

CIS OCCASIONAL PAPER 164

RED TAPE AND AUSTRALIA'S ECONOMIC MALAISE

MICHAEL POTTER



THE CENTRE FOR
INDEPENDENT
STUDIES

RED TAPE AND AUSTRALIA'S ECONOMIC MALAISE

MICHAEL POTTER

TARGET30
REDUCING THE BURDEN FOR
FUTURE GENERATIONS

CIS Occasional Paper 164



2018

Published February 2018
by The Centre for Independent Studies Limited
Level 1, 131 Macquarie Street, Sydney NSW 2000
Email: cis@cis.org.au
Website: www.cis.org.au

Views expressed in the publications of The Centre for Independent Studies are those of the authors and do not necessarily reflect the views of the Centre's staff, advisers, directors, or officers.

©2018 The Centre for Independent Studies

I thank Karla Pincott, Robert Carling, Pero Stojanovski, Matthew O'Donnell and an anonymous reviewer for comments on this paper. Their comments have been of substantial assistance in improving the paper.

This paper is based on a forthcoming book chapter in Darcy Allen and Chris Berg (eds., forthcoming) *Australia's Red Tape Crisis*, Conor Court Publishing



A catalogue record for this
book is available from the
National Library of Australia

RED TAPE AND AUSTRALIA'S ECONOMIC MALAISE

After many years of strong economic performance compared to other developed countries, Australia is now showing many signs of weaker performance. As Australia is performing worse than other similar countries, the causes of this malaise are most likely Australia-specific. This paper focuses on one likely cause—the substantial and growing red tape burden on the economy.¹

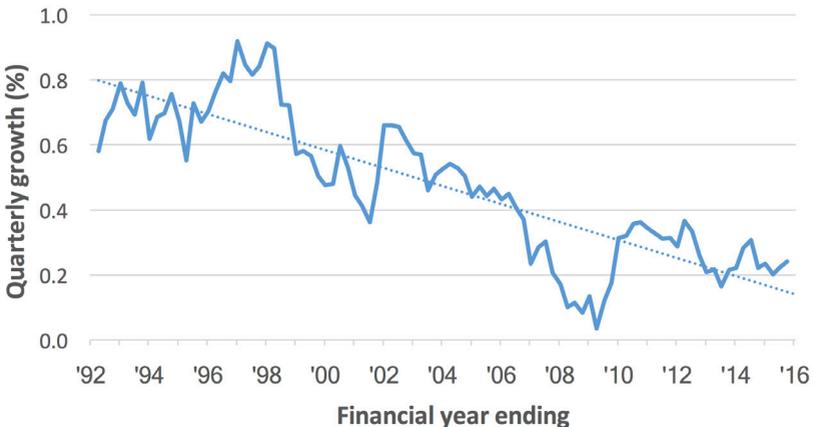
There are many reasons for the growth in poor quality regulation in Australia, including the benefits of regulation being identifiable and concentrated while the costs are more abstract and diffuse; and widespread (but erroneous) beliefs that market failures usually exceed government failure.

A focus of this paper is on the fiscal incentives faced by state governments and how these incentives cause regulatory problems. This suggests reforms to the federation—worthwhile for many reasons—will also assist in cutting back Australia's red tape burden. These reforms should be combined with a range of changes to regulatory processes, to stem the flow of regulation and reduce the existing stock of regulation.

Evidence of the malaise

The clearest evidence for a deterioration in Australia's performance is provided by GDP per person. This is shown in Figure 1 below, with a downward trend also shown. The period from 2008 to 2017 is easily the longest sustained period on record for low growth in GDP per person — 9 years of (smoothed) growth below 0.4% per quarter. This is much longer than any other period since records started in 1973, including recessions.²

Figure 1: Quarterly growth in real GDP per person (smoothed)

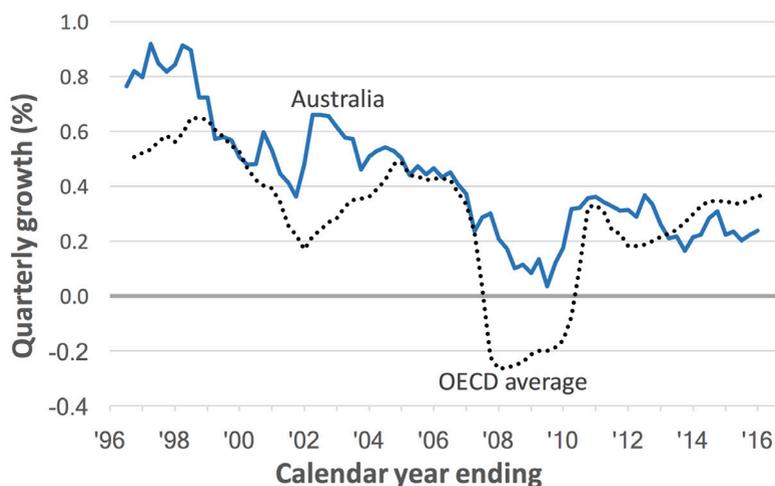


Source: ABS.³ The solid line is quarterly smoothed growth (3 year centred moving average); the dotted line is the linear trend for the period shown.

Unsurprisingly, the federal government, and many other commentators, do not focus on these figures — instead arguing Australia is having a record-breaking period of headline GDP growth.⁴ For example, headline growth in Australia in 2016 was stronger than in any G8 country.⁵ However, this apparent strength in recent years is an artefact of our strong population growth rates.⁶ High levels of immigration are effectively papering over underlying weaknesses in the economy, as shown in Figure 1. We sometimes hear that Australia has had 26 years without a recession; but using the better GDP per person measure there were in fact recessions in 2000 and 2006.⁷

Using the GDP per person measure, Australia's performance relative to the OECD was strong before the Global Financial Crisis (GFC), growing by more than the OECD weighted average between 1995 and about 2008; as shown in Figure 2 below. This was during the so-called golden period of economic reform.

Figure 2: Real GDP growth per person in Australia and OECD (smoothed)



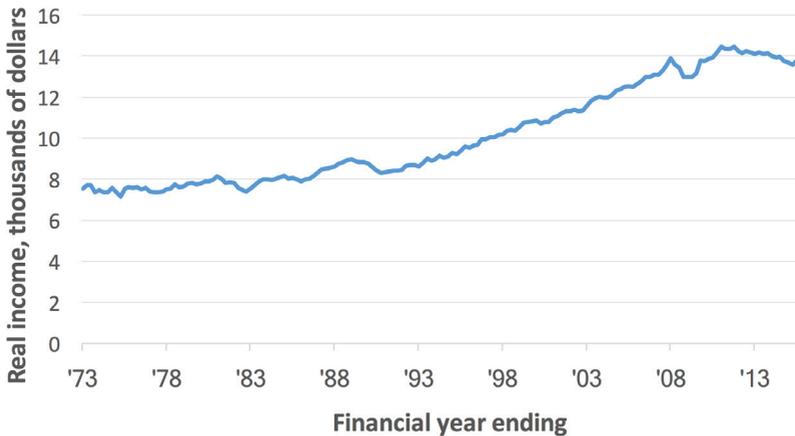
Source: OECD.⁸ Figures are quarterly smoothed growth, using 3 year centred moving average. OECD average is weighted by economy size (see endnote 8).

