

FINANCIAL REVIEW

Bernardi exit must fire Liberal resolve

Seven months ago, the Liberal Party's most outspoken conservative, Cory Bernardi, won a six-year Senate term under the flag of the Liberals. Then he went on a three-month junket at the United Nations in New York – an organisation with which he would have little sympathy – where he witnessed up close the extraordinary presidential win of Donald Trump. On the first day of Australia's 2017 parliamentary year, he defected from the Liberals to form his own conservative party.

Senator Bernardi's giddiness may be lubricated by Mr Trump's humiliation of the cultural left, its obsession with identity politics and its lost legitimacy on uncontrolled immigration, Islamic terrorism, Indigenous affairs and even freedom of speech.

Yet the triumph of cultural conservatism now cheers a thrice-married property developer president who has boasted about grabbing women by the "pussy", who sidles up to Russian strongman Vladimir Putin and who openly flirts with America-first protectionism that threatens to harm Australia's national interest.

Conservatism used to be based on personal responsibility, civil society and economic freedom against the power of the state and grand ideologies imposed on people from above. The spectrum of Australia's Liberal Party stretches from libertarian capitalists to tradition-worshipping social conservatives. But Senator Bernardi's defection rides on the unconservative wave of brash Trump populism: big-government, inward-looking economic nationalism also exemplified by Pauline Hanson in Australia and leftists such as Bernie Sanders in the US.

Senator Bernardi yesterday justified his defection by complaining that the political class had lost touch with the people. But he offered little specific complaint about the Prime Minister, against whom his act of political treachery is aimed. Notwithstanding his personal convictions as a cosmopolitan liberal, Malcolm Turnbull has stood firm on the policy he took to last year's election of requiring a plebiscite of voters, rather than a conscience vote of parliamentarians, over same-sex marriage. Similarly, Mr Turnbull has maintained former prime minister Tony Abbott's hardline border protection policy. And in opening the door to cleaner coal-fired power generation, he has ruled out any explicit form of carbon pricing, even though a higher price is implicitly embedded in the renewable energy targets Mr Abbott accepted. Mr Turnbull even has opened the door to watering down the anti-free speech section 18C of the Racial Discrimination Act that Mr Abbott sidelined because, however valid, it was diverting the Coalition government from its central purpose of promoting the prosperity that does most to build family, community and opportunity.

Unlike the conservative Mr Abbott, Mr Turnbull hasn't proposed another big-ticket entitlement program in paid parental leave amid a chronic budget deficit. And Mr Abbott's captain's call of giving Prince Philip a knighthood didn't do much to connect the political class with the Australian people.

Here is the real crux of Mr Turnbull's problem. Former prime minister John Key in New Zealand and former premier Mike Baird in NSW have both shown that centre-right governments can run successful governments by concentrating on promoting economic growth and the jobs and incomes that comes with it. Both Mr Key and Mr Baird stumbled – on trying to change the Kiwi flag or shutting down the greyhound industry. But these stumbles were outside their core programs of promoting prosperity.

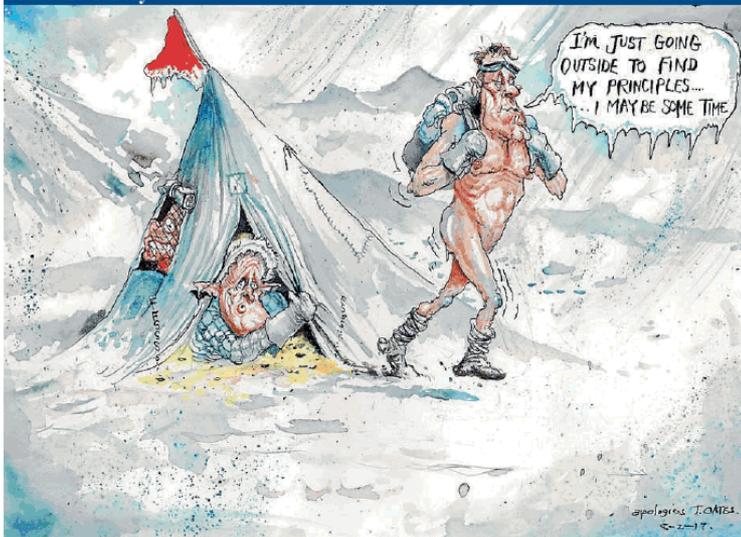
Mr Turnbull, in contrast, has shied away from the incentives-based political program implemented by Mr Key and pushed by Mr Baird. Without a conviction-based economic program, he has exposed himself more to the splintering of the political process embodied in Senator Bernardi's defection.

