We can spend like Keynes and cut tax like Friedman

Recovery
Low public debt and cheap money makes both big fiscal stimulus and lower personal and company tax possible.

Richard Holden

The Australian economy is facing an unprecedented challenge from COVID-19, as last week's budget update made clear.

In meeting those challenges, we need to use every economic tool in our arsenal, and not hide behind outworn slogans of ideological battles from the 1980s such as "trickle-down economics".

Australia needs aggressive fiscal measures to combat COVID-19, but we also need to reform both company and individual income tax rates. A good starting point would be to bring forward the second and third phase of the government's income tax cuts, and to lower the company tax rate to 25 per cent right away for all businesses, regardless of size.

The backdrop for both fiscal measures and tax cuts is that the Australian government can borrow long term at less than 1 per cent a year. So the real cost of $200 billion of fiscal measures is $2 billion a year in interest cost. Equally, the true cost of income tax cuts that cost $95 billion over a decade is 1 per cent of $9.5 billion a year – less than $100 million per annum.

We can afford to spend aggressively and cut taxes at the same time.

And we should. Australia has gone from having one of the lowest tax rates in the OECD – after first Hawke and Keating, then Howard and Costello cut it to 30 per cent – to one of the highest as other countries have lowered their rates.

We can like that or not, but as a capital-thirsty country we compete for capital with other nations. High relative company tax rates are a barrier to investment that creates jobs.

Moreover, as I wrote on these pages in 2018, the best evidence on the causal effect of cuts in company tax rates is that about half the benefit accrues to capital and half to workers.

Indeed, the workers who benefit the most from tax cuts are young people, women and lower-paid workers.

On the personal tax side, through so-called "bracket creep", we have drifted into the inefficient and inequitable situation where, prior to the start of reforms by this government, workers on average full-time earnings were set to pay the second top marginal rate of 39 per cent (including the Medicare levy).

Milton Friedman, left, with Nancy Reagan and former US president Ronald Reagan. The 1980s economic reformers certainly got some things right. PHOTO: BLOOMBERG

As economists of all stripes know, when you tax something you get less of it. In this case that is less labour supply – i.e. less work and fewer jobs.

The Treasurer twice invoked the legacy of Margaret Thatcher and Ronald Reagan in recent days. For some this is a lightning rod, invoking memories of union-busting and cuts to the welfare state on both sides of the Atlantic.

But an important part of their legacy was to cut taxes from very high and economically crippling levels to more competitive rates that spurred economic growth. Whatever one thinks about the other policies Thatcher and Reagan enacted

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– and I have been harshly critical of many of those – they got stagnant, overtaxed economies moving again.

Among all the suffering and misery, perhaps the one good thing to come out of COVID-19 is that we are moving to a new national narrative on debt and deficits.

Both sides of politics have been stricken by a severe case of balanced-budget fetishism. That has prevented many reforms.

In particular, the glacial pace of the Coalition's "enterprise tax plan" that sought to cut company rates to 25 per cent over a decade was clearly because of concerns about the four-year forward estimate period of the budget. The same accounting gimmick was at play with the three phases of personal income tax cuts it announced.

We have come to understand that, while deficits do and always will matter, we live in an age of "secular stagnation", with low growth, low inflation and low interest rates.

This was painfully obvious before COVID-19. Post COVID-19, economic growth is at even more of a premium, and the Australian government has the capacity to run deficits to get the economy moving again.

Much of that spending is and should be on income support to get households and businesses through the worst of COVID-19. But – as every government report on the matter has said for a decade, and as the Reserve Bank of Australia (RBA) governor continues to emphasise – we need to boost investment and productivity.

Spending on social and physical infrastructure is an important part of that agenda. So, too, is having an internationally competitive company tax regime, and personal income tax rates that don't act as a handbrake on the economy.

If I were Josh Frydenberg's speech writer, I might not have invoked the image of Thatcher and Reagan. But he was not wrong to do so.

Australia's low ingoing net debt to GDP and ability to borrow cheaply puts us in a unique position to be Keynesians and Friedmanites at the same time.

We can spend aggressively and cut taxes at the same time.

In fact, we must.

Richard Holden is professor of economics at UNSW.

