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Productivity Review Inquiry
Productivity Commission
GPO Box 1428
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Productivity Commission Annual Productivity Review

Submission on behalf on the Australian Taxpayers' Alliance

Introduction

1. The Australian Taxpayers' Alliance (ATA) welcomes the decision by the Australian Government to undertake a 12 month inquiry into Australia's productivity and to provide recommendations on reform.

2. The ATA is a grassroots, free-market advocacy group, consisting of over 25,000 members. The ATA stands for promoting efficient government, personal responsibility, federalism and rolling back the regulatory state. The ATA expresses thanks the government for this opportunity to participate in the discourse to increase productivity within Australia in order to promote a strong and robust economy that will continue to be a world leader in economic growth and positive financial results.

3. The discussion paper that frames the inquiry will be carefully considered including key aspects of the labour market, the role of government policy as a driver for productivity and taxation, providing a wide range of ideas for reform that are included in this submission. There will also be a consideration of practices from other countries to learn from the lessons in other jurisdictions as recommended by the discussion paper.

4. The ATA puts forward the following policy recommendations to improve levels of productivity that will be discussed in extensive detail:

    a. Removing restrictions on foreign direct investment.
    b. Reducing capital gains taxation to a flat rate of 15%.
    c. A formal Inquiry into existing industrial relations, in relation to the *Fair Work Act 2009 (Cth).*
    d. Reforming minimum wage legislation.
    e. Taking a new approach to education and education expenditure.
    f. Reducing company taxation to a flat rate of 25% within the next three years.
    g. The adoption of functional regulations to disruptive technologies.

5. The submission will precede these policy proposals with an assessment of the 2016 Budget. Further exploration into the extent of challenges and the feasibility for reform should be considered to facilitating the conditions for increased productivity.

6. The Australian Taxpayers Alliance recognises that productivity growth is a long term factor for growth in the Australian economy and living standards. Since the mid-1980s, it is evident that growth in productivity is a factor in more than 80 percent of rising material living standards in Australia and increases in wages.[1] The ATA notes that the government has an influential role on productivity growth, including the regulations and policies on foreign domestic investment would have a significant impact on the ability to fund domestic investment opportunities which would be crucial to the productivity growth in Australia across various sectors.

[1] Productivity and Position Paper. A Working Paper for the National Reform Summit Commissioned by the Menzies Research Centre. Menzies Research Centre July 2015 p 4

Brief overview of the Budget

7. In the 2015 – 16 budget reduced the tax rate for small business with up to $2 million in annual turnover to a rate of 28.5%, a modest 1.5% reductions. These major policy decisions by the government and their commitment to reducing the company tax rate is welcomed by the ATA as the reduced company taxes will increase the cash flow of businesses and increase their capacity to further engage and contribute to the economic growth in Australia. The reforms that included changes in the entry thresholds for Pay-As-You-Go instalments that benefitted 447,000 businesses and generated $2.45 billion in annual savings is acknowledged to have allowed businesses more time to focus on developing new ideas and growing.[2] This is particularly significant for small businesses as they experientially a relatively higher regulatory burden in their proportional costs than large businesses in the same industry.

8. The 2016-17 budget provided a preliminary assessment on the Australian economy and opportunities by the government to implement certain decisions and policies that would have had a significant impact on driving productivity growth. The Commonwealth budget revealed that gross government debt was $499 billion and reveals the need for long-term structural reforms in order reduce government liability.

9. The ten year enterprise tax plan aims to increase investment and promote employment outcomes through the introduction of a $9.2 billion package of tax reforms. This plan that reduces company tax that would reduce tax rates for all companies to reach 25% by 2026-27 is a modest approach in reducing the corporate tax in Australia and the ATA submits that this be accelerated for a more swifter reduction over 3 years.

10. A common theme that will be recommended to the Government as submitted by the ATA is to promote changes that make it easier to invest in Australia and to allow for alternative sources of investment capital in the economy. The ATA supports the introduction of two new collective investment vehicles for investors and the changes to the taxation treatment of asset backed financing.[3] Through a recognition that the vast investment opportunities cannot be funded by domestic savings alone, the budgetary measures to encourage foreign investment to provide a framework that will allow foreign investors to see Australia as an assessable opportunity will be critical to the potential for productivity growth.

