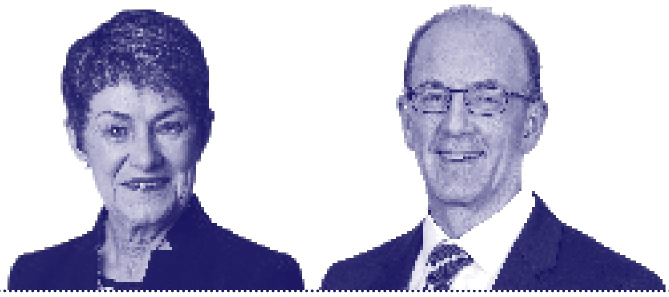
AUSTRALIAN INSTITUTE
of COMPANY DIRECTORS

Governance of the Nation

A report card on progress

APRIL 2018

Foreword



In 2017, the Australian Institute of Company Directors (AICD) challenged the nation's policy-makers and leaders in our *Governance of the Nation: A Blueprint for Growth* report.

The AICD believes Australia's proud track record of growth and international competitiveness cannot be sustained without a bold policy agenda.

Our *Blueprint for Growth* proposed reforms in national governance, fiscal sustainability, innovation, education, human capital, infrastructure and the not-for-profit sector – critical areas to support better economic and social outcomes for all Australians.

Importantly, this is not a job for government alone. Our recommendations explicitly recognise the vital role of the private sector, including boards and directors, in driving change.

As the voice of excellence in governance, the AICD brings a unique perspective to the challenges facing our nation.

The views expressed in the *Blueprint* were informed by insights drawn from the AICD's membership of more than 41,000 leaders from across business, not-for-profits and government organisations, responsible for millions of jobs and billions of dollars in investment and services across the country.

While our *Blueprint* reform proposals aim for long-term outcomes – a key good governance focus – to make them reality, we need commitment and action now.

That is why this year, we are issuing a Report Card against our *Blueprint* recommendations.

Unfortunately, the results can only be summarised as disappointing.

While there are some reasons for optimism – such as progress on national infrastructure and an improved fiscal standing – overall, we are yet to see the commitment to action on the reform agenda that Australia needs.

With the many challenges posed by today's political, economic, and social environment, all stakeholders must focus on the long-term good of the nation. In the coming years, as debates intensify around the policies that will take our nation forward, Australians must focus on their commitment to future generations as they consider the options being presented.

We hope this report helps to impel our national leaders to take up this critical task.

Elizabeth Proust AO FAICD
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Executive Summary: Scoring our Progress

The AICD's *2017 Blueprint for Growth: Governance of the Nation* report set out a plan for our national leaders to sustain and boost Australia's growth and prosperity.

In particular, the *Blueprint* made the case for a clear and expansive national reform agenda.

One year on, the case for action is only stronger, as Australia deals with continuing global uncertainty and economic and social challenges.

Unfortunately, as this report shows, we are failing to rise to the challenge.

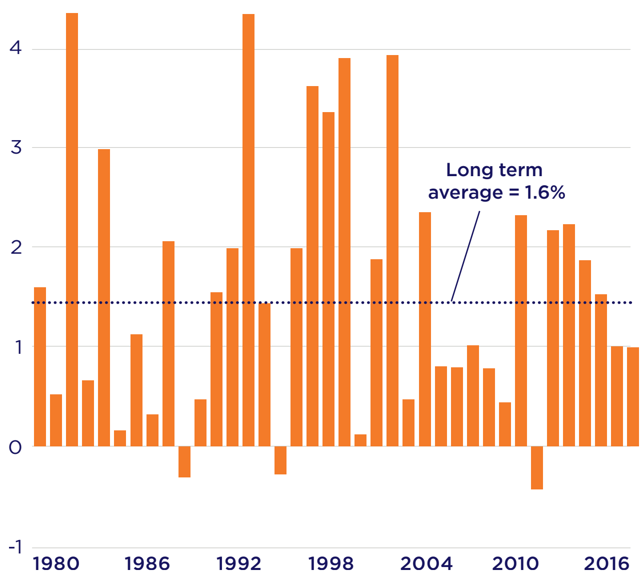
Australia's productivity has languished for a decade or more. We are running out of booms, so need to focus on the factors that will trigger the next phase of growth in our economy. Australia has enjoyed 27 years without recession – a remarkable and unmatched achievement – but the drivers of our next phase of growth are not yet apparent.

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 our nation.

Most importantly, Australia must address our poor productivity growth. Bold policy action is needed. As things stand, Australia has no fiscal buffer to fall back on should economic circumstances deteriorate.

The recommendations put forward in the *Blueprint* for Growth draw on the insights from the AICD's members through our twice-yearly *Director Sentiment Index*, as well as analysis by the AICD's Chief Economist and Policy team. While not exhaustive, the recommended reforms focus on areas where the AICD is confident that action can deliver marked growth and governance dividends.

LABOUR PRODUCTIVITY, ANNUAL % CHANGE



Source: ABS, AICD

This year, rather than revisit recommendations, the AICD has decided to mark progress on these important initiatives. Our report card is mixed, but overall, disappointing. This report seeks to build a greater sense of urgency in policy-makers and leaders on the pressing need for comprehensive reform.

We will continue to debate these substantive issues with our members in the coming years and to look for opportunities to work with all stakeholders to achieve momentum for reform, particularly where there is a bipartisan basis.

Progress Report – Our Approach

The recommendations in the *Blueprint* spanned a broad spectrum of issues, including national governance, fiscal sustainability, innovation, education, human capital, infrastructure and the not for profit sector.

In assessing progress against our recommendations the AICD has considered a range of factors, supported by analysis from our Chief Economist, Stephen Walters GAICD. We have sought to apply a governance lens to our performance as a nation and our rationale for each grading is spelt out in the report.

Critically, the AICD's progress report scores are not intended as a means to apportion blame to any particular government, political party or leader, past or present. When and where a particular policy foundered is often difficult to unpick.

Instead, the scores presented in this report are a means of marking ourselves on how well we are rising to the challenge of national reform – government, business, trade unions, representative and industry bodies, NFP organisations and other stakeholders.

We are all responsible for our performance, so should be scored collectively on progress – or lack thereof.

Of course, a progress report of this nature involves considerable subjectivity, and we expect our ratings to be contested and challenged. The AICD welcomes and encourages such debate.

Australia's energy policy – national interest must prevail

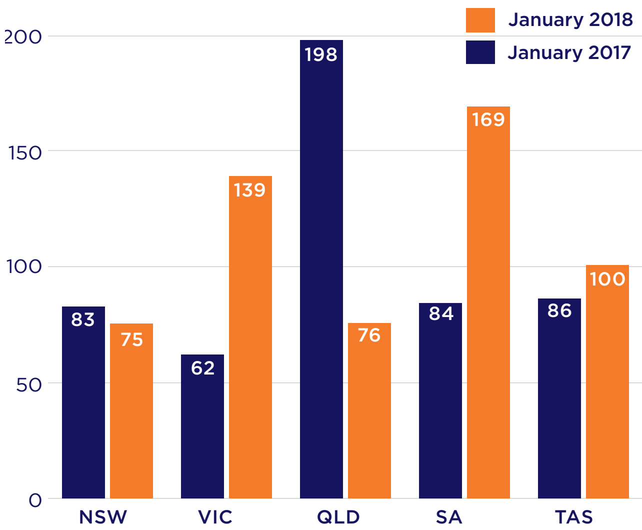
A progress report on national reform would be incomplete without specific mention of national energy policy, an issue which we did not address in detail last year.

Directors are crying out for durable solutions, not temporary band-aids. In the *Director Sentiment Index* survey of company directors, "energy policy" and "energy prices" topped the list of areas AICD members believe the government should address in the near term[1]. Tellingly, addressing the energy impasse was ranked above infrastructure shortages, a perennial favourite.

The list of failures on energy policy is long: a lack of market transparency; too much market concentration; public policy inconsistency; the appearance of domestic price gouging; over-investment in some areas; under investment in others; and much more.

For too long, short-term "fixes" have been prioritised over the development of durable, long term solutions.

WHOLESALE ELECTRICITY PRICES ON NATIONAL GRID – $A PER Mwh



Source: AEMO

NB: WA is the only state which is not part of the national grid.

The result is that, in what seems to have been a blink of the eye, Australia has gone from having the world's cheapest energy to among the world's most expensive. This is despite us having abundant energy resources.

There is plenty of blame to go around, and not all of it is aimed at governments. The regulators are copping their share, as are large energy users. Meanwhile, some power providers, accused of making excessive profits while shutting down aging capacity, are defying government pleas for delays. In some cases, the private sector has stepped in with solutions.

Without much stronger, coordinated action by all stakeholders, Australia will remain in a state of perpetual crisis. Therefore, the AICD calls for a bipartisan approach to energy that will provide long overdue policy certainty.