While Australia had a slowdown during the GFC, Figure 2 shows it was remarkably milder than the OECD average. The reasons for this performance are not the subject of this paper, but the outperformance is likely to be related to foreign demand for mining commodities, the floating exchange rate and monetary policy and not with fiscal or other government policies, as argued in Taylor & Tyers (2017).⁹ This view is consistent with a paper published by the RBA estimating the mining boom provided a significant boost to Australia's GDP.¹⁰ However, since the end of the GFC recovery, Australia's performance

has been at or around the OECD average—likely below average since about 2013. This lacklustre performance can't be explained as being due to the end of the mining boom—estimates published by the RBA suggest the end of the boom would cut GDP only slightly compared to the earlier positive effect;¹¹ and other evidence suggests GDP growth should in fact be higher, not lower, after the end of the mining boom.¹²

Income and wages affect Australian households more directly than GDP, and the stagnation is even clearer on these figures. Nominal wages are growing at a record low rate and real wages (subtracting inflation) have been flatlining for some time.¹³ Real income per person has barely increased for almost 10 years, as shown in Figure 3 below.

Figure 3: Real net national disposable income per person



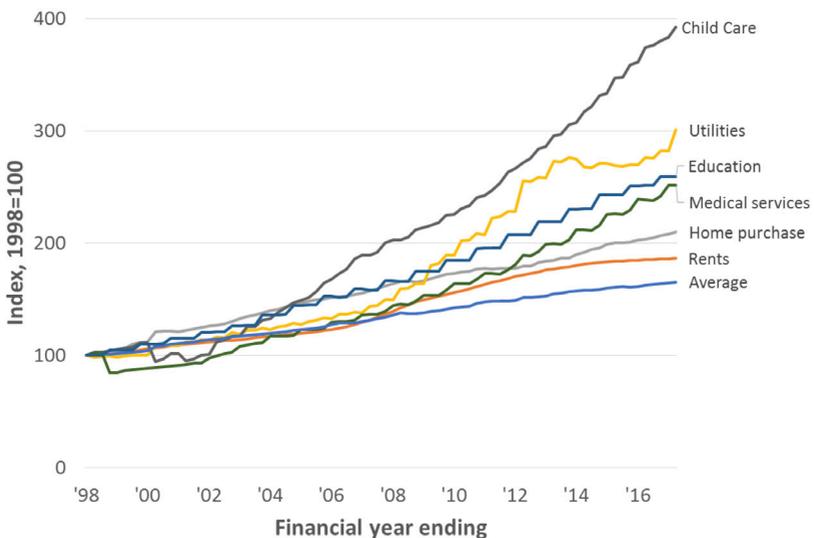
Source: ABS.¹⁴ Reference year for real income is 2014–15.

While employment growth has recently been strong,¹⁵ this is more than offset by the weakness in wages growth; as a result total compensation of employees, a measure that combines the effect of both wages and employment, has been growing at a historically slow pace.¹⁶ These income, wage and compensation measures are additional evidence of Australia's recent economic weakness.

However, the end of the mining boom affected national incomes and wages much more than GDP,¹⁷ so the current flatlining of these measures could just be a result of the end of the boom rather than a symptom of underlying economic problems. In addition, weakness in wage growth is occurring in other developed countries, with Australia's recent performance not noticeably worse.¹⁸ As a consequence, sluggish wage and income growth does not provide clear cut evidence of an economic malaise.

Nevertheless, poor performance on wage and income measures is partly caused by red tape and regulation. This is because government rules are driving up the cost of living, which in turn reduces real incomes and wages. There have been steep increases in prices in sectors that are heavily regulated by the government, such as childcare, health, education and utilities while prices in less regulated sectors, such as food and clothing have barely grown at all.¹⁹ A selection of government-influenced price changes are shown in Figure 4.

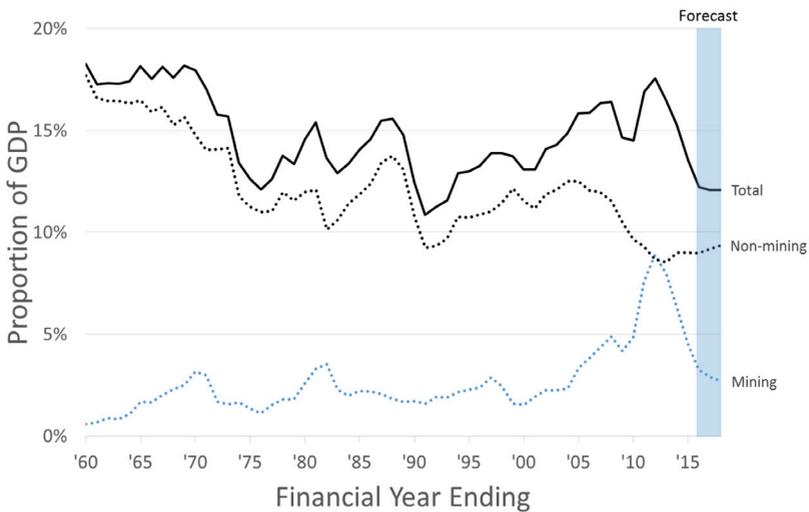
Figure 4: Selected price changes since 1998



Source: ABS.²⁰ Only a selection of items are included in the graph above. Child care figures have been adjusted to remove the effects of structural breaks in 2007 and 2008.

Australia is also performing weakly on business investment, with the Productivity Commission in 2017 arguing “The investment slump is particularly concerning.”²¹ Figure 5 below shows business investment from 1960 to 2018 as a share of the economy, using Treasury forecasts. The decline in mining investment since the end of the boom is unsurprising; what is surprising is the failure of non-mining investment to rebound to previous levels. This means total investment is forecast to flatline at very low levels as a share of GDP; these levels have only previously been seen in the middle of the 1990s recession. Investment was stronger in the middle of the 1970s and 1980s recession than it is today.

