Business Council of Australia

SUBMISSION

Impediments to business investment - Submission to the Standing Committee on Economics

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CONTENTS

The Business Council of Australia draws on the expertise of Australia's leading companies to develop and promote solutions to the nation's most pressing economic and social challenges.

ABOUT THIS SUBMISSION

The Business Council welcomes the opportunity to make a submission to the Standing Committee on Economics inquiry into *"Impediments to Business Investment in Australia"*.

Stronger investment will be crucial for future income growth

Notwithstanding some recent welcome signs of stronger growth in non-mining investment, the Business Council remains concerned about the level of business investment.

Stronger investment growth — capital deepening — will be essential for higher incomes and future growth in living standards. Capital deepening has been the single biggest driver of higher labour productivity and hence real per capita income growth in Australia for several decades.

Going forward, labour productivity — from both new investment and multi-factor productivity — will need to become an even greater driver of income growth. Labour participation will decline as the population ages. The terms of trade cannot be relied on as they could go either way.

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

Achieving this would be unprecedented in modern history, higher than the 'golden decade' of productivity growth in the 1990s when it averaged around 2.2%. This is Australia's growth challenge.

Productivity growth has been averaging around 1.2% a year over the past decade, and the Budget forecasts assume growth will reach 1.6%. Achieving productivity growth of over 2% will require a renewed focus on business investment and innovation.

Ultimately, it is businesses that must deliver stronger productivity though investing and innovating, but the environment in which businesses operate is profoundly shaped by governments, for better or for worse.

We need a circuit breaker to embed the right settings for growth including structural reforms to reduce impediments to private business investment and productivity growth.

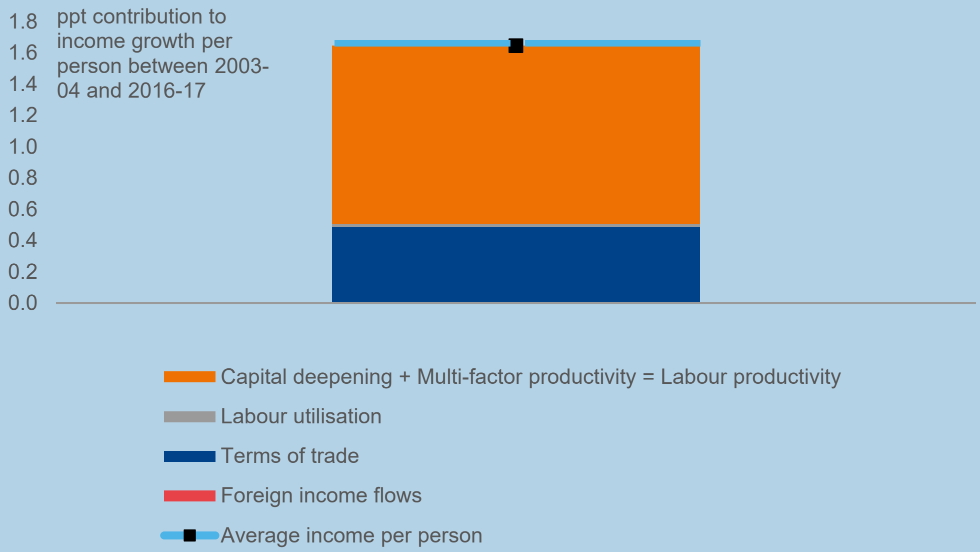
The Business Council's main priorities for promoting investment are competitive tax settings; competitive and reliable energy; efficient regulation; efficient infrastructure; productive workplaces; and a skilled workforce.

Specific recommendations in each of these areas, which have previously been drawn together in the Business Council's 2018-19 budget report "*Economic Realities: Budget Choices for a Strong Australia",* are attached.

Investment has been the main driver of Australia's per capita income growth

Labour productivity has been by far the main driver of per capita income growth in Australia in recent decades, dominating other factors such as labour utilisation and terms of trade changes (Figure 1).