11. The ATA welcomes the Government initiative to reduce the red tape for businesses by bringing about changes that would allow businesses to comply with regulations and laws in a smoother manner. The targeted changes to simply Davison 7A of Part III of the Income Tax Assessment Act 1936 and the amendments to amend rules with appropriate transitional arrangements and the ability for businesses to voluntarily correct arrangements without penalty through the self-correction mechanism is recognised to be a positive step.[4] The ATA submits that the government continues this ambition to provide greater certainty, to reduce the costs and burden of red tape by allowing businesses to focus on their important responsibilities given their pivotal role in the Australian economy.

Remove Restrictions on Foreign Direct Investment

12. Australia requires foreign investment to meet the constant shortfall of domestic savings for domestic investment needs which has a profound impact on productivity growth in the Australian economy.[5] Historically, the opportunities in Australia for domestic investment has outweighed domestic savings. This shortfall is accounted for by foreign domestic investment, an essential source to fund the formation of new capital that underpins the long term productivity and economic growth. With half of Australia's overall capital stock accounted for by foreign investment accounts, FDI plays a pivotal role in ensuring productivity growth in Australia.[6]

13. ITS Global estimates that the approval process of foreign investment and the cost of delays amounts to $4 billion, an annual cost from the administration of the regulation scheme of FDI in Australia.[7] This is a significant cost and provides

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[2] Cutting Red Tape. Budget 2015, Australian Government. Accessed online on: http://www.budget.gov.au/2015-16/content/glossy/sml_bus/html/sml_bus-09.htm

[3] Making it Easier to Invest in Australia. Tax Fact Sheet 05. Budget 2016, Australian Government. Accessed online on: http://www.budget.gov.au/2016-17/content/glossies/tax_super/downloads/FS-Tax/05-TFS-Making_it_easier_to_invest_in_Australia.pdf

[4] Ibid

[5] Foreign Investment Policy in Australia: A Brief History and Recent Developments. Treasury Archive 1999 pp 63 – 70 p 63

[6] Access Economics, 'Foreign Investment in Australia' (Report prepared for the Business Council of Australia, 2010) p 3

[7] 'Foreign Direct Investment in Australia — The Increasing Cost of Regulation' (Report, ITS Global, 2008), 21.

a great opportunity for reform in order to streamline the process so that investors are not deterred from pursuing opportunities in Australia as a consequence of the various red tape and regulations.

14. A comparison with other countries exemplifies the need to continually reform the FDI regime to ensure that the Australian economy is an attractive destination for foreign investment. Recently there has been a protectionist trend as demonstrated in the US elections, resulting in an impact on investment policy. The ratio between a liberal national investment policy and the restrictive counterparts has fallen from 94:4 in 2000 to 75:25 in 2012 highlighting this protectionist shift.[8] However, given the need for foreign investment to continue to fund the various opportunities and needs in the Australian economy, the ATA submits that the Government continue to reform the current regulatory regime to ensure that any changes will reduce the restrictions for foreign investment, instead of promoting an environment that becomes increasingly restrictive.

15. Therefore, the ATA submits that any restrictions on FDI should be carefully considered as government intervention could have an adverse impact on the allocation of capital stock and the return on capital assets would be misaligned. An example for Australia's need for foreign capital and the importance to ensure that domestic opportunities are met is evident through an ANZ Banking Group study that recognised that the agricultural sector would require $600 billion by 2050 to upgrade food supply chains to meet the changing demand.[9] Another investment gap is found in other sectors such as in infrastructure where there is a $750 billion shortfall.[10] Given Australia's historically low domestic savings and investment, the potential for growth in Australian productivity requires the supplementation of foreign direct investment. The contemporary approach in the regulation of FDI has led to multiple restrictions and costs on the Australian economy. [11]

16. An analysis of China as a major trading partner shows their level of FDI in the United States is on par to New Zealand and Austria.[12] With China's potential for foreign investment estimated to be at $US 2 trillion in 2020, Australia would benefit greatly from the growth of Australian FDI and a regulatory regime that would attract foreign investment rather than increasing the burden and costs for investing in Australia.[13] The reduction of screening thresholds[14] introduction of the Corporate Collective Investment Vehicle in the 2016-2017 budget is recognised by the ATA as an important step to encourage investment from the Asia region. The ATA submits that these measures are a step in the right direction as these vehicles would assist Australians to have access to the Asia Region Funds Passport and lead to better networks with financial markets in the Asia region.

