advances in technology. Australia's resource giants have evolved into advanced manufacturing companies, and productivity gains in Australian agriculture have outpaced the rest of the economy over the past couple of decades.

Traditional capabilities are heavily represented in Australia's exports and underpin large segments of the economy. Australia's continued success in these capabilities will lead to more jobs and/or high levels of economic growth. But this growth relies on continually strengthening these capabilities with more innovative practices and integrating emerging and frontier capabilities into production methods to ensure strong growth into the future.

Emerging and frontier capabilities

Emerging and frontier capabilities are where Australia has demonstrated its ability to use technology and innovation to disrupt markets and create a new class of value. They have potential to tap into a niche spot in global value chains, allowing Australia to capitalise on the demand for high-value, small-batch, customised products and services. Examples of these emerging and frontier capabilities include battery technology, aerospace and defence technology, and quantum silicon computing.

Emerging and frontier capabilities may have achieved significant commercial success in international markets or may still be in the process of being commercialised. As these capabilities become more developed internationally, Australia will need to invest heavily and strategically in research and development to remain ahead of international competitors, attractive to investors, and ensure a growing market share.

Reimagined industry policy to strengthen traditional, emerging and frontier capabilities

Industry policy in Australia has a bad reputation.

It has a bad reputation because despite good intentions, there have been some very poor outcomes for the economy. When all was said and done, there were also poor outcomes for many of the industries the policy was designed to support or protect.

Too often, policy makers started with the premise that Australia needed to have end-to-end production, rather than finding our niche in a supply chain and being exceptional at that.

Inevitably, this meant we focused on an industry or sector rather than looking across the whole economy to identify where and how Australia could most benefit from governments providing the best environment for businesses to succeed.

But past failures should not see industry policy ignored. It is unrealistic to think that Australia can harness the potential of our regions, create the new jobs, new industries, and achieve the next wave of economic growth we need without sound industry policy.

Wasteful, unnecessarily costly or ineffective spending does not promote community benefits or provide value for taxpayers' dollars. It also leaves lost opportunities to increase funding for programs that are effective and efficient at achieving the policy goals they are designed to meet.

Each and every dollar spent by governments should promote overall community wellbeing. Spending without regard to the costs or benefits is in no-one's interests. Assessing this is not an easy task because often community benefits are hard to measure. But the challenges do not excuse not even trying.

This principle must also be upheld for the estimated $12 billion the federal government spends every year on net assistance to industry.[9]

Despite the best intentions, it is likely that some industry programs are ineffective or inefficient. There may also be duplication and overlap, and sometimes inconsistency. Some programs may have unintended consequences that actually make things worse.

However, value for money is unlikely to be achieved through ad hoc cuts and knee-jerk budget 'fixes' that diminish critical capacity and capability and create bigger problems down the track.

It demands systematic processes and fundamental cultural change with a view to delivering sustainable outcomes over time. In some cases, achieving cost-effective outcomes will require upfront investments – in systems, infrastructure and, importantly, in people.

It will also require an open and direct conversation about the appropriate role of government provision and funding versus the role and responsibility of businesses.

Australia needs a stocktake and assessment of existing industry policy expenditure

The Business Council calls for government to undertake an immediate stocktake of expenditure on existing industry policy and programmes to assess:

- whether its investment is directed towards strengthening traditional, emerging and frontier capabilities rather than siloed industries
- the extent of collaboration between research institutions, business and government
- whether there are robust checks in place to withdraw funding for policies and programmes that fail to achieve agreed outcomes.

A comprehensive stocktake would allow government to:

9. https://www.pc.gov.au/research/ongoing/trade-assistance/2017-18/trade-assistance-review-2017-18.pdf

- prioritise capabilities that are critical to accelerating economic growth and implement a reimagined industry policy framework
- reallocate funding into projects with the greatest potential
- leverage its investment by incentivising private sector investment into identified capabilities with secure, sustainable funding.

