

## Transcript - Q and A

**Event:** NATIONAL PRESS CLUB                      **Date:** 19.04.2006

**Time:** 12:30 PM

**Item:** "BALANCING THE RISKS: ENSURING OUR PROSPERITY SURVIVES THE BOOM"

SPEAKER: HEATHER RIDOUT, CEO - AUSTRALIAN INDUSTRY GROUP

CHAIR: Thank you very much Heather Ridout. As usual our media questions. The first one today is from Scott Murdoch.

QUESTION: Heather, it's Scott Murdoch from *News Limited*. You've spoken today and many times in the past about the role of productivity in the Australian economy and particularly how it's dwindling at the moment. What are your thoughts on what role or responsibility the personal income tax system has in reversing that productivity wane?

The Hendy-Warburton Report found last week based on OECD figures that there are you know crippling high effective marginal tax rates, particularly for workers looking to take on more overtime. What role does the tax system have in turning around that productivity, particularly at a time when the Government has sort of trumpeted its changes to the IR system through Work Choices and you know one of its goals is to turn around productivity yet we've got a tax system which is slugging workers for taking on extra work?

HEATHER RIDOUT: Scott, our view is that domestic policy goals, and I said it right from the start of this discussion, should drive our tax policy and not whether Luxemburg has a lower tax rate than we do. I think that's fairly important. But within that, our view on tax reform is that to actually undertake it in a wholesale way would involve some very difficult choices for Australia and I think they were highlighted in the Warburton-Hendy Report. Ai Group's view is that the emphasis on tax reform this time should go to those lower paid workers...those earning between twenty-one and a half and thirty thousand a year who are currently subject to a marginal tax rate of thirty cents...there the marginal tax rate should be slashed to fifteen cents. That would not only give tax relief to lower middle income earners including families, but it would also slash their effective marginal tax rates as they move from welfare to work, as retirees want to take on more work etc. etc. So we see that policy as very consistent with the domestic policy goal of increasing participation which we all know is absolutely fundamental to lifting our performance.

In terms of productivity which is also inherent in that it would increase the incentive to work and save for those people at the low end. We also advocate the reduction in the top rate from forty-seven cents to forty-two cents and again that would have inherent advantages in terms of supporting savings and supporting participation. People taking on more overtime, people saving into superannuation and other saving vehicles would not attract such a high marginal tax rate. So, we think together the bottom changes would cost about eight and a half billion. The top changes somewhere between five hundred and a billion. So, the big weight of change in Ai Group's view should go to the bottom. We believe they would be tax reforms, they wouldn't just be tinkering at the threshold and that they would, together with some changes to the lower income tax offset, complement the Government's Welfare to Work reform, complement people engaging in more paid work whether they're retirees, new entrants or second income earners.

CHAIR: The next question is from Malcolm Farr.

QUESTION: Malcolm Farr from the *Daily Telegraph*. On the other end of the tax scale - you or your Report advocates a cut to the company tax rate and you've listed some of the options of Australian business relocation overseas. How would a Government handle the enormous political problem of being seen to encourage, in fact even to be funding, the exporting of Australian jobs overseas through its industry policy?

HEATHER RIDOUT: Well I think we are exporting jobs because the jobs won't exist in Australia, Malcolm. Inevitably companies having to make adjustments to the global economy and the intensity of import competition as our Report said - 60% of our members say import competition is the most fraught issue they're facing. They have to get costs out of their businesses and part of that activity, not all of it, part of it, has to be actually engaging in global supply chains. Now at the moment that happens but it's going to happen in the future at an accelerating rate and there's not an awful lot the Government can do about it.

In terms of investing in offshore operations, the issue that we've identified is when companies repatriate profit they have to pay double tax on that. The Board of Taxation looked at this issue in 2003 and recommended that the issue be addressed through appropriate changes. And so, we really have to say well this is the way it's going to be - we have to encourage big companies like BlueScope and SimsMetal and others to open up global operations by retaining operations in Australia, otherwise we're simply not recognising how manufacturing in the world is performing. Now that will - that may require some difficult selections for Government, but I don't think it's as difficult as

letting hundreds of thousands of jobs to be lost out of the sector here in the absence of successful global Australian players.

CHAIR: Joseph Kerr.