Figure 5: New private business investment as % of GDP



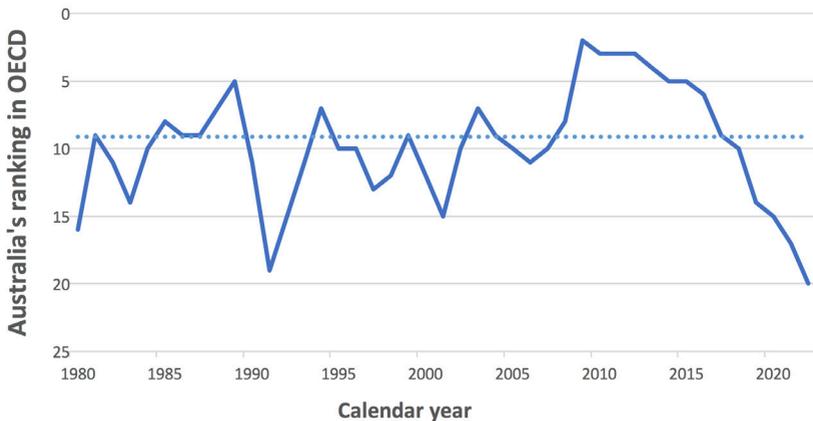
Sources: ABS for history, Treasury for forecasts.²²

As investment is one of the main drivers of future economic growth and wellbeing, this does not bode well for Australia being able to recover from the malaise outlined earlier.

There are global problems with private investment, as identified by several experts.²³ However, Australia's investment performance is sliding relative to other developed countries. Based on the IMF's

World Economic Outlook, Australia's total investment to GDP ratio is ranked as ninth in the OECD in 2017, around the historical average, but is forecast to fall to twentieth by 2022, the lowest ranking on record as shown in Figure 6. Similarly, Australia's investment to GDP ratio is set to decline relative to the OECD average over the same period.²⁴ Australia's historical advantages in investment will be lost if nothing is done.²⁵

Figure 6: Australia's investment to GDP ratio: ranking in the OECD



Source: IMF World Economic Outlook.²⁶ Dotted line is average rank (of about 9) for the historical period from 1980 to 2016.

Australia has also had a marked decline in our ranking against other countries on various competitiveness measures, as shown in Table 1 overleaf.

The figures above show Australia's economic performance is declining relative to other developed countries and compared to our past performance.

There are a number of other measures of economic wellbeing, but they are not the focus of this article as the outcomes on these measures are less clear cut:

- Overall productivity has stagnated for more than a decade, with the *level* of multifactor productivity (MFP) in 2017 about

Table 1—Australia’s declining competitiveness

Index	Ranking		Change
	2010	Current	
World Economic Forum Global Competitiveness Reports	15	22	Down 7 places
World Bank Ease of Doing Business Index	9	15	Down 6 places
Heritage Foundation Index of Economic Freedom	3	5	Down 2 places
IMD Competitiveness Ranking	5	21	Down 16 places
Fraser Institute Economic Freedom of the World index	5	9 (in 2015)	Down 4 places

Source: various.²⁷ Australia’s best rating was in 2010 on most measures.²⁸ Current ranking is for 2017 unless specified.

the same as the level in 2004.²⁹ In other words, MFP growth over that period has essentially been zero. Conversely, labour productivity growth has been stronger over this period, driven by large capital investment.³⁰ However, both these productivity figures have been heavily affected by the mining boom and the post-mining boom figures are not yet clear.³¹

- Inequality and the labour share of income are frequently used to criticise Australia’s economic performance, but it is not clear that either measure has deteriorated in recent years.³² More importantly, inequality and the labour share are poor indicators of economic performance. A highly innovative economy is good, but this is likely to result in a gain in incomes at the top, which will cause an increase in inequality. Substantial capital deepening in an economy is also likely to be good, but will probably cause a reduction in the labour share of income.³³
- There have also been large increases in household wealth, largely driven by increases in house prices.³⁴ However this is not an indicator of good economic performance because a major

driver of house prices is burdensome planning and development regulations—that is, excessive red tape.³⁵

Causes of the malaise

The decline in Australia's relative performance is likely caused by several factors.³⁶ A significant factor is the growing tax burden; in particular, bracket creep and fiscal drag more broadly are adding to the tax burden by about 0.3 percentage points per year cumulatively.³⁷ In 2016, Treasury estimated that bracket creep over four years to 2020–21 would reduce GDP by 0.35%.³⁸ The economic cost of tax increases would be larger for a longer period of bracket creep. The ongoing declines in the competitiveness of Australia's taxes on capital are another factor.³⁹ As argued earlier, the mining boom cannot provide a substantial explanation of Australia's underperformance since the GFC recovery.⁴⁰

However, most relevant to this paper, another contributor to Australia's lacklustre performance is the excessive red tape burden on the economy. Some examples of the economic cost of red tape include:

- Rules imposed by the government have been estimated to cost the economy \$94 billion per year, and rules imposed by businesses themselves, probably as an indirect result of government regulation, cost \$155bn per year for a total cost of \$249bn per year.⁴¹ There has also been a growing share of employment in compliance work, from 6% in 1996 to 9% in 2014.⁴²
- NAB indicated its annual cost of complying with regulation was \$265m in 2014, a figure that had tripled over the previous three years.⁴³ The increase in regulation since 2014 would mean this figure is an underestimate.
- Annual tax compliance costs for individuals was estimated at 0.3% of GDP in 1995, a figure that doubled to 0.6% in 2014.⁴⁴
- One estimate is that the overall cost of excessive regulation to the Australian economy (in terms of lost GDP) is \$176bn per year.⁴⁵ This is the estimated cost caused by regulation being more burdensome than the minimal effective level of regulation.

These costs of red tape cause substantial reductions in GDP and the other economic measures which have been weak since the GFC as noted at the start of this chapter.

Most governments at state and federal levels have an agenda for deregulation and regulation review, but significant concerns can be raised that these agendas are not succeeding in reducing either the stock or flow of regulation. A 2009 review argued many regulations that should not be seen as adequate were subject to regulatory review and were found to be adequate—even best practice.⁴⁶ A 2012 Productivity Commission review found there were considerable gaps between agreed regulatory review principles and practice; and the primary benefits of regulation review have been forfeited through a lack of ministerial and agency commitment.⁴⁷

Flaws with the current federal government's deregulation agenda include, for example:

- A number of important federal government regulations implemented in 2015–16 were not required to have a Regulation Impact Statement (RIS) because the policies were subject to 'independent review'. This included three of the most significant policy announcements in that period: the setting of Australia's greenhouse emissions target after 2020; the government's response to the Competition Policy Review (the Harper Review); and the government's response to the Financial Systems Inquiry (the Murray Inquiry).⁴⁸ These were major areas of regulation and they have not been assessed as to whether they are in fact 'best practice'.
- The federal government's Major Bank Levy was assessed by the OBPR as being compliant with the government's requirements.⁴⁹ This is despite the Levy having major flaws, including that:⁵⁰
 - It is poorly designed, does not align with international experience, and will largely or completely be passed on to consumers;
 - It is estimated to reduce GDP by \$1.7 billion per year, more than 100% of the forecast annual revenue from the levy of \$1.5–1.6 billion;