The Government's proposed solution to the energy crisis is the National Energy Guarantee (NEG), which attempts to ensure reliable delivery of energy at affordable prices, while complying with Australia's global climate change agreements. But, the NEG must be approved by the states and territories via the fraught COAG process.

The AICD will continue to monitor developments closely, while urging all players to agree on a durable solution to this most critical challenge.

[1] Director Sentiment Index: Research Summary – Second Half 2017.

Report card in summary

Improving national governance

Blueprint Objective

Modernise systems of government to support longer-term policy decisions, with directors to lead by example on governance practice.

Progress summary

Constructive conversation began on extending Parliamentary terms, but COAG continues to underperform and trust in business remains low.

Recommendations from 2017 Blueprint for Growth

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

Fiscal Sustainability

Blueprint Objective

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

Progress summary

Some progress towards Budget repair, including via spending restraint, but comprehensive tax reform remains off the agenda.

Recommendations from 2017 Blueprint for Growth

- 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, incorporating:
  - Lift the GST rate to 15 per cent and broaden the GST base, with targeted compensation.
  - Significant reductions in personal income tax rates.
  - Incentivise states to remove inefficient taxes.
  - Reduce the CGT discount to 40 per cent.
  - Review negative gearing and the nexus with the CGT discount.
  - Reduce the corporate tax rate.

Innovation and Entrepreneurialism

Blueprint 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.

Progress summary

Safe harbour laws and the firm push back against protectionism are significant achievements.

Recommendations from 2017 Blueprint for Growth

- Push back on protectionism to support an open, export-orientated economy.
- Develop a regulatory environment to better foster innovation.
- Boost Australia's innovation system, prioritising collaboration in R&D and targeted skills.

Human Capital

Blueprint Objective

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

Progress summary

Welcome resistance to changes to immigration laws and rising female labour participation rate, but little progress on workplace reform.

Recommendations from 2017 Blueprint for Growth

- Further workplace system reform to simplify the award system and improve industrial relations regulation.
- Increase workforce participation by women, including in governance and leadership roles.
- Expand Australia's focus on education and skills training, including STEM and VET streams.
- A non-discriminatory immigration program with a strong skilled migration stream.

Partnerships with NFPs

Blueprint Objective

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

Progress summary

Slow, but positive, progress on regulatory consistency, but funding cycles and duplication remain key challenges.

Recommendations from 2017 Blueprint for Growth

- Set 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 (e.g. fundraising reform).

Infrastructure

Blueprint Objective

Improved infrastructure is critical to lifting productivity and economic growth.

Progress summary

Treasurer's positive position on borrowing offset by ongoing infrastructure governance faults.

Recommendations from 2017 Blueprint for Growth

- COAG commitment to a 15 year infrastructure plan targeting strategic national needs, with a strong focus on improved governance standards.
- Careful distinction between "good" and "bad" government borrowing.
- State and territory governments to prioritise asset recycling in infrastructure planning.
- Call to action for private sector investment.

Reforming national governance

In the *2017 Blueprint*, the AICD called for reforms to our national system of governance, from longer parliamentary terms to a reinvigorated COAG. We also called for high governance standards and a constructive contribution to national debate from the private sector.

Our recommendations are not a criticism of any political party, leader or government, past or present. Rather, they reflect the need for structural change to support long-term decision-making and lift public confidence in our national democratic system.

There has been mixed progress over the past year, and renewed focus and commitment is required by all.

Progress scorecard

SUMMARY RATIONALE:

Constructive conversation began on extending Parliamentary terms, but COAG continues to underperform and trust in business remains low.

CRITERIA:	SCORE:
Fixed, four-year terms for Federal Parliament	C-
Review of the Federation	D
Reinvigorate COAG	D
Leadership in governance standards and practice	C

RECOMMENDATIONS:

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

OVERALL SCORE:

Fixed, four-year terms

The AICD called for a bipartisan commitment to constitutional change that would see fixed four-year terms introduced for the House of Representatives.

On average, Australia's last 15 federal governments served terms of only two and a half years. This means that three out of every 10 years are effectively lost to election campaigning rather than long-term policy-making. A move to fixed, four-year terms would, in the AICD's view, improve certainty and support a focus on longer term policy outcomes.

In July 2017, the Federal Opposition called for an agreement between the major parties to support constitutional change.[2] The initial response from Government was promising[3], supported by ongoing work by advocates in Parliament such as David Coleman MP.[4] Public opinion, too, favours change[5].

While these signs have been promising, there is still no clear path to action. The lack of a serious discussion about the benefits of four-year terms has highlighted a deeper issue confronting the nation. We are now in the longest drought in Constitutional change since Federation, with the last successful referendum in 1974.

This is a significant issue.

Recent discussions around Indigenous recognition, four-year terms and dual citizenship challenges have only sought to highlight the lack of bi-partisan commitment to important constitutional reform.

A century ago, Australia was one of the most innovative democracies in the world. To regain this mantle, we must re-energise debate on constitutional change.

Review of the Federation

Our Federation has served the nation for 117 years.

Moreover, just as the laws and practice of governance have changed to adapt to the needs of stakeholders and the community, so too must the machinery and infrastructure of our Federal system.

To support better outcomes in our Federation, the AICD has called for a comprehensive review to clarify Commonwealth, State and Territory responsibilities, funding and accountability. In the *2017 Blueprint* we called for this work to commence immediately, reporting in 2018, noting that the Government had walked away from an earlier white paper process in 2016.

Disappointingly, there has been no material progress since.

One positive development, although limited in scope, is the Productivity Commission being tasked by the Treasurer to provide alternatives for the distribution of GST revenue. This review, however, does not focus on the low rate or shrinking base of the GST (issues we refer to in the next section).

"We are now in the longest drought in Constitutional change since Federation"

[2] *ABC Insiders* 23 July 2017 **http://www.abc.net.au/insiders/bill-shorten-joins-insiders/8735534**

[3] 'Malcolm Turnbull backs Shorten's call to introduce four year fixed terms of parliament', Sydney Morning Herald 23 July 2017 **https://www.smh.com.au/politics/federal/bill-shorten-calls-for-referendum-to-give-federal-governments-fixed-fouryear-terms-20170723-gxgs3s.html**

[4] **https://www.davidcoleman.com.au/draft-legislation-introduce-fixed-four-year-terms-house-representatives**

[5] See '4 year fixed or maximum terms are preferred alternatives to three year minimum term for the House of Representatives', term', JWS Research, March 2017 **http://jwsresearch.com/news_files/jws-research-federal-parliamentary-terms-survey-march-2017.pdf** and '58 per cent support 4-year fixed terms for Federal Parliament and 24 per cent oppose', Essential Research August 2017, **http://www.essentialvision.com.au/wp-content/uploads/2017/08/Essential-Report_010811.pdf**

Reinvigorate COAG

The *2017 Blueprint* called for a renewed focus on a forward reform agenda for COAG, supported by an independent secretariat and chair for the Council.

Unfortunately, little progress has been made.

In fact, the COAG process appears increasingly broken. Even the useful COAG work that facilitated agreement and cooperation across state borders and between levels of government seems less apparent.

The COAG meeting in June 2016 showed that governments can work together in the national interest, when all jurisdictions agreed to anti-terrorism provisions. Success shouldn't, however, be limited to national security when other critical matters, like energy policy, fail to progress. Upcoming COAG meetings dealing with the National Energy Guarantee (NEG) will be a key test for COAG as a reform body.

Australians will have much more faith in their governments at all levels if they see them working together to provide durable, long-term solutions for the nation. An effective and forward-looking COAG is critical to this outcome.

While the AICD recognises that there has been little support for appointing an independent chair for COAG, we maintain our view that these measures would work to enhance the Council's effectiveness by helping to de-politicise the process.

Leadership in governance standards and practice

The AICD's *2017 Blueprint* recognised that improving the quality of national governance is not a job for government alone. Governance leaders in organisations of all kinds – from large listed companies to charities – have an important role in shaping a positive, constructive debate and leading by example in governance standards.

While there have been good examples of such leadership, unfortunately, the past year also saw a continuing low-level of trust in business. The Royal Commission into the financial services sector can be viewed partly as a response to this.

The 2018 Edelman Trust Barometer shows the extent of this challenge. On almost every measure, Edelman's global results for government, media, NGOs and business world-wide was damning, with a strong call for business to take action on social policy and rebuilding trust.[6]

Domestically, Edelman's data showed that more than half of Australian respondents believe that government is broken. Australia's trust in business, at 42 per cent, is well below the global average. Media and NGOs are also distrusted, with trust in NGOs falling below 50 per cent in Australia for the first time.

