

Australian Investment Guarantee

Our economy is not delivering a fair go for working and middle-class Australians. Economic growth is below trend, wages are flat-lining, more than 700,000 Australians are unemployed and around 1.1 million Australians are looking for more work.

The Government's only response a \$65 billion company tax cut – a giveaway to big business and multinational corporations. The Government's approach does not guarantee a single dollar of new investment or new jobs. It only guarantees a windfall to multinational corporations at a huge cost to the budget.

Labor has the right plan for a stronger and fairer economy – one that creates good jobs and drives wages and productivity growth. Labor has a broad suite of policies to grow human capital through substantial investments in education and skills, and our physical capital through targeted investments in national and local infrastructure.

To complement these policies, more can be done to support business investment in the near term, boosting demand, productivity and underpinning the creation of decent, well-paid jobs.

That's why a Shorten Labor Government will introduce a new **Australian Investment Guarantee** to kick-start new investment, support jobs and build the long-term capacity of our economy. Unlike the Government's company tax cut, the Australian Investment Guarantee will guarantee that every dollar spent underpins new investment.

The Australian Investment Guarantee is well targeted, fully funded and affordable. It is cost-effective and fiscally responsible, funded by Labor's reforms to the tax system.

What's the problem?

Following the mining boom, Australia suffered its worst fall in business investment in decades. Over the past five years, business investment has collapsed by 20 per cent. Despite strengthening global economic conditions, business investment in Australia has remained sluggish – largely reflecting the slow recovery in non-mining business investment which the RBA says has been “disappointingly low” in recent years.¹

The lack of business investment is partly due to weak consumption growth, weighed down by record low wages growth and high levels of household debt. The Governor of the Reserve Bank has pointed out that growth in average hourly earnings has been running at the lowest rate since at least the 1960s.² Weak consumption and demand has meant that many businesses have delayed investment plans, contributing to Australia's weak growth performance. Australia has recorded below trend economic growth (on average) since September 2013.

¹ <https://www.rba.gov.au/speeches/2017/sp-dg-2017-11-13.html>

² Philip Lowe, Address to the Australian Business Economists Annual Dinner, Sydney, 21 November.

Weak business investment not only limits demand, growth and jobs now – it means businesses are not making the necessary decisions to improve the productivity of their operations which sustains growth and jobs into the future.

The Government's answer to these problems is to cut the rate of company tax to 25 per cent, costing the budget \$65 billion over a decade. The chorus of economists questioning the government's approach is growing.

"Committing to the [corporate tax] plan now, before the budget is on a clear path to recovery, risks reducing future living standards"

Grattan Institute, February 2018

"I doubt a lower corporate tax in isolation would be of significant benefit to the Australian economy ..."

"Lower corporate tax rate is a windfall transfer of tax revenue from Australia to non-residents on existing investments, and on future investments which earn more than the required marginal return"

John Freebairn, 18 February 2018

"if we were to respond to this competition by having lower corporate tax rates here then it's really important that that doesn't come at the expense of higher budget deficits"

Phillip Lowe, House of Representatives Economic Committee, 17 February 2018

"I would say that most economists agree with the theory, but economists have struggled to prove that it works with any statistical significance in practice"

Saul Eslake, 24 February 2018

"The cost to revenue from a company tax cut would add pressure on government to reduce spending in areas such as health and education and income support, or to raise personal taxes"

Dr Janine Dixon, Melbourne Economic Forum 2016

The Government's plan would deliver windfall gains to big businesses, including more than \$7 billion for the big four banks, without guaranteeing a single dollar of new investment or a single new job in these businesses. In fact, this plan would deliver windfall gains on investments made years ago under a higher corporate tax rate. Treasury modelling confirms that estimated economic gains from the Government's approach are small and would not transpire for decades.

The biggest winners from the Government's approach are foreign multinational corporations which, while benefiting from higher profits, would be under no obligation to undertake more investment in

