AUSTRALIAN INSTITUTE *of* COMPANY DIRECTORS

Governance of the Nation

A Blueprint for Growth 2017

The Australian Institute
of Company Directors
is renewing its call for a
national reform agenda
focused on the long-term.

Governance of the Nation:
A Blueprint for Growth

A long-term plan for growth

Australia's proud track record of growth and our openness to the world will not be sustained by complacency. A strong and competitive economy is vital as we face new global and economic uncertainties. National reforms to drive long-term growth and increased prosperity for all are critical for Australia's future.

To support this, the Australian Institute of Company Directors (AICD) has updated and refreshed our national reform agenda *Governance of the Nation: A Blueprint for Growth*.

Last year, we called for bipartisan support for a plan to drive growth and improve national governance. Our call for policymakers to engage on the long-term view – the essence of good governance – is even more pertinent today as we face new economic and global challenges, a rising tide of protectionism and declining trust in institutions.

Our agenda for reform draws on the views of our broad membership of more than 40,000 from across business, government and the not-for-profit sectors, including six years of surveys on priorities.

This is not a narrow or partisan view. It is deliberately big picture.

We believe that it is important for the AICD to engage on issues of national reform.

The AICD has a diverse membership collectively responsible for millions of jobs and billions of dollars of investment and services across the country. Our mission of excellence in governance requires a broad focus that includes issues of national importance. It is critical there is a governance perspective in the policy debate.

Our updated *Blueprint for Growth* sets out solutions to support better economic and social outcomes for all Australians. These are achievable reforms worthy of wide support.

Importantly, this is not a job for government alone. The Blueprint explicitly recognises the vital role that the private sector – and directors and boards in particular – must play to drive reform and boost productivity.

We encourage national leaders in all spheres to consider our recommendations in an open and forward-looking dialogue to adopt a long-term plan for growth.

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Executive summary

As the voice of excellence in governance, the Australian Institute of Company Directors brings a unique governance perspective to the challenges facing our nation.

The AICD's *Governance of the Nation: A Blueprint for Growth* seeks to set an agenda for our national leaders to sustain and boost Australia's growth and prosperity. Lifting productivity is a key element of this objective.

The 2017 edition recognises that the case for a clear and expansive national reform agenda is even more important today, as Australia confronts increasing global uncertainty and new economic and social challenges.

Our focus remains on long-term thinking to support national growth and prosperity, with boosting Australia's productivity the unifying theme of the AICD's recommendations.

We recognise the frustration of many boards at the lack of a clear plan to deliver a strong and competitive Australian economy and a fairer society. Our recommendations plot a course for action by taking a long-term perspective on opportunities and challenges facing the nation.

We also recognise that this is not a job for politicians alone. National leaders in all fields - especially the business community - have an important role to play in lifting the standard of governance, embracing innovation and supporting initiatives on participation and inclusion.

Why national reform?

Australia's economic and policy settings, and the lack of progress on substantive national reforms, remain matters of serious concern. Without policies to grow the economy, wages and wealth of Australia and its people, we risk losing the economic leadership that has delivered sustained growth for the nation.

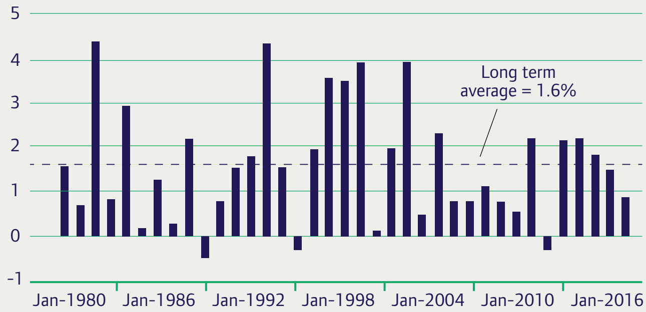
Our nation's advantages are significant – a wealthy economy with high social cohesion, an open and outward-facing economy with a strong track record of growth, a society that values equality of opportunity and a democratic system supported by the rule of law.[1]

These strong foundations, however, must be built on by national policy settings that adapt and respond to changing circumstances if we are to continue to grow national prosperity.

Most importantly, Australia must address our poor productivity growth. While record terms of trade have helped support GDP growth, without a real and sustainable boost to productivity, Australia will be poorly placed to deal with declining contributions from investment in the mining and energy sectors.

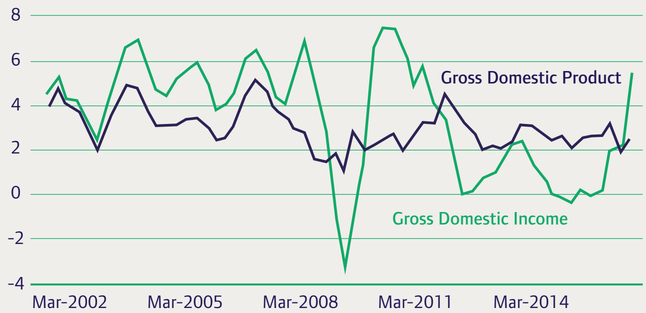
[1] **www.oecdbetterlifeindex.org**

Chart 1: Labour productivity, annual % change



Source: Australian Bureau of Statistics; Australian Institute of Company Directors

Chart 2: GDP vs GDI, annual % change



Source: Australian Bureau of Statistics; Australian Institute of Company Directors

While GDP growth remains positive, national income has lagged – meaning for many Australians, the conditions are weaker and more difficult than the economic headlines suggest. Recent quarters have seen a welcome return to growth in living standards – measured in real net disposable income per capita – but this will not be sustained without lifting productivity.

Our national finances also pose a key risk for the nation, with federal government debt approaching $500 billion (and climbing), and budget deficits projected until at least FY21.

Bold policy action is needed. As things stand, Australia has no fiscal buffer to fall back on should economic circumstances deteriorate, and limited flexibility to respond to the challenges of a transitioning economy.

The AICD's *Blueprint for Growth* seeks to build a greater sense of urgency in tackling these challenges.

Blueprint for Growth

Drawing on member insights the AICD has set out solutions to boost growth over the long-term in six key areas:

- **Reforming national governance**, to modernise our machinery of government and encourage a longer-term perspective in policy settings and implementation.
- **Fiscal sustainability**, calling for bold policy action to address the nation's unsustainable fiscal position through spending restraint and comprehensive tax reform.
- **Innovation and entrepreneurialism**, urging push back against protectionism and ongoing improvements to Australia's 'innovation system'.
- **Human capital**, to simplify industrial relations regulation, boost female participation, and enhance and improve Australia's investment in skills and training.
- **Not-for-profit partnership**, recognising the vital role that the sector plays, the need for funding certainty, and a fit for purpose regulatory system for its effective operation and governance.
- **National infrastructure**, urging investment in national infrastructure priorities through 'good' government borrowing, infrastructure bonds and asset recycling.

Our list is not exhaustive. Rather, we focus on areas where the AICD's *Director Sentiment Index* shows a consensus for action, and where reform can deliver real growth and governance gains.

Our recommendations are not partisan – they reflect positions held across politics – and they are achievable, provided the national debate focuses on the long-term interests of the nation.

This Blueprint includes a clearer call to action for the private sector, recognising that reform cannot be the job of government alone. From boosting infrastructure investment to leading by example in governance standards, directors have a direct role to play.

If adopted, the recommendations in the AICD's *Blueprint for Growth* will ensure a nation that is more prosperous, more successful and more innovative than we are today.

We urge Australia's public and private sector leaders to embrace this opportunity for lasting gains.

Blueprint for Growth: at a glance

Reforming national governance

Objective:
Modernise our national system of government to support longer-term policy decisions, with directors to lead by example on governance practice.

Recommendations:

- Fixed four-year terms for the Commonwealth House of Representatives, with eight-year terms for the Senate.
- Review the Federation, to clarify responsibilities and accountability.
- Reinvigorate COAG with a forward reform agenda and an independent secretariat.
- Leadership by Australian directors in governance practice and national debate.

Fiscal sustainability

Objective:
Address Australia's unsustainable fiscal position and return the Commonwealth Budget to surplus, with bold policy on both spending and tax reform.

Recommendations:

- Fiscal restraint to reduce Commonwealth expenditure to pre-GFC levels as a percentage of GDP, restricting annual growth in spending to 1.5 per cent in real terms.
- Comprehensive tax reform to deliver a more efficient, fair and growth-focused tax system. Reform of the GST, personal income tax rates, CGT discount, negative gearing and corporate tax rates are proposed, with incentives for reform of inefficient state taxes.

Innovation and entrepreneurialism

Objective:
Innovation-led growth is key to national prosperity, as the economy continues to transition from the latest resources boom. Regulatory reform to support appropriate corporate risk-taking is also needed.

Recommendations:

- Push back on protectionism in all its forms, including on trade and in industry support policies.
- A regulatory environment to foster innovation, including safe harbour reforms under insolvency laws.
- Boost Australia's innovation system to strengthen collaboration between business, government and academia.

Human capital

Objective:
The workplace and its demands are changing, and regulations, education and participation must adapt to this new landscape.

Recommendations:

- Simplify the award system (number and scope).
- Increase workforce and leadership participation by women.
- Expand the national focus on education and skills, including tertiary education reform.
- Maintain support for Australia's non-discriminatory immigration policy and a strong skilled migration stream.

Partnership with not-for-profits

Objective:
This vital contributor to society and the economy is hampered by an uncertain funding landscape and complex and duplicative regulations.

Recommendations:

- Set a best-practice target of five-year funding cycles with 12 months' notice, and allow for internal investment in capacity.
- A 'fit for purpose' regulatory environment with nationally consistent definitions and reporting systems and less duplication (for example, NFP fundraising reform).

National infrastructure

Objective:
Directors consistently rank infrastructure investment as the most significant long term priority for the nation. A new focus on national infrastructure priorities, and support for new funding sources for infrastructure investment.

Recommendations:

- COAG to lead a 15-year infrastructure investment plan based on national priorities.
- Boost 'good' government borrowing for productive infrastructure investment.
- Support innovative funding options, such as infrastructure bonds.
- Boost private sector investment including through asset-recycling programs.

Reforming national governance

Australia's robust democratic system is one of the great strengths of our nation.