QUESTION: Heather, Joseph Kerr from *The Australian*. On the prospects of a Free Trade deal with China, given the legal and regulatory difficulties of operating foreign companies in China, how realistic is it do you think that we might actually achieve positive gains through a Free Trade deal or is our scale simply too small for that?

HEATHER RIDOUT: Look I think the Report really highlights the fact that tariff reform between Australia and China doesn't go far enough. If we're going to have global players we need to get into that economy in a real way and that means if we have great knowledge it has to be protected so we have to have IP protection. If we're going to make investments into China, we need to have those conditions of those investments dealt with. So too with services going over there - we need to get mutual recognition of our qualifications. There's a whole lot of behind the border issues that we believe need to be front and centre of any Free Trade Agreement with China. FTA or no FTA, China and Australia are going to have an engagement and for the manufacturing sector, it's tougher than for most sectors because I recall going to China and speaking with the Chinese equivalent to me who said "well we have more manufacturing, you have resources - it's a natural fit. We'll take your manufacturing markets and you can have some of our resources markets". And I said well sorry, we do actually have a manufacturing sector in Australia. It does have ambitions, it's quite an important sector. So I think our role in this debate is to make sure some of the issues that really can level the playing field, that really can give Australia a fair go in that market - and it goes to these behind the border issues - is really front and centre. And of course that's consistent with any WTO compliant arrangement anyway.

CHAIR: Next question from Paul Osborne.

QUESTION: Paul Osborne from *AAP*. Heather, we're moving to the half way point of the latest Howard term. What problems do three year terms raise for industry? And do you think we should have four or even five year and possibly fixed terms and what pressure can industry put on the Parties to reform that area?

HEATHER RIDOUT: Well one of the reasons why Ai Group's been around a hundred and thirty years in one form or another is we don't get involved in politics. We're an apolitical organisation but we do have a view about this.

You know, the average life of an Australian Government is I think about two years and four months. So it's - we might not

be half way through, we might be more than half way through depending on circumstances. We actually do think there should be a four year term. We have an open mind whether it's a fixed term. We talked to governments who have fixed terms - they hate them, but you know, that's an argument that can be had. But we think it would provide more certainty around policy and stop this kind of one year we do it, next year we settle it down, the last year we campaign. I think we need a bit longer. The issues facing Australia are very important. They're very important and I think we need a longer political cycle to give them a chance to be invested in. Industry needs to invest for the next five to ten years if it's going to have a future and Australia needs to make those sorts of investments and very short political cycles don't help. In the long term as Keynes said, "we are all dead"..

CHAIR: Mark Davis.

QUESTION: Heather, Mark Davis from the *Australian Financial Review*. I have a question about the Government's Industrial Relations reforms. The Government said that the reforms would introduce a simpler national industrial relations system that would reduce business compliance costs and be easier for business to negotiate than the seven State and Federal systems. I'm just wondering now that those reforms are in place what's been the experience of your members in this area and are they in fact finding it's a simpler system that's easier to negotiate?

HEATHER RIDOUT: Well I think it's very hard to make that judgment yet, Mark. I mean if you look at all the big changes in 1993 and 1996, the GST. It takes a long time for business to get to grips with it and the majority - the vast majority of our members at the moment are trying to understand their obligations. And of course it's only a few weeks since we had the regulations out.

We've had hundreds of companies through - one company asked a question - "I'm a dinosaur can I just stay the same and do nothing?" And you can't of course because this legislation does require you to do something. You have responsibilities under it as well as rights and companies at the moment are very focused on understanding their responsibilities. That goes to record keeping, it goes to the structure of bargaining. We have a very major enterprise bargaining round now in our industry. Nine hundred plus enterprise agreements expire between now and the end of March and the end of June. So we're going to have nine hundred companies enterprise bargaining under a new legislative framework. Very, very challenging, requiring secret ballots for industrial action, the whole issue of prohibited content, the issue of [indistinct] dispute at the moment about common law deeds which are very, very dangerous things for companies to enter into

because you lock in work conditions until you can bury that deed which may be a long time out and if you breach that deed of course you're open to major damages.

So, I would say Mark, that at the moment companies have got their heads down, tails up trying to understand their obligations. I think it's too early to say, to pass a judgment on the legislation in an adverse way but I think we still believe having one national system is the way to go. We still believe having a concise set of conditions is the way to go but clearly there's a lot of changes that need to be worked through and I think we'll probably see some court cases to get some more settled law around the issue and you know we're optimistic that the Government will listen when industry has concerns on this.