- It has a potential to increase the risk of the financial system as a whole; and
- The process for developing the levy breaches numerous regulation requirements, even though the federal government absurdly asserted the Major Bank Levy was best practice regulation.⁵¹
- The regular red tape repeal days have stopped and the deregulation reports appear to be defunct, with no additions to the relevant website relating to 2016 or 2017.⁵²

Problems with incentives for reform

If poor regulation is harmful to the economy, why do governments persist in implementing bad regulation and fail to remove or reform existing poor regulations? In general terms, this damaging outcome occurs because governments face disincentives for regulatory reform, and conversely face perverse incentives to implement excessive or badly designed regulation.

Some of these harmful incentives include:⁵³

- the benefits of regulatory reform are abstract and diffuse while the costs are identifiable and concentrated;
- a widespread view that the government can fix all problems;
- policy makers (and the general community) overstate market failure and understate government failure;
- excessive risk aversion of policy makers;
- a failure to understand business costs are largely passed on to consumers;
- a desire by governments to appear to be ‘doing something’; and
- policy asymmetry — regulation faces low hurdles while deregulation faces high hurdles.

This paper focuses on an additional perverse incentive: the fiscal incentives faced by state governments — particularly from the system for distributing the GST to the states.⁵⁴

For the federal Budget, 87% of tax revenue in 2017–18 is expected to come from taxes related to income, while 13% is forecast to come from consumption-related taxes, when the GST is excluded, as shown in Table 2 below (the GST is included in state government analysis later).⁵⁵ Regulatory reform, broadly speaking, will result in increased economic activity, leading to growth in income and consumption, and causing increases in the revenue from all the taxes connected with income and consumption. Therefore regulatory reform will likely increase all the major federal government revenue sources and the federal government has financial incentives to implement higher-quality regulation, and to reform existing regulations.

Table 2—Federal government tax revenue excluding GST, 2016–17

Tax	% of total revenue (excl GST)	Impact of regulatory reform on tax revenue
Personal & related taxes	63%	Positive
Company & related taxes	24%	Positive
Total income taxes	87%	Positive
Excise	7%	Positive
Other indirect, excl GST	7%	Positive
Indirect taxes, excl GST	13%	Positive

Source: 2017–18 Budget.⁵⁶ Numbers may not add due to rounding.

By contrast, many of the financial incentives for state governments are neutral to harmful because many regulatory reforms do not improve state government revenues.

Land tax revenue is reduced by reforms to planning laws. This is because planning reforms are likely to result in lower property prices.⁵⁷ Planning reforms are likely to increase housing turnover so the net effect on stamp duty revenue is less clear, but some analysis suggests the impact of price movements on stamp duty outweigh the movements in turnover.⁵⁸ Therefore it is likely that planning reforms will have a neutral or negative impact on overall revenue from taxes on land.

The other major tax that causes perverse regulatory incentives is the GST. As the GST is fully passed on to the states, all the incentives

caused by this tax affect the states alone. It might appear that the GST provides the right incentives for regulatory reform, because deregulation will grow the size of the economy and hence GST revenue. However, this superficial analysis ignores two redistributions of GST revenue that severely mute, or even negate, the incentives for reform.

First, any additional GST revenue generated in a particular state due to regulatory reform is distributed to all other states in proportion to population. New South Wales (NSW) was about 32% of Australia's population in 2016, so NSW received 32% of the GST revenue it generated in that year, as shown in the Table below. By contrast, the Northern Territory (NT) was only 1% of Australia's population, so received only about 1% of GST revenue it generates. In other words, NT initially gets just 1% of the revenue benefit of reform in the territory. Just this effect alone substantially mutes the revenue benefit of reform.

Table 3—Share of Australia's population, 2016

State/Territory	Share of Australian population
New South Wales	32%
Victoria	25%
Queensland	20%
Western Australia	11%
South Australia	7%
Tasmania	2%
Australian Capital Territory	2%
Northern Territory	1%

Source: ABS.⁵⁹ The year 2016 is used for consistency with Table 4.

But the redistribution does not end there. There is further redistribution from richer states to poorer states through Horizontal Fiscal Equalisation (HFE).⁶⁰ This HFE redistribution further reduces the fiscal benefit of reform. A reforming state becomes richer, and the HFE formula redistributes the increased income in that state to other states, while a state that becomes poorer because of bad regulation

is subsidised by richer states. Thus the combination of population redistribution and HFE redistribution severely mutes the incentives for regulatory reform, and in fact is likely to discourage reform.⁶¹

So the analysis above indicates that land tax revenue is reduced by regulatory reform, while reform is likely to reduce GST and stamp duty revenue. In total, this is about 65% of the revenue of all state governments in 2015–16, as shown in Table 4 below where incentives are either neutral or negative.

By contrast, only about 35% of state government revenue has positive incentives. Payroll tax revenue, for example, broadly grows with the state economy, so revenue from this tax provides positive incentives for state-level reform.⁶²

Table 4: State government total revenue including GST, 2015–16

Tax	% of total revenue (including GST)	Impact of regulatory reform on tax revenue
GST	42%	Negative/Zero
Land tax	8%	Negative
Stamp duty on land	15%	Negative/Zero
GST & taxes on land	65%	Negative
Payroll tax	17%	Positive
Other taxes, incl gambling, insurance, motor vehicle	19%	Positive
All excl GST & taxes on land	35%	Positive

Source: ABS.63 Numbers may not add due to rounding.

The analysis above is of the revenue side of government budgets. The incentives on the spending side are less clear-cut: regulatory reforms can boost spending, as many spending items grow automatically with wages or GDP such as the Age Pension and defence spending. The growth caused by reform may reduce welfare spending, but on the other hand transitory unemployment can be caused in reformed sectors, potentially requiring structural adjustment packages such as occurred in the dairy, car manufacturing and irrigation industries.⁶⁴

The federal Budget has analysis supporting this argument; finding faster GDP growth will tend to increase federal revenue as a share of

GDP and reduce unemployment spending, while implying that other areas of federal spending are largely unaffected as a share of GDP.⁶⁵

In summary, while there are many incentives discouraging regulatory reform at both the state and federal level, there is an additional disincentive for state government regulatory reform: the tax systems of state governments and the GST distribution formula create additional poor regulatory incentives.