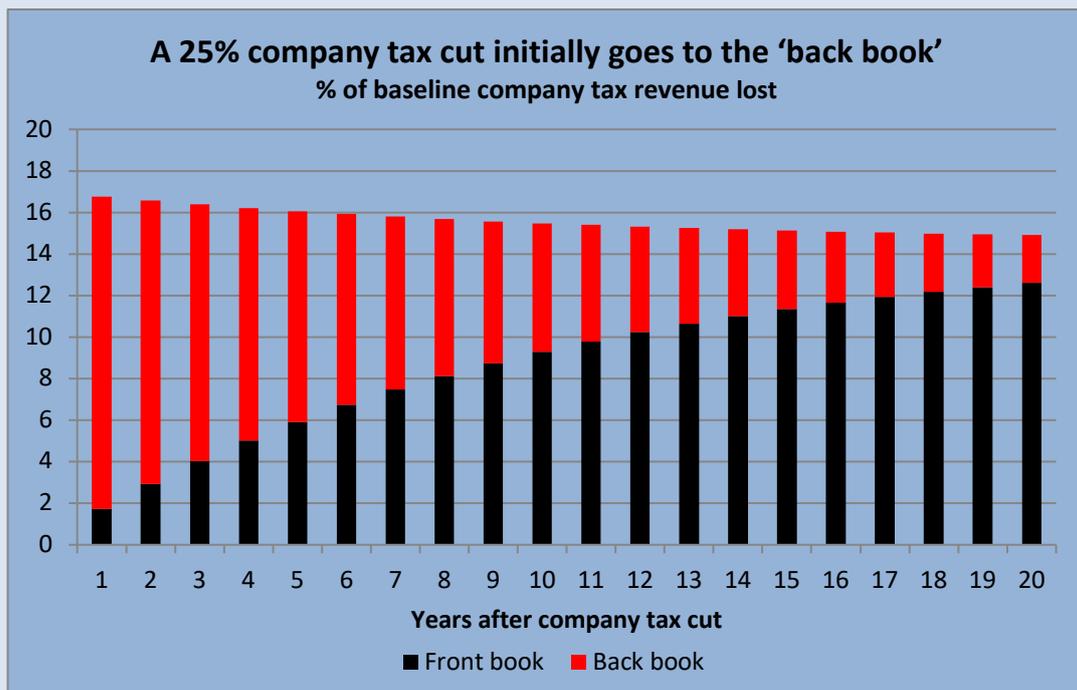
Australia. Up to 60 per cent of the Government’s company tax handout goes directly to foreign shareholders. The Government’s cut in the company tax rate doesn’t deliver benefits to domestic investors because they are subject to dividend imputation and therefore do not face the same tax arrangements that foreign investors do.

There is also evidence that the Government’s plan hurts Australian living standards. Modelling undertaken by Victoria University’s Dr Janine Dixon shows the government’s company tax cut reduces national welfare, and would leave Australians worse off by an average of \$1,600 each³.

At a time when growth in company profits has been tracking well above wages growth, and government debt is at record highs, the budget cannot afford a massive handout to multinationals. The Government’s approach would cost \$15 billion each year when it’s fully mature by the end of the next decade without any guarantee it will lift investment.

A 25% corporate tax cut is costly and delivers windfall gains to previous investments

Analysis by the Grattan Institute shows that when it comes to cutting the company tax rate to 25 per cent, a huge amount of revenue is lost over the short to medium term because it results in windfall gains for “back book” (that is, previously made) investments.



Source: Grattan analysis of ABS (2017)

This is why alternative targeted policies are a more cost-effective way of supporting investment in the economy when the budget is under pressure.

The Government’s plan is not only unaffordable, it’s unfunded. The Government is seeking to lower tax rates, without replacing the lost revenue with alternative sources of revenue.

³ <https://www.vu.edu.au/news-events/news/company-tax-cut-not-in-national-interest>

A more targeted and affordable way to boost investment

Labor understands the importance of boosting investment, to support growth and jobs now and into the future. Labor’s position on the Government’s company tax cut for big businesses and multinationals is not an opposition to boosting investment. But we do believe the Government’s plan is unaffordable, and there is a need for a more targeted and cost-effective approach over the short to medium term.

Labor’s more targeted approach is to use accelerated depreciation arrangements, also known as “immediate expensing”, which have been used in Australia and around the world in recent decades. Accelerated depreciation is where the value of an asset is written down at a faster rate in its early years, which helps to lower the taxable income of the asset owner in those years, improving the net present value of an investment, or its rate of return. Accelerated depreciation gives an immediate and direct incentive for business to undertake new investments.

There is significant evidence to suggest that accelerated depreciation arrangements are a more cost effective driver of investment and growth than reductions in the company tax rate. International Monetary Fund Chief Economist, Maurice Obstfeld, has noted that the new US tax legislation “will contribute noticeably to US growth over the next few years, largely because of the temporary exceptional investment incentives”⁴. Australian economist Saul Eslake has also observed that “the IMF is saying the thing that is providing the boost is not the company tax rates, it is the immediate expensing of investment”.⁵

“Tax incentives based on investment expenditures, such as accelerated or enhanced depreciation, immediate expensing of some proportion of capital costs and investment tax credits, provide a larger investment response for each dollar of tax revenue foregone, compared to a corporate tax rate reduction”

OECD Tax Treatment of SMEs, 2015

“alternative company tax models like accelerated depreciation or a cash flow tax can make investment more attractive”

“International evidence suggests that the ability to bring forward depreciation will increase investment”

Grattan Institute, February 2017

The benefit of accelerated depreciation is that it directly encourages new investments, ensuring every dollar spent by the government underpins new economic activity. Unlike the Government’s company tax cut for big businesses, accelerated depreciation does not confer windfall gains on previous investments made many years ago. It is not a tax giveaway.