Reforming Capital Gains Tax

17. Legislation introduced in 1999 to reduce capital gains taxation by 50% for assets held longer than a year is no longer sufficient for an internationally competitive or productive economy. In contrast to Australia's current rate of taxation, both New Zealand and Singapore have no capital gains tax at all.[15] Even the United States with one of the highest corporate taxes in the OECD has a maximum CGT of 20% where this can reach 45% in Australia. A removal of CGT should begin with reducing current taxation to a flat rate of 15%. This would provide incentives for asset and shareholders to realise their gains instead of withholding the sale to delay the costly CGT liability. This would in turn provide improved market conditions for greater levels of domestic investment and growth.

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[8] United Nations Conference on Trade and Development, World Investment Report 2013 (2013), 93.

[9] ANZ Bank, 'Greener Pastures: The Global Soft Commodity Opportunity for Australia and New Zealand' (ANZ Insight, Issue Four, 2012).

[10] Australian Government, Infrastructure Australia, Australia's Public Infrastructure — Part of the Answer to Removing the Infrastructure Deficit (2012).

[11] Regulating Foreign Direct Investment in Australia: A Discussion Paper. Financial Services Institute of Australia, February 2014 p 21

[12] Daniel Rosen and Thilo Hanemann, 'An American Open Door? Maximizing the Benefits of Chinese Foreign Direct Investment' (Asia Society Special Report, 2011), 18.

[13] [13] Daniel Rosen and Thilo Hanemann, 'An American Open Door? Maximizing the Benefits of Chinese Foreign Direct Investment' (Asia Society Special Report, 2011), 34.

[14] Kirchner, Stephan. Foreign Direct Investment in Australia Following the Australia – US Free Trade Agreement. Melbourne Institute of Applied Economic and Social Research. The Australian Economic Review, vol. 45, no 4 pp 410 – 21 P 419

[15] Taxploitation II. Tax Reform for Incentive, Productivity and Economic Growth. Edited by Robert Carling. Centre of Independent Studies July 2011. p 9

A Review into existing Industrial Relations legislation

18. 70% of the 11.8 million working Australians were affected by federal workplace laws, a profound statistic of the impact of workplace relations and regulations over the labour market.[16] The Menzies Research Centre recognises that there are certain drivers and enablers of productivity, in which flexible labour laws can profoundly contribute towards innovation.[17]

19. A comparison between the difference of a particular country's performance reveals that between 1995 and 2004, the growth rate for labour productivity grew 1.3 per cent for the 15 oldest member countries in the European Union. The rate of 2.4% is close to Australia's long term average and is courtesy of a flexible labour market in which "price signals encourage movement of resources into profitable opportunities and out of unprofitable ones".[18] These estimates of labour productivity suggests where there is lesser regulation",[19] this is conducive to an environment that fosters greater productivity growth. The ATA submits that removing bureaucratic red tape would allow for the efficient movement of labour resources.[20] The efficient allocation of resources through market competition forces companies to be innovative in the pursuit of profitable outcomes. A flexible labour market without layers of regulations would likewise be vital to improve productivity.

20. The Royal Commission in Union Corruption has also shed light on a range of criminal practices such as extortion and variety of additional costs of doing business in Australia. The ATA congratulates the Australian Government in re-stablishing the Australian Building and Construction Commission and submits that businesses and unions be subject to the same laws, that these laws be enforced equitably and to keep unions accountable to the same transparency and standards of businesses.

21. The ATA submits that regulations and taxes based on business size incentivise businesses to restructure to take advantage of these benefits and is not conducive to productivity growth. Unfair dismissal laws, for example, present extensive legal and financial burdens to any business with over 15 employees[21] as well as to any employee who wishes to work more than 38 hours per week.[22] Statistics have illustrated that these laws have "a number of unintended effects on firm behaviour" in which 21.3% employers decided to hire more casuals and fewer permanent staff and 44% of employers said the management was "more difficult than it otherwise would be" following legislation.[23]

22. The ATA recommends a comprehensive review into the Fair Work Act 2009 (Cth) to assess its overall impact, advantages and disadvantages to the productivity of the resources industry. Following the implementation of the Act, $316 billion worth of approved minerals, energy and related infrastructure projects are "committed or under construction"[24] in every Australia state and territory, with an added $307.6 billion awaiting approval.[25] The Fair Work Act in its current form has reduced the capacity for employers to "engage and negotiate directly with their workforce" despite the "overwhelming desire of both the employer and employees."[26]