Solutions

Along with tax reductions, a priority for addressing Australia's economic malaise should be reforming harmful regulation. This paper does not focus on the reform of individual regulations, instead recommending government-wide framework reforms that will reduce both the stock and flow of regulation.

State government financial incentives

The analysis above suggests that reforms to the incentives facing state governments should be a priority. Such worthwhile reforms include the following:

- Moving towards a per capita distribution of GST revenue to the states. A complete move to per capita distribution is unlikely, but there are worthwhile reforms to move in that direction. For example:
 - The Minerals Council has proposed that mining activity be partly excluded from the GST redistribution formula.⁶⁶ This should encourage increased mining development—or at least reduce the disincentives to development.
 - The Productivity Commission has suggested that the extent of GST redistribution could be reduced.⁶⁷ This would reduce the penalties imposed on states that reform and reduce the subsidies provided to states that fail to reform.
- Transfer some income taxing powers to the states. Each state could choose an income tax surcharge applying in that state, and would retain all the funds raised with no redistribution to other states. This tax increase would be offset by a reduction

in federal government income taxes and a cut in funding from the Commonwealth to the states. Further discussion on this proposal is in Hendy (2015) and the National Commission of Audit in 2014.⁶⁸

- This reform will provide states with sharper incentives for reform—they will gain direct access to the revenue base that is most likely to grow with improved economic growth.

Another significant reform would be to reinstate reform incentive payments, based on the successes of the incentive payments that were used under National Competition Policy (NCP). Under this approach, the Commonwealth provided states with substantial funding, but states that didn't reform, or were slow to reform, were penalised. The Productivity Commission in a major review of NCP found the payments:⁶⁹

- played a critical role in keeping reforms on track (pXXIII);
- could help to leverage reforms which, in the face of opposition from vested interests, might otherwise be put in the 'too hard basket' (pXLII);
- allowed states to share in the fiscal dividend of reform (p XIV); and
- allowed states to address transition costs or any adverse distributional effects from reform (p XLII).

The Commission also found that the threat of financial penalties locked in earlier regulatory reforms and discouraged reform 'backsliding'—the reversal of previous regulatory reforms.⁷⁰

The NCP incentive payments ended in 2005–06, which was just before the period when Australia's economic malaise started (see Figure 1), suggesting the abolition of the payments could be part of the reason for the subsequent declining performance.⁷¹

The 2017–18 federal Budget proposed the substantial housing payments to the states be amended to include financial incentives for reform in this sector.⁷² If designed well, this could provide the many benefits of incentive payments as outlined above.

However, there are risks with this approach. Incentive payments could be seen as contrary to proper federalism that would minimise federal government interference in states. There is also a risk that if the federal government starts down a path of regulation, this would be easy to turn into micro-management of states. This could then easily become a harmful, rather than beneficial, system. For example, incentives payments for reducing planning red tape could turn into incentives for increasing green tape—mandating environmentally-friendly design, energy efficiency, water tanks and similar.

However, the NCP framework shows how to design incentive payments to avoid this trap—have a simple framework. For the NCP legislation review program, this was broadly that states had to systematically review regulations that restricted competition, and reform or remove those regulations that did not meet a public benefit test.⁷³ The simplicity of this approach made it hard for governments to convert the system from good incentives to bad incentives.

This framework should be used for future incentive payments—require review and removal of regulations that do not meet a public benefit test. This would make it harder for the system to transform into micromanagement.

Other Solutions

There are a range of other useful framework solutions to reduce the burden of excessive regulation. These solutions are not new. Over-regulation is a recognised problem, and many have proposed significant reforms, including the Business Council of Australia and the Productivity Commission in recent reports.⁷⁴ The worthwhile reforms include the following:

- Establish an Inspector-General of Regulation, modelled on the existing Inspector-General of Taxation but monitoring regulatory burdens across government. This was proposed by the 2002 Uhrig Review, which recommended this new body would investigate the systems and procedures used by regulatory authorities in administering regulation.⁷⁵
- Separate the Office of Best Practice Regulation (and state equivalents) from government departments and establish these

bodies as independent statutory bodies to reduce political imperatives in decision making.⁷⁶

- Make a regulation impact statement (RIS) a statutory requirement for all substantial regulations, having only very limited exemptions, such as for issues of national security and emergency.⁷⁷ For emergency regulations that do not have a RIS, mandate speedy sunseting of the regulation with a RIS required for replacement.⁷⁸
 - This could include a requirement that draft RISs be required to be published for early consultation in relation to more significant regulations.
- Ensure RIS requirements apply to subordinate or delegated regulation.⁷⁹
- Require regulators to provide an annual statement on regulatory reform, to be approved by the proposed Inspector-General of Regulation.⁸⁰
- Implement regulatory budgeting, which involves measuring the economic cost of regulation and placing caps on this cost. A government implementing a new regulation that imposes a cost on society will need to implement regulatory reform to reduce the costs of regulation elsewhere. This approach can make use of already established approaches to estimate the economic costs of regulation.⁸¹
 - There are other proposals/policies to mandate a 'one in, one out' approach to regulatory changes, requiring one regulation (or more) to be abolished for every new regulation.⁸² This might be a worthwhile step in the process towards more sophisticated approaches involving regulatory budgeting.
- To reduce the stock of regulation, implement automatic sunseting of most existing regulations, and require rigorous processes outlined in this section for the reintroduction of regulations that have sunsetted.
 - This could be done as a reinvigoration of previous rolling reviews of industries conducted by the Productivity

Commission.⁸³ The proposed Inspector-General of Regulation could be involved in these reviews.

- Ensure the onus of proof is on those wishing to add regulation, and is not reversed.⁸⁴ When regulations are sunsetted, have the onus of proof on the *retention* of regulation not the removal—that is, those wishing to retain regulation have to satisfy the burden of proof.

There is a long way to go to reach best practice in regulatory reform, as has been made clear in many reviews, particularly by the Productivity Commission.⁸⁵ The changes proposed above should close this gap and help address Australia's poor economic performance. Doing nothing will risk a continuation of Australia's economic malaise—at significant cost to all.