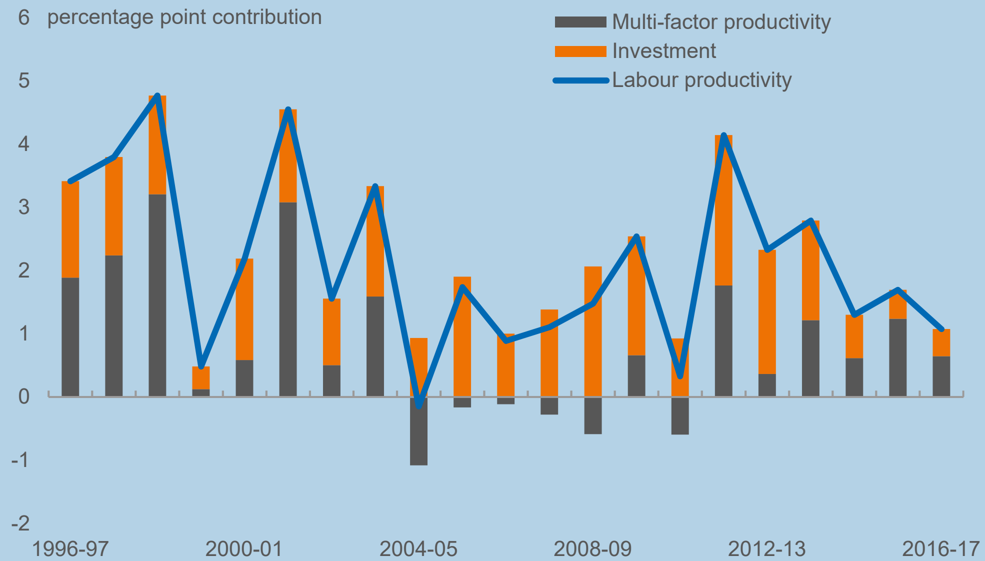
Figure 1: Labour productivity has driven growth in average income (2003-04 to 2016-17)



Source: Business Council calculation using ABS cat. no. 5260.0

Aggregate labour productivity, or national output per hour worked, reflects two things – capital deepening and multi-factor productivity growth. Capital deepening rather than multifactor-productivity has been the major driver of labour productivity (Figure 2).

Figure 2: Investment has been the main driver of labour productivity



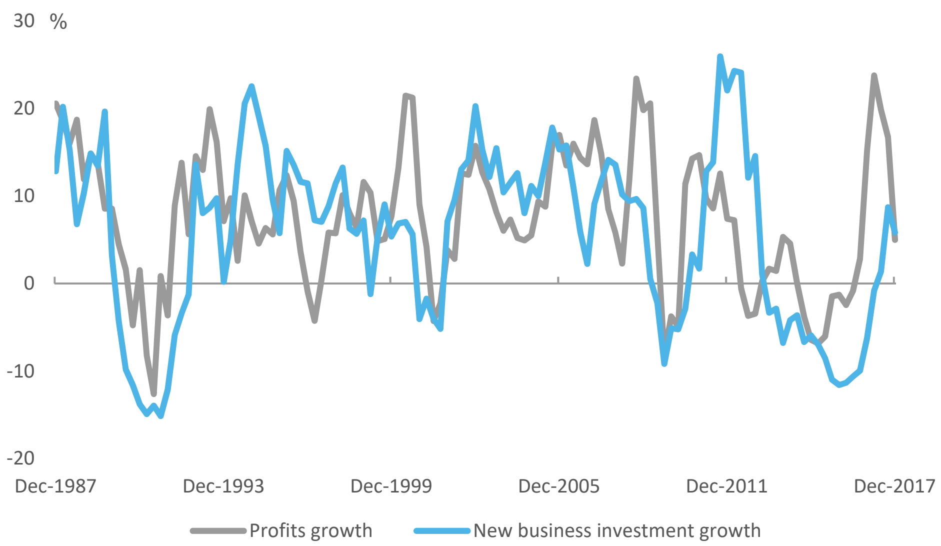
Source: Business Council calculation using ABS cat. no. 5260.0.55.002

The investment challenge

After the mining investment boom in the 2000s, it was not surprising that mining sector investment abated. Overall investment was also not expected to remain at boom levels, but non-mining investment was expected to pick up some of the slack. Instead, non-mining investment also fell over the past decade and new investment as a share of GDP dropped to levels not seen since the last recession in the early 1990s (Figure 3).

More recently, non-mining investment has picked up a little, off the back of a turnaround in business profits (in large part due to some recovery in commodity prices). Yet new investment remains low relative to GDP — 12.4%, around the same as in the mid-1990s following the earlier recession.

Figure 3: Profits and new investment growth begin to emerge from the doldrums



Source: ABS cat. no. 5260.0

Long-term structural factors may be playing some role including the growth of intangibles investment (not all of which is recorded as investment) and a continuing shift in the composition of the economy to labour-intensive services (particularly those provided and/or subsidised by the government sector such as healthcare).