Design is key to a reimagined industry policy

Australia needs to institute a clear framework to design and evaluate industry policy. This will enable governments to effectively audit whether the money they spend across all industry policy is targeted to the areas with the greatest capacity to grow.

A well-designed industry policy framework would:

1. set out the purpose and desired outcomes of any policy initiative
2. align funding timelines to the project, not the budget cycle, to ensure they are realistic and linked
3. embed a culture of evaluation, starting with rigorous and robust evaluations of projects
    - evaluations should be underpinned by more effective collection and analysis of performance data
    - budget bids for new or continued funding should be required to demonstrate that a thorough whole-of-program evaluation has been undertaken
4. retain the ability to change course of action based on the outcomes of an evaluation.

Government should focus on a small number of precincts of national significance

- Precincts for technologies and new industries have potential to harness the characteristics of place-based investment, the benefits of collaboration and the intrinsic value that comes from having a shared purpose.
- But in a country of just 26 million people, we should not have hundreds of them.
- If Australia has too many, we risk diluting their potential and we will not get precincts working at sufficient scale.
- Federal and state governments should work together to audit the number of precincts currently operating in Australia.
- Together, governments should direct funding towards a small number of precincts of national significance. These precincts must be stand-out examples of collaboration if they are to thrive.
- Industry must be genuinely consulted and have a seat at the table.

A well-designed industry policy framework should:

- deliver maximum value for the $12 billion of taxpayers' money being spent by the federal government on industry assistance each year
- ensure that programs achieve what they set out to achieve
- ensure that wasteful spending is not crowding out potentially valuable spending – or lower taxes
- allow government to invest at scale in identified capabilities.

Modern industry policy isn't about pretending that we can stop change, rather it's about adapting to and accepting change. It's about removing barriers to our success and focusing on our strengths.

Creating new sources of value is vital to long-term growth. Australia's natural advantages (such as our warm climate and abundance of natural resources) allow us to compete on an international scale, but these natural advantages do not guarantee our success.

Instead, Australia must build a culture where new ideas and identifying new sources of value are encouraged. This means identifying the traditional, emerging and frontier capabilities that will support our traditional products and services as well as prepare us for the jobs and industries of the 21st century.

To find Australia's next wave of growth, we need a culture in this country, and in government, where new ideas and identifying new sources of value are encouraged.

An R&D Tax Incentive that supports and retains R&D investment in Australia

Global R&D investment is highly mobile and operates in an intensely competitive environment as countries seek to attract this investment. Many factors influence companies' decisions on locating R&D investment, some of which, like a skilled workforce, count in Australia's favour. But the competitiveness of a country's tax system, which includes the R&D Tax Incentive, is nonetheless critical for attracting investment.

As other countries become more attractive investment destinations, the risk is that the marginal R&D investment dollar moves overseas. This is particularly the case as international company tax rates decline and other countries introduce more competitive R&D tax incentives – such as the recently introduced changes in New Zealand. But business expenditure on R&D:

- has fallen an average 1.5 per cent a year since 2010-11 in real terms
- fell from 1.3 per cent of GDP in 2010-11 to just 0.9 per cent of GDP in 2017-18.[10]

The R&D Tax Incentive recognises that the wider productivity and economic benefits of much commercial R&D activity cannot be adequately recouped by those bearing the costs, resulting in under-investment from a whole-of-economy perspective.

[10] ABS cat. no. 8104.0.

Changes to the R&D Tax Incentive were proposed in the 2018-19 Budget, and the Business Council endorsed the objectives of those changes "to better target the program, and improve its effectiveness, integrity and fiscal affordability". However, the proposed intensity measure rewards certain company structures – not necessarily R&D spending. It will disadvantage large companies that employ, operate, purchase materials and conduct R&D in Australia relative to companies that primarily conduct R&D.

The value of R&D Tax Incentive claims processed by the ATO fell over $1 billion, or around a fifth, the past two years – driven by a reduction in claims by larger companies.[11] The number of claims processed also fell around 5 per cent over the same period. Policy or administrative issues that limit R&D support for larger businesses could be counterproductive as ABS data show that they have a greater propensity to innovate.[12]

Tax incentives for R&D have been changed, or changes have been proposed, multiple times in recent years – including both policy and administrative changes. This has created uncertainty and made it difficult for businesses to plan confidently, and likely limited the success of various schemes. Successful innovation policies overseas have been underpinned by frameworks that have been maintained for long periods.