It is too important to be taken for granted, especially in times of global economic and political uncertainty.

Unfortunately, public confidence in the quality of our national governance is being put at risk as successive governments focus on short-term planning and policy implementation.

To address the policy impasse in parliament, in 2016 the AICD recommended substantive reforms to parliamentary procedures, government systems and Senate voting. Some progress has been made. For example, Senate voting reforms were introduced in 2016.

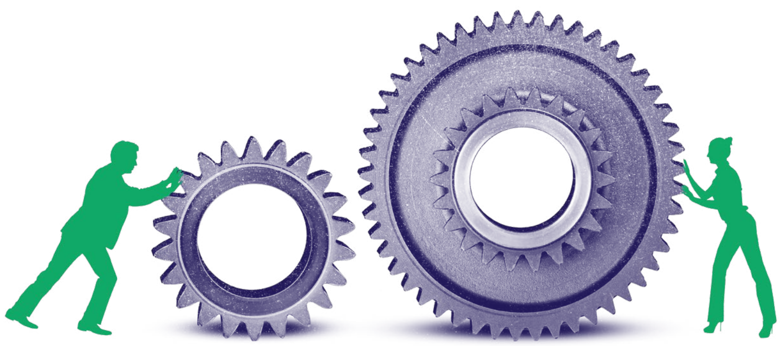
Much more remains to be done

This is not a criticism of any particular political party, leader or government, past or present. Rather, it reflects the need for structural change to support long-term decision-making and lift public confidence in our national democratic systems.

Our national parliament and federal system operate within structures and practices that were designed over a century ago. The machinery of our government needs reform to adapt to the demands and expectations of Australia today.

Recommendations

1. **Fixed, four-year terms** for the House of Representatives, with eight-year terms for the Senate.
2. **Review of the Federation,** reporting in 2018.
3. **Reinvigorate COAG** with a medium-term reform agenda, independent secretariat and consideration of an independent chair.
4. **Leadership in governance** standards and practice by Australian directors.



1. Fixed, four-year parliamentary terms

Short-term policymaking is now a feature in modern government, with successive administrations focusing on re-election in a highly unpredictable climate.

On average, Australia's last 15 federal governments served terms of only two and a half years.[2] This cycle can mean that three out of every 10 years are lost as governments respond to a shorter election time span.

The Commonwealth Parliament's short, variable terms places it in the minority across the globe and at home. Australian states and territories have all moved to four year election cycles over recent decades. Most have fixed terms. The Commonwealth is now the only jurisdiction in Australia with such short terms.

It is time to move to a fixed, four-year parliamentary term to support a longer-term focus in policy planning and implementation.[3]

Constitutional change will be required to effect this reform. The AICD is calling for all sides of politics to support a referendum, coinciding with the next federal election, to seek public support for a move to fixed four-year parliamentary terms. On that basis we could expect to see the first four-year Federal Parliament following the election to be held no later than 2022.

2. Reform of the Federation

The Federation of Australia (the Federation) has served the interests of the nation for 116 years, but our 2017 landscape is very different to that of 1901.

Over this period, there has been no comprehensive review of our federal structure of government. No competent board would allow their structure of governance and operation to go unreviewed for over a century. Australians expect and deserve the same standards in our national governance.

Cost-shifting, duplication and a lack of clarity in accountability between layers of government hurts our nation's efficiency, while diminishing public and business confidence in our system.

With the Federation White Paper announced in 2014 now abandoned, the prospects of any substantive update to our federal system have faded. But the challenges remain – we need a system fit for the times with a clearer allocation of roles, responsibilities and improved accountability.

The AICD recommends that a comprehensive review of the Federation be championed by the Commonwealth with the support and engagement of state and territory governments. This review should commence in 2017 as The Council of Australian Governments (COAG) priority, with a 12 month timetable.

3. Reinvigorate COAG

COAG continues to operate with a short-term focus driven by issues of the day and the immediate concerns of the Commonwealth. The AICD is calling for governance reforms to reinvigorate COAG as a national body, through development of a 15 year economic reform program. Improved transparency of COAG priorities and progress towards them, with a well-resourced and independent permanent secretariat, must also be implemented.

The AICD also encourages consideration of an independent chair.

4. Leadership in governance standards and practice

The AICD recognises that the quality and focus of national governance requires more than structural reforms to our system of government.

With 84 per cent of the AICD's broad membership rating the quality of national policy debate as 'poor' or 'very poor', there is a role for governance leaders in Australia to help shape a positive, constructive debate and to lead by example in the quality of governance standards.[4]

The AICD, as the voice and advocate of good governance, has an important role in promoting good practice and standards on our nation's boards, as well as providing education and development opportunities for directors.

2 Analysis by the AICD using data extracted from **www.australianpolitics.com**

3 The AICD is recommending fixed, four-year terms for the House of Representatives, with eight-year terms for the Senate.

4 AICD *Director Sentiment Index* (December 2016) **www.aicd.com.au**

Fiscal sustainability

Every good director understands the importance of sound financial management as a cornerstone of good governance. It is the same for government.

In fact, for the elected guardians of the nation's finances, the imperative of good fiscal governance is even more important. Maintenance of our living standards depends on it.

Nine consecutive years of deficits have been incurred since the Budget plunged into deficit during the Global Financial Crisis (GFC). The federal government deployed extensive fiscal stimulus to support the economy as the Reserve Bank of Australia (RBA) simultaneously slashed interest rates.

This helped the economy avoid a technical recession, as did the sharp fall in the Australian dollar. With the benefit of hindsight, though, the fiscal stimulus was overdone and extended for too long, leaving the Budget in significant *structural* deficit.

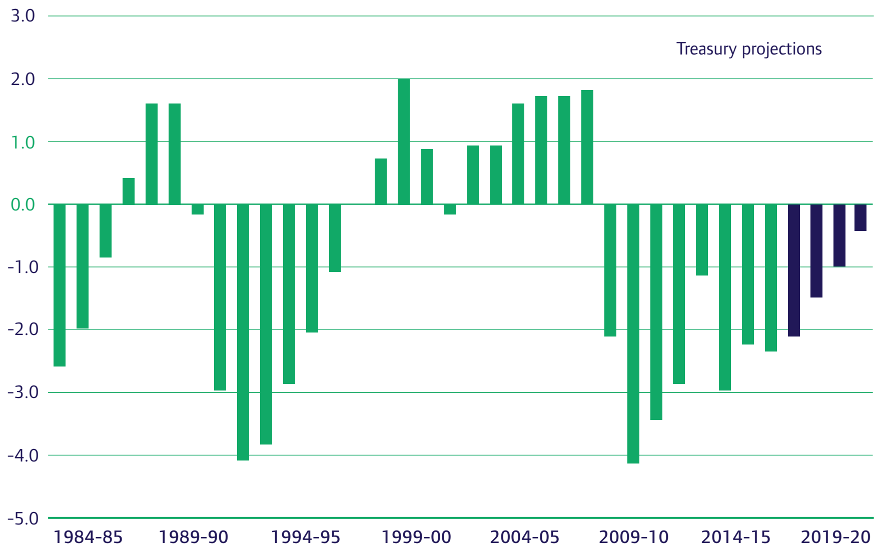
Almost a decade on from the GFC, Treasury still predicts budget deficits until at least 2020/21, based on the forecasts released in December 2016 in the Mid-Year Economic and Fiscal Outlook (MYEFO). But even this looks optimistic, framed on upbeat economic growth assumptions.

Australia's ratio of public debt to GDP is low by global standards, but the debt ratio here is rising – comparable ratios are falling in other jurisdictions. Federal debt now is forecast to peak above 19 per cent of GDP in 2018 – 19.[5] Outstanding federal government debt in Australia is already approaching $500 billion, but with budget deficits certain in the near term, debt will continue to climb.

Recommendations

1. **Spending reform**, to bring government expenditure below 25 per cent of GDP by 2020.
2. **Comprehensive tax reform**, to boost economic growth and improve fairness in the system.

Chart 3: Commonwealth Budget balance - % GDP



Source: MYEFO, December 2016

5 *Mid-Year Economic and Fiscal Outlook 2016-17* (19 December 2016) **www.budget.gov.au**

Australia's current fiscal position is unsustainable

The interest bill paid by taxpayers amounts to more than $1 billion per month, despite close-to-record low levels of government bond yields.[6] This interest bill will become even larger as interest rates normalise over time, which most economists expect.

The Treasury's projected budget deficit for the current fiscal year remains above two per cent of the nation's GDP. A succession of federal treasurers has failed to deliver on the oft-promised return to surplus. With the demands on Australia's public purse growing over time, particularly in health costs and welfare, this position is simply not sustainable.

Governments can no longer wait for optimistic assumptions about growth in the economy and commodity prices to do the heavy lifting to return the Budget to surplus. Bold policy action is needed. As things currently stand, Australia has no fiscal buffer to fall back on should economic circumstances deteriorate.

The AICD is calling for political leaders to take the tough decisions needed so that Australia can afford its future aspirations, particularly on the expenditure side of the Budget. Failure to act now risks abrupt economic dislocation in the future.

Protecting the AAA credit rating

Australia is one of just 10 countries in the world enjoying the highest available ranking from all three of the major credit ratings agencies. But, significant fiscal slippage in recent years means the rating is under threat. Without urgent action to restore fiscal sustainability, it is merely a matter of time before Australia's rating is downgraded.

The major ratings agencies have effectively given the government until the time of the Federal Budget in May to show that the plan to return the Budget to surplus is on track. The signs so far are not encouraging. MYEFO revealed fiscal slippage of $10 billion across the four-year forward estimates period. Loss of the AAA credit rating would incur significant costs, including a higher cost of borrowing for governments.

The loss of Australia's AAA credit rating would flow through to credit rating downgrades for affected state and territory governments and the commercial banks. The result would be higher funding costs for the banks on global markets and, therefore, higher interest rates for Australian households and businesses.

Spending and tax reform is needed

Nearly three quarters of the AICD's members believe the government should aim for a return to surplus within a 10-year period. Difficult decisions must be taken now if this target is to be met.[7]

The nation's fiscal sustainability is too complex a task to be defined as a binary choice between a 'spending' or 'revenue' problem. Australia has both a revenue and a spending problem.