Yesterday I think we had some announcements on record keeping. They're quite encouraging although we'll need to see the detail of what the regulatory change or the legislative change will involve. But you know we are in constant dialogue with the Government about these issues to make the system work better. But I think you can't be [indistinct] in saying well the ambitions for workplace reform aren't being achieved at this time - it's far too early to make that call and I doubt that it will ever be made. I'd also say that one of the reasons why this piece of legislation is such a big confronting piece is that we have all these transition arrangements to actually take in the state systems and once that process is worked through, the legislation will be a lot more simple. One of the issues of course is the state systems are fighting back in Queensland and New South Wales and other places and this only makes life harder for employers.

CHAIR: Laura Tingle.

QUESTION: Laura Tingle from *The Financial Review* Heather. Just back on tax. You're still ambitious about reform of the tax scales, but a week after the Warburton-Hendy Report we've already seen the tax debate off into a debate about the family tax benefits. I was just wondering to what extent are you concerned about the way family tax benefits now seem to be coming front and centre of the political debate in the Prime Minister's mind that he sees the focus so much on families that in some ways that may be distorting not just the debate about welfare reform but also about tax reform?

HEATHER RIDOUT: Well I mean I think the Government has been very generous to Australian families and I think John Howard can - it will be one of his legacies - the extraordinary support he's given to lower middle income families and I think that will be - the whole mark of the system as it now exists. I think that what the Prime Minister's saying though is that it doesn't rule out support to low

and medium income earners and what we're - what our policy is suggesting is that we operate at that level, at the lower end.

Last time the tax changes really focused on the middle income earner, the person subject to the forty-two cent rate and lifting the threshold for the forty-seven cent rate so what we're trying to do is work down the bottom. But you know I think what we need also if we're talking about family benefits is parallel efforts on childcare and making it possible for women to go back to work at a cost that they can afford and which gives them some incentive to actually incur these high effective marginal tax rates. Now when you don't have that, as the Prime Minister's pointed out, when you have a means tested system you have a high effective marginal tax rate because people have to move from one to the other. And so, I think this is an issue we have, we can only manage it, but on this occasion our view is that low income earners including low-income single people should get some support which would of course go right up through the scale.

CHAIR: Michelle Grattan.

QUESTION: Michelle Grattan from *The Age*. Following on from Laura's question Ms Ridout, the Government is signalling tax cuts but not tax reform. Are you disappointed that it appears to have backed off this area of change and why do you think it's done that? And secondly on family benefits, there's an emerging debate about whether there's too much middle class welfare. Do you think there is middle class welfare in the tax system and would you like to see family benefit means tested?

HEATHER RIDOUT: In terms of tax reform, as I alluded to in one of my earlier comments, the Hendy-Warburton Report really did draw up some of the lines of this. We have a very high reliance on income taxes whether they're personal or whether they're corporate and to look, say, at the area of work related deductions would only broaden the income tax base and not address the reliance on this tax base. If we wanted to change the tax mix - we had this debate, and Mark Paterson will remember it, a number of years ago, when we introduced the GST about changing the tax mix - switching the tax mix between indirect and direct taxes. It was a very, very tough one and so - if we want tax reform, does it mean increasing the GST?

One of the other issues that came through in the Hendy-Warburton Report was we don't have a wealth tax, an inheritance tax. Do we want one of those and therefore reduce other taxes? These issues are not straight forward. What we're saying is that you can do tax reform and tax cuts at the same time - and those tax cuts can reinforce the domestic policy goals around participation and productivity. If you get rid

of the top rate that's tax reform. And if you have a big enough sweep of that bottom rate you will have reform. So that's really where we're coming from. In relation to means testing, you know I think the issue of wealthy people getting the family tax benefit - I don't know, that's something for politicians to work through. It's a very small wedge to create a very big argument about. But you know I think means testing has this effect of increasing effective marginal tax rates in the shade out areas so it has its disadvantages.

CHAIR: Tim Colebatch.

