

JOINT OP-ED FOR THE AFR

BACK STRONGER BUSINESSES SO AUSTRALIANS GET AHEAD

**By Innes Willox, Australian Industry Group
James Pearson, Australian Chamber of Commerce and Industry
Jennifer Westacott, Business Council of Australia
Brendan Pearson, Minerals Council of Australia.**

This election, politics has obscured and distorted the facts that the community needs to know to properly appreciate the deep benefits we all gain from a strong businesses environment, including a more competitive business tax system.

Australia faces considerable challenges over the coming decades. These include our budgetary position, our ageing population, greater globalisation and technological changes.

Against this backdrop, we must take every opportunity to maintain and indeed improve on our high living standards – including the capacity to create better, higher paid jobs, and to fund high-quality health, education and other social services.

The simple reality is strong businesses are critical to this.

Some of the discussion about business this election seems to assume that the business sector is somehow separate from the broader community. But the reality is that businesses small, medium and large, are an integral part of the community too. Businesses employ people in the community, they provide the goods and services that the community wants, and they are a very real part of the communities in which they operate. It is business that many in the community depend on for their incomes, their way of life, and their futures.

Australian private businesses employ 80 per cent of all workers – around 10 million people. Almost five million Australians have investments in the share market and each Australian on average holds \$23,000 in domestic equity through their membership of superannuation funds.

Businesses depend on each other too. There is around \$440 billion in economic activity between businesses of all sizes Australia each year. If you hold back one section of the business community you are effectively holding every business back.

Today our economy is struggling through a difficult transition. Non-mining business investment as a share of GDP is at a 50-year low. Productivity growth is weak. Global markets remain volatile.

Amid the economic uncertainty, the world in which all of our businesses are operating in is changing. Global supply chains where a product is designed and made in a dozen different countries are putting pressure on traditional business models. Technology is changing the way business is done. Capital and labour are increasingly mobile – they seek out the most competitive environment.

The reality is that in the modern global economy almost everything is tradeable on a world stage. A small business anywhere in the world can compete for business in Australia using the internet. Larger businesses with traditional stores are having to invest heavily in online trading and back end logistics too to stay competitive and keep up with what consumers of today want.

But our country does have breathtaking opportunities. More than half the world's population live in the neighbouring region to our north and north-west. Income growth in these countries is

strong and is set to continue and with it demand for a whole range of goods and services is escalating. Australians and Australia's industries can participate in this historic "rise of the Asian middle class" but we need to ensure we are fit for purpose.

As always, success is not assured. Rather, to be successful as a country, our businesses and our workforce need to be internationally competitive and innovative with the capability and flexibility to respond to these challenges and these opportunities.

Standing still is not an option, because other countries are taking steps to rise to their own challenges and they are eyeing the same opportunities. We need to take the necessary steps to incentivise risk-taking and entrepreneurship and encourage greater investment, innovation and job creation in Australia.

It means taking action across a number of policy fronts – to enable agile workplaces of the future, to create a globally competitive tax system, to ensure regulation isn't holding back productivity and innovation. But tax settings are critical, and they are a controllable factor we can change now.

So let's look at some facts around why improving the competitiveness of our business tax arrangements is important.

The net benefits of more competitive business taxes are permanent and significant

Some have argued that the benefits of proposed company tax cuts do not justify the estimated 10-year revenue cost of \$50 billion. They are effectively comparing apples and oranges.

First, they compare a cumulative ten-year cost with just one year of benefits. Second, they compare net benefits with gross revenue costs, which is not meaningful.

So it's important to remember that Treasury's estimated benefit of 1 per cent of GDP (equivalent to \$16 billion in today's economy) already includes the cost of a fully funded tax cut, as does the extra \$4 billion of government revenue that flows from a bigger economy.

Moreover, once it kicks in it is a permanent uplift – year in year out GDP will be 1 per cent higher than otherwise. So, when the economy reaches \$2 trillion in the future, the benefit is \$20 billion in that year. And when it is \$2.1 trillion, the economy's \$21 billion bigger than otherwise and these gains will continue to accumulate.

There are also a range of other benefits including the technology, innovation and new ideas that come with new investment which are not captured in these estimates but could be significant. History also shows that when business taxes have been lowered to be more competitive with other countries, Australia's corporate tax revenue as a proportion of GDP has actually grown over time due to the strong performance of Australian businesses.

In this context, a \$50 billion tax switch is an investment in making Australia more competitive.