The AICD's membership believes that the emphasis of budget repair should fall most heavily on the expenditure side of the accounts. While tax reform has an important role, its focus should be to drive growth over the longer term. An improved tax mix can create better incentives for success for Australians and boost economic growth. A more sustainable and equitable tax mix will support fiscal sustainability over the long term.

> Business, too, has an important role to play in ensuring that governance practice and standards reflect the expectations of the community.

However, the heavy lifting of deficit reduction must prioritise spending reform, which has often been neglected in the debate on fiscal sustainability.

Business, too, has an important role to play in ensuring that governance practice and standards reflect the expectations of the community. The AICD supports measures to improve transparency in taxation and reforms to address profit shifting practices by multinational corporations.

[6] The Hon Joe Hockey MP, 26 May 2014, Commonwealth of Australia House of Representatives: official Hansard vol 7, p 4088

[7] AICD *Director Sentiment Index* (December 2016) **www.aicd.com.au**

1. Spending reform

The current level of Commonwealth Government spending is simply not sustainable. Previous attempts at spending restraint either have failed to pass through the parliament, have not been taken seriously, or had only limited impact.

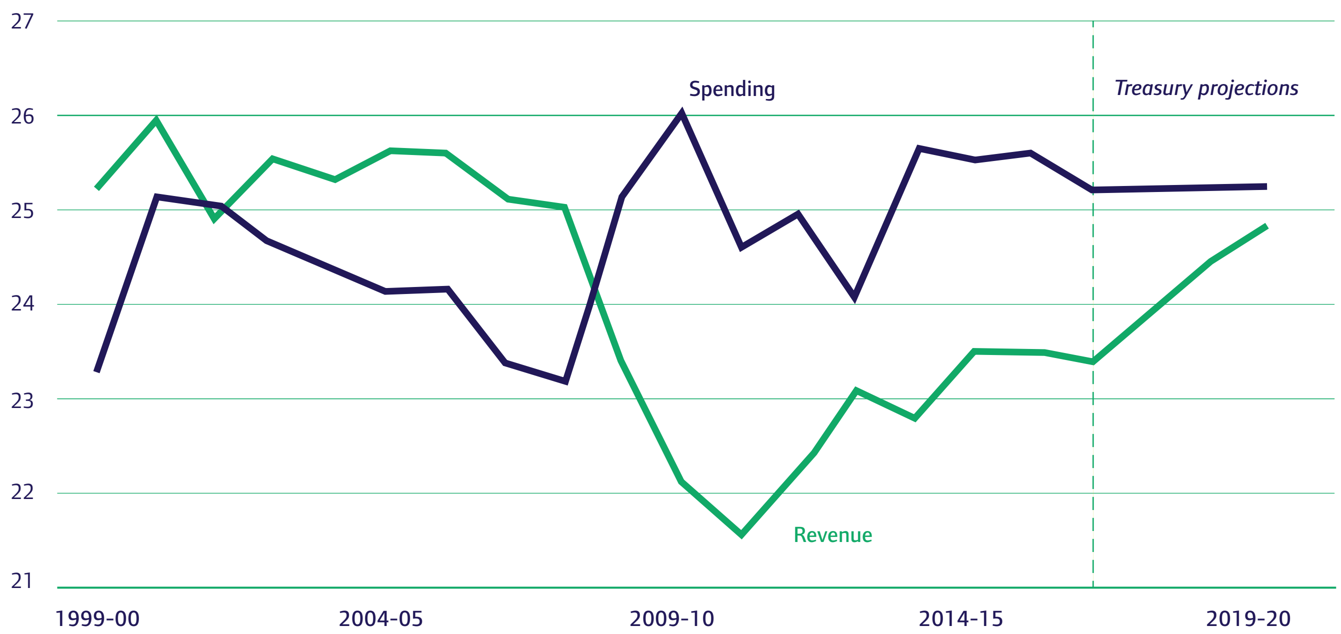
Unfortunately, while the Commonwealth's revenue share of the economy slipped, the spending share of the economy approached the elevated 26 per cent of GDP previously reached during the peak spending demands during the GFC.

Worryingly, Treasury projects that the ratio of Commonwealth Government spending still will be above 25 per cent of GDP even in four years' time.[8] The AICD believes that budget surpluses are not possible if the government spending ratio is above 25 per cent of the economy.

Australia's structural budget deficit represents a significant challenge to the long-term prosperity of the nation. Over the last two decades, higher levels of government spending as a share of the economy have been locked in, funded by revenue that was boosted temporarily by cyclical forces like higher commodity prices. Commodity prices have receded, but not the elevated spending they funded.

Directors appreciate that challenging economic circumstances demand fiscal restraint – and apply this with a view to impacts on the company and stakeholders. They expect government to adopt the same discipline.

Chart 4: Commonwealth Budget spending and revenue - % of GDP



Source: Mid-Year Economic and Fiscal Outlook (MYEFO), December 2016

[8] *Mid-Year Economic and Fiscal Outlook 2016-17* (19 December 2016) **www.budget.gov.au**

The table below shows the underlying cash balance of the Federal Budget, total government expenditure and total government revenues as a percentage of GDP from 2007/08 (immediately preceding the Global Financial Crisis) to Treasury's 2019/20 forecasts.

The figures highlight two important points on spending:

- The GFC had a significant impact on government expenditure as the Budget was used to smooth changes in the business cycle; and
- Since 2008, the Commonwealth has not been able to reduce the level of government spending as a proportion of GDP to below GFC levels.

As the former Governor of the Reserve Bank, Glenn Stevens, noted, Australia needs to have a conversation about fiscal repair: as a community, we have voted for the services we want, but we have not yet voted for the means to pay for them.[9]

The AICD welcomes the government's initiatives thus far in prosecuting expenditure savings measures in paring back access to family benefits, in particular, the cost of which blew out during the commodity price boom, although some of the measures remain before the Federal Parliament.

Spending reform priorities

- Restrict annual growth in Commonwealth spending to 1.5 per cent in real terms over the business cycle.
- Develop funding plans for new initiatives extending beyond the forward estimates, with review by the Parliamentary Budget Office.
- Target spending reform in middle-class welfare and industry assistance, with ongoing efficiency dividends to drive cost constraint across the public sector.

Table 1: Commonwealth Budget receipts and expenses - % GDP

Year		Surplus/deficit (% GDP)	Revenue (% GDP)	Expenditure (% GDP)
2007/08		1.7%	25.0%	23.1%
2008/09		-2.1%	23.3%	25.1%
2009/10		-4.2%	21.9%	26.0%
2010/11		-3.4%	21.4%	24.5%
2011/12		-2.9%	22.1%	24.9%
2012/13		-1.2%	23.0%	24.0%
2013/14		-3.0%	22.7%	25.6%
2014/15		-2.3%	23.4%	25.5%
2015/16		-2.4%	23.4%	25.6%
2016/17	*Treasury projections*	-2.1%	23.3%	25.2%
2017/18		-1.6%	23.8%	25.2%
2018/19		-1.0%	24.4%	25.2%
2019/20		-0.5%	24.8%	25.2%

Source: MYEFO, December 2016

9 Australian Financial Review, 12 December 2014

The AICD recommends that annual growth in government spending be restricted to 1.5 per cent in real terms, on average, over the business cycle.

The AICD recommends that annual growth in government spending be restricted to 1.5 per cent in real terms on average over the business cycle. That is, growth rates above this benchmark over the business cycle should be offset by slower growth in subsequent periods, to maintain the targeted average growth rate.

By adopting this target, the government would retain the ability to help offset fluctuations in the business cycle with fiscal stimulus, as was done during the GFC.

MYEFO projects that spending growth will average 1.9 per cent in the four years to 2019/20 and an unchanged ratio of 25.2 per cent of GDP. A 1.5 per cent average real spending growth cap compares to average real spending growth of 2.8 per cent over the last three decades, so its maintenance will require a new level of discipline.[10]

The AICD's preferred options for spending reform, to help keep Commonwealth Government spending below 25 per cent of the economy, are:

- Further paring back so-called middle class welfare, including access to the family tax benefits system;
- Efficiency dividends across government, targeting duplication between jurisdictions; and
- Cuts to industry assistance where funding is based on protecting inefficient industries.

None of these reforms are easy, but all offer scope for substantial savings on both budget repair and equity/fairness grounds.

Indeed, work by Treasury in 2015 shows that the biggest contribution to fairness in government's impact on society and the economy comes via spending (mainly transfer payments), rather than through the tax system, despite Australia's tax system already being highly progressive.[11]

Nearly half of all AICD members advocate further reform to the welfare portfolio as a key part of expenditure restraint.[12] Fifty-six per cent of our members advocate for smaller government, and 51 per cent argue for concurrent general spending restraint.

In addition to providing significant budget savings, further reforms to the welfare system will also mitigate against some of the disincentives that discourage many thousands of people from making the sometimes difficult journey from welfare back to work. These impediments contribute to Australia's low workforce participation rates, particularly among women.

More needs to be done to ensure the government's transfer payments are directed towards those most in need. The welfare system should be a safety net, not a system of entitlement that, once established, is difficult to unwind.

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10 *Mid-Year Economic and Fiscal Outlook* 2016-17 (19 December 2016) **www.budget.gov.au**

11 *Re:Think Tax Discussion Paper*, 2015. **www.treasury.com.au**

12 AICD *Director Sentiment Index* (December 2016) **www.aicd.com.au**

2. Tax reform – whole-of-system, not piecemeal changes

Federal tax revenue has dipped from a healthy level of nearly 26 per cent of GDP a decade ago to less than 24 per cent of the economy now.

The AICD applauds the government's recent efforts to pare back generous tax concessions on superannuation, and for raising additional revenue from measures like the so-called backpackers' tax. These are steps in the right direction, and should help to reduce distortions embedded in the tax system.