Endnotes

- 1 There are many other factors that could also be harming Australia's economic performance, including tax and high energy costs, but the harmful effect of regulation is substantial as argued in this paper.
- 2 Source: ABS, Australian National Accounts: National Income, Expenditure and Product, September 2017, Cat No 5206, Table 1. Figures are real quarterly growth, seasonally adjusted and smoothed by taking the 3 year centred moving average. The 1980s recession had 11 quarters (2.75 years) where quarterly smoothed growth was below 0.4%, and the 1990s recession had 14 quarters (3.5 years) below 0.4%; the current period of slow growth has to date lasted 37 quarters (9.25 years).
- 3 Source: see endnote 2.
- 4 For example Scott Morrison (2017) *Address to the Higgins Budget Breakfast*, Melbourne, 12 May.
- 5 Source: OECD.Stat, see: <https://stats.oecd.org/index.aspx?queryid=60702>
- 6 In the period 2010–2015, Australia's population growth rate was faster than growth in Japan, Korea, North America and almost all countries in Europe. See: United Nations World Population Prospects 2017, available from: <https://esa.un.org/unpd/wpp/Download/Standard/Population/>
- 7 Using the standard definition that a recession is two consecutive quarters of negative real growth. Using trend growth in real GDP per person there were recessions in 2008 and 2000. Source: ABS, Australian National Accounts: National Income, Expenditure and Product, September 2017, Cat No 5206, Table 1.

- 8 Source: OECD.Stat, code HVPVOBARSA, available from: <https://stats.oecd.org/Index.aspx?DataSetCode=QNA>
Figures are for real quarterly growth, seasonally adjusted and smoothed by taking a three year centred moving average. The data source for Figure 1 is different from the source for Figure 2, explaining the differences in the two series for Australia. The OECD figures for most countries start in 1995, so no inference can be made about Australia's relative performance before 1995. The argument for using weighted rather than unweighted averages is presented in Michael Potter (2016) *The case against tax increases in Australia: The growing burden*, CIS Research Report 15 in Box 2; and Peter Burn (2004) *How Highly Taxed are We?*, CIS Policy Monograph 67.
- 9 Grace Taylor & Rod Tyers (2017) "Secular Stagnation: Determinants and Consequences for Australia" *Economic Record* 93 (303), p642.
- 10 Graph 3 of Peter Tulip (2014) "The Effect of the Mining Boom on the Australian Economy", *RBA Bulletin*, December Quarter. That paper estimates the boom would cause a short-term addition to GDP of 6%, moderating to about 5% in the long term.
- 11 Op cit. Graph 3 of that paper indicates the decline in the level of GDP from the peak of the mining boom to the long-term figure is about 1 percentage point.
- 12 See Figure 3.9 of Jim Minifie, Ittima Cherastidtham, Daniel Mullerworth and James Savage (2013) *The mining boom: impacts and prospects*, Grattan Institute. If this analysis is correct, excluding the effect of the mining boom will make the extent of the malaise since the end of the boom worse.
- 13 ABS Wage Price Index, Australia, 2017, Cat No 6345.0, Table 1; and James Bishop and Natasha Cassidy (2017) "Insights into Low Wage Growth in Australia", *RBA Bulletin*, March Quarter, Graph 11.
- 14 ABS Australian National Accounts: National Income, Expenditure and Product, September 2017, Cat No 5206, Table 1. Figures are seasonally adjusted. On this measure, real income per person was \$13,883 in September 2008 and \$14,318 in September 2017, a total increase over that period of 3.1%, or an annualised growth rate of 0.3%.
- 15 Over 400,000 new jobs were created in the 2017 calendar year, see Rachel Baxendale (2018) "Turnbull hails record job figures", *The Australian*, January 18.
- 16 Compensation of employees grew on average by 0.3% per quarter in real terms over the past three years, compared to an average real growth of 0.8% per quarter since 1992 (the last major recession). Source: ABS Australian National Accounts: National Income, Expenditure and Product, September 2017, Cat No 5206, Table 1 and ABS Consumer Price Index, Cat No 6401, Table 1.
- 17 The RBA paper cited earlier estimated the mining boom would lead to a boost to household incomes of 13% and a boost to wages at its peak of about 6%. The

- expected decline since the peak appears to be about 2% for household incomes and 3% for wages. Source: Section 5.1 and Figure 9 of Tulip (2014) *The Effect of the Mining Boom on the Australian Economy*.
- 18 Guy Debelle (2017) *Global Influences on Domestic Monetary Policy, speech to Committee for Economic Development of Australia (CEDA) Mid-Year Economic Update*, Adelaide, 21 July, Graph 1.
 - 19 See also David Uren (2018) “Rising cost of essential services putting the squeeze on homes” *The Australian*, 15 January.
 - 20 ABS Consumer Price Index, Cat No 6401, various tables. Food prices (not shown in the graph) have barely increased from September 2011 to September 2017; clothing and footwear prices (not shown) have fallen over the period September 2009 to September 2017 by 7%.
 - 21 Productivity Commission (2017) *Shifting the Dial: 5 Year Productivity Review*, Report No. 84, Canberra, p34.
 - 22 For 1960–61 to 2016–17, sources: for new private business investment, ABS, Australian National Accounts: National Income, Expenditure and Product, September 2017, Cat No 5206, Table 34; and for mining investment, ABS, Australian System of National Accounts, 2016–17, Cat No 5204, Table 58. For 2017–18 to 2019–20, source: Australian Government (2017) *Mid-Year Economic and Fiscal Outlook*, Table 2.2. Non-mining investment is the difference between new private business investment and mining investment.
 - 23 For example Mark Carney (2017) *Policy Panel - Investment and growth in advanced economies*, ECB Forum on Central Banking; and IMF (2015) *World Economic Outlook: uneven growth—short- and long-term factors, Chapter 4: Private Investment: what’s the holdup?*, April.
 - 24 The difference between Australia’s investment to GDP ratio and the OECD weighted average is forecast to decline by 1.9 percentage points from 2017 to 2022.
 - 25 A more detailed analysis of this issue, based on earlier data, is in Michael Potter (2016) “The looming crisis in business investment”, *Policy Magazine*, Vol 4 No 32, Summer.
 - 26 IMF (2017) *World Economic Outlook Database*, October.
 - 27 Sources: World Economic Forum *Global Competitiveness Reports*, various years; World Bank *Ease of Doing Business Index*, various years. Note the World Bank is revising these figures, see Josh Zumbrun and Ian Talley (2018) “World Bank Unfairly Influenced Its Own Competitiveness Rankings” *Wall Street Journal*, 12 January; Heritage Foundation *Index of Economic Freedom*, various years; IMD World Competitiveness Center, *World Competitiveness Yearbook*, various years; and Fraser Institute *Economic Freedom of the World Annual Report*, various years.
 - 28 Except the World Bank Ease of Doing Business index where our best performance was a rating of 5 in 2005; and the IMD Competitiveness Scorecard where our best performance was a rating of 4 in 2004.