A lift in the perceived credibility of Australian board directors and CEOs in the report this year was a positive sign however. Trust in directors rose from 24 per cent to 34 per cent and trust in CEOs grew from 26 per cent to 39 per cent. Both gains are off a low base and we continue to lag global averages however.

[6] Tonia E Ries, David Bersoff, Cody Armstrong, James Bruening, Sarah Adkins, '2018 Edelman Trust Barometer – Global Report', (Report, 2018) Edelman: **https://www.edelman.com/trust-barometer**

In this environment, business faces continuing calls to invest in their 'social licence to operate', as well as new layers of regulation targeting corporate accountability and a greater focus on culture.

In a positive sign, directors have increased their focus on corporate culture. The AICD's Second Half *2017 Director Sentiment Index* revealed that the vast majority of directors (92 per cent) are devoting effort to change culture within their organisation.

Australian business leaders have also stepped up to engage in the national policy debate. This was evident on energy policy, by necessity as costs soared, and tax reform, but also on topics such as Indigenous recognition, marriage equality, the republic and the parliamentary citizenship crisis.

Culture will continue to be a core focus of the AICD over the year ahead, as well as championing diversity, by consistently advocating for at least 30 per cent female representation on boards by the end of 2018.

"Australia's trust in business, at 42 per cent, is well below the global average. Media and NGOs are distrusted, with trust in NGOs falling below 50 per cent in Australia for the first time."

Fiscal sustainability

The Budget is heading back towards surplus, projected by the Government to be achieved in 2020-21. For this, the Government deserves some credit. The improvement, however, has more to do with rising profits, higher commodity prices and delayed spending, than meaningful restraint and broad-based tax reform – the key recommendations from the *2017 Blueprint* report.

Indeed, meaningful change in terms of improving our fiscal sustainability remains elusive:

- We continue to run Budget deficits, albeit smaller than before, 10-years on from the global financial crisis, and will do so for a few more years yet.
- Spending as a share of GDP remains too high, the revenue share too low - so we continue to live beyond our means.
- Commonwealth public debt already is approaching $600 billion (30 per cent of GDP), a record high. This mountain of debt will continue to rise without action.

As things stand, we are leaving the task of fiscal repair to future taxpayers – our children and even our grandchildren.

Progress scorecard

SUMMARY RATIONALE:

Some progress towards Budget repair, including via spending restraint, but comprehensive tax reform remains off the agenda.

CRITERIA:	SCORE:
Restrained government spending	C+
GST reform – higher rate and broader base	F
Personal tax regime – cuts required	B
Abolishing inefficient state taxes	D
Reduced capital gains tax discount	C
Negative gearing reform	C
Staged corporate tax cuts	B

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;
- Lift the GST rate to 15 per cent and broaden the GST base, with targeted compensation;
- Significant reductions in personal income tax rates;
- Incentivise states to remove inefficient taxes;
- Reduce the CGT discount to 40 per cent;
- Review negative gearing and the nexus with the CGT discount; and
- Reducing the corporate tax rate.

OVERALL SCORE:

On taxation, the priority of the AICD has been on whole-of-system reform, rather than the individual steps that have been taken to date, no matter how worthy. Importantly, merely cutting or raising taxes in isolation, no matter how beneficial, is not the same as whole of system reform. Nor is it politically palatable.

No proper review of Australia's complex tax system can be complete without examination of the goods and services tax (the GST) – its rate, breadth and the distribution of proceeds.

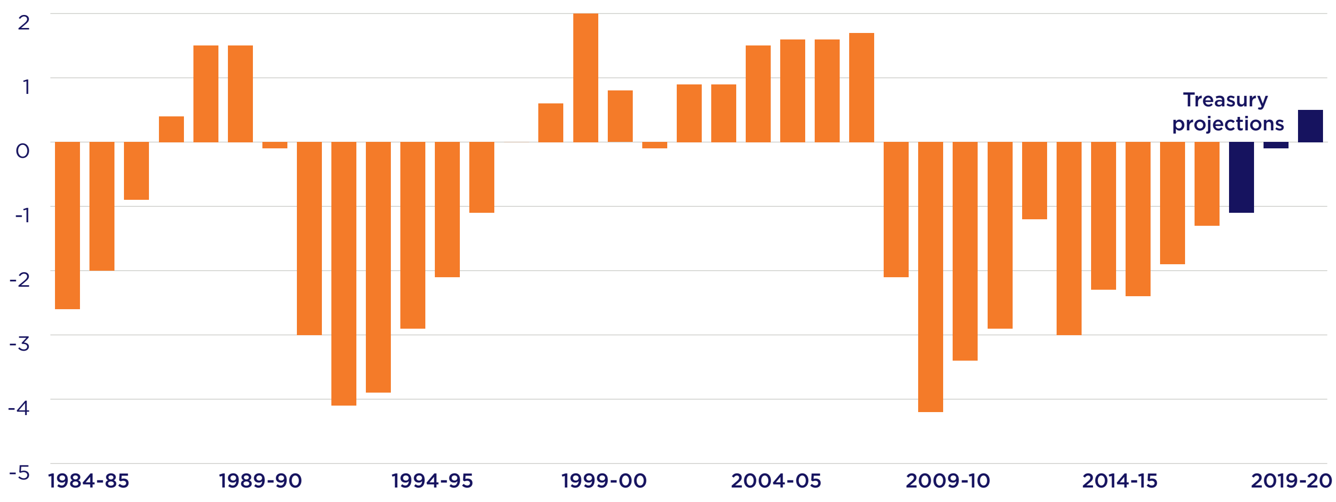
In positive news however, the updated fiscal position announced by the Treasurer in the Mid-year Economic and Fiscal Outlook (MYEFO) in December 2017 revealed that the underlying cash deficit for the year ended June 2018 was likely to be nearly $6 billion smaller than had been expected at the time of the Budget back in May last year.[7] This improvement reflected both delayed spending, particularly on the National Disability Insurance Scheme (NDIS) and higher than expected receipts.

More needs to be done. Even with the recent improvement in the underlying Budget position, Treasury still predicts annual shortfalls across the forward estimates. The ratings agencies probably will be satisfied at the progress thus far, but will be on the lookout for slippage. Australia's coveted AAA credit rating could be at risk.

The better than expected fiscal performance in recent months does not lessen the need to put national finances on a more sustainable footing.

Bold policy change is needed, as the AICD recommended in the *2017 Blueprint*.

UNDERLYING CASH BUDGET BALANCE – % OF GDP



Source: MYEFO

[7] *Mid-Year Economic and Fiscal Outlook 2017-18* (December 2017) **www.budget.gov.au**

Spending Reform – some advances, but not enough progress

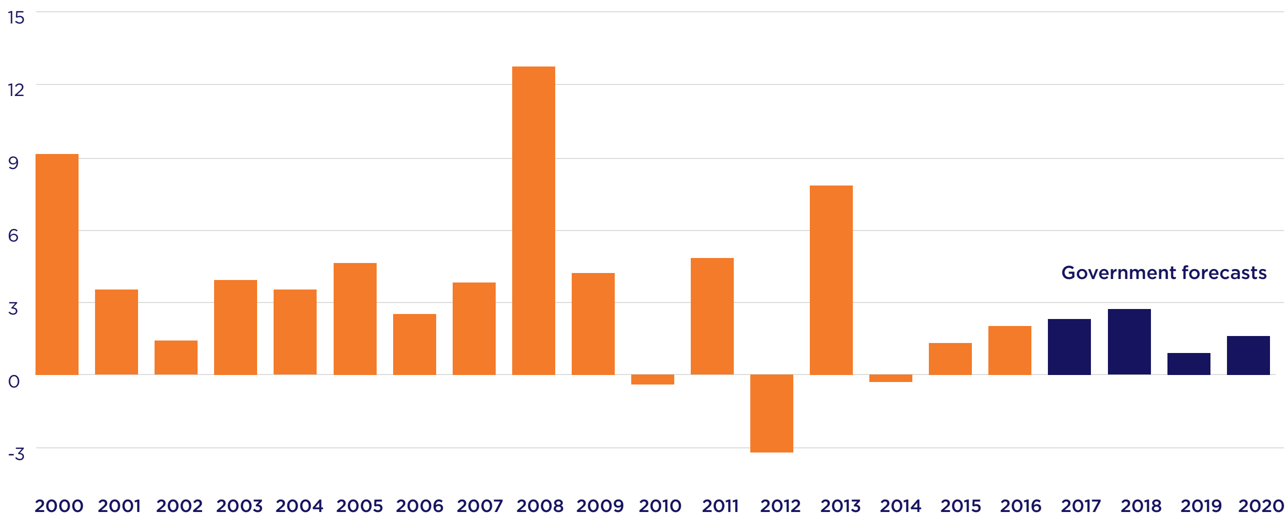
Commonwealth spending remains too high as a share of GDP, well above levels consistent with the maintenance of Budget surpluses. The Government has tried to slow growth in spending, including with several attempts at welfare reform, some of which have succeeded while others failed or were stalled in the Senate. In the absence of support for broader spending restraint, the Government has largely focused on intensified compliance efforts.