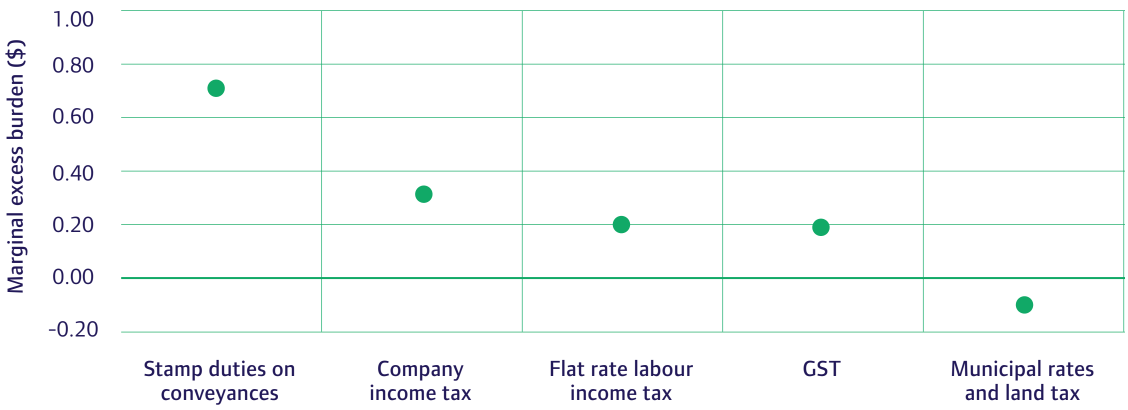
But, the tax measures passed by the current parliament are piecemeal. The tax system has an important role to play in influencing corporate and household behaviour, including decisions about workforce participation and investment by businesses, which has been flagging for some years now.

Encouraging both spending restraint and tax reform requires ambition and a broader scope for reform.

The Australian Institute of Company Directors has set three key objectives for tax reform:

BOOST NATIONAL PROSPERITY	Reduce Australia's reliance on direct, inefficient taxes that limit growth, including inefficient state taxes	Boost incentives for individual and business effort, and build a more efficient tax system overall
IMPROVE FAIRNESS	Reform Capital Gains Tax concessions that favour high income earners and review negative gearing	Targeted compensation for low and middle income earners for GST expansion
LIFT GLOBAL COMPETITIVENESS	Reduce Australia's comparatively high personal tax rates	Progressively reduce the company tax rate to the OECD average

Chart 5: Estimates of tax efficiency



Source: Treasury, *Re-Think Tax Discussion Paper*, March 2015

The AICD commissioned *Deloitte Access Economics* to support our analysis of tax reform scenarios. The reforms recommended here aim to shift the current burden of tax away from income towards land and consumption, and help reduce the dead weight of tax on the economy (particularly by reforming the state tax regime), while maintaining broad revenue neutrality.

The work done by *Deloitte Access Economics* confirms that the *mix* of tax matters as much as the *level* of taxation in an economy. There are ways of taxing 'smarter' that reduce the inefficiencies embedded in any taxation regime, to minimise the damage inevitably done to economic activity.

Cutting tax rates applied to income will help shift the tax burden in relative terms towards the taxation of capital which currently is lightly taxed in Australia in relative terms. This imbalance helps create distortions that encourage tax avoidance and too much investment in relatively unproductive assets like existing residential property.

The tax reforms recommended here yield an estimated 'prosperity dividend' (i.e. the boost to national income) of the equivalent of one per cent of GDP.[13] Most of this comes from reform of the state tax regimes, which include the most damaging, inefficient taxes in the federation – particularly stamp duties.

Most critically, this is a tax reform scenario that should be taken as a whole – with the gains to be drawn from across the recommended reforms collectively.

Details of the assumptions in our tax reform scenario are included in the appendix.

The mix of tax matters as much as the level of taxation in an economy.

[13] The prosperity dividend estimates are approximate and indicative of the direction and magnitude of the selected tax reform package on the economy of Australia, measured by national income. For further detail, see appendix.

The AICD's comprehensive tax reform scenario:

- Lift the GST rate to 15 per cent and broaden the GST base, with a substantial compensation package for lower income earners.
- Cut personal income taxes across the board.
- Incentivise states to reform inefficient taxes.
- Reduce the Capital Gains Tax discount to 40 per cent.
- Review negative gearing and the nexus with the CGT discount.
- Staged reductions in the corporate tax rate.

GST reform

Australia's tax mix needs adjustment to shift the burden of taxation in the economy to more indirect and efficient sources.

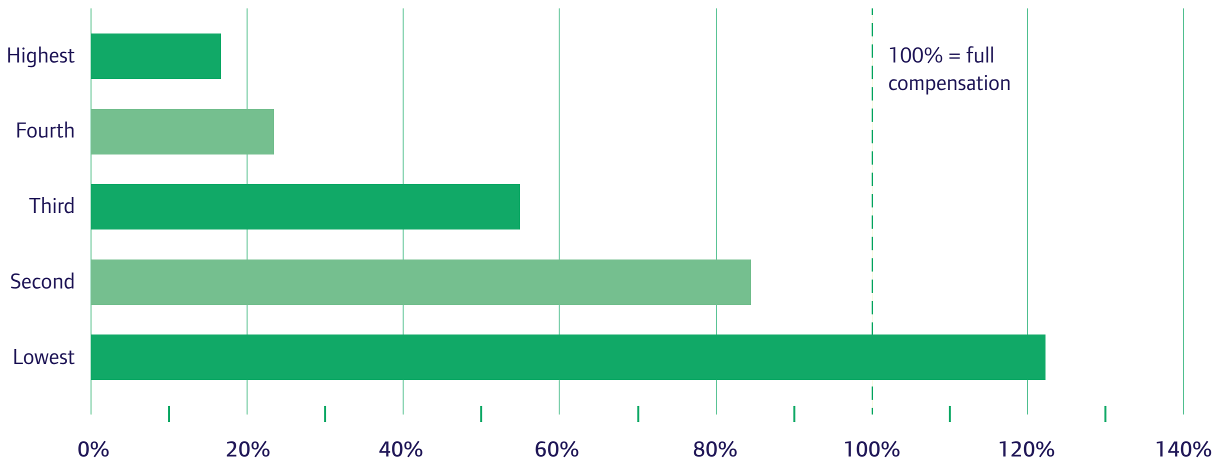
The AICD recommends that government lift the rate of the goods and services tax (GST) from the current 10 per cent to 15 per cent. This would bring the GST more into line with rates in comparable jurisdictions, noting the average GST rate in the developed world is 19 per cent.[14]

In addition, the AICD recommends broadening the base of the GST to include spending on fresh food, education, healthcare, childcare and utilities, much of which are excluded from the tax base. The current base to which the GST in Australia applies represents less than 50 per cent of household spending (compared to 97 per cent in New Zealand). Worse, the tax base is shrinking in relative terms because spending that is currently untaxed is growing more quickly than spending subject to the GST.

A significant compensation package must accompany this reform to offset the increase in consumer prices, particularly to lower income households. This compensation would be in the form of a mix of tax relief and increased transfer payments.

The suggested compensation package is comprehensive and well-targeted. In particular, it over-compensates lower income earners in recognition that the GST is a regressive tax.

Chart 6: Proposed GST compensation by income quintile



Source: Deloitte Access Economics

A higher GST rate and broader GST base would raise an estimated additional $273 billion over four years. While this revenue will be partly offset by another round of personal tax cuts (including a component designed to compensate lower income earners), and compensation in the form of increased welfare payments, it will provide a more sustainable, equitable and efficient revenue base for the nation.

[14] Ernst & Young, 2015, Indirect Tax in 2015: A review of global indirect tax developments and issues.

Reductions in personal tax rates

The AICD welcomes the government's progress last year in lowering the personal tax burden for middle income earners via the modest tax cuts announced in the Budget.

These cuts, however, do not go far enough. The AICD advocated in the *2016 Blueprint for Growth* that the personal tax rates across all income thresholds be reduced by five percentage points. Our updated proposal for GST reform would allow marginal tax rates to be reduced by 6.5 percentage points, the additional cuts being funded by the broadening of the GST base.

Partly offsetting the cost of these proposed personal income tax cuts would be the removal of general workplace deductions (while preserving deductions for donations to charitable organisations). These deductions have a huge cost to the Budget and are open to exploitation – they cost the Budget close to $20 billion over the four-year forward estimates period.

Removal of work-related deductions would allow the top personal tax rate to be reduced from the current 45 per cent to 37 per cent, bringing Australia more into line with global averages, noting reductions are also proposed for all tax rate thresholds under our reforms. The move would also reduce the compliance costs associated with millions of Australians submitting tax returns principally for the purpose of claiming workplace deductions.

The AICD also recommends that the tax-free threshold be reduced from the current $18,200 to $15,000, but that the revenue impact be offset by a rise in the Low Income Tax Offset (LITO), from the current $445 to $1,200. The changes will compensate for the GST changes, better target tax relief at lower income earners, and mitigate against the current disincentive for lower income earners to re-enter the workforce.

Cleaning up inefficient state taxes

The AICD continues to recommend reform of state tax regimes. Many of the taxes levied by state governments, like activity-based stamp duties, are among the most inefficient taxes, damaging productivity and discouraging economic activity. The recommendations here are revenue neutral for state governments.

Under our scenario, the states would see increased funding from an incentive payment of 10 per cent of the increased GST revenue (a net $19 billion over four years). Payment would be contingent on progress in cleaning up the inefficient state taxes.

The AICD recommends that state governments replace stamp duties on property with different forms of land tax. Work by the Federal Treasury in 2015[15] showed that the "dead weight" cost to the economy of stamp duties was the highest of all taxes in the federation at 72 cents in the dollar. That is, for every dollar of revenue collected, the economy shrinks by 72 cents. Land tax, by contrast, has no net cost to the economy.

Land taxes reduce the disincentive to engage in transactions. Stamp duties on residential property are a major impost on the purchase of a property and, therefore, are a powerful disincentive for the mobility of labour. Australia currently suffers shortages of skills in some regions, but surpluses elsewhere, partly due to our notoriously immobile workforce.

The equity issues associated with this proposal (i.e. how some asset-rich, income-poor taxpayers could fund an annual land tax impost) can be addressed partly by structuring appropriate tax thresholds. The benefits to the economy, however, should outweigh the costs. One clear benefit would be a more equitable distribution of housing assets, improving housing affordability over time.

[15] *Re:Think Tax Discussion Paper*, 2015. **www.treasury.com.au**

Most critically, this is a tax reform scenario that should be taken as a whole – with the gains to be drawn from across the recommended reforms collectively.