One of Australia's most successful reforms, National Competition Policy is estimated to have delivered an extra \$40 billion of economic benefit each and every year. This took a decade of comprehensive microeconomic reforms across federal and state governments, covering close to 1,800 pieces of legislation. Against this benchmark, more competitive business taxes are simpler to implement and deliver a relatively big bang for the buck.

There have also been claims that our system dividend imputation confines the benefits to foreign shareholders. But this ignores the increased incentive to retain profits and invest in domestic companies. And the simple reality is that new investment – whether it comes from domestic or

foreign sources – means a bigger business, newer machinery, better technology and more productive Australian enterprises. This provides the potential for stronger capital growth and higher dividends for domestic investors in the future.

The benefits of lower business taxes come from higher investment

The benefit of more competitive business taxes will come from businesses making decisions to invest more. We are confident of this from the thousands of businesses that our groups collectively represent.

Businesses invest when the expected rate of return from a new investment – whether that is buying new technology, building a mine or a manufacturing facility – adequately compensates investors for their capital and the risks involved.

Company taxes increase the required rate of return for investors to receive an adequate return after tax. The rate of return investors demand is largely set by returns available in global capital markets. If companies do not deliver competitive returns to investors, investors will quite simply put their money somewhere else. Looking at tax alone, we know that other countries present a much more competitive offering than Australia – the current average of competitors on our doorstep in Asia is 23 per cent compared to our 30 per cent.

For investors requiring a 10 per cent return on an equity investment, a company tax rate of 30 per cent would mean that a new project would have to deliver a pre-tax return of around 14 per cent. A 25 per cent tax would reduce this pre-tax threshold to about 13 per cent. Investment decisions are made at the margin and this will be enough to ensure that some investments that would not otherwise go ahead, will go ahead. This is why Treasury's modelling suggests you get a 2.6 per cent boost to investment over time.

Increased business investment lifts real wages

Businesses generally invest for one or more of three reasons – to expand existing operations, create new operations or to introduce new technology or equipment.

The first two will often involve hiring additional workers and depending on labour market conditions higher wages. The latter may involve new jobs but is more likely to involve the prospect of higher wages for existing staff as their skills combine with new technology to perform tasks more efficiently or to develop better products and services demanded by consumers. As they become more productive, they are paid more.

The Treasury analysis of a cut in the company tax rate to 25 per cent finds that real wages increase by 1.2 per cent (the equivalent of \$8.5 billion), or the equivalent of adding 100,000 full-time jobs paying average wages to the economy.

Our recent experience with the resources boom is a fairly fresh reminder for all Australians that investment translates into jobs – the unemployment rate in 2008 was just 4 per cent. We also know that the United Kingdom have cut their rate from 28 per cent to 20 per cent since 2010 amongst a range of reforms and they appear to be reaping the rewards – a record of inward investment projects last year creating almost 85,000 new jobs.

More competitive business taxes boost national incomes

Treasury and Independent Economics find a positive boost to national incomes, so what of the claim that despite increasing GDP and wages, reducing business taxes would actually detract from national incomes?

As it turns out this claim rests on an implausible assumption that investors will continue forever to accept lower after-tax returns from investing in Australia, rather than directing their investment to more competitive countries. From the perspective of our members who range from SMEs to large multinationals that are at the coalface of an intensely competitive global economy, this is a most unrealistic assumption.

Foreign tax arrangements don't undermine benefits from lower Australian business taxes

There have been suggestions that due to the United States international tax laws, a reduced rate in Australia will simply see more top-up tax paid by Australian subsidiaries of US companies to the Internal Revenue Service in the US, delivering a revenue windfall for the US Government.

This analysis neglects the fact that the US only levies top-up taxes when Australian subsidiaries of US companies pay out profits as dividends, yet in practice much of the profit of these subsidiaries is retained right here in Australia, deferring tax payable in the US. This is why US companies will want to keep investing here with a lower company tax rate.

Is there a better alternative?

The criticisms levelled at proposed tax reforms do not seriously challenge the potential gains to be had nor do they provide alternatives to address the challenges confronting our economy.

Those criticising policies to create a more competitive business environment need to answer how will we lift non-mining investment from its 50-year low, how will we fix the budget deficit without imposing a greater tax burden or relying on punitive spending cuts, and how will we support higher wages so our standard of living keeps pace with the world.

The case for a more competitive business tax rate to boost investment, growth and jobs stacks up on paper and in practice.

The business community is united that a strong business environment including more competitive business taxes are essential for Australia's future. Understanding that we are a community that prospers based on the strength of every business within the community, and on the relationships between businesses of all sizes is important.

Together, with the government and the community each doing its part, we can continue to ensure Australia's economy and the way of life of its people are the envy of the world.