The AICD still believes that not enough has been done to restrain growth in spending. On current Treasury estimates, Commonwealth spending as a share of the economy will still be around 25 per cent of GDP by the time the Budget is expected to return to a modest position of surplus. This is well above long term averages, and only modestly below the record 26 per cent of GDP peak reached at the height of the GFC.

Spending growth has been wound back, but nowhere near quickly enough. In fact, the December MYEFO document forecasts that spending in real terms will grow by 1.8 per cent annually, on average, over the forward estimates period.[8] This is a marked improvement on the previous forecasts, and has been achieved despite intense political resistance, but still represents insufficient progress. And, some of the improvement reflects slower than expected implementation of government programs, not genuine restraint.

We recommended in the *2017 Blueprint* that government spending growth be restricted to 1.5 per cent in real terms over the cycle. The Government's cap on average spending growth is a step in the right direction, but meeting this objective will require more concerted efforts.

REAL GROWTH IN COMMONWEALTH EXPENDITURE – %



Source: MYEFO

[8] *Mid-Year Economic and Fiscal Outlook 2017-18* (December 2017) **www.budget.gov.au**

Tax reform – whole of system … not individual measures

Some positive strides have been taken on the revenue side of the Budget, but there have been material missteps, too, such as the imposition of new taxes like the bank levy.

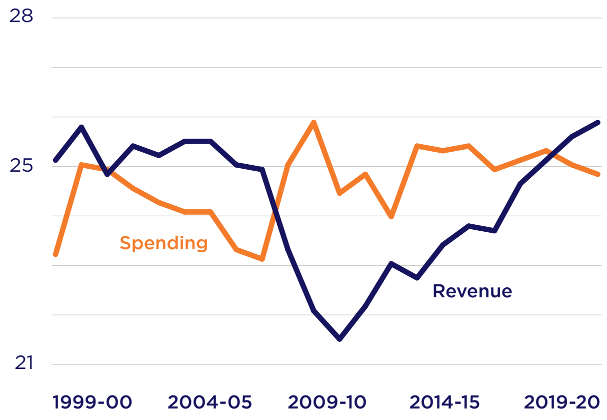
The AICD welcomes the Government's reduced company tax burden for smaller businesses, which already has been legislated. Indeed, this policy is broadly in line with the AICD's recommendation from last year. The AICD also welcomes plans to lower the impost for larger business, and the early indications that personal tax relief is on the way.

However, the ill-conceived levy on the five largest banks and the higher Medicare levy from 1 July in the last Budget work against these aims. Moreover, there has been no progress on reform of inefficient state taxes.

Fundamentally however, what is required is holistic, comprehensive tax reform that can produce a "grand bargain" for all stakeholders.

Each of the major areas of tax, and progress on reform, is examined in turn below.

COMMONWEALTH SPENDING AND REVENUE – % OF GDP



Source: MYEFO

"Fundamentally however, what is required is holistic, comprehensive tax reform that can produce a 'grand bargain' for all stakeholders."

GST reform – no progress

No progress has been made on the urgent matter of reforming the GST – increasing the tax rate and broadening the tax base - as was recommended in the *Blueprint*.

In our view, comprehensive tax reform is not possible without a fresh look at the GST. The 10 per cent rate is half the global average, and the base to which the tax is applied is shrinking, as household spending on items not taxed (e.g. education, healthcare, fresh food), grows more quickly than spending on items subject to the GST.

The Federal Government attempted to start a conversation with the states about GST reform, but met stiff resistance. The only progress is that the Treasurer has asked the Productivity Commission (PC) to examine options for an alternative distribution of the proceeds.

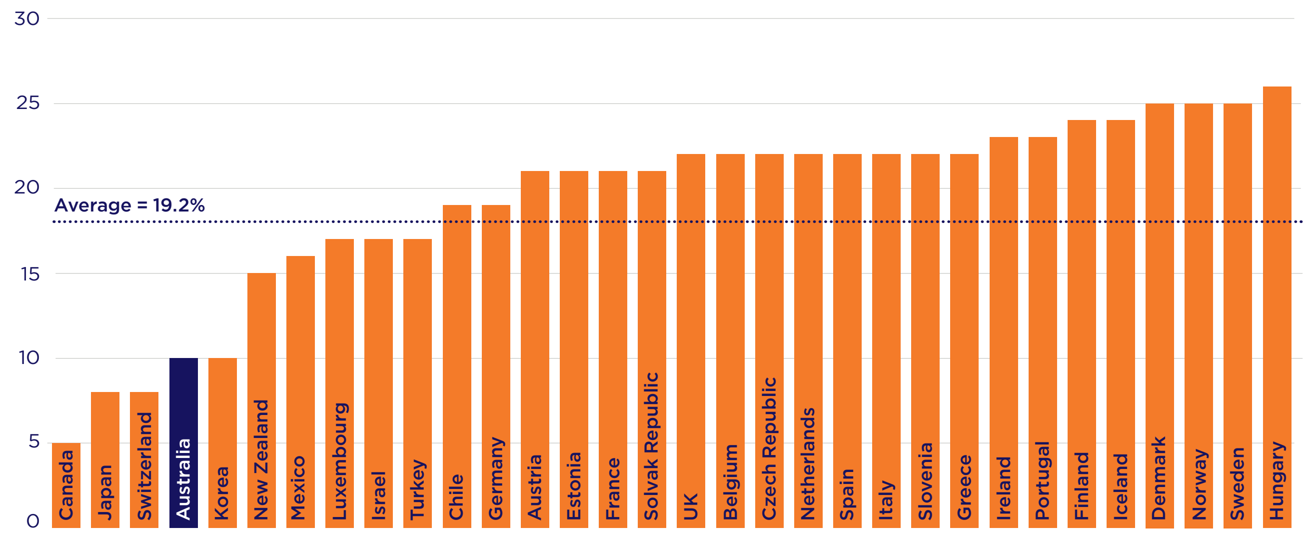
As with most areas of the GST, however, changes to the carve-up of the proceeds is fraught with difficulties, with one state or territory inevitably resisting.

Unfortunately, the release of the PC's report on GST distribution options has now been delayed until just after the Budget in May.

The AICD strongly argued in the *2017 Blueprint* for a higher, 15 per cent rate of the GST (up from the current 10 per cent) and a much broader base, with compensation paid to those affected by the resulting higher prices, particularly lower income households. However, neither major party has shown a willingness to look closely at the proposal.

Tax reform without changes to the current GST regime, by definition, will be piecemeal and incomplete. We as a nation must do better.

OECD VAT/GST RATES, 2015



Source: OECD

Personal tax regime – further cuts required

The AICD welcomes the recent lift of the income tax thresholds to compensate personal taxpayers for bracket creep. The *2017 Blueprint*, however, advocated for much larger, substantive reductions in personal tax rates.

The AICD also welcomes the government's public statements that personal tax relief will feature in the upcoming Budget, and looks forward to seeing the detail.

Australia's personal tax rates remain high by global standards, with the top marginal rates approaching 50 per cent when the proposed rise in the Medicare levy is included.[9] These high rates of tax compromise the nation's competitiveness, and discourage additional hours of work. They also can interact adversely with the high cost of child care and eligibility to the welfare system, to create disincentives for people to move back into the workforce.

The larger personal tax cuts recommended by the AICD in last year's *Blueprint* were predicated on reform of the GST regime, including a lift in the rate and the broadening of the base. These changes would leave the Commonwealth in a revenue neutral position, but with a much more efficient tax base, including materially lower rates of personal tax.

Abolishing inefficient state taxes

In the *2017 Blueprint*, AICD recommended that stamp duties on home sales be replaced with land taxes. The latter is much less damaging than stamp duty, which is a hugely-inefficient tax that distorts investment decision making.[10]

Unfortunately, there has been only modest, isolated progress on state-based tax reform. The Australian Capital Territory (ACT), for example, successfully substituted other taxes for stamp duties, and there have been some productive discussions of similar changes elsewhere. Most Premiers, Chief Ministers and Treasurers, however, have baulked at foregoing one of their most significant sources of tax revenue. This is particularly so in the larger south-eastern states, where the capital city housing markets have been hottest.

Without a substantial incentive – supported by GST reform – it is unlikely that traction can be made on these issues.

The AICD's comprehensive tax reform scenario recommendations included in the *2017 Blueprint*:

- Lift the GST rate to 15 per cent and broaden the GST base, with a substantial compensation package for lower income earners;
- Significant cuts in 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
- Staged reductions in the corporate tax rate.