But these shifts are gradual and unlikely to account for the depth of the current investment slowdown. Moreover, major export sectors are becoming more rather than less capital-intensive over time.

Treasury has observed that low investment is puzzling given apparently favourable conditions such as record low interest rates, reportedly solid business confidence and above-average levels of capacity utilisation.

However, it seems implausible that Australian companies are overlooking profitable investment opportunities. The more logical explanation is that, for many, the global and domestic economic outlooks, while showing some improvement, remain risky. Debt levels remain high and trade tensions are increasing.

As noted in this year's Budget Papers (no. 1, p. 1-9): "Globally these risks are broadly balanced in the short term, although they are tilted to the downside in the longer term".

Policy uncertainty exacerbates risk

In this climate of economic uncertainty, the political climate is exacerbating rather than easing investment risks.

Opposition to the Government's proposed modest and graduated reduction in the company tax rate from 30% to 25% for businesses with turnover above $50 million is a prime example. The passage of this legislation would have immediate benefits for investment by larger businesses which undertake the lion's share of investment. Even if enacted, the Opposition has committed to repealing it, creating another layer of uncertainty.

There are many other examples:

- There has been a decade of uncertainty in climate policy which has undermined investor confidence. A clear and comprehensive policy framework must be implemented at a national level. Companies will only invest in new infrastructure in electricity and other key industries if they can see a stable policy framework, with minimal government intervention, that will endure no matter who is in power. The National Energy Guarantee (NEG) offers a framework for achieving this but will require a great deal of work and political goodwill.

- There are some signs that the long-standing consensus about the benefits of freer trade is fracturing, as evidenced by questioning of Australia ratifying the TPP11. This new agreement has the potential to offer substantial export opportunities to Australian businesses in the fastest growing region, spurring investment and jobs.

- State governments have repudiated major infrastructure contracts and major project approvals are often subject to undue delay. This increases risk premiums for future projects.

- Uncertainty around foreign direct investment (FDI) assessment criteria has resulted in late-in-the-day rejection of proposals. The lowering of screening thresholds for FDI in agribusinesses is also of concern in an industry desperately in need of major capital injection.

While individual policy decisions may be discounted as 'one-offs', taken together, they are having significant ramifications, increasing risk and chilling decisions to invest in Australia. These atmospherics are not conducive to a rekindling of confidence and 'animal spirits'.

Impediments to doing business in Australia

Businesses are doing everything within their control to improve their productivity in a far more competitive environment, including investing in cost-saving technologies and processes. For example, the mining sector has managed to implement quite remarkable productivity improvements to reduce costs in existing mines.

But businesses face many cost and investment hurdles outside their control:

- Reducing the company tax rate for larger businesses is becoming more urgent by the day. Since 2008, almost two in every three industrialised nations have reduced or are planning to reduce their rates. In this rapidly changing global environment, the government's 10-year plan will barely keep Australia in the game. A company tax rate of 25% in 2026-27 is still above the current OECD average of 24% and Asian average of 21%. As the rest of the world moves, not changing our rate is akin to increasing it. This increases the marginal burden of the tax: that is, the harmful impact on investment and growth increases.
- The Business Council's *Competitive Project Approvals* report published in December 2016 notes that major project assessment complexity and delay can add as much as $2 billion to a project's costs and that uncertainty has led companies to defer or redirect some $150 billion of investment overseas.
- Notwithstanding some welcome efforts to reduce red tape, the cumulative burden of regulation on business is increasing not decreasing. All too often, regulation and intervention are the first resort of policy-makers to deal with a perceived market failure and cost-benefit assessments are either by-passed or given mere lip service. Excessive regulation risks undermining the incentives that drive businesses to invest and innovate in the first place.
- Australia's workplace relations framework continues to place a drag on flexibility and productivity improvement, including for greenfield developments.
- Rising energy costs and supply uncertainty flowing from inconsistent carbon emissions reduction policies are jeopardising existing business operations let alone new investments in Australia. Progressing the NEG will be critical for providing a more stable investment framework. Replacement of gas exploration moratoriums in some jurisdictions with scientific assessments would directly encourage exploration investments.
- Investment does not occur in a vacuum — it requires people with appropriate skills. It is important that Australia invest in skilling its own people as well as allow flows of people with complementary skills from overseas.