R&D investment could be better supported by:

- repealing the R&D expenditure threshold (it is due to expire 1 July 2024), or at least increasing it to $150 million
- ensuring the scheme is administered consistently and predictably to avoid undermining confidence in it, and to provide claimants with certainty
- simplifying and reducing the administration and compliance costs borne by business and government
- introducing a collaboration premium of up to 20 per cent on non-refundable tax offsets to incentivise collaborations between industry and public research organisations and universities[13]
- not reducing the overall support or incentives for business expenditure on R&D, with consideration given for the balance between grants, tax incentives and business and university collaboration.

[11] Australian Taxation Office Annual Report 2018-19

[12] ABS cat. no. 8158.0.

[13] As recommended by *Australia 2030: Prosperity through Innovation*, and the *Review of the R&D Tax Incentive*.

3. LONGER TERM FOOTING FOR SUCCESS

Key points

Underlying spending pressures and broader challenges will continue to build over the long term. The state of the economy will also evolve over time.

It is therefore critical that we better understand the long-term outlook of the economy and federal, state and territory budgets, and the major risks Australia faces. This is also important for making sure that we remain on track and to better inform decision-making.

Australia must also confront the need to move to a more modern, sensible mix of taxes that will best promote the wellbeing of the Australian community and support job creation.

REFORM OF THE IGR

Improving Australia's long-term fiscal sustainability

Understanding the long-term outlook of the economy and federal, state and territory[14] budgets, and the major risks Australia faces, puts current policy decisions in a crucial long-term context. It can help our governments make decisions which set Australia up to succeed in the decades to come.

Australia was at the forefront of recognising the importance of regularly reviewing and reporting on the long-term sustainability of the budget. In the mid-1990s only four OECD countries were doing this. By 2009, the number of countries had increased to 27.[15]

Intergenerational reports (IGRs) by the federal, NSW and Tasmanian governments have built our understanding of the longer-term spending and economic pressures Australia faces, particularly from an ageing population.

However, Australia does not have a combined picture of the long-term fiscal outlook for all governments. In addition, as a country, we need to look more broadly at the major long-term economic and fiscal risks we face, not just an ageing population.

We must also ensure that Australian IGRs are not turned into political tools. Independent, non-partisan IGRs are the gold-standard world-wide.

While a four-year forward estimates period remains an appropriate timeframe to present decisions made in the budget, increasingly governments also need to be planning over 10-year horizons. This is where IGRs can provide an essential long-term context for short and medium-term planning.

After more than 20 years since the first Intergenerational Report was published in Australia as part of the federal budget, now is a good time to reflect on ways to improve how all Australian government's report on their long-term fiscal outlook and learn from best-practice

[14] Hereafter, references to the states includes states and territories.

[15] Anderson and Sheppard, 'Fiscal futures, institutional budget reforms, and their effects: What can be learned?', *OECD Journal on Budgeting*, Vol. 9(3).

around the world so that IGRs continue to serve the Australian community well in the decades to come.

The community benefits of a stronger fiscal position

The Business Council has consistently advocated for a stronger fiscal position for Australia. This is not an end in itself, however.

Budget surpluses with low levels of net debt provide the country with policy ammunition to deal with the next global or domestic economic shock. While the federal budget is expected to return to surplus, it needs to remain there for some time to lower government debt. A materially lower level of debt would give Australia more ability to deal with negative economic shocks.

The focus on reducing budget deficits is very important, but how the deficit is reduced is equally, if not more critical. Fiscal discipline is needed to ensure the community gets better value for the money government spends on its behalf. Each and every dollar spent by governments on behalf of taxpayers should promote overall community wellbeing.