- 29 This refers to multifactor productivity based on labour inputs adjusted for quality. Source: Australian Bureau of Statistics, Australian System of National Accounts 2016–17, Cat No 5204.0, Table 13.
- 30 Op cit.
- 31 See Simon Campbell and Harry Withers (2017) “Australian productivity trends and the effect of structural change”, *Economic Roundup*, 28 August; and Arif Syed, R Quentin Grafton, Kaliappa Kalirajan & Dean Parham (2015) “Productivity in the Australian Mining Sector”, *Australian Journal of Agricultural and Resource Economics*, 59(4), pp549–570.
- 32 “The HILDA Survey indicates there has been little net change in income inequality between 2001 and 2015. For example, the Gini coefficient, a common measure of overall inequality, has remained at approximately 0.3 over the entire 15 years of the HILDA Survey”: page 29 of Roger Wilkins (2017) *The Household, Income and Labour Dynamics in Australia Survey: Selected Findings from Waves 1 to 15*, Melbourne Institute, Melbourne. The latest data from the ABS shows negligible change in inequality from 2007–08 to 2015–16, see ABS, *Household Income and Wealth, Australia, 2015–16*, Cat No 6523.0.
For labour share of income, see Declan Trott (2017) *Adjusting the Australian wage share for depreciation, housing, and other factors, 1960-2016*, Paper presented to 2017 Australian Conference of Economists.
- 33 If the labour share has declined in Australia (see endnote 32), then this could be a direct result of the capital deepening caused by the mining boom. See Dean Parham (2013) *Labour's Share of Growth in Income and Prosperity*, Visiting Researcher Paper, Productivity Commission, Canberra.
- 34 Since 1988, household net worth has increased by over 400%, of which two thirds is attributable to increased dwelling prices, see ABS *Australian National Accounts: Finance and Wealth*, 2017, Cat No 5232.0, Table 34.
- 35 For example Christian Hilber & Wouter Vermeulen (2015) “The Impact of Supply Constraints on House Prices in England”, *Economic Journal*, Vol 126 No 591, pp358–405; Edward Glaeser & Joseph Gyourko (2003) “The Impact Of Building Restrictions On Housing Affordability” *FRBNY Economic Policy Review*, Vol 9 No 2, June, pp21–39; and Jason Furman (2015) *Barriers to Shared Growth: The Case of Land Use Regulation and Economic Rents*, Remarks to The Urban Institute, November 20. Furman was Chairman of the Whitehouse Council of Economic Advisers under President Obama.
- 36 The slowdown could be explained by factors common to many developed countries, for example the secular stagnation theory as outlined in Larry Summers (2016) “The Age of Secular Stagnation: What It Is and What to Do About It” *Foreign Affairs*, February. However, this cannot explain the decline in Australia's performance relative to other countries, as discussed earlier. Hence, Australia-specific factors will be major contributors to the slowdown.

- 37 This is the cumulative annual increase in the personal tax to GDP ratio per year from 2010–11 to 2016–17, based on figures in the 2017–18 Budget. Further discussion of bracket creep and fiscal drag, including definitions, are in Robert Carling & Michael Potter (2015) *Exposing the stealth tax: the bracket creep rip-off*, CIS Research Report 8, 13 December.
- 38 Treasury (2016) *Economic and Fiscal Effects of Rising Average Tax Rates*, Treasury Ministerial Brief, 1 February.
- 39 See Michael Potter (2016) *Fix it or Fail: Why we must cut company tax now*, CIS Research Report 20, 4 October.
- 40 See endnotes 10, 11 and 12.
- 41 Deloitte (2014) *Get out of your own way: unleashing productivity*, Building the Lucky Country Report 4.
- 42 Deloitte (2014), Chart 9
- 43 Lucille Keen (2014) “NAB Says compliance costs unsustainable” *Australian Financial Review*, 14 July 2014.
- 44 Justin Douglas (2014) “Deregulation in Australia”, *Treasury Economic Roundup*, 25 July 2014.
- 45 Daniel Wild (2017) *Barriers to Prosperity: Red Tape and the Regulatory State in Australia*, IPA.
- 46 Mark Harrison (2009) “Assessing the impact of regulatory impact assessments” *Agenda*, Vol 3 No 16 (2009), pp41–49.
- 47 Productivity Commission (2012) *Regulatory Impact Analysis: Benchmarking*, Research Report, Canberra, p2.
- 48 Office of Best Practice Regulation (OBPR) (2017) *Best Practice Regulation Report 2015–16*.
- 49 The OBPR assessed the Major Bank Levy as compliant but not best practice because of poor consultation. Source: Wayne Poels (2017) *Letter to Treasury: Regulation Impact Statement – Second Pass Assessment – Major bank levy*, Office of Best Practice Regulation.
- 50 The subsequent points are all from Michael Potter (2017) *The Major Bank Levy: We’re all going to be hit*, CIS Research Report 29.
- 51 John Lonsdale (2017) *Letter to OBPR: Regulatory Impact Statement – Final Assessment Second Pass*, OBPR ID 22319. The OBPR assessed the Levy breached consultation requirements, see Wayne Poels (2017).
- 52 See: <https://www.cuttingredtape.gov.au/>
- 53 Sources for the list of harmful incentives include: Daniel Wild (2017) *Barriers to Prosperity: Red Tape and the Regulatory State in Australia*; Business Council of Australia (BCA) *Action Plan for enduring prosperity: Rethinking our approach to regulation and governance*, July 2013; and Productivity Commission (2012) *Regulatory Impact Analysis: Benchmarking*, Research Report, Canberra.
- 54 This is not to say the financial incentives for the federal government are good — just the state government incentives are much worse.

