Submission to the Five Pillars Inquiries

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Overview

This brief submission recommends an amendment to the cash flow tax proposal from the Productivity Commission's Interim Report on 'Creating a More Dynamic and Resilient Economy' as part of the 'Five Pillars of Productivity' Inquiries, as well as a number of other reforms pertaining to either the 'Creating a More Dynamic and Resilient Economy' or the 'Building a Skilled and Adaptable Workforce' inquiries, or both.

Section 1 addresses the cash flow tax, while Section 2 addresses other proposals.

Section 1: Cash flow tax

While the Commission's proposal to introduce a cash flow tax is highly commendable—and would be a vast improvement on the current business tax system—there is no need to create a 'hybrid' system where company income tax is retained and reduced from 30% to 20% and the new cash flow tax rate is only 5%.

A far better, simpler, and more effective model would be [REDACTED] proposal to **replace company income tax <u>entirely</u> with a revenue-neutral corporate cash flow tax**.

A cash flow tax (CFT) would ensure tax relief is only going to firms that invest. It would also benefit small businesses and start-ups, especially during their first few (typically cash-poor) years of operation—particularly if the 'straightforward rebate' model for compensating negative cash flows is adopted. This would greatly aid competition and innovation, especially given Australia's highly concentrated industries, and thus support lower prices, lower inflation, higher real wages and higher living standards in the long-run.

The largest benefit in replacing CIT *entirely* with a CFT is the simplification of the tax system. While **any CFT is always better than no CFT**, we should take the opportunity to secure major efficiency gains by slashing the complexity and red tape of tax system compliance, by replacing CIT entirely.

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Tax system complexity is not just a drag on efficiency and productivity; it is also a drag on equity, fairness, and a just distribution of income and wealth. Tax system complexity benefits big corporations at the expense of small business: large firms can afford an army of tax lawyers and accountants, while smaller firms cannot. This means larger firms can also afford to exploit every lurk-and-perk in the tax code. Complexity disadvantages small businesses and start-ups, in turn undermining competition and innovation while increasing economic rents.

Replacing CIT entirely with a CFT is the most effective means of both minimising corporate rent-seeking *and* maximising private investment.

Garnaut et al. (2020) canvas three options for compensating negative cash flows: a 'straightforward rebate' model, a tradeable offset model, and a carry-forward offset model:

> "In years when negative net cash flows are recorded, we propose that an amount equal to the negative net cash flow multiplied by the tax rate be certified by the Australian Taxation Office (ATO) and rebated to the taxpayer. If political judgements weighed against a straightforward rebate, the certified cash loss could be made available for offset against any cash flow tax payable by any entity. The taxpayer would be permitted to sell the certified amount to another company for offset against its own current cash flow tax liabilities. The private sector, the Australian Securities Exchange (ASX) or the ATO could create a market for such offsets, which would trade at face value minus transaction costs." (Garnaut et al. [2020: 471])

The carry-forward offset model would allow a firm which incurs a negative cash flow tax liability in a particular year to offset it against any positive cash flow tax liability owed in a future year.

This submission recommends the 'straightforward rebate' model, for two reasons:

1. This is the simplest model, involving the least administrative burden for firms.
    - Trading offsets on the ASX or other private markets is a hassle for small businesses and makes the whole process needlessly complex, which means small businesses may simply not bother with it—which risks artificially skewing the benefits towards large firms
    - Either way, the tradeable offset model adds complexity and administrative burden to the system, even for large firms.
2. The 'straightforward rebate' model strengthens the counter-cyclical automatic stabilisers, while the carry-forward model unfortunately makes fiscal policy more *pro*-cyclical
    - The carry-forward offset model, while *almost* (but not) as simple as the straightforward rebate model, smooths revenue over the cycle.

- While this may delight the Department of Finance, it is atrocious from a macroeconomic stability standpoint.
- It would involve giving firms tax relief (i.e. fiscal stimulus) during the "good years" at the peak of the business cycle, while *denying* them such tax relief/stimulus during the "bad years" in the troughs of the business cycle.

The 'straightforward rebate' model is the right model because of efficiency and macroeconomic stability.

The tradeable offset model is the wrong model because it is needlessly complex for all businesses, and therefore also biased against time-poor small businesses. The last thing we want to do is needlessly *add* red tape or further entrench big corporations' advantages (undermining competition).

The carry-forward model is the wrong model because the last thing we want to do is give firms fiscal support when they don't need it (during a macroeconomic expansion) and deny them fiscal support when they *do* need it (during a contraction or stagnation).