Improving Australia's intergenerational reports

The federal, NSW and Tasmanian governments should make improvements to their IGRs and the remaining states should start producing their own IGRs. IGRs are a crucial tool to help governments plan, not only over the forward estimates but for the next decade.

The framework provided by the *Charter of Budget Honesty Act 1998* has served Australia well at the federal level. The Charter requires that the federal government produce an Intergenerational Report every five years, with the fifth report due by early 2020. As the IGR has evolved over time, it continues to largely successfully fulfil the ambitions set out in the Charter. However, it also has limitations that should be addressed.

Among the states and territories, currently only the NSW and Tasmanian governments produce intergenerational reports. This needs to change, so we can fully understand the long-term fiscal pressures Australia faces.

Intergenerational reports should be independent

Intergenerational reports should be independent and non-partisan. This is the gold standard world-wide. In the UK, Canada and the US, the long-term fiscal sustainability reports are produced by independent authorities. In New Zealand, it is a document of the Treasury, not of the government.

To ensure the federal IGR is independent and non-partisan, the Business Council calls for the government to move responsibility for the IGR to the Parliamentary Budget Office (PBO). State governments should also make their existing or new IGRs independent of government.

An ageing population is not the only long-term risk facing Australia

To date, Australian IGRs have primarily focused on the impact of an ageing population on economic growth and government spending. This analysis should continue. However, there is also a case for future IGRs to examine other long-term policy challenges and risks beyond ageing: climate change, off balance sheet equity investment in infrastructure and chronic disease, for example.

Make all IGRs more accessible and transparent

The community should be able to easily assess the merits of the government's and parliament's fiscal choices. Information, clearly and accurately presented, provides a sound basis for our democratic choices.

Fiscal transparency also has indirect benefits. The IMF has found that there is a relationship between fiscal transparency and how a country is perceived in global markets including credit ratings and foreign investment.[16]

While there is an inescapably large degree of uncertainty when making long-term economic projections, detailed analysis of the main risks and assumptions can help to manage this risk.

- Thorough sensitivity and scenario analysis of the main economic, demographic and policy assumptions is essential. For example, setting out population and migration scenarios could usefully inform current and future settings in the migration program.
- Governments should also consider releasing short updates of the main indicators in the IGR every one or two years while maintaining the current level of detail in the five-yearly report.
- The data and modelling underpinning IGRs should be accessible and transparent to enable much greater scrutiny. Australia should follow the example of New Zealand's Treasury which makes its long-term fiscal model and assumptions publicly available.

We need to understand the long-term fiscal outlook for the whole country

We need to understand the long-term budget position of the whole nation – federal, state and territory governments. In total, federal and state governments spend around 36 per cent of GDP or around $700 billion each year on public services.[17]

Given the complexity of federal financial relations and the political and policy tensions that can emerge amongst governments, understanding and assessing the fiscal state of the federation as a whole is essential. Delivering better services for Australians will ultimately require federal and state governments to work together to prepare long-term national reforms and plans. This also means we must consider the pressures, risks and sustainability of the various taxes across the federation. Combined with spending, the sustainability of the tax system is also a key component of the long-term fiscal outlook of the nation.

The Business Council agrees with others including the OECD and the Grattan Institute that Australia needs a full picture of the nation's long-term fiscal outlook, and that any cost-shifting between governments should be highlighted.

This is why the Business Council welcomes the NSW Review of Federal Financial Relations. It provides an opportunity to assess how the federation is functioning and to have a national discussion on appropriate governance, funding arrangements and allocation of

[16] IMF, *Fiscal Transparency, Accountability, and Risk*, 2012.
[17] Australian Government, *Budget 2019-20*

responsibilities across the federation. A well-functioning federation underpins efficient delivery of government services and better community outcomes for each dollar spent.