- 55 Source: Scott Morrison & Matthias Cormann (2017) *Budget 2017–18: Budget Strategy and Outlook*, Budget Paper 1, Table 9, pp5–18. FBT is included with personal tax; resource rent taxes and superannuation funds taxes are included with company tax.
- 56 See endnote 55.
- 57 As noted in endnote 35, planning rules and regulations are a substantial cause of higher house prices. As a result, regulatory reform should lead to lower prices or reduced price growth.
- 58 See for example page 26 of Hannah Leal, Stephanie Parsons, Graham White and Andrew Zurawski (2017) “Housing Market Turnover”, *RBA Bulletin*, March Quarter.
- 59 ABS Australian Demographic Statistics, Sept 2016, Cat No 3101.0.
- 60 Details of HFE are in John Brumby, Bruce Carter & Nick Greiner (2012) *GST Distribution Review Interim Report*, Chapter 1; and Commonwealth Grants Commission *How HFE works*, available from: https://cgc.gov.au/index.php?option=com_content&view=article&id=258&Itemid=536
- 61 Two recent reports found the GST distribution formula in theory creates perverse incentives, discouraging economic reform. See John Brumby, Bruce Carter & Nick Greiner (2012) *GST Distribution Review Final Report*, 2012, Chapter 9; and Productivity Commission (2017) *Horizontal Fiscal Equalisation*, Draft Report, Canberra. These reports were unable to list beneficial reforms that were discouraged because of the formula, but the Commission noted “absence of evidence is not equivalent to evidence of absence” and the disincentives the formula creates for desirable policies “when viewed cumulatively over time, could be at significant cost to the Australian economy” (p13).
- 62 This is not to say that payroll tax is particularly efficient — instead the argument is payroll tax provides the right incentives to state governments for reform.
- 63 ABS Taxation Revenue, 2015–6, Cat No 5506, Table 10.
- 64 For dairy see David Harris (2005) *Industry Adjustment to Policy Reform—a case study of the Australian dairy industry*, RIRDC, Canberra; and for industry structural assistance more broadly see Productivity Commission (2017) *Trade and Assistance Review 2015–16*, and the same report in earlier years.
- 65 See 2017–18 Budget, pp8-19 to 8-20.
- 66 Minerals Council of Australia (2017) *Submission to the Productivity Commission Inquiry on Horizontal Fiscal Equalisation in Australia*, June.
- 67 Chapter 8 of Productivity Commission (2017) *Horizontal Fiscal Equalisation*, Draft Report.
- 68 Peter Hendy (2015) “Reforming taxation isn’t about increasing taxes” *IPA Review* Vol 67 No 2, May, pp44–49.
Tony Shepherd, Peter Boxall, Tony Cole, Robert Fisher & Amanda Vanstone (2014) *Towards Responsible Government—The Report of the National Commission of Audit*, Part One, February.

- 69 Source: Productivity Commission (2005) *Review of National Competition Policy Arrangements*, Inquiry Report. The Commission supported the incentive payments while also proposing various technical improvements to the payment system (pp152–157).
- 70 Productivity Commission (2005) *Review of National Competition Policy Arrangements* at p381 and p387.
- 71 The ending of the incentive payments in 2005–06 is stated on the National Competition Council website: <http://ncp.ncc.gov.au/pages/about>
- 72 Australian Government (2017) *Reducing Pressure on Housing Affordability: Fact Sheet 1.7—A new National Housing and Homelessness Agreement*, Canberra.
- 73 For more details see Productivity Commission (2005) *Review of National Competition Policy Arrangements*.
- 74 Business Council of Australia (BCA) *Action Plan for enduring prosperity: Rethinking our approach to regulation and governance*, July 2013; and Productivity Commission (2012) *Regulatory Impact Analysis: Benchmarking*, Research Report, Canberra.
- 75 John Uhrig (2003) *Review of the corporate governance of statutory authorities and office holders*, pp 67–68. This proposal was also supported in BCA (2013).
- 76 Productivity Commission (2012) p27.
- 77 See BCA (2013) p13; Productivity Commission (2012) p24.
- 78 BCA (2013) p13.
- 79 Productivity Commission (2012) p23.
- 80 BCA (2013) p14.
- 81 Australian Government (2014) *Australian Government Guide to Regulation*, Canberra. See also the proposal for a ‘red tape trading scheme’ involving a stocktake of existing regulatory costs and setting a limit on total costs below this original level. This would mean departments and agencies will need to cut regulation over time. See Oliver Marc Hartwich (2010) *Towards a Red Tape Trading Scheme: Treating Excessive Bureaucracy as Just Another Kind of Pollution*, CIS Issue Analysis No 121, 19 May.
- 82 See for example a requirement for one in two out in The White House (2017) “Presidential Executive Order on Reducing Regulation and Controlling Regulatory Costs” Office of the Press Secretary.
- 83 As part of the series of Productivity Commission inquiries into Performance Benchmarking of Australian Business Regulation, see <https://www.pc.gov.au/inquiries/completed/regulation-benchmarking>
- 84 The onus of proof is discussed in Productivity Commission (2005) pp134–137.
- 85 See for example Productivity Commission (2012) Table 1 on p5 showing most jurisdictions fall well behind best practice for regulatory assessment.



The Centre for Independent Studies is a non-profit, public policy research institute. Its major concern is with the principles and conditions underlying a free and open society. The Centre's activities cover a wide variety of areas dealing broadly with social, economic and foreign policy.

The Centre meets the need for informed debate on issues of importance to a free and democratic society in which individuals and business flourish, unhindered by government intervention. In encouraging competition in ideas, The Centre for Independent Studies carries out an activities programme which includes:

- research
- holding lectures, seminars and policy forums
- publishing books and papers
- issuing a quarterly journal, *POLICY*

For more information about CIS or to become a member, please contact:

Australia

Level 1/131 Macquarie Street,
Sydney NSW 2000 Australia
Ph: +61 2 9438 4377
Fax: +61 2 9439 7310
Email: cis@cis.org.au

www.cis.org.au

Council of Academic Advisers

Professor James Allan
Professor Ray Ball
Professor Jeff Bennett
Professor Geoffrey Brennan
Professor Lauchlan Chipman
Professor Kenneth Clements
Professor Sinclair Davidson
Professor David Emanuel
Professor Ian Harper
Professor Wolfgang Kasper

Professor Chandran Kukathas
Professor Tony Makin
Professor R. R. Officer
Professor Suri Ratnapala
Professor David Robertson
Professor Steven Schwartz
Professor Judith Sloan
Professor Peter Swan AM
Professor Geoffrey de Q. Walker

RED TAPE AND AUSTRALIA'S ECONOMIC MALAISE

Australia is in a period of economic malaise. GDP per person has been growing slowly ever since the GFC. Australia's performance is mediocre compared to other developed countries; by contrast, we outperformed before the GFC. Household incomes and wages are also growing at slow rates, though some of this is caused by the end of the mining boom.

One likely cause for this poor economic performance is the ongoing proliferation of poor quality regulations across the economy. The causes of flawed regulation are many. One important cause is the harmful incentives for state-level reform created by the GST distribution formula. This formula should be reformed to reduce the penalties imposed on regulatory reform.

The gatekeeping on regulatory processes also needs significant strengthening, including by reintroducing incentive payments to states that reform; introducing an Inspector-General of Regulation; mandatory sunseting of existing regulations; and broadening the requirements to publish comprehensive estimates of regulatory impacts.

Michael Potter works as an economist in Sydney. He has worked for The Centre for Independent Studies, the Parliamentary Budget Office, the Federal Departments of Treasury, Environment and Prime Minister & Cabinet (where he advised then Prime Minister John Howard on the introduction of the GST).

He has also worked as Policy Manager, Economics at the National Farmers' Federation, and Director, Economics and Taxation at the Australian Chamber of Commerce and Industry.

Michael has a Masters of Applied Economics from ANU and a Bachelor of Economics (Honours) from the University of Sydney.