[9] Commonwealth Budget Papers, 2017.

[10] Treasury, Re-Think for Tax Discussion Paper, March 2015.

Reduced capital gains tax discount

There has been talk of change here, but no real progress.

For housing, the prevailing 50 per cent discount on capital gains tax liabilities, together with record low interest rates and the generous negative gearing provisions, has contributed to widespread housing affordability concerns, particularly in Sydney and Melbourne. Large household debt has dampened broader consumer spending, while posing questions of inter-generational equity.

The AICD recommended last year in the *Blueprint* that the 50 per cent discount on capital gains be pared back to 40 per cent, but to date policy makers have steered clear of even this modest suggestion.

Negative gearing reform – keep the debate going

In the 2017 *Blueprint*, the AICD called for reform of negative gearing as it applies to housing, arguing that current arrangements have encouraged speculative investment in housing, driving up prices and affecting affordability. Unfortunately, this important reform remains in the 'too-hard' basket.

The Federal Opposition has advocated reform of the negative gearing arrangements as they apply to housing,[11] with existing investments grandfathered. The Government appears reluctant to act however, due to a range of factors including concerns that reforms would destabilise the housing market, property sector, and therefore broader economy.

Official modelling of the likely consequences of changes to negative gearing by the Reserve Bank of Australia and Treasury found that there would be a small fall in house prices, and modest rises in rents, if negative gearing was wound back as it applies to existing housing. There would, though, be an increase in housing supply, which would contribute towards improving housing affordability.

The AICD would welcome a comprehensive debate on this reform.

[11] www.alp.org.au/negativegearing

Corporate tax reform – important, as part of a comprehensive plan

There has been important progress towards lowering the corporate tax burden. The focus thus far has been on relief for smaller companies, with tax cuts for larger firms spread over the next decade. Last year, the AICD recommended staged corporate tax cuts by size of company, but we are concerned that the relief for larger firms may be delayed for much longer than was anticipated.

The first round of the Federal Government's corporate tax package passed through the Federal Parliament last year, lowering to 27.5 per cent the tax rate for businesses with turnover of up to $10 million.[12] The AICD also welcomes the further tax relief in the pipeline - from 1 July 2018, for businesses with turnover of up to $50 million.

The pressing need for further progress on corporate tax reform is highlighted, however, by offshore developments, where the burden is being lowered much more quickly. International tax competition is intensifying, with a number of countries lowering their corporate tax rates, including the US.[13]

Already, according to OECD data, Australia's 30 per cent corporate tax rate stands out as one of the highest in the world, although direct comparisons are difficult in part because of Australia's unique dividend imputation model, and other cascading tax imposts by jurisdiction. Still, as corporate tax rates fall more quickly elsewhere, Australia is at risk of losing increasingly mobile capital to lower taxing jurisdictions. As former Treasury Secretary Ken Henry observed at the 2018 Australian Governance Summit, countries do not always get to choose their company tax rate.

Interestingly, the International Monetary Fund (IMF) this year upgraded its forecast of economic growth in the US on the back of the likely impact of the corporate tax cuts on business investment and employment, in particular.[14] Reflecting this, the IMF expects global GDP growth this year to be 3.9 per cent, the fastest rate of expansion since the global financial crisis (GFC).

The reality is that any single piece of tax reform – viewed in isolation – is difficult to achieve. Therefore it is imperative that a holistic, balanced package be developed, of which corporate tax reform will be an integral part.

> "…Australia's 30 per cent corporate tax rate stands out as one of the highest in the world."

[12] Federal Budget 2016/17.

[13] At April 2018 the United States had reduced the corporate tax rate to 21 per cent.

[14] International Monetary Fund, 'World Economic Outlook Update' (January 2018) **www.imf.org**

Innovation and entrepreneurialism

The AICD advocated in the *2017 Blueprint* that Australia should do everything possible to foster innovation, including by streamlining approvals processes and establishing a regulatory framework more conducive to prudent risk-taking. We argued that our leaders should push back against the populist trend to adopt more inward looking policies, particularly in regards to trade.

Unfortunately, Australia continues to fall behind comparable nations in key areas, like business spending on research and development, secondary student education achievement, university rankings, teacher training, vocational education and public funds allocated to innovation.

That said, there have been notable successes, particularly the passage of the safe harbour insolvency laws and the creation of significant Government co-investment programs such as the Biomedical Translation Fund and the CSIRO Innovation Fund. Politicians also mounted strong arguments in favour of free trade, including via the Trans Pacific Partnership (TPP) trade agreement.

Much more needs to be done however, or else Australia will continue to under-perform by world standards.

Progress scorecard

SUMMARY RATIONALE:

Safe harbour laws and the firm push back against protectionism are worthy achievements.

CRITERIA:	SCORE:
Push back against protectionism	B+
A regulatory framework to foster innovation	B+
Boosting Australia's innovation system	B-

RECOMMENDATIONS:

- Push back on protectionism to support an open, export-orientated economy;
- Develop a regulatory environment to better foster innovation; and
- Boost Australia's innovation system, prioritising collaboration in R&D and targeted skills.

OVERALL SCORE:

Push back against protectionism

In the *2017 Blueprint*, the AICD urged strong resistance against more protectionist policies. Such populist policies can be attractive because they can contrive to secure local jobs and industries, at least for a time. In the long-term however, these benefits are illusory.

In the US, the Trump Administration has promised to bring back manufacturing jobs lost over recent decades, including by imposing punitive tariffs on imports of steel and aluminium, subsidising domestic industries, and penalising imports and offshoring. The US has also abandoned the TPP and is renegotiating the North America Free Trade Agreement (NAFTA) with its partners Canada and Mexico.

Longer term, isolationist policies like higher tariffs aimed at protecting uncompetitive industries ultimately fail, adding to the cost for taxpayers in the process. Indeed, by definition, if all countries adopted buy-local campaigns, global trade would shrink, to the detriment of open, exporting nations like Australia that rely on global trade.[15]

Australia has shown strength in this regard, with policymakers making clear that Australia favours free and open trade, and being prepared to make the case both at home and abroad. Further, Australia continues to negotiate free trade agreements, including with the UK and European Union, which previously were off limits until the Brexit vote in mid-2016.

To their strong credit, Australia's trade officials helped keep alive negotiations on the TPP free trade regime culminating in the 11-member (non-US) agreement, signed in March 2018.[16] The agreement offers significant potential benefits to Australia, while demonstrating that progress can be made despite a challenging political environment.

A regulatory framework to foster innovation

Over the last year, one significant piece of reform – long advocated for by the AICD - has strengthened the regulatory infrastructure for corporate innovation.

In September 2017, an insolvent trading 'safe harbour' was introduced, recalibrating insolvency laws that discouraged informal workouts and were overly focused on penalising and stigmatising corporate failures. Inadvertent breaches of these laws were often cited as a reason that early-stage investors and directors were reluctant to become involved in start-ups.

The 'safe harbour' has the potential to energise the economy by enabling directors to take reasonable steps to rehabilitate distressed businesses in certain circumstances – saving jobs, goodwill and corporate value, and encouraging greater engagement and investment in start-ups.[17]

While this is a major step forward, more action is needed. Many other laws are onerous, compelling an excessive focus by business leaders on compliance and caution. Year on year, our research reveals that a majority of directors surveyed report a risk-averse culture on boards.[18] Australian corporate law should better support the responsible risk-taking needed for innovation and economic growth. At our 2018 Australian Governance Summit, Sir John Key made the observation that New Zealand's principles-based 50 page Corporations Law had served the country well.

[15] In FY2017, exports of goods and services accounted for 21 per cent of Australian GDP: 'Trade and Investment Note: Australia's Export Performance in FY2017', Austrade, December 2017.

[16] Agreement for Trans-Pacific Partnership (TPP-11).

[17] *Treasury Laws Amendment (2017 Enterprise Incentives No.2) Bill 2017* (Cth).

[18] See, for instance, the *AICD Director Sentiment Index* (November 2017).

Boosting Australia's innovation system

The AICD has supported the Government's initiatives to support innovation across the economy, including via the National Innovation and Science Agenda (NISA), launched in December 2015.[19]

Australia's track record before the announcement of the NISA was patchy. Government funding for innovation had been cut significantly and science and STEM issues received inadequate focus. Collaboration between business and research universities was also lacking, well below comparable nations.

AICD members are favourable towards NISA, based on responses to our Directors' Sentiment Index.[20]

There were two important developments over the past year that lifted the score awarded here. The first was the compilation of Innovation and Science Australia's Strategic Plan for 2030.[21]

The ISA report includes 30 recommendations across five main initiatives that should help to address Australia's disappointing position on global innovation rankings.

The AICD strongly supports the report's premise that, as a nation, we need to focus on the key role that innovation and lifting productivity will play in driving growth in Australia's economy - we cannot wait for another commodities, mining or housing boom.