Huawei ban is just the start of the great tech decoupling

Cyber wars
The days of Australian R&D partnering with both China and the US are drawing to a close.

Dirk van der Kley

Australia now faces uncomfortable decisions as the world rushes toward substantial decoupling of technology. After years of inching toward a partial separation of the tech systems in China and the US, both sides hastened the tempo in the past few months.

The Chinese government and companies know developed markets are becoming increasingly difficult because of security concerns around their tech products.

As Simon Lacey, the former vice-president of trade facilitation and market access at Huawei, writes, "In China, it [Huawei] had to demonstrate unwavering loyalty to the goals of the Communist Party leadership. Outside China, it had to argue that it had little or nothing to do with the Chinese state." This is proving untenable in developed democracies.

For many emerging economies, the quality and price of Chinese technology to enhance development often outweighs security concerns. Thus, the global battle for tech standards, systems and ethics is going to be decided in Asia, home to most of the world's large, emerging economies.

In the short term, if the US follows India in trying to block TikTok (India also blocked 58 other apps owned by Chinese companies), then Washington's attention will turn to all other apps owned by Chinese parent companies such as WeChat and Didi.

The security concerns are the same for all apps made by Chinese-owned companies – the Chinese government will be able to access user data. It is more difficult to block apps in a democracy than in China but the US has tools to severely limit access to Chinese apps.

Australia and other Asian countries will come under pressure to follow suit. Beijing will apply bluster and threats of coercion in attempts to stop this. Canberra will need to make a call about data security versus the consumer appeal and benefits of many Chinese apps. Didi, for example, offers a lower commission than Uber, which benefits both drivers and passengers.

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Beyond this, every collaboration between China and foreign tech organisations could potentially be impacted by ever-expanding US export controls.

Any Chinese entity that publicly claims to be involved with civil-military fusion (CMF) could be blocked from US tech exports. For political reasons, almost every university and large tech company in China feels obliged to publicly say they support CMF. Numerous Australian (and Asian) universities have large deals with organisations that publicly state they support CMF. If their collaboration relies on equipment from the US, as it often does, they are vulnerable to supply disruption.

In response to expanding US export controls, China is developing export controls to be applied internationally. In May 2019, Beijing announced an unreliable entity list and a national security management list. A Ministry of Commerce official said companies are to be placed on the unreliable entity list if they take "discriminatory actions taken against Chinese companies, such as boycotting or cutting off supplies."

It has still not been made clear how the lists will work in practice. But they will be implemented in some way as part of a suite of new measures designed to counter US efforts. The Communist Party's Central Committee and State Council published a document in May that calls for the establishment and improvement of both lists as part of a system of technology controls. It may be impossible for international companies to comply with both sets of requirements.

A Biden presidency would likely bring more predictability to US actions. But it does not guarantee a rollback of already-significant restrictions. Many in the US recognise their capacity to pressure China and other tech companies will only reduce over time. This leads to a view that if the US wants to maintain its tech lead, it is now or never in terms of punishing China.

Observers point out that much tech collaboration still exists between China and the US. Research conducted by Andrew Kennedy of the Australian National University shows Chinese research organisations concluded 144 R&D alliances with foreign partners between 2017 and 2019, which is a large jump compared with the years up to 2016. The US is the lead partner of choice.

Much of the R&D collaboration growth has been driven by foreign organisations investing in biotechnology R&D in China. Many of the new controls under President Donald Trump so far have focused on information and communications technology. Biotech is just one of many fields in the sights of the US government for future controls. Australia has a strong biotech sector with deep linkages to both China and the US.

Australian universities such as UNSW and Monash have recently signed deals with Chinese entities worth hundreds of millions of dollars to commercialise their research. These provide obvious benefits for Australia's innovation economy and national wellbeing (and resilience).

These collaborations will find it more difficult to walk the tightrope between China and the US, let alone multilateral collaboration between China, the US and third countries.

For years, the costs for Australia of Sino-US tensions have been limited. Australia has been able to successfully take funding and technology from and collaborate with both as part of bigger projects. Those days are over. The only really hard decision so far on tech for the government was Huawei's involvement in Australia's 5G network.

Decisions of equal difficulty will be regular now.

Dirk van der Kley is program director – policy research at China Matters.

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