QUESTION: Tim Colebatch from *The Age* Heather. Coming back to the Report itself. You've made the point that manufacturing's going to face a lot of pressures. It will see companies move their componentry offshore, move their production offshore in some cases, and become - essentially become multi-nationals producing elsewhere but sort of based in Australia and sort of (indistinct) model if you like. I wonder if you could put a figure on how many of those 1.1 million jobs in the industry you see as being at risk? It was stated on the radio this morning that your figure in the Report which we've only just got estimates that up to one in four, a quarter of manufacturing output now could be moved offshore or could be simply sort of packaging imported materials in ten years time. Can you give us some indication how large the potential downsize is if we don't take action and how large it is if we do take action?

HEATHER RIDOUT: Primary amongst the responses our members are investing in product development, investing in their people and investing in R&D. So don't think that companies aren't doing a lot of that very rich investment which is core to their agenda. But they also know they have to become part of global supply chains, whether they're small or large, if they're going to survive.

Last year we lost thirty thousand jobs in the industry. This year we estimate another 4% which is roughly the same number will be lost again. So it's not a painless process, but I have - and you're quite right, at the moment some 15% of activity is overseas based that's going to increase to 25% over the course of the next three years. So they're very big shifts in the industry. But yes. I think this is really highlighting - but at the same time I would say 75% of the activity is still going from here so don't lose sight of the flipside. But I think being an open economy, being able to engage in global supply is critical. The automotive sector; that's going through huge pain at the moment, particularly the components area but also the OEMs ] are facing massive competitive pressures. Around the world there's global restructuring in that sector and if our components' companies don't try to be a part of that - to try and get a slice of that global action, there just won't be enough business for them to make the investments they need to become competitive.

They need to be able to write off their investments in technology, in R&D and people against a much larger market than Australia if they're going to have a future. So, it is a hard thistle to grasp. What we're saying is quite leading edge but I think in a sense it's where the industry's headed.

CHAIR: Steve Lewis.

QUESTION: Steve Lewis from *The Australian* Ms Ridout. Just following on from Tim Colebatch's question, just on this issue of the future of manufacturing, it's a bit unclear to me at least exactly what you're asking the Government or Canberra to do. I would have thought this Government had been fairly kind to industry, particularly manufacturing of recent years, getting rid of the 3% nuisance tariff for instance after many years of lobbying by yourself and others.

What exactly is it that you're asking this Government to do? You talked about R&D. Do you want the R&D concession increased to 150%? If you could highlight one or two issues. What are the priorities for manufacturing?

HEATHER RIDOUT: Well, we want for example more exporters brought through the EMDG scheme. I think that's an issue that - it's very, very fraught within industry. On the R&D side we want to make the R&D tax concession more effective. We want to enable companies to do collaborative R&D internationally by reviewing the cap that exists on those sorts of issues. We want to drive closer partnerships between business and the public research institutions - there's a range of issues there. Driving business capability, this new programme where we're advocating it should co-ordinate and put into organisations people to help them do a plan for their business, whether it's about lean manufacturing, whether it's about export capability, whether it's about business development, whether it's linking them up with the global supply chain. There's a whole - twenty-nine recommendations around this issue.

QUESTION CNT'D: I know, but are you saying that that's a greater priority than for instance cutting the company tax rate from 30 to 25%?

HEATHER RIDOUT: Well the idea there is really that you can have a choice between giving companies capital allowances that are more generous than they exist at the moment and you'll recall industry traded off accelerated depreciation for a 30% tax rate in 2000 as part of the Ralph reforms. We could go either of two ways and our members told us a cut in the company tax rate was the best way to go and we've advocated that over the next five years but we are concerned that if we still have a high marginal tax - top marginal tax rate of forty-seven cents, as Mr Warburton's been saying, there're really large distortions in the system. So we said it should happen but it should happen in

parallel with other personal tax reform. But you know this issue of what the role of Government is in industry policy these days is very different. It's not a matter of slapping on another tariff or whatever and the Government have done a lot in the automotive industry and they're still doing it, it's quite an interventionist scheme in the clothing and footwear industry and as you said they got rid of a competitiveness-detracting tax on our industry with great encouragement from our organisation last year. But we simply have to push some of these drivers of business capability and they do go to these business skill issues. .

CHAIR: Jason Koutsoukis.

QUESTION: Ms Ridout, Jason Koutsoukis from *The Sunday Age*. The US Free Trade Agreement has been in place for almost eighteen months now and I'd like to ask you what impact do you think it's had on Australian manufacturing? What anecdotal evidence are you picking up from your members as to the effect it's had? Has it been worth the effort...?