Reduced capital gains tax discount

The AICD recommends that the government examine the unfortunate nexus between the treatment of negative gearing of investment losses on housing and the current discounted capital gains tax arrangements. These provisions have combined to help substantially boost the after-tax returns from investment in existing residential property, investment in which fails to add to the productive capacity of the nation.

The current 50 per cent discount on Capital Gains Tax (CGT) liability far exceeds that necessary to compensate investors for the impact of inflation, which was the intention. The AICD argues that the CGT discount should be pared back from the current 50 per cent to 40 per cent, as was recommended in the Government's Henry Tax Review back in 2010.[16]

This change would further improve the balance between the current sub-optimal tax burdens carried by labour income. The estimated boost to the Budget from this reform is material at $6.4 billion over four years.

Review negative gearing and the nexus with the CGT discount

Negative gearing is a part of many Australians' investment plans. However, it has led to ineffective tax outcomes and, in part, distortions in the housing market.

The current tax arrangements encourage investment in relatively unproductive assets, like existing residential property. While the shortage of housing stock and record-low interest rates are the main drivers of housing affordability challenges, current tax arrangements also play a role.

Negative gearing should be reformed so that it applies only to productive assets. Government should examine all options for reform of negative gearing (eg. the tax deductibility of losses) on housing. The AICD recommends, in particular, that the government examines the nexus between negative gearing and the capital gains tax discount (introduced in 1999), which the Reserve Bank believes 'may have the effect of encouraging leveraged investment in property', particularly in an environment of low interest rates.[17]

The current 50 per cent discount on capital gains tax liability far exceeds that necessary to compensate investors for the impact of inflation, which was the intention.

[16] *Australia's Future Tax System*, 2010. **www.taxreview.treasury.com.au**

[17] Reserve Bank of Australia, Submission to the Inquiry into Home Ownership, House of Representatives Standing Committee on Economics, June 2015 p 23

Reducing the corporate tax rate

Australia's current corporate tax regime is making Australia increasingly uncompetitive. Corporate taxation is very inefficient relative to other sources of government revenue – Treasury estimates damage to the economy of 50 cents for every dollar in revenue collected from company tax.[18]

Australia's 30 per cent corporate tax rate stands out as one of the highest in the developed world, well above the OECD average of 25 per cent. The average corporate tax rate in countries in our major trading zones in Asia is just 22 per cent. Only four countries in the OECD have a corporate tax rate higher than our own.[19]

The AICD acknowledges the government's attempts to lower the tax burden progressively over the next decade.[20] However, we consider the best approach is to ensure that corporate tax is part of a comprehensive reform model, rather than piecemeal changes.

More competitive corporate tax rates will make Australia a more attractive place for foreign investment and deliver a dividend in the form of job creation and higher investment.

[18] *Re:Think Tax Discussion Paper*, 2015. **www.treasury.com.au**

[19] The UK corporate tax rate currently is 20 per cent (with plans to lower it further to 17 per cent by 2020), and US President Trump has promised to cut the corporate tax rate in the US from the current 35 per cent to 15 per cent, half the current rate in Australia. In Europe, Germany and France also are contemplating corporate tax reform. The corporate tax rate in New Zealand is 28 per cent.

[20] The Government's 10-year Enterprise Tax plan advocated staged reductions in the corporate tax rate, with all companies eventually taxed at 25 per cent.

A commitment to inclusive growth will be critical to fostering an embrace of innovation across the community and economy more broadly.

Innovation and entrepreuneurialsim

Recommendations

1. **Push back on protectionism** to support an open, export-orientated economy.
2. **A regulatory environment** to foster innovation, including a safe harbour under insolvency laws.
3. **Boost Australia's innovation system**, prioritising collaboration in R&D and targeted skills investment.

An established culture of innovation, creativity and entrepreneurialism is critical if Australia is to prosper and grow. The OECD estimates that up to half of all GDP growth in its member countries can be attributed to innovation, yet Australia has lagged behind.[21] We have relied too much on the 'old' industries of our past and the next phase of our growth requires a better productivity performance.

We need to better nurture industries that generate the jobs of the future and develop a culture that better celebrates success and considered risk taking. For Australia, with an economy in long-term transition from the latest resources boom, innovation-led growth is essential to our future prosperity – the jobs of our children depend on it.

A commitment to inclusive growth is a key part of improving Australia's innovation performance. Technological change and disruption can be seen as a threat as workforce skills and employment changes. There needs to be a better nexus between education and jobs, and a culture of collaboration, to make sure the system is geared to producing workers with the appropriate skill set.

Australia needs to better develop an ecosystem of collaboration to replace the silos of competence that many of us are used to. We need to better share technology and data – we need to collaborate as well as compete with each other.

Cultural change in innovation and a commitment to research is essential – we need to better reward entrepreneurship. Business needs to be less risk averse, adopt longer-term attitudes to innovation and adoption of new technologies. Incentives, including those embedded in the tax system, need to be modified.

Much of our innovation agenda has focussed on transforming our 'old' industries, particularly those in manufacturing where we used to excel. Not enough emphasis is placed on Australia's dominant service sector, which generates around 70 per cent of our GDP and the bulk of our employment.

For example, Australia's global standing in primary and secondary education standards, while strong, is falling. We have a natural advantage that we need to exploit – proximity to the rapidly-advancing economies of Asia, and a high-quality product. We are also world leaders in healthcare and tourism.

Governments and business leaders need to embrace the opportunities of innovation. Failure to do so inevitably means slower adoption of the very technologies that are needed to lift productivity, launch new industries and create jobs.

[21] OECD *Innovation Strategy 2015: An Agenda for Action*, **www.oecd.org**

Embracing and embedding systems of innovation across the economy requires a national focus and a bipartisan approach. The National Innovation and Science Agenda (NISA), launched in December 2015, makes a strong start.[22] The AICD supports the government's initiative to set up an innovation fund to invest in start-up technology with private investors and the Opposition's plans to invest in and boost national innovation as a priority.[23]

1. Push back against protectionism

It is critical that Australia pushes back against the troubling lurch globally towards protectionism, in all of its forms. Unfortunately, there has been a global trend towards political leaders becoming inward looking and focussing on isolated domestic economic performance, rather than the greater global good.

Increased protectionism can be attractive to political leaders because it can generate near-term benefits, minimising economic adjustment and protecting jobs in inefficient industries. These benefits are an illusion, however, with the inevitable adjustment by competitive forces merely delayed.

For Australia, poorly-designed 'buy-local' campaigns, or taxpayers' funds being used to protect inefficient, loss-making industries and practices, are merely protectionism in a friendlier form. These policies act against competition and the adoption of new technologies.

Australian leaders must resist the global trend towards more protectionism. The US economy is large enough to prosper for a time while turning inwards. Australia, a small, open, export-oriented economy, is not.

2. A regulatory framework to foster innovation

Innovation by corporate Australia is hampered by overly complex, unnecessary and inefficient regulation, as well as by concerns over personal liability. Proposed safe harbour insolvency reforms in NISA are an important first step in addressing these issues.

Our current laws hold directors personally liable for the risk of insolvent trading and, as the government has acknowledged, 'put too much focus on penalising and stigmatising the failures'.[24]

Inadvertent breaches of insolvent trading laws are often cited as a reason early stage investors and directors are reluctant to become involved in start-ups.[25] They can also lead to premature invocation of insolvency, resulting in job losses, contract terminations, destruction of goodwill and overall value diminution.

> The AICD strongly supports the introduction of a 'safe harbour' in Australia's insolvency regime, to support boards in saving firms that can be saved – along with the value and jobs they create.

Many other areas of law also create personal liability risks that compel an excessive focus on compliance and caution. Our research proves this point, with more than 70 per cent of directors surveyed reporting a risk-averse culture on boards.[26] It will be very challenging to foster innovation while Australia maintains a comparably punitive and restrictive regulatory environment in these areas.

To reduce undesirable risk-aversion, reforms are needed to support directors who perform their roles honestly and diligently. We urge the government to review and publicly consult on the appropriateness of the many and varied ways in which directors' roles place

[22] National Science and Innovation Agenda December 2015, **www.innovation.gov.au**

[23] **www.alp.org.au/poweringinnovation**

[24] Australian Government, *Improving bankruptcy and insolvency laws*, p3

[25] NISA, *Improving insolvency laws to encourage innovation*

[26] AICD *Director Sentiment Index* (December 2016) **www.aicd.com.au**

them at undue risk of personal liability and the adequacy of the defences available to them.

3. Boosting Australia's innovation system

Policy consistency and coordination are critical to boosting Australia's innovation performance. Globally, Australia continues to lag comparable economies in our performance, falling to a ranking of 19th in the 2016 Global Innovation Index.[27] Worryingly, the OECD places Australia near the bottom of global performance on industry and higher education collaboration.[28]

Other nations are able to better nurture this important nexus – as it is, many of our research ideas are funded and developed elsewhere. The AICD supports the focus being brought to Australia's innovation system. As the 2016 Australian Innovation System report notes:

A well-functioning innovation system requires the participation of a range of actors across the spectrum of business, government, academia and other parts of the community.[29]

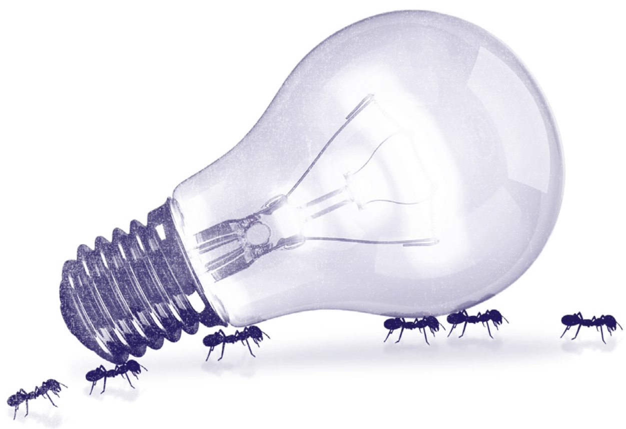
A well-functioning innovation system requires the participation of a range of actors across the spectrum of business, government, academia and other parts of the community.

We must enhance the collaborative relationship between corporate Australia, government and our world-class academic institutions.