The AICD also supports the report's recommendations that the education system be reformed to lift the profile of STEM in teaching at all levels, and improving the readiness of graduates for the digital economy.

The second was the roll-out of significant government co-investment programs such as the Biomedical Translation Fund and CSIRO Innovation Fund which will see hundreds of millions of dollars invested in cutting-edge Australian businesses. This investment will be important to the growth of high value, technology-driven industries.

Other welcome developments since the *2017 Blueprint* include moves towards the legitimisation of *Blockchain* technology and, to a lesser extent, crypto-currencies, for which Australian regulators seem to retain a somewhat open, albeit sceptical, mind. If regulated appropriately, these technologies have the potential to drive down business costs.

The opening of the on-line market to allow small business better access to government procurement is also welcome, although take up thus far has been disappointingly limited. The 2030 Strategic Plan also addresses concerns here, recommending that a higher proportion of government procurement be directed to smaller businesses, which often are the driver of more innovative products and practices.[22]

The AICD has strongly favoured the maintenance of a skilled based migration program, discussed under 'Human Capital' below. This is particularly critical for innovation and technology sectors, where Australia must be able to draw on a global talent pool.

On the negative side however, the business sector continues to await the Government's final position on the parameters of R&D tax incentive, in the wake of the Ferris-Fraser-Finkel review, and the subsequent ISA 2030 Strategy.[23] Certainty is needed to help promote further business investment into R&D, a metric which Australia continues to scores disappointingly on.

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[19] See: **www.innovation.gov.au**

[20] *AICD Director Sentiment Index* (November 2017).

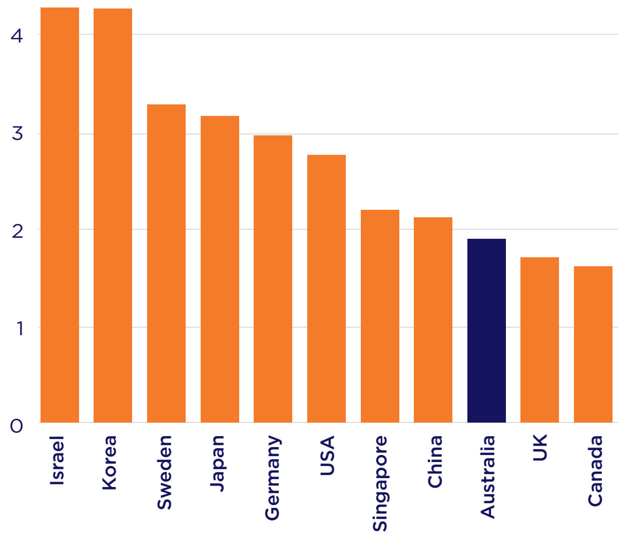
[21] '2030 Strategic Plan for the Australian Innovation, Science and Research System', *Innovation and Science Australia*, January 2018.

[22] '2030 Strategic Plan for the Australian Innovation, Science and Research System', *Innovation and Science Australia*, January 2018.

[23] Bill Ferris AC, Alan Finkel AO, John Fraser, 'Review of the R&D Tax Incentive', 4 April 2016.

More broadly, the Government seems to have tempered its enthusiasm for bold innovation, with a second wave of the National Innovation & Science Agenda now considered unlikely, despite Australia's continued under-performance. Political leaders from all sides must proactively embrace the opportunity posed by technology change, while sensitively prosecuting the case for reform. There is no responsible alternative.

GROSS EXPENDITURE ON RESEARCH AND DEVELOPMENT - 2016, % OF GDP



Source: OECD

> "Political leaders from all sides must proactively embrace the opportunity posed by technology change, while sensitively prosecuting the case for reform. There is no responsible alternative."

Human capital: Workplace participation and flexibility

The AICD has called for reform of Australia's award system to modernise workplace regulation and address inefficiencies. In the *2017 Blueprint*, we registered concern that broad industrial relations reform seemed unlikely.

Unfortunately, this prediction has proved correct. Despite some advances, substantive reform of our complex and cumbersome industrial relations system remains stalled, and the prospects for change seem more remote.

On a more positive note, the AICD's *Blueprint* called for further progress to be made in closing the labour force participation gap between men and women. There has been steady progress here, thanks in large part to a year of strong jobs growth. Much more focus is needed on women in leadership positions however. Critically, this includes women on boards, where current momentum must be maintained.

The AICD also called for a re-examination of Australia's education system. There have been some positive steps in higher education reform and needs-based funding for pre-tertiary education since then, however the solutions needed are longer term in nature.

Progress scorecard

SUMMARY RATIONALE:

Welcome resistance to changes to immigration laws and rising female labour participation rate, but little progress on workplace reform

CRITERIA:	SCORE:
Workplace regulation	C
Women in work	C
Education and skills training, including STEM and VET	C
A non-discriminatory immigration program	C-

RECOMMENDATIONS:

- Further workplace system reform to simplify the award system and improve industrial relations regulation;
- Increase workforce participation by women, including in governance and leadership roles;
- Expand Australia's focus on education and skills training, including STEM and VET streams; and
- A non-discriminatory immigration program with a strong skilled migration stream.

OVERALL SCORE:

Workplace system reform – still waiting for meaningful change

The Productivity Commission has previously found that Australia's current system of workplace relations involves a complex array of laws, regulations and institutions, with "unquestionable inefficiencies, remnant unfairness, some mischief and absurd anachronisms.[24] The current system does not meet the requirements of the evolving workplace and workforce.

Unfortunately, system-wide reform of Australia's industrial relations landscape has barely progressed, although action to align weekend penalty rates was a step forward.

42 per cent of directors responding to the AICD's *Director Sentiment Index* support action on industrial relations reform, with an emphasis on modernising the award system.[25] Other priority issues include individual workplace agreements, penalty rates and union right of entry.

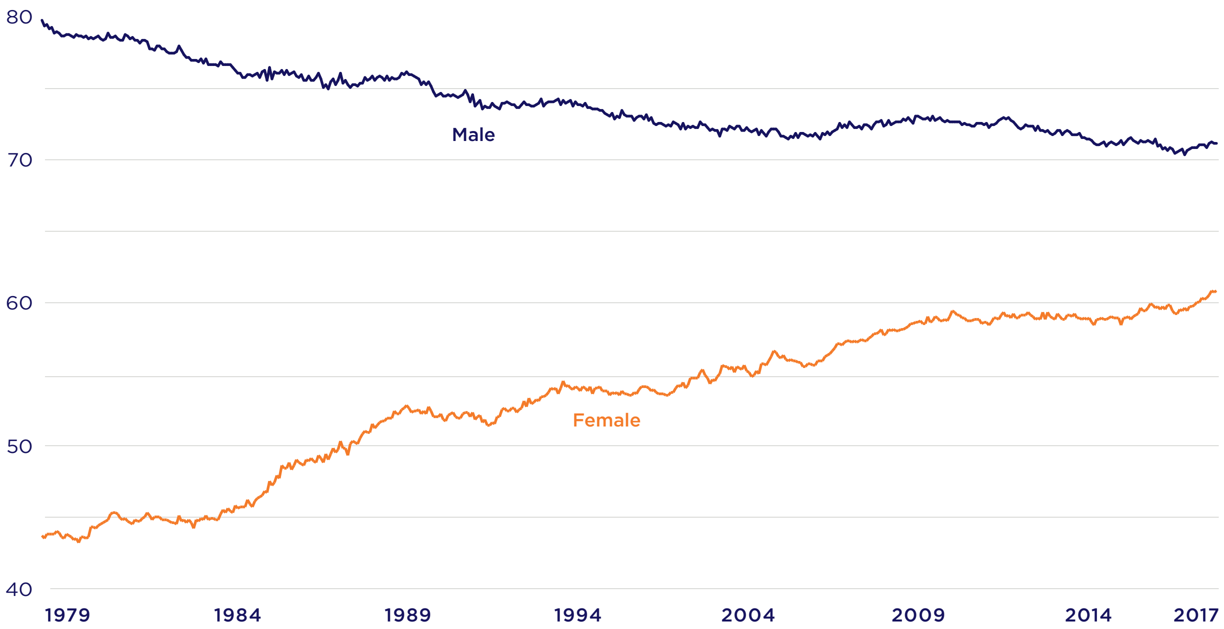
Workforce participation - positive progress

Improving female workforce participation rates is an important challenge for Australia.

Australia's labour market just completed the 17th straight month of employment gains – the longest stretch since the last recession in the 1990s. Around 400,000 jobs were created nationally in net terms in 2017 alone, 75 per cent of them full-time roles. This has encouraged increased labour force participation, with the rate of engaged workers rising to a seven-year high in December 2017.