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[16] Workplace Relations Framework. Productivity Commission Inquiry Report: Overview and Recommendations. No. 76 30 November 2015. Productivity Commission 2015, Canberra. P 5
[17] Productivity and Position Paper. Menzies Research Centre July 2015 p 6
[18] Hancock, Keith. Bai, Tracy. Flavel, Joanne & Lane, Anna. Industrial Relations and Productivity. National Institute of Labour Studies, Flinders University, Adelaide 29th June 2007. P 29
[19] Ibid P 29
[20] Ibid P 9
[21] Unfair Dismissal. Fair Work Ombudsman. Australian Government 2016. Accessed online on: https://www.fairwork.gov.au/ending-employment/unfair-dismissal
[22] Moore, Des. Submission on Review of the Fair Work Act, February 2012. HR Nicholls Society, 2012. P 10
[23] Harding, Don. The Effect of Unfair Dismissal Laws on Small and Medium Sized Businesses. Melbourne Institute Report No. 2. Melbourne Institute of Applied Economic and Social Research, University of Melbourne. 29th October 2002. Executive Summary p iv
[24] Submission to the Fair Work Act Review Panel. Review of the Fair Work Act 2009. AMMA Resource Industry Employer Group. February 2012 p 3
[25] Ibid p 3
[26] Ibid p 4

Reforming Minimum Wage Laws

23. Relative to average earnings, Australia has the third highest minimum wage and is considered a high reliance on the minimum wage.[27] Minimum wages have significant policy implications due to their long run and short run impacts. Any potential increase in the minimum wage must be matched with an improvement in the average skills over a sustained period in order to not have adverse effects on employment prospects. Some countries have different geographically-varying rates with substantial disparities between rates across various regions such as the different minimum wage by state in Canada and Japan.

24. However there are pragmatic difficulties for its execution in the Australian system and would therefore be carefully considered. The ATA recommends creative alternatives to navigate through the challenges of minimum wages to include skill development programs that are carefully designed and targeted.[28] As minimum wages are generally earned by low or unskilled workers, a high minimum wage may discourage young people to pursue education when they are satisfied with the return of the minimum wage. Rather a framework that promotes training and education should be adopted to ensure that the labour force continues to increase in productivity. Inevitably, any consideration of an increase in the minimum wage can only be effective when there is an equal or greater increase in the productivity of the labour force.

25. In Australia, the best estimates from Andrew Leigh found that "minimum wage elasticity of labour demand" to be at 0.29, with a range from 0.24 to 0.4. With over 1 million people working, a 3% minimum wage increase would reduce labour b almost 1% and lead to increased unemployment by 100,000.[29] The ATA therefore recommends ruling out any potential legislation to increase the minimum wage, and instead adopt measures aiming at its reduction.

26. International case studies illustrate the unintended negative consequences of minimum wage laws to employment and productivity. In the Swedish house and restaurant sector, an increase in the minimum wage correlated to negative employment outcomes.[30] It was also found that the elasticity of net employment to wage costs of -0.57 demonstrated that the increase in minimum wage has a significant impact on the ability for youth to be employed at the level of the minimum wage, often pricing them out of employment. These findings must be incorporated into the discussion of improved outcome for national productivity through the reform of current minimum wage legislation.

Reforming Education

27. Education is a policy area that is often discussed alongside productivity and has a major impact on the expenditure and the budget. However Davidson and De Silva argue that it has not be shown that spending more money on education necessarily has a large impact on productivity. [31] Rather the training of workers is more crucial to increasing productivity as found by William Lewis when he observed that illiterate Latin American agricultural works were able to be trained and learn the world's best practice in the US construction industry highlighting the importance of training.[32]

Reducing the level of Company Taxation

28. Business tax reform through a reduction in the company tax rate would be instrumental to improving the productivity and facilitate continued economic growth. A important principle in approaching the taxation of companies is to minimise the effect of taxes on business decisions and to prevent the misallocation of resources. A lower company tax rate has a significant influence on the international competitive and attractiveness for foreign investment in Australia. In the United States, Christina and David Romer found a tax increase equivalent to 1% of GDP lowered real GDP by 2% -

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[27] OECD 2012

[28] Workplace Relations Framework. Productivity Commission Inquiry Report: Overview and Recommendations. No. 76 30 November 2015. Productivity Commission 2015, Canberra. P 19