⁴ <https://blogs.imf.org/2018/01/22/the-current-economic-sweet-spot-is-not-the-new-normal/>

⁵ Saul Eslake, The Australian, 25th January 2018

Previous forms of accelerated depreciation schemes in Australia have typically been *temporary*. However, research shows that temporary accelerated depreciation schemes can simply encourage businesses to bring future investments forward to take advantage of the larger deductions, without necessarily leading to a permanent uplift in investment. When appraising the US government’s new immediate expensing arrangements, the US Taxation Foundation notes that “permanent full expensing of all capital investments would permanently boost GDP”⁶. This is why a permanent acceleration of depreciation will help to permanently lift investment.

What Labor will do

From 1 July 2020, all businesses operating in Australia will enjoy a new Australian Investment Guarantee. This will allow all businesses to “immediately expense” 20 per cent of the value of eligible depreciable assets in the first year of all new investments, with the balance depreciated in line with normal depreciation schedules from the first year. The Australian Investment Guarantee is a permanent accelerated depreciation scheme – it will operate indefinitely.

The scope and key design features of the new Australian Investment Guarantee are:

- Eligible assets will include tangible machinery, plant and equipment for both upgrades and new purchases (for example, farm tractors and food processing machinery)
- Depreciable intangible assets (often referred to as “knowledge assets”) which make up an increasingly larger component of non-mining investment will also be eligible (for example, patents and copyrights)
- Investments in structures and buildings are excluded, consistent with previous accelerated depreciation policies used in Australia
- It would not apply to otherwise eligible expenditure currently claimed under the existing research and development tax concession
- It would not apply to passenger motor vehicles, but it would apply to non-passenger motor vehicles such as lorries, vans, utes and trucks that are used to support trade businesses
- It would only apply to eligible investments valued at over \$20,000 (with no pooling of assets allowed) to ensure it is well-targeted at productivity-enhancing investments

Because the Australian Investment Guarantee applies to depreciable intangible assets, it will include new investments in computerised technology (such as new software) and intellectual property such as patents and copyrights. This will help ensure the Australian Investment Guarantee helps drive investments in new physical capital, but also in the jobs of the future which embody more innovation and human capital.

The Australian Investment Guarantee is a pro-growth, pro-jobs reform that rewards businesses making new investments in Australia. Only companies that make the decision to invest in Australia will benefit from this tax relief, while up to 60 per cent of the Government’s company tax handout goes directly to foreign shareholders.

⁶ <https://taxfoundation.org/economic-budgetary-impact-temporary-expensing/>

Example

Under current depreciation arrangements manufacturing company A, an Australian based SME, is struggling to purchase a new \$10 million piece of machinery that would greatly enhance its productivity and output allowing it to expand and create additional jobs.

Current arrangements (without the Australian Investment Guarantee)

Under normal depreciation rules for this piece of machinery (assuming a straight line depreciation method) manufacturing company A is allowed to deduct 10 per cent or \$1 million of the \$10 million in each year over the effective 10 year life of the asset. In other words, \$1 million is deducted in the first year with the remaining \$9 million in equal proportions over the remaining 9 years. But these arrangements are not quite attractive enough to get the project off the ground.

Arrangements with Labor’s Australian Investment Guarantee

Under Labor’s Australian Investment Guarantee, manufacturing company A will be able to immediately expense 20% (\$2 million) of its investment in the first year.

The remaining 80% (\$8 million) would then be depreciated over the effective life of the asset from the first year in line with the original depreciation schedule – which in this case is 10 per cent per year, or \$800,000 of the \$8 million.

This means Manufacturing company A can write off a total of \$2.8 million in the first year (\$2 million plus \$800,000) of its investment (instead of \$1 million under existing arrangements).

This means the SME company has additional immediate cash flow, which tips the balance and triggers the positive investment decision. The company can then use the extra cash flow to bring forward other investments and hire new employees.

	2018-19	2019-20	2020-21	2021-22	Forward estimates
Total financial impact (UCB)	..	20	-1,790	-1,590	-3,360