This strengthened job market helps to explain why there has been steady progress over the last year in further narrowing the male-female participation rates, which a generation ago was 35 per cent. Now, the gap has narrowed to an all-time low of 10.5 per cent, from 11 per cent when the *Blueprint* was published a year ago. The gap between the two rates was 13 per cent just five years ago.

LABOUR FORCE PARTICIPATION RATES – %



Source: ABS

[24] Productivity Commission of Australia, "Australia's workplace relations framework: repair not replacement" October 2015.

[25] *AICD Director Sentiment Index* (November 2017).

[26] *Australian Bureau of Statistics, Labour Force Survey, December 2017.*

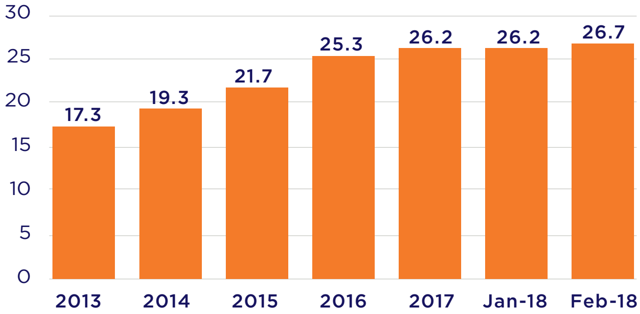
In the *2017 Blueprint*, the AICD supported Australia's commitment to the G20 target of reducing the gender gap by 25 per cent by 2025. That is, assuming annual progress in a linear fashion, a 2.5 per cent point reduction each and every year for 10 years. The progress over the last year then - a 3.6 per cent rate of closure of the gender participation gap - is a major step forward.

As we argued last year though, a national action plan is needed if we are to meet this objective. We cannot rely on a cyclical job market alone. Action on the structural impediments influencing female participation requires a whole-of-economy focus and clear national response.

The AICD continues its commitment to promote gender diversity and lifting the representation of women in governance roles, with a target of at least 30 per cent female directors on S&P/ASX 200 companies by the end of 2018.

While there has been significant progress on board gender diversity since 2009 – with the percentage of director positions on the ASX 200 increasing from eight per cent to over 26 per cent, and the number of boards with no women directors falling to five – the slower rate of female appointments through 2017 was concerning.

PER CENT OF FEMALE DIRECTORS – ASX 200



Source: AICD

Government boards are leading the way at Commonwealth, State and Territory levels, but the private sector has more work to do to demonstrate effective change.

Early 2018 ASX 200 board appointment rates, showing a substantial increase, are encouraging. This momentum must be maintained if the 30 per cent target is to be achieved.[27]

"...the private sector has more work to do to demonstrate effective change."

[27] '30 per cent by 2018: Gender diversity progress report', Volume 11, AICD, February 2018.

[28] '2030 Strategic Plan for the Australian Innovation, Science and Research System', *Innovation and Science Australia*, January 2018.

Expand Australia’s focus on education and skills training, including STEM and VET

The AICD has argued that Australia’s education landscape requires wholesale reform. This is necessary to ensure that the system is producing graduates with the skills necessary to take Australia into the next century, including digital competency.

Over the last twelve months, the Government has developed a needs-based funding approach to pre-tertiary education which will hopefully help arrest Australia’s decline on global education rankings, particularly regarding literacy.

Funding reform and efficiency measures have also been introduced in the university sector. These new arrangements may help to realign priorities between universities and vocational training. $2.2 billion in other savings are also planned.

The ongoing overhaul of the vocational education system, including student loans and quality of providers, is also being watched closely.

The AICD also welcomes the call for graduates to be more “job-ready”, and the recommendations from Innovation and Science Australia’s 2030 Strategic Plan to target and improve teacher training, particularly in the maths disciplines.[28]

Unfortunately, while there have been steps in the right direction, collaboration and engagement between academia and industry remains a cause for concern. Australia still fails to sufficiently commercialise enough of our high quality academic research, the benefits of which too often head overseas.

Australia is not producing enough university and vocational graduates who are job-ready to face the great challenges associated with, among other things, artificial intelligence, automation and the digital economy. These issues confront us now, but we are not moving quickly enough, and what we are doing is without sufficient planning or collaboration.

This requires a concerted effort from business, educators and government to produce the skilled Australian workforce needed for the future.

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

Immigration is an essential element of Australia’s ongoing growth and development. In fact, an appropriate migrant intake delivers a crucial component of potential economic growth, alongside productivity improvements. In turn, this will ensure higher incomes and living standards for all Australians.

The AICD acknowledges the Government’s stand on ensuring that Australia maintains a credible migration policy, with a focus on skilled migration. This contrasts with efforts in other countries to cut back on migration on non-economic grounds.

One obvious place that we as a nation lost marks was on the disruptive changes to the 457 visa regime. While ongoing review of eligible occupations and skills shortages is vital, along with compliance to ensure the system is not being abused, last year’s abrupt changes caused significant concern across many sectors.

The AICD considers it vital that the boards of Australian organisations have the ability to draw on global talent, experience and skills in recruiting staff and leaders for their organisations. Limiting this capacity will harm Australia’s competitiveness and presents a significant governance issue for the nation, with negative impacts for stakeholders.

While the Government has responded with subsequent amendments, the AICD strongly recommends that Australia’s visa program remains open to the global talent pool.

NFP sector:
A partnership approach

The AICD has an extensive and growing not-for-profit (NFP) membership. Directors of NFP organisations have called for a more collaborative and mature relationship with government, to strengthen and improve the operating environment and support a high standard of governance and efficiency in the sector.

To support these outcomes, the *2017 Blueprint* proposed reforms to the funding environment for NFPs and national reform to deliver a 'fit for purpose' regulatory regime.

While some progress has been made, greater national priority must be placed on these proposals.

Australia's NFP sector makes a substantial contribution to the economy and society. Charities alone (themselves only 10 per cent of the NFP sector) employ over 1.3 million Australians and have a combined annual revenue of over $142 billion.[29] Providing greater certainty and clarity for the sector will enhance its ability to deliver for the community.

Progress scorecard

SUMMARY RATIONALE:

Slow, but positive, progress on regulatory consistency, but funding cycles and duplication remain key challenges.

CRITERIA:	SCORE:
Set best-practice target of five-year funding cycles	C
Develop a 'fit for purpose regulatory regime	C

RECOMMENDATIONS:

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

OVERALL SCORE:

[29] A Powell, N Cortis, I Ramia, and A Marjolin, 'Australian Charities Report 2016', Centre for Social Impact and Social Policy Research Centre, UNSW Australia.

Set best-practice target of five-year funding cycles

Government is a major source of funding for the not-for-profit (NFP) sector. According to the *Australian Charities Report*, 43 per cent of charitable revenue (as much as $61 billion) comes from federal, state and territory governments.[30] As a result, government funding practices have a significant impact on the sustainability, effectiveness and governance of NFPs.

Many NFPs are subject to short-term, precarious funding arrangements which undermine their ability to plan effectively and to deliver the essential services on which our community depends.

Since this document was published in 2017, there has been some improvement.

The Northern Territory Government has announced an intention to move towards five-year funding cycles, while in South Australia, a government-wide funding policy, announced in July 2017, recommended rolling funding contracts of three years.

The AICD recommends that all Australian governments adopt five-year funding cycles where practical and include sufficient notice prior to termination or renewal of agreements.

Develop a fit-for-purpose regulatory regime

Significant progress has been made towards achieving a fit-for-purpose regulatory regime, largely led by the efforts of the Australian Charities and Not-for-profits Commission.

Streamlined reporting is now either achieved or underway for a majority of incorporation types (including state and territory regulators of incorporated associations), as is the establishment of common audit thresholds. Queensland however, has yet to take action to reduce red tape for their incorporated associations.

Incorporation type	Streamlined reporting	Common audit thresholds	Updating addresses once	Waived fee
Companies	Yes	Yes	Yes	Yes
Indigenous corporations	Yes	N/A	Yes	N/A
Ancillary funds	Yes	Yes	Yes	N/A
TAS – Incorporated Association	Yes	Yes	No	Yes
SA – Incorporated Association	Yes	Yes	No	Yes
ACT – Incorporated Association	Yes	Yes	Yes	Yes
VIC – Incorporated Association	In progress	Yes	No	In progress
NT – Incorporated Association	In progress	In progress	No	In progress
WA – Incorporated Association	In progress	Yes	No	In progress
NSW – Incorporated Association	In progress	In progress	In progress	In progress
QLD – Incorporated Association	No	No	No	No

Yes No In progress

[30] A Powell, N Cortis, I Ramia, and A Marjolin, 'Australian Charities Report 2016', Centre for Social Impact and Social Policy Research Centre, UNSW Australia.