Section 2: Additional proposals

Additional proposed reforms (whose rationale will be explored in greater detail in a forthcoming paper) include:

- Replacing **personal income tax** on all labour/active/earned income (PIT-L) with a highly progressive **personal expenditure tax** (PET), as proposed by Kaldor (1955), but, unlike Kaldor's proposal, retaining the existing personal income tax on all passive/non-labour income. Key benefits of this reform include:
    1. Lifting participation rates (by reducing EMTRs) and inducing a large positive aggregate supply shock (reducing any current positive output gap).
    2. Shifting the Beveridge Curve inwards (improving job-matching efficiency) and incentivising greater job mobility, thus lifting labour productivity
    3. Increasing individual incentives for labour productivity by strengthening any transmission from productivity to wages.
    4. Greatly enhanced price stability and lower inflation via a stronger automatic fiscal stabiliser (PET), properly calibrated towards price stability.
    5. Greater financial security for working families (and thus greater macroeconomic and financial system stability) via higher savings rates.
    6. Redistributing income from wealthy passive income recipients to the working class.
- A "**Progressive GST**" modelled on Holden and Dixon (2025)'s proposal wherein every Australian aged 18 years or older is provided with an annual GST-free

spending threshold (ideally by exempting GST at point-of-sale through the EFTPOS network), to be "paid for" by removing all current GST exemptions (such as education and health) and raising the rate of the GST to 15%. My proposal differs from Holden and Dixon's in that:

1. **Payroll tax should be abolished** to boost real wages growth, employment[2], competition, and tax system simplicity (reduced compliance costs).
2. The annual GST-free threshold would necessarily be somewhat lower than the $22,000 p.a. proposed by Holden and Dixon (2025) in order to pay for the abolition of payroll tax, but should still be as high as possible (within the constraint of state/territory revenue neutrality) to maximise progressivity[3].

- A wealth tax
- An inheritance tax
- A windfall profits tax
- Worker representation on company boards (which evidence suggests has positive effects of various sizes on firm-level productivity—see Harju, Jager and Schoefer [2025] and Jones and Pliskin [2025])
- The introduction of individual, portable, lifelong learning accounts
- National portable long service leave (to both improve worker wellbeing and reduce possible disincentives to job mobility)
- The expansion of the old Latrobe Valley Authority's "pooled redundancy" scheme
- A federal Job Guarantee, which could initially take the form of a federally-funded, state-administered reintroduction of the Victorian Government's highly successful 'Working for Victoria' (WfV) job program.
    - Analysis in Deloitte Access Economics' evaluation[4] of WfV found the program was highly cost-effective and efficient, dramatically improved workers' outcomes (jobs, wages, and health), and delivered sizeable fiscal savings to the Commonwealth ($219.2 million, out of a total program cost of $446.9 million, with a five-year economic growth dividend of $911

[2] While all economists know (per the Henry Tax Review) that payroll tax is primarily passed on to workers through lower nominal wages and to consumers through higher prices, rather than being strictly an "employment tax", the e61 Institute has found evidence of smaller firms "bunching" below payroll tax thresholds, inhibiting firm growth—which obviously implies *some* negative effects on employment (see Andrews, Buckley and Lee [2024]).

[3] It should be noted that because payroll tax primarily affects real wages through higher prices and lower nominal wages, it is a "stealth" consumption tax and a "stealth" flat labour income tax—highly regressive. Hence, abolishing payroll tax would primarily benefit the working class, and, along with the introduction of a progressive GST-free threshold, constitutes full compensation for the effects of GST rate-raising and base-broadening.

[4] Copies available upon request.

million—i.e. a gross fiscal multiplier of 2.04 and a *net* fiscal multiplier of 4.0)

- My own research (forthcoming) using OECD data on labour market program expenditure in Australia from 1985 to 2023 finds that the only three categories of ALMP expenditure to have successfully shifted the Beveridge Curve inwards are 'direct job creation', 'training', and 'start-up incentives'.
- Results from a recent Oxford University randomised control trial (Kasy and Lehner [2025]) found a Job Guarantee eliminated long-term unemployment and delivered substantial economic and social benefits, with no negative employment spillovers (i.e. no crowding-out of private sector employment).
- Godin (2012) simulated a Job Guarantee versus discretionary fiscal expansionary "demand spur" policies ("KDS") using a structural model, and found a JG is "more efficient at tackling poverty and income inequality than a traditional KDS"; and that "when inflation arises, the JG scheme is more flexible and leads to lower inflation rates. This is due to the fact that the spur in aggregate demand comes from households' consumption, which is more sensible to inflationary pressure. On the other hand, the KDS policy spurs directly real government expenditure and thus has a stronger impact on inflation." Moreover, "the goal of full employment through a JG scheme might be obtained **while still having balanced budgets and without having inflationary pressures**" [emphasis added]. Moreover, using a JG to achieve full employment involves lower public debt than KDS.
- In summary, job guarantee policies both eliminate unemployment *and* improve labour supply and job-matching efficiency.

Conclusion

This submission emphasises that productivity-enhancing reforms must be inclusive. This is not just because of a personal political view that workers' interests must come first, but also because economics—as the cliché goes—is all about incentives. How can any economist who has built a RANK model with unbounded rationality be surprised that workers—and their trade unions—have grown sceptical about productivity reform, when the decoupling of real wages from productivity growth during the 2010s reduced their basic incentive for productivity growth? If there is any one *structural* factor we can change to pull Australia out of the productivity crisis, it is to ensure that workers enjoy their deserved benefits from productivity growth. The common view that productivity reform requires sacrifices by workers is absurd.

Similarly, it would be a grave error to let budget deficit hysteria hobble the productivity agenda. Deficit reduction is an *outcome*—not the *precondition*—of productivity reform. Never put the fiscal cart before the productivity horse.