[29] Humphries, John. Unseen Damage of Raising the Minimum Wage. ABC News Online, June 2012 Accessed online on: http://www.abc.net.au/news/2012-06-11/humphreys---minimum-wage/4064106

[30] Skedinger, Per. Minimum Wages and Employment in Swedish hotels and Restaurants. Institute for Labour Market Policy Evaluation, 2002 p 19

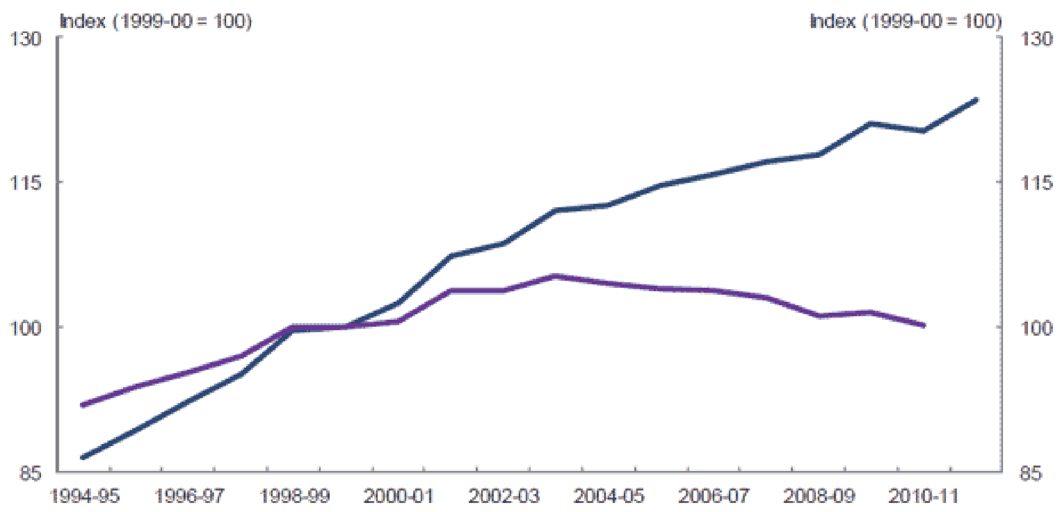
[31] Davidson, Sinclair & de Silva, Ashton. Does Australia Have a Productivity Problem? Institute of Public Affairs, March 2012. P 14

[32] William Lewis, 2004, The power of productivity: Wealth, poverty, and the threat to global stability, The University of Chicago Press.

3%.[33] While Padovano and Galli analysed data for 23 OECD countries and concluded that high marginal tax rate had a significant adverse effect with long term growth.[34]

29. Historically, the company tax rate has been reduced from 46% in the mid-1980s and will be phased to 25% in 2026-2027. The ATA welcomes this reduction in the company tax rate and submits that this phasing be accelerated so that the 25% target would be reached in 3 years. The ATA submits that the 25% should be a starting point and not the end goal for reforming the corporate tax system. This is especially with regards to an understanding that Australia's company tax rate is higher than most OECD Countries which include nations such as the United Kingdom, Canada and New Zealand.[35] The current corporation tax rate in the United Kingdom is currently 20%, while in Canada, Canadian-controlled private corporations that claim the small business deduction have a net tax rate of 11%, which would decrease to 9% by 2019. By international comparison, the Australian corporate tax is remarkably high and the ATA submits that the Government continues to pursue measure which reduce the rate of company tax in Australia. This would also allow businesses to fund their investment opportunities as the lower taxes reduces the required rate of return on investment for foreign investors, improving the competitiveness of Australia as a destination for investment.

30. Other benefits of a lower corporate tax result and the increasing capital could lead to an increase in the marginal product of labour, where 'capital deepening' would occur resulting in higher economic growth and labour productivity.[36] Higher rates of return for businesses would be reinvested within businesses and the ATA therefore urges the government to consider the various benefits of a lower corporate tax on incentivising Australia as a destination for investment.



Source: Dolman & Gruen (2012) and ABS Cat. 5206.0

31. Over the past 15 years, this graph highlights Australia's multifactor productivity, which measures the economy's ability to combined capital and labour into production, has stagnated. Increasing investment in Australia ensures that the level of capital in the economy is increased which is vital to enhance the marginal productivity of labour, resulting in subsequent productivity increases.