Too often, our universities help develop and nurture valuable technologies that are commercialised elsewhere.

Too often, the technology and jobs head overseas. Moreover, our business leaders should adopt the innovations and technologies developed offshore, not just those nurtured in our own backyard.

We need a renewed focus on the adoption of new technology and its impact on productivity growth. We no longer can rely on the old model of exploitation of our natural resources to drive our national income and prosperity. We also need to make the changes necessary to ensure we are turning out graduates with the necessary skills, that the courses offered by our education facilities are fit-for-purpose.



[27] **www.globalinnovationindex.org** (2015 ranking 17)

[28] *National Science and Innovation Agenda* December 2015 **www.innovation.gov.au**

[29] **www.industry.gov.au/innovationreport**

Human capital: workplace participation and flexibility

Rapid changes impacting the workplace – such as technology-driven changes to the nature of work and evolving expectations about employment – are key strategic concerns for the boards of all Australian businesses, large and small.

The same strategic focus is needed by our governments if Australia is to make the most of our smart, ambitious people and embrace the opportunity for growth.

These are complex policy areas where much public and private sector work already is underway. The AICD's proposals apply a governance lens to these challenges and promote reforms that draw on the insights and concerns of directors.

Recommendations

1. **Simplify the award system** and improve industrial relations regulation.
2. **Increase workforce participation** by women, including in governance and leadership roles.
3. **Expand Australia's focus on education** and skills training.
4. **Maintain a strong skilled migration stream** as part of non-discriminatory immigration policies.

Directors understand that Australia's true competitive advantage lies in its people. An engaged, skilled and flexible workforce is critical to sustainable economic growth.

1. Workplace system reform

Our most recent *Director Sentiment Index* ranked modernising workplace practices as a priority for the government.[30] Three quarters of the AICD's membership support reform of Australia's industrial relations system, with most recommending this be implemented with a clear electoral mandate.

Penalty rate reform, individual workplace arrangements, the enterprise bargaining system, modernising the award system and union right of entry provisions were the top priorities for directors.[31]

The AICD welcomes the recent decision by the Fair Work Commission to better align Sunday penalty rates with Saturday rates, but further reform is needed.

As the Productivity Commission has noted, Australia's system of workplace relations involves a complex array of laws, regulations and institutions, with 'unquestionable inefficiencies, remnant unfairness, some mischief and absurd anachronisms.'[32] This system won't meet the challenges of the changing workplace.

Simplifying the award system by reducing the number and scope of individual awards, would provide an effective and consistent safety net to the workplace regime.

2. Workforce participation

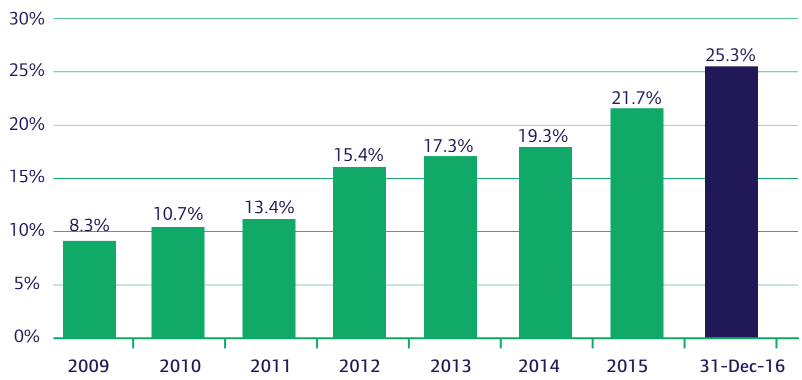
Improving female participation remains a challenge for Australia, but one that can deliver both productivity and equity results. As the Grattan Institute has noted, merely lifting our female participation rate to equal Canada's could deliver a $25 billion annual boost to GDP.[33]

The AICD supports Australia's commitment to the G20 target of reducing the gap in male and female participation rates by 25 per cent by 2025. Australia's participation rate gap is 11 per cent. This ambitious target won't be reached on current policy settings, as Treasury's 2015 *Intergenerational Report* showed.[34]

A national action plan is needed to prioritise reforms that will achieve the participation target. One principle of the OECD target is that the representation of women in decision-making positions should be increased by voluntary targets to enhance gender diversity on boards and in senior management of listed companies.[35]

To this end, the AICD remains committed to increasing the representation of women in governance roles, with a target of a minimum of 30 per cent female directors on S&P/ASX200 companies by the end of 2018. Among the broader ASX200, women now account for 25 per cent of board positions, up from 8.3 per cent in 2009 when the AICD began compiling figures.

Chart 7: Percentage of female directorships on ASX200 boards



Source: Australian Institute of Company Directors

30 AICD *Director Sentiment Index* (December 2016) **www.aicd.com.au**

31 AICD *Director Sentiment Index* (December 2016) **www.aicd.com.au**

32 Productivity Commission "Australia's workplace relations framework: repair not replacement" October 2015: **http://www.pc.gov.au/news-media/pc-news/**workplace-relations

33 "How can Australian governments change the game for economic growth?" 2012: **http://grattan.edu.au/wp-content/uploads/2014/04/game_changers_the_conversation_op-ed.pdf**

34 2015 Intergenerational Report: Australia in 2055, 2015. **www.treasury.gov.au**

35 "Monitoring progress in reducing the gender gap in labour force participation", OECD G20 Report (May 2015), **www.oecd.org**

Another important consideration is for government to examine the existing system of childcare to determine the extent of impediments for many returning to the workforce, particularly women. The cost of professional child care in Australia is notoriously high and rising, highlighting the need for further reform.

The high cost of child care and its interaction with high marginal tax rates can create powerful disincentives for people to return to the workforce from child caring duties. This means that, while the participation rate gap between males and females is relatively low, our aggregate workforce participation rates are below global averages, particularly for women.

3. Expand Australia's focus on education and skills training, including tertiary system reform

Australia's system of tertiary education requires review to ensure it is fit for the future. The structure of vocational, university and other forms of higher education was framed decades ago in the old economy, when manufacturing still represented 40 per cent of Australia's national output – it now represents only eight per cent of our GDP.

Graduates need not only credible and recognisable academic qualifications, but the additional ability to problem-solve in the real, rapidly-changing world, and think creatively and innovatively. A recent report by education provider Navitas[36] argues that Australian students need a mindset of creating a job for the future, not finding a job of the past.

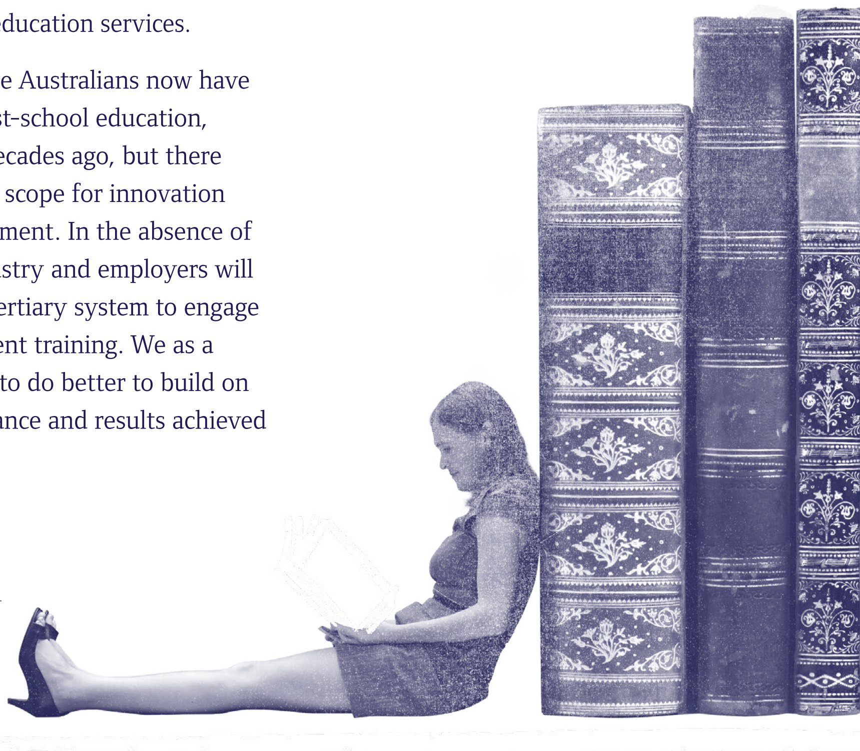
Navitas also says that digital competence needs to be embedded into all tertiary programs.[37] More than half (53 per cent) of respondents to a recent survey of 10,000 people in China, Germany, India, the UK and the US said that technology breakthroughs will change the way people work over the next decade. Another third of respondents said demographic shifts will drive change.

The digital disruptions associated with the Fourth Industrial Revolution are here to stay, but their nature is changing rapidly. We cannot stand still with an education system designed in another era.

Higher education in Australia is not yet well suited to the 'borderless' education needed in the future, if Australia is to become an even more successful exporter of education services.

Millions more Australians now have access to post-school education, relative to decades ago, but there is significant scope for innovation and improvement. In the absence of change, industry and employers will bypass the tertiary system to engage in independent training. We as a nation need to do better to build on the performance and results achieved to date.

Graduates need not only credible and recognisable academic qualifications, but the additional ability to problem-solve in the real, rapidly-changing world, and to think creatively and innovatively.