RECOMMENDATIONS

Priorities for growth over the next 12 months

Priority: Start making the tax system fairer and more competitive

- Enact the full Enterprise Tax Plan to reduce the company tax rate to 25% for all businesses over 10 years.
- Provide bracket creep relief for lower and middle-income earners.
- Maintain the R&D Tax Incentive scheme to encourage innovation activity across enterprises while reducing administrative costs and complexity. An intensity-based scheme will bring unintended consequences and add complexity.
- Continue to ensure and promote trust in the integrity of the tax system.

Priority: Make it easier to do business and modernise workplace relations

- All jurisdictions agree a reinvigorated program of regulation reform, leveraged by incentive payments, that prioritises:
  - streamlined major project approval processes
  - simplification of zoning restrictions
  - liberalisation of retail trading hours.
- Clearly define conduct that is prohibited under section 46 of the *Competition and Consumer Act 2010*.
- Reformulate the *Fair Work Act 2009* as a matter of urgency:
  - Allow Enterprise Agreements to be approved if employees covered by the agreement 'on the whole' are better off under the agreement compared to the award.
  - Begin to limit the scope of what can be included in agreements.

Priority: More reliable, affordable and sustainable energy

- Progress implementation of the National Energy Guarantee through the COAG Energy Council in consultation with industry.
- Remove state-based emissions targets inconsistent with the Guarantee.
- Replace moratoriums on gas exploration with evidence-based, project-by-project assessment.

Priority: Efficient infrastructure for growing cities and regions

- Stop using major infrastructure projects as political footballs — governments should agree to fund high-priority projects on Infrastructure Australia's (IA) priority projects list.
- Reinstate 'asset recycling' initiatives to incentivise state and territory governments to privatise infrastructure assets and reinvest the proceeds into new infrastructure.
- Agree an intergovernmental infrastructure reform agenda that implements the planning, pricing and procurement reforms in IA's plan.
- Streamline approval processes.

Priority: Better choices for future proofing through skills and education

- Begin work to adopt the tertiary model set out in the Business Council's *Future Proof* discussion paper to establish a culture of lifelong learning centred around the needs of individuals and their working lives.

Priority: Champion open trade and investment

- Enact the TPP11 as soon as practicable.
- Reverse the lower screening thresholds introduced for FDI in agribusiness.
- Continue to champion and uphold the international rules-based trading system.

Priorities for growth over the medium term

Priority: Fairer, more competitive taxes

- Implement broader tax reforms to reduce the overall burden of the tax system on individual and business enterprise, reduce distortions and complexity, and to shore up the national revenue base in the face of increasing international mobility of capital and people and the structural erosion of other bases.
  - Restructure personal income tax rates to relieve work disincentives posed by higher effective tax rates.
  - Introduce more neutral and fairer treatment of savings income.
  - Examine the retirement income system holistically.
  - Reduce reliance on stamp duties and shift gradually to broader based land taxes.
  - Harmonise payroll tax rules across the states and territories.
  - Simplify taxes and improve integrity and voluntary compliance.
- Explore deeper restructuring of tax bases, including greater reliance on the consumption tax base in the face of global mobility of capital, labour and production.

Priority: Make it easier to do business and modernise workplace relations

- Progress the reform agenda pipeline agreed by COAG as part of the 12-month priorities.
- Strengthen the Australian Government's Regulator Performance Framework and establish similar regimes in the states and territories.
- Implement a workplace relations system that gives enterprises and their employees space and opportunity to improve productivity and increase wages.
  - Define the employment relationship in the legislation, rather than rely on legal precedent, so there is a clear set of rules about what can be included in agreements.
  - Streamline awards to their core purpose of establishing a floor of wages and conditions.
  - Respond to employer concerns about right-of-entry provisions, caused by inherent issues in the legislation.
  - Understand the problems organisations face when undertaking structural change, and the barriers that the adverse action provisions present.

Priority: More reliable, affordable and sustainable energy

- Develop a whole-of-economy emissions reduction strategy incorporating access to credible international permits and continuation of the Emissions Reduction Fund.

Priority: Efficient infrastructure

- Implement road policy reforms to link cost-reflective pricing models with road funding and efficient investment.

Priority: A better skilled and responsive workforce

- Implement a seamless national tertiary system to drive a better skilled, more responsive workforce, better matched to changing job opportunities.

Priority: Promote open trade and investment

- Continue pursuing trade liberalisation opportunities within the multilateral framework and existing agreements, and by forging new agreements.
- Implement a stable and transparent foreign direct investment regime that delivers clear community benefits.
- Explore scope for further reductions in residual domestic trade barriers to facilitate trade flows and global supply chain linkages.

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