Recommendations

Improving the federal IGR

- Intergenerational reports should be independent and non-partisan. The Parliamentary Budget Office is the most suitable authority to undertake the task.
- Intergenerational reports should include long-term projections under both 'currently legislated' and 'proposed' government policies. The reasons for any large differences in the two scenarios should be clearly explained.
- Expand the scope of the IGR beyond the economic and fiscal risks of population ageing. This could include climate change, off-balance sheet equity investment in infrastructure or chronic disease.
- The PBO should consider releasing short updates of the main indicators in the IGR every one or two years while maintaining the current level of detail in the five-yearly report.
- Conduct sensitivity and scenario analysis on the main economic, demographic and policy assumptions. Such analysis can help inform national discussions around population policy, for example.
- Compare the latest projections with past IGRs and actual outcomes. Explain the cause of any substantive differences.
- Publish the full set of assumptions and data to aid transparency, contestability and scrutiny of the work.
- The IGR should contain more analysis on the pressures, risks, adequacy and sustainability of the various taxes across the federation. This could help identify priority areas for reform.

All states should produce an IGR

- State PBOs or treasuries should produce independent IGRs guided by international best-practice.
- All recommendations in this report to improve the federal IGR should also be considered by state governments.

Creating a national IGR

- An assessment of Australia's long-term fiscal sustainability should include all levels of government to give a full picture of Australia's fiscal outlook and highlight any cost-shifting between tiers of government.
  – On the advice of PBOs and relevant state and territory experts, first ministers should agree to a national framework through COAG which will form the basis of all IGRs in Australia. This framework would then underpin each jurisdiction's independent, non-partisan IGR so that the long-term budget position of the whole nation can be brought together.

- Alternatively, the federal PBO could estimate federal and state fiscal outlooks using ABS Government Finance Statistics guided by experts with state government experience.

LONG TERM TAX REFORM TO DRIVE GROWTH

The Business Council has long advocated for comprehensive tax reform. Australia needs to move to a more modern, sensible mix of taxes that will best promote the wellbeing of the Australian community and support job creation. It is not about one tax, but the combination of taxes, and setting an overall tax mix that is most able to achieve the goal of growing the economy and creating jobs while funding vital government services across the federation. An IGR that better considers the sustainability of the various taxes across the federation can help to identify the priorities for long-term tax reform. It could also help to keep track of personal tax and the effects of bracket creep.

The overarching objective of tax reform over the medium term must be to redesign and improve the tax system by shifting from less efficient taxes to more efficient ones. This should reduce the average economic burden of raising each dollar of revenue. While a tax system that promotes economic growth must be the primary objective of reform, the tax system as a whole must also be equitable, have integrity, provide a stable revenue base and be as simple as possible.

The Australian economy faces immediate and long-term challenges and uncertainties, from its ageing population, shifting global economic forces and digital technologies. Ultimately the current tax system must be fit-for-purpose to take on these challenges, which means addressing issues such as:

- the over-reliance on direct taxation
- the mismatch between federal and state taxes and spending
- the volatile and inefficient state tax base (notably stamp duties)
- a globally uncompetitive tax rate for larger companies, and
- fragmented payroll tax regimes.

The Business Council continues to call for:

- improved work incentives, especially around the tax/transfer interface for low income earners
- progressively lowering the company tax rate to 25 per cent to make all businesses more competitive in the global contest for investment
- better harmonise payroll tax bases
- more neutral tax treatment of savings income, such as capital gains, rental income and interest on savings deposits.

Bracket creep must be constantly managed

The Business Council strongly supports the government's legislated Personal Income Tax Plan. Australians will have more money in their pockets and the economy will receive a much-needed boost. The reforms remove disincentives that discourage workers from entering the workforce, working extra hours, or getting a new job. It achieves this while maintaining a progressive and fair tax system overall.

The Parliamentary Budget Office recently observed that average tax rates will continue to rise over the next decade, particularly for low income earners. This is because bracket creep will continue in the years following the legislated tax cuts. As the Business Council has previously noted, the Plan does not fully eliminate bracket creep but the changes are a positive step and provide the foundation for broader reform. In addition, bracket creep disproportionately and unfairly hurts lower- and middle-income earners.

The PBO analysis simply illustrates that constant recalibration or indexation of tax thresholds is required to manage bracket creep.

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