As *The Australian Financial Review* has repeatedly argued, Mr Turnbull needs to return to the Liberals' economic virtues of reducing the tax burden on enterprise and initiative, removing regulations that get in the way of productive workplaces and removing barriers to competition as outlined in the Harper review.

He has been too timid here, and is paying the price for the lack of results, both in his own ranks and with the electorate.

From the Gallery

David Rowe



High company tax is a slow death

Tax debate

Scare away new capital and we are left with an out-of-date economy and a much smaller tax base.



Richard Holden

Amid all the commotion of the Trump presidency, you might have missed the fact that we are having an important debate about company tax policy in Australia.

Trump has announced that he will lower the US rate to 15 per cent, and there are proposals in Britain to lower their rate to 17 per cent. With Singapore already at 17 per cent, and Ireland famously at 12.5 per cent, there are real concerns that Australia's 30 per cent rate is uncompetitive.

Even the dean of the Australian company directorate, David Gonski, said at the ANZ annual general meeting in December, "why would any corporations wish to basically be here?" in the face of such a high tax rate.

On the other hand, the Labor Party claims that even a cut to 25 per cent – as the Turnbull government has proposed – is a boondoggle for the big four banks and other large companies.

Who's right?

Those who point out that a corporate tax cut will benefit installed capital – like the big four banks – are right. Those investments are sunk, so the investment behaviour can't be changed by a change in the tax rate. But those who argue that new investments are less likely to be made in Australia if our tax rate is higher than countries are also right – prospective investment behaviour certainly can be changed by the tax rate.

So, what are those prospective investments that could be affected by a change, or the absence of a change, in the tax rate? Or, as economists would say: "Forget about averages, I want to know who the marginal investor is."

It is unclear that it is large mining projects. Are we competing with Singapore for those, or countries like Brazil and Venezuela – where the tax rate pales in comparison to sovereign risk? Similarly, the big four banks can't easily move their existing operations.

But new foreign capital and home-grown innovators are likely to be very sensitive to the tax rate, and they have choices. Those sectors might not be as big as banking and mining right now, but they arguably could be – and need to be – a big part of the Australian economy of the future.

It is also dangerous to take a static view of installed capital. The existing investments might be there, but they depreciate over time. And decisions on how quickly and completely to replenish them depend very much on the corporate tax rate.

Moreover, earnings are much less likely to be reinvested in Australia if they will be taxed more heavily here than abroad. A significant tax-rate differential could lead to

large Australian companies slowly diversifying offshore.

This all suggests that if we fail to act on the corporate tax regime, there is relatively little risk of significant short-term problems. So, should we conclude that it is not as bad as Gonski, the Business Council of Australia, and other proponents of a cut in the corporate rate think?

Actually, no. It's much worse.

Our corporate tax regime presents a massive long-term problem, where installed capital slowly depreciates away and new capital goes elsewhere. And eventually we are left with an out-of-date economy and a much lower tax base overall. We risk becoming the economic equivalent of the proverbial frog that doesn't feel the water's incremental temperature rise, fails to jump out of the pot, and boils to death.

Here's a problem with little short-term pain from inaction, but definite political costs from acting in the long-term national

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interest. Given the state of political discourse and compromise in Australia it is not hard to guess what will happen.

Nothing.

It looks like there will not be agreement on the government's proposal to lower the rate from 30 per cent to 25 per cent – at glacial pace mind you – despite front-loading it with benefits to small business. This, by the way, despite the fact that the current opposition said as recently as late 2015 that the rate should be cut to 25 per cent and that the economic incidence is actually on workers.

On both sides, a cheap political win today is too tantalising to resist.

Companies that dodge tax through transfer pricing and other dubious schemes should be clamped down on. But we also need to recognise the perhaps uncomfortable reality that we live in a world with globally mobile capital.

That isn't going to change. And if our company tax rate doesn't, then we will find out just exactly how mobile. Maybe not tomorrow. But soon, and painfully.

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