32. The ATA also submits an opposition to different tax rates for small and big businesses as it leads to perverse incentives that would encourage businesses from pursuing a structure that may not be productive as they seek to pursue certain

[33] Christina Romer and David Romer, The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks, NBER Working Paper 13264 (National Bureau of Economic Research, 2007).
[34] Fabio Padovano and Emma Galli, 'Tax Rates and Economic Growth in OECD Countries (1950–1990),' Economic Inquiry 39:1 (2001); and Fabio Padovano and Emma Galli, 'Comparing the Growth Effects of Marginal vs Average Tax Rates and Progressivity,' European Journal of Political Economy 18 (2002).
[35] Source: OECD tax database (2012) and weightings calculated using figures sourced from the IMF World Economic Outlook Database (2011).
[36] Business Tax Working Group Draft Final Report: The Case for a Cut in the Company Tax Rate. The Treasury, Australian Government. Commonwealth of Australia, 2012 p 2

to benefits. The proposed rates for certain businesses under a given aggregated annual turnover threshold to benefit from a 27.5% corporate tax rate as compared to 30% should be reconsidered to allow all businesses, regardless of size to be given the 27.5% corporate tax rate. This would ensure that businesses that near the threshold do not engage in practice that is not conducive to productivity or economic growth.

A Better Approach to Disruptive Technology

33. The rise of disruptive technology has paved the view that productivity in the long run will be determined by "entrepreneurial action rather than government design."[37] This is evident on a case by case basis, particularly with the sharing economy services like Uber and AirBnB, that growing opportunities for productivity depend on business and labour flexibility.[38] The ATA therefore recommends an policy approach that considers the current contribution of disruptive technologies to productivity by allowing for "bottom-up, organic, self-regulating institutions" before "introducing top-down government control."[39]

34. The ATA recommends a similar policy position for undeveloped disruptive technology that include but are not limited to cryptocurrencies such as BitCoin. A recent Productivity Commission Research Paper on Disruptive Technology stated that legislation should adopt a 'wait and see' approach when dealing with new business models and products rather than overreacting and regulating on unrealized risk.[40] Recommendations by Thierer include the adoption of a 'permissionless innovation' approach or otherwise known as the 'wait and see regulation'. [41] This would allow for products to first emerge and they would therefore be regulated on a case-by-case basis as they develop over time.

35. The ATA further recommends the adoption of regulation that harnesses the potential of disruptive technologies to change the landscape of innovation and productivity. This includes self – regulation through agencies such as the Australian Digital Currency Commerce Association[42] and a functional regulatory approach that focuses primarily on products and services as they emerge.[43]

Conclusion

36. It is submitted that although there is no single solution to increase productivity in the Australian economy, certain principles are prevalent and recurring in their thematic concerns to ensure that Australia continues to be a nation of economic growth and prosperity. The principles lead to tangible and pragmatic policy recommendations that could facilitate an unprecedented level of productivity and economic growth for Australia.

37. The ATA submits these policy recommendations to include:

    a. Removing restrictions on foreign direct investment.
    b. Reducing capital gains taxation to a flat rate of 15%.
    c. A formal Inquiry into existing industrial relations, in relation to the *Fair Work Act 2009 (Cth).*
    d. Reforming minimum wage legislation.
    e. Taking a new approach to education and education expenditure.
    f. Reducing company taxation to a flat rate of 25% within the next three years.
    g. The adoption of functional regulations to disruptive technologies.

38. The ATA notes that the implementation of the above recommendations will demonstrate key milestones on behalf of our government to achieve long lasting, sustainable productivity growth.

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[37] Davidson, Sinclair & de Silva, Ashton. Does Australia Have a Productivity Problem? Institute of Public Affairs, March 2012. P 2

[38] Allan, Darcy & Berg, Chris. The Sharing Economy: How Overregulation Could Destroy an Economic Revolution. Institute of Public Affairs, December 2014. P 4

[39] Ibid P 28

[40] Digital Disruption: What Do Governments Need to Do? Productivity Commission Research Paper. Australian Government Commonwealth of Australia, 15th June 2016. P 9

[41] Thierer, Adam. Permissionless Innovation: The Continuing Case for Comprehensive Technological Freedom. Mercatus Centre, George Mason University: 2014. P 69

[42] Potts, Jason & McDonald, Trent. Who Should Regulate BitCoin? Challenges and Opportunities for Blockchain Technology in Australia. 2016 P 29

[43] Ibid P 29

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Date of publication:

09/12/2016