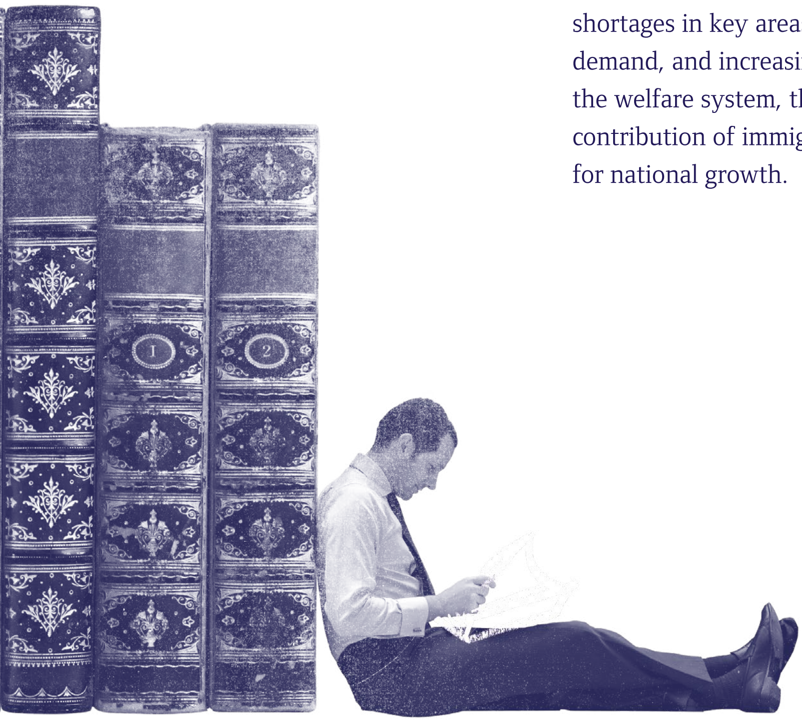
[36] Submission from Navitas Limited to the House of Representatives Standing Committee on Employment, Education and Training, 1 February 2017

[37] Ibid

To drive national improvements to our tertiary system, the AICD suggests:

- A whole-of-system re-think of priorities for higher education, to break down silos and streamline convoluted regulatory structures.
- Leadership by industry groups, including the AICD, to foster engagement and collaboration across levels of government, with providers of capital and the education sector.

The current system is not collaborative enough, favours providers operating in silos, is too rigid and inflexible, and is anchored in the past. The unfortunate failure in the VET loan scheme is emblematic of what can go wrong when there is poor policy design and implementation, and not enough consultation and collaboration.



The AICD welcomes progress on boosting the number of people with access to tertiary education and the success of tertiary education as a rapidly-expanding services export. A systemic review will ensure that our system remains 'fit for purpose' in educational and skills outcomes for Australian students, and as a driver of services export growth.

4. Maintain a non-discriminatory immigration program with a strong skilled migration stream

Immigration is a positive contributor to the Australian economy and community more broadly. More than seven million people have migrated to Australia since 1945, and one in four Australians were born overseas or have a parent who was born overseas.[38]

Immigration is important for Australia's ongoing economic growth. Migrants contribute positively to the labour participation rates and productivity. With an ageing population, select skills shortages in key areas of economic demand, and increasing demands on the welfare system, the continued contribution of immigration is critical for national growth.

For Australian businesses, having access to global skills and talent is an important contributor to driving innovation and entrepreneurialism. Maintaining a well-targeted and robust skilled migration stream is especially important as a contributor to our nation's human capital.

In line with our call for a push back against protectionism, the AICD encourages governments to commit to maintaining and building on our immigration program, including a strong skilled migration stream.

The AICD supports a shared political commitment to non-discrimination in Australia's immigration policies, ensuring our intake is non-discriminatory in terms of nation of origin, sex, race or religion.

[38] Australian Government Department of Immigration and Border Protection, Fact Sheet – More than 65 Years of Post-war Migration **www.border.gov.au**

Not-for-profit sector: a partnership approach

Australia's NFP sector occupies a critical position within the community and plays an increasingly significant role in the marketplace. Charities alone (themselves only 10 per cent of the broader NFP sector) employ over 1.2 million Australians and have a combined annual income equivalent to 8.3 per cent of GDP.

Record numbers of NFP directors and executives are attending the AICD's courses and events, demonstrating the sector's commitment to good governance. As the challenges the sector faces become more complex, capability in governance must continue to improve.

At present, regulation and funding structures present barriers to good governance for many NFPs.

The AICD's *2016 NFP Governance and Performance Study* revealed that funding uncertainty and regulatory change were distracting boards from long-term strategy. This represents an enormous challenge to the sector.

NFP directors have called for a more collaborative and mature relationship with government. This reflects a desire to work in genuine partnership to achieve the shared goals of the sector and the government – it is not a grab for more funding.

Government must enter into genuine partnership with the NFP sector if these challenges are to be overcome.

The AICD is proposing reforms that will strengthen and improve the landscape for NFP organisations and support a high standard of governance, outcomes and efficiency.

Recommendations

1. **Improve the funding environment** for NFPs with a shift to five-year funding cycles, with 12 month notice periods.
2. **Develop a fit-for-purpose regulatory regime** with national consistency and less red tape.

1. Improve the funding environment for not-for-profits to support good governance and a more impactful sector

The way government funds and procures services from NFPs is a major influence on their governance, performance and sustainability. Short-term, ad hoc and outputs-driven funding prevents NFPs from focusing on the strategic and long-term challenges they seek to address. The AICD is concerned that many NFP directors are exposed to unreasonable risk as funding arrangements are changed, withdrawn or delayed, exposing them to the potential for insolvent trading.

We are calling for the adoption of a best practice model for government funding agreements, implemented on an 'if not, why not' basis, to establish:

- Five-year cycles for funding agreements, with 12 months' notice of termination (where appropriate and feasible);
- Outcomes-focused reporting, with a focus on 'report once, use often' through the ACNC;
- Freedom of voice in public debate for government-funded NFPs and their boards; and
- Investment in internal governance and capacity building as part of all funding agreements.

2. Develop a fit-for-purpose regulatory regime

NFPs are subject to an out-of-date regulatory regime that stifles innovation, wastes resources and distracts NFPs from pursuing their missions efficiently and effectively. A modern and fit-for-purpose regulatory regime is required to support the demands of an increasingly complex environment.

The AICD is calling for a national reform agenda for NFP regulation, including:

- A new simplified reporting framework for NFPs supported by a 'report once, use often' approach across all Australian Government agencies; and
- Greater access to aggregate government data to support NFPs to be more impactful.

The goals of these reforms are realistic, achievable within the next two years and critical to supporting NFPs to achieve good governance which will have positive flow-on effects to individuals, communities and the economy.

The AICD is proposing reforms that will strengthen and improve the landscape for not-for-profit organisations and support a high standard of governance, outcomes and efficiency.

National infrastructure

Effective and efficient infrastructure is essential to support our nation's productivity and growth.

Australia's national infrastructure is straining at the seams, particularly in transportation and in power generation. There are bottlenecks and costly congestion on our roads; the latter imposes significant costs and can be a major impediment for investment.

Productivity has lagged behind long-term averages in recent years, partly owing to inefficiencies and inadequacies in national infrastructure. Productivity is a fundamental element of the nation's potential growth rate – the economy's effective speed limit. Failure to address the inadequacies in the nation's infrastructure means lower economic growth in the future.

As the *Australian Infrastructure Audit* from 2015 highlights, without action on infrastructure increasing congestion and bottlenecks will test Australia's productivity and quality of life.[39]

A key problem is that there is inconsistent assessment of public projects across jurisdictions, many of which are guided by political rather than economic imperatives. The Productivity Commission has noted that significant questions continue to be raised about the efficiency, governance and cost-benefit methodologies applying to infrastructure planning and investment.[40] Australian governments have an established system of project assessment and prioritisation, but this process often is subsumed by the demands of politics.

The AICD recommends a renewed focus on national, productive infrastructure to boost growth.

1. COAG commitment to a 15-year infrastructure plan

The AICD encourages Australian governments to develop consistent and strong governance standards for nationally-significant infrastructure projects, increase the transparency of forecasts of the costs and benefits of infrastructure investments, and develop nationally consistent measures of infrastructure performance to aid benchmarking and review.

Recommendations

1. **COAG commitment to a 15-year infrastructure plan** targeting strategic national needs, with a strong focus on improved governance standards.
2. **Increase 'good' government borrowing** to fund investment in productive infrastructure.
3. **Support innovative funding options,** including infrastructure bonds.
4. **Call to action for private sector investment,** including promoting asset recycling initiatives.

The AICD recommends that Infrastructure Australia's list of priority projects be adopted as the 'to-do' list for infrastructure investment. There is no need for governments to reinvent the wheel – some of these projects are "shovel-ready" and have been assessed

[39] *Australian Infrastructure Audit Report 2015* Infrastructure Australia **www.infrastructureaustralia.gov.au**. Infrastructure Australia forecasts that by 2031 road travel times in capital cities will increase by at least 20%, the national freight networking will have exceeded capacity, and regional roads and town water infrastructure will have deteriorated to service standards that the Australian community will be unlikely to accept.

[40] *PC Productivity Update (July 2015)* Productivity Commission **www.pc.gov.au**

There are important issues to be addressed in regards to governance of infrastructure in Australia, in addition to the need to address issues around the nature of government borrowing, private sector involvement and the pressing need to boost productivity.

for their economic and financial viability. The services of the various state infrastructure bodies should also be better utilised.

The AICD also recommends the adoption of standardised cost benefit analysis for project assessment, with oversight by the established national body Infrastructure Australia. This would help to ensure that projects selected in each jurisdiction generate sufficient national benefits when benchmarked against alternative projects. A standardised assessment approach should help to minimise political elements of project selection.

While the AICD favours adoption of the national project priority list published by Infrastructure Australia, the latest *Director Sentiment Index* provided an interesting snapshot of our members' priorities for government attention. In order of priority, the top ranked areas for government investment included renewable energy sources (44 per cent of members responding to the survey cited this as a priority), regional infrastructure (also 44 per cent), roads (40 per cent), telecommunications (36 per cent) and urban rail (29 per cent). Respondents' priorities for additional spending on airports and ports was relatively low, at 12 per cent and 11 per cent, respectively.

Recent episodes of power shedding also highlight the importance of there being a fresh examination of the governance and security of the national energy grid. There is little point focusing on productivity, competitiveness and innovation if the lights can't be kept on.

2. Good versus bad government borrowing

In principle, the AICD supports more essential public infrastructure being debt-financed, particularly given low levels of interest rates.

Not all government debt is 'bad', provided additional borrowing is used to fund productive assets that ultimately boost the economy's long run capacity. Previous debates that concluded that all government debt is 'bad' was unhelpful and unproductive.

The AICD welcomes the Treasurer's recent commitment[41] to boost 'good' borrowing to fund more infrastructure, particularly with government 10-year bond yields recently trading at the lowest levels in 160 years. However, we submit that addressing the infrastructure shortfall cannot wait until the 'bad' borrowing to fund recurrent budget shortfalls has ended, as the Treasurer has suggested.