Some progress has been made in fundraising reform, with the release of dedicated guidance on the application of the Australian Consumer Law Guide to fundraising in 2017 and a commitment for further consultation in 2018/19.[31] However legislative change is required in order to create a truly fit-for-purpose fundraising regime.

Most state and territory fundraising regulators have yet to take action to streamline regulatory obligations for charities that undertake fundraising. Duplicative reporting and inconsistent regulatory standards, as well as unnecessary licensing fees continue to plague fundraisers across Australia. Governments in Tasmania and the Australian Capital Territory are leading the way in this regard.

"…legislative change is required in order to create a truly fit-for-purpose fundraising regime."

Jurisdiction	Report once	Common audit thresholds	Exempt from licence
Tasmania	Yes	Yes	Yes
South Australia	In progress	In progress	No
Australian Capital Territory	Yes	Yes	Yes
Victoria	Yes	Yes	No
New South Wales	No	No	No
Western Australia	No	No	No
Northern Territory	N/A	N/A	N/A
Queensland	No	No	No

Yes No In progress

NB: There is no regulatory regime for fundraising in the Northern Territory.

[31] 'A guide to the Australian Consumer Law for fundraising and other activities of charities, not-for-profits, and fundraisers', Commonwealth of Australia, December 2017.

National infrastructure

AICD members consistently nominate infrastructure shortages as an area that government should address as a long-term national policy priority.[32] Directors realise that boosting infrastructure is a key element of lifting national productivity growth.

The *2017 Blueprint* called for a national focus on infrastructure, including a needs-based forward pipeline of projects and reforms to encourage innovative and expanded funding options.

There has been some progress in recent times, with the Federal Treasurer committing the government to cease borrowing for recurrent purposes from later this year.[33] Other progress has been less apparent, although Infrastructure Australia's more extensive priority list of national projects is very welcome. Unfortunately, politics still intervenes too heavily in project selection and funding, negatively impacting on tax payers' return on investment.

Progress scorecard

SUMMARY RATIONALE:

Treasurer's positive position on borrowing offset by ongoing infrastructure governance faults

CRITERIA:	GRADE:
COAG commitment to a 15 year infrastructure plan	C+
Good versus bad government borrowing	B+
Funding of infrastructure	C+
Boosting private sector infrastructure investment	C

RECOMMENDATIONS:

- COAG commitment to a 15 year infrastructure plan targeting strategic national needs, with a strong focus on improved governance standards
- Careful distinction between "good" and "bad" government borrowing
- State and territory governments to prioritise asset recycling in infrastructure planning
- Call to action for private sector investment

OVERALL GRADE:

[32] See *AICD Director Sentiment Index* (November 2017).

[33] Federal Budget 2016/17.

COAG commitment to a 15 year infrastructure plan

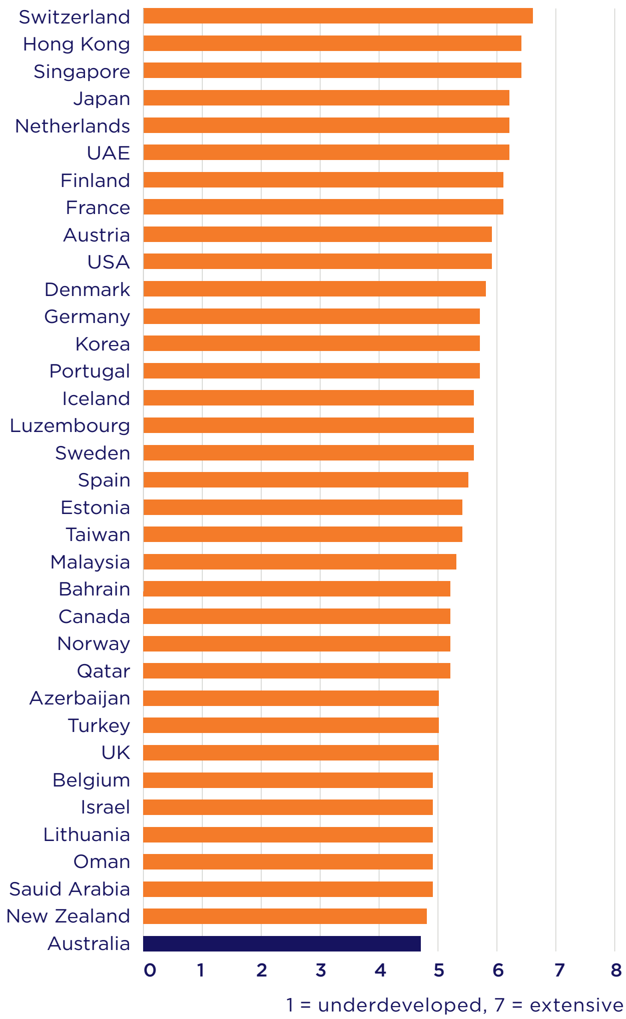
The AICD has recommended that a long term strategy for infrastructure priorities and delivery be formulated. Therefore, the March 2018 release by Infrastructure Australia (IA) of an updated priority list worth over $55bn, was a welcome step.[34] The list includes six high priority and six priority projects, all of which have business cases in place. This independent advice will help ensure that evidence-based decision making on infrastructure priorities grows, particularly at this crucial economic juncture.

It is positive too, that states and territories are proceeding with increased infrastructure spending, with billions being spent on transport initiatives in the major cities. There remains, however, a lack of coordination across states and also a lack of transparency in funding for city or regional projects.

Points are lost in this space by the apparent preference for state and territory leaders to circumvent the COAG process and announce projects that otherwise may not meet more stringent nationally consistent criteria. Uneconomic decisions on politically sensitive infrastructure projects still are being made, despite significant steps forward in other areas of governance. Prominent state leaders are thought to distrust the COAG process.

The AICD welcomes the Federal Government's regional cities plan that targets urban renewal and essential infrastructure in major regional centres.[36] The concept represents a worthy attempt to coordinate the infrastructure intentions of the three levels of government – federal, state and local – rather than have sometimes competing priorities. The coordination also, hopefully, will help minimise the political interference in project selection and funding.

QUALITY OF INFRASTRUCTURE RANKINGS



Source: World Economic Forum[35]

[34] 'Infrastructure Priority List', Infrastructure Australia, 27 March 2018.

[35] Global Competitiveness Report 2017-2018, World Economic Forum.

[36] Smart Cities Plan, Commonwealth Government, 2016.

Good versus bad government borrowing

The AICD has recommended that the Government should distinguish between borrowing for recurrent and capital purposes. In other words, there should be a distinction between borrowing for so-called "bad" (recurrent) and "good" (more productive infrastructure and nation building projects) purposes.

Not all borrowing is bad, particularly if it is used to fund essential infrastructure that lifts the economy's potential growth and productivity. In this regard, the AICD welcomes the Government's renewed focus on infrastructure and funding the Commonwealth's pipeline of projects.[37]

We also welcome the Treasurer's commitment in the 2017 Budget that the Government would cease borrowing for recurrent purposes in 2018-19.[38] Previously, such borrowing was undertaken to plug the annual hole in public finances - a clearly unsustainable model.

Funding of infrastructure

The conversation about governments borrowing to fund public infrastructure is important but there has been little material progress on examining other options to boost the amount of funding available for infrastructure spending.

The push by Infrastructure Australia for options like user funding of roads, implementation of heavy vehicle charges, greater cost recovery in public transport and appropriate use of value capture is welcome. However, sensitivities around each of these options at a time of compressed household budgets means they have not generally advanced.

The AICD welcomes the initiative from the 2017 Commonwealth Budget to launch the Infrastructure and Project Financing Agency (IPFA) as a means of advising government on funding of nationally significant infrastructure projects. The new body commenced operations on 1 July last year and, if successful, will help to improve the governance of significant project funding arrangements.[39]

Boosting private sector infrastructure investment

The AICD recommended that asset recycling be supported and incentivised to boost aggregate spending on infrastructure.

Unfortunately, the national track record of asset recycling is poor. For example, the 2014 Budget announced a 15 per cent top-up of state spending sourced from asset sales[40], but the take-up of the scheme was low. Subsequent Budgets pared back available funds, diverting funds elsewhere. The original funding of $5 billion announced in 2014 had fallen to $3.2 billion when the scheme was ended in 2016.

The AICD holds up as a positive example the experience of the NSW government, which sold parts of its electricity network distribution and used the proceeds to fund construction of new infrastructure. This experience demonstrates the way in which public and private capital can be brought together via an asset recycling program.

Another positive step was the announcement that the IPFA will work in collaboration with the private sector. This new body aims to boost the funding options available for essential infrastructure, with the Commonwealth able to deploy funding levels not available to the private sector.

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[37] Federal Budget 2016/17

[38] Federal Budget 2016/17

[39] This body lacks bi-partisan support.

[40] Federal Budget 2014/15.

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