We agree in principle that the government should *not* be borrowing for recurrent purposes merely to plug the gaping hole in the government's finances - essentially, to pay for pensions and the salaries of public servants. Waiting until such borrowing ends, however, would mean even more pressure is placed on infrastructure that already is under great strain.

[41] *Speech to the Australasian Finance and Banking Conference*, 14 December 2016 **www.sjm.ministers.treasury.gov.au**

Any new government spending, of course, should always be assessed within a framework of rigorous project assessment. Construction of long-lived assets that generate a positive economic return over time allows government to service the additional debt, and the consistent revenue stream makes the asset attractive to private sector investors.

International pension funds, for example, have a great appetite for investment in long-lived infrastructure assets, allowing government to recycle the sale proceeds into other productive assets, creating a virtuous cycle. The construction phase, for example, has clear benefits for national economic activity and employment.

3. Funding of infrastructure

The AICD recommends that government examine innovative ways of funding national infrastructure. Governments should examine the merits of infrastructure bonds, for example, which provide an alternative that already is being used in some jurisdictions. Again, there is a ready market for these bonds among offshore investors.

Ongoing underinvestment by private businesses in Australia remains something of a puzzle. There is evidence that some firms maintain hurdle rates of return on investment that are too high, making it difficult to get board approval for new projects. The AICD encourages hurdle rates to be revised downwards to reflect the new world of lower inflation so that projects can be started. The current regime encourages risk aversion.

To aid transparency, the AICD also recommends that government fine tune the list of active projects attracting government funding. There has been a tendency of late for governments to recycle lists of pre-announced (and re-announced) projects, a practice that makes it difficult to determine new funding and priorities.

4. Boosting private sector infrastructure investment

Australia's infrastructure needs cannot be funded by public investment alone.

Expanding private sector engagement in infrastructure delivery and operation is critical if we are to avoid the forecast shortfall in capacity and service levels.

Government should focus on private sector contributions enhancing public funding commitments, including via public-private partnerships, which have tended to fade from consideration.

The AICD endorses the *Australian Infrastructure Plan's* call for greater use of well-regulated, market-based solutions and increase engagement with the private sector to fund and deliver productive infrastructure.[42] The AICD supports expansion of asset recycling as a means of maximising infrastructure use and investment.

The recent strong performance of the New South Wales economy, fuelled in particular by extensive infrastructure spending and funded in part by an innovative asset recycling program, shows how effective such efforts can be. The AICD calls on state and territory governments to significantly increase asset recycling, supported over time by nationally consistent standards on governance, benchmarking and reporting metrics.

[42] *Australian Infrastructure Plan*, Infrastructure Australia, February 2016.

Appendix:
AICD tax reform scenario

Estimating the financial impact of reform options

The AICD has worked with Deloitte Access Economics to develop estimates of the financial impact of proposed reform scenarios. The interactive model developed for the AICD by Deloitte Access Economics estimates the impact on the Federal Budget of changes to the tax mix, based on publicly available material (referenced at the conclusion of this appendix).

This is an innovative tool that allows reform options to be tested to help inform the AICD's tax advocacy. However:

- It does not allow for interactions between different reforms, and as a result is likely to underestimate both costs and benefits of reforms;
- It adopts an 'average state' for estimates of state tax reform impact, and does not take account of specific jurisdictional exemptions and tax;
- The estimated prosperity dividends draws on rule of thumb analysis from Treasury work and not full computable general equilibrium (CGE) modelling; and
- The tool produces estimates and approximations that should be relied upon as illustrative only, noting that CGE modelling has not been conducted.

In addition to budget impacts, the model estimates the 'prosperity dividend' that a package of reforms could deliver. These estimates are approximate and indicative of the direction and magnitude of the selected tax reform options on the economic prosperity of Australia, as measured by national incomes.

They are based on 'rule of thumb' analysis drawn from Treasury's *Re:Think Tax Discussion Paper 2015*. Neither the AICD nor Deloitte Access Economics has conducted detailed computable general equilibrium modelling of the AICD's preferred tax options.

Tax reform scenario

- Increase the GST rate to 15 per cent, with compensation for lower income earners.
- Broaden the GST base to include fresh food, education, health and utilities.
- Decrease all personal income tax rates by 6.5 per cent.
- Remove work related deductions and channel savings to reduce inefficient top marginal tax rate.
- Staged reduction in corporate tax rate over four years to 26 per cent.
- Capital gains tax discount cut to 40 per cent from 50 per cent.
- Review negative gearing.
- Incentive payment to states to drive reform of inefficient taxes – stamp duty replaced by land tax.

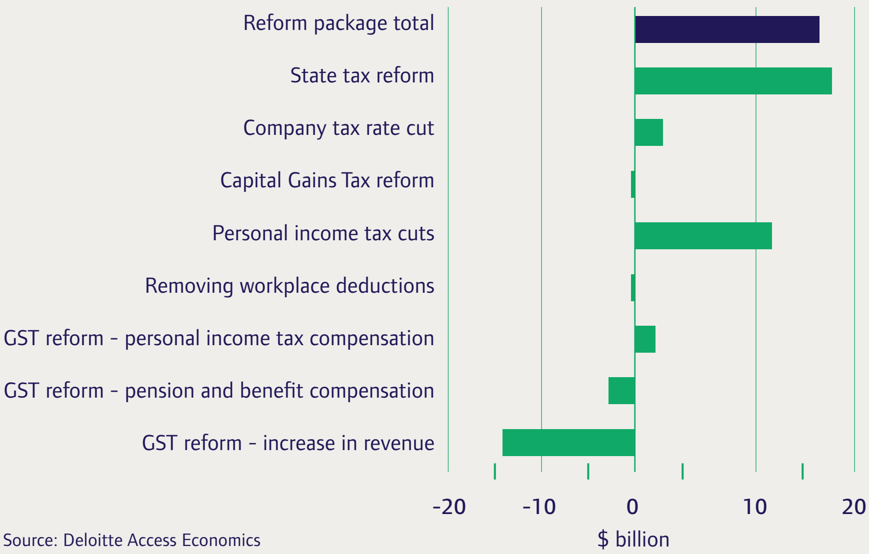
Key assumptions

While the figures included on the impact of reforms are estimates only, they provide a strong indication of the benefits from different reform options.

Key assumptions applied in assessing impact include:

- Increased revenue from the GST flows to the Commonwealth Government, for application across compensation, tax cuts and reforms, and a funding boost to states and territories;
- A substantial compensation package targeted at low and middle income earners, via tax (changes to the low income tax offset) and welfare benefits, to restore net financial position;
- Ten per cent of net positive GST revenue is allocated to states and territories as a funding boost, with payment contingent upon progress on reforming state taxes;
- Tax reform by states and territories, with stamp duty replaced with land tax; and
- Estimates are based on an 'average state' estimate, assuming a constant rate of land tax across all jurisdictions.

Chart 8: Estimated prosperity dividend ($ billion)



Source: Deloitte Access Economics

Table 2: AICD tax reform scenario

	Projected budget impact over four years - $ billion	
	Revenue	**Cost**
GST – Increase GST rate to 15%, broaden base	273.1	
GST compensation – Tax cuts		36.6
GST compensation – Transfer and pension payments		45.1
Personal income tax – Reduction in personal tax rates		165.0
Personal income tax – Removal of general deductions	0.7	
Capital gains tax discount – Reduce CGT discount to 40%	6.4	
Company tax rate – Staged reduction in tax rate		19.7
State and territory incentive payments – Dedicate 10% of net GST revenue		19.1
State and territory incentive payments – Net Commonwealth budget position	5.3	
Estimated prosperity dividend	**16.4**	

Sources and assumptions

The outputs of the AICD model developed by Deloitte Access Economics should be considered in light of the assumptions and caveats listed below.

GST Estimates

- Deloitte's *Mythbusters 1* report available at: http://www2.deloitte.com/au/en/pages/media-releases/articles/mythbusting-the-tax-reform-debate-140915.html
- Estimates of the impact of expanding the GST base as proposed in Scenario B are based on the Federal Treasury *Tax Expenditure Statement* (TES) 2014. These estimates vary in reliability depending on the quality, detail and frequency of underlying data. For example, unexpected changes in economic conditions may influence the future value of tax expenditures, impacting the reliability of tax expenditure projections. The TES is available at: http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/TES-2014
- Compensation figures relating to GST scenarios are based on the current tax and transfer system. Other reforms to the tax or transfer system in addition to those undertaken as part of the GST reform scenario would alter the amount and distribution of the compensation provided.

Personal Income Tax Estimates

- Deloitte's *Mythbusters 1* report available at: http://www2.deloitte.com/au/en/pages/media-releases/articles/mythbusting-the-tax-reform-debate-140915.html

Capital Gains Tax

- Extrapolated from Parliamentary Budget Office (PBO) costings prepared for the Australian Greens, released at: http://scott-ludlam.greensmps.org.au/sites/default/files/cgt_factsheet.pdf
- The PBO costing is based on TES estimates regarding realisation rates; growth in different asset prices; and utilisation of losses. These assumptions are discussed in detail in the Federal Treasury working paper *Capital Gains Tax: Historical Trends & Forecasting Frameworks*, available at http://treasury.gov.au.

Company Tax

- Deloitte's *Mythbusters 1* report available at: http://www2.deloitte.com/au/en/pages/media-releases/articles/mythbusting-the-tax-reform-debate-140915.html
- Federal Treasury paper on the incidence of company tax (Rimmer, X., Smith, J., & Wende, S., 2014, 'The incidence of company tax in Australia', *Economic Roundup*, Issue 1, pp. 33-48) provides three different scenarios around company tax marginal tax reform: excess burdens – 'open and competitive', 'economic rents', and 'economic rents and imperfect capital mobility'. Their central case is for 'economic rents'.

State Taxes:

- Deloitte Access Economics report the Property Council of Australia, available at: http://www.propertycouncil.com.au
- An 'average state' is assumed for the purposes of the estimate, actual impacts on specific jurisdictions would vary. Estimates are based on ABS data on tax revenue for 2013/14. Figures for 2016/17 have been escalated by five per cent. Estimates do not take account of the specific forecasts of states and territories.

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