HEATHER RIDOUT: Well again and going back to the point I made to Mark about the IR reforms, I don't think you can judge an agreement after twelve months. We were very enthusiastic supporters of the Free Trade agreement with the US - we saw it as part of this global agenda, the biggest economy - at that time it was the major source of our imports but China's overtaken it now. But you know I think we are very enthusiastic about it. Now that said, I think over the last twelve months our members tell us that if they have operations that already have links into the American market that they're doing better. They're actually benefiting from the agreement. Those that have tried to break into the market haven't found it any easier and areas like the Government procurement market that we hoped would be opened up by this FTA is proving to be problematic. But I think that just means we have to try harder.

I think the currency's a major issue for us. I think that if that fell to somewhere between sixty-five and seventy cents we'd also have much less head wind to confront that into the market. But I think Free Trade Agreements are only as good as - you've got to keep working on them and if you look at the CER with New Zealand it's a totally different document than the one that was signed twenty-one years and I think we just have to think as an organisation, as an industry, as a country, and push for further changes to the system.

CHAIR: And a question from Glen Milne.

QUESTION: Glen Milne from *News Limited Sunday Publications* and *The Australian*. I'd like to refer directly to your speech where you highlighted what you called a very poor export performance and

high current account deficit which I think you actually added off text were unsustainable. Now for my sins I am old enough to remember being lectured by Paul Keating by a pointed finger in the chest about the J Curve theory and of course the linkage between the J Curve theory and the current account deficits was the use of interest rates as a lever. At what point do you think interest rates could be used or should be used to address the current account deficit?

Secondly, if I may, in your text you also, and I'm following up on an earlier question regarding Industrial Relations, you said there remains a lot that can and should be done. I wonder if you could elaborate on that?

HEATHER RIDOUT: In relation to interest rates, they are a very blunt instrument to deal with the current account deficit. A very, very blunt instrument indeed and the Ai Group would be adamantly opposed to that course of action unless it was forced on us. I mean the issue with the current account deficit is that if it stays high for long you're left with a very high level of debt and an ongoing income deficit As we service that greater level of debt. You have to simply keep paying and I think everyone agrees that it's disappointing that while we've had such high terms of trade we also have this very high current account deficit. When I said it was unsustainable I was quoting the Treasury when it says it's unsustainable in the long term at around those 6% levels and it's because we have this debt overhang. The issue is I suppose when you look at the flushness of world markets and liquidity and the Bernanke Thesis which points to the excess saving in some countries these things have a long time to sort themselves out. It becomes an issue of capital flows and not just about trade flows. So, Australia's current account deficit, US current account deficit, it's all about China and other net energy exporters kind of financing the States' twin deficits . So there's a lot of things happening in the world, but I think it does make Australia vulnerable. What we're really concerned about is if the 43% of Australia's exports, goods and services which come from the –manufacturing sector, continue to struggle even though they have picked up a little bit, that will make it all the harder for us to do it. The Reserve Bank I think understand much better than they used to the transmission mechanisms on the exchange rate relating to inflation because with the openness of our economy and whilst they've probably been very happy that the dollar's been quite high for so long because this has put a lid on inflationary pressures, I guess if the currency fell down, it would be quite tricky.

In terms of IR reform, you know, our organisation has never been one to flag it didn't go far enough. Some organisations said - I recall the day, when you know we were working our first Sunday, under the new Act down here - some organisations said it didn't go far enough. Well we said it went further than

we thought it was going to go. But we are working inside that legislation. I would say those two companies, the meat works and the juice company if they had been members of ours we would have said we suspect and we think and we would advise you that you may be in breach of the law. But they take their advice from lawyers who say "look I think I can mount an argument around this, it's got a 10% hope. Let's have a go." But if they were members of the Australian Industry Group (and we do have twenty plus lawyers working for us I might add) we would say they may be in breach of the Freedom of association laws... So I think we've got enough IR reform to deal with at the moment and there's a lot of people, our members, most of all who want good relations with their people and given the changes we are going to have to make and are now making in our sector which is highly engaged in IR policy ... but certainly for the next few months we'll have this enterprise bargaining round, it's going to be tough and it's taking place in this economic context where the industry's under a lot of pressure. So it's going to be quite challenging...

[Applause]

CHAIR:

Thank you very much Heather Ridout. You're one of the most skilled time management people around but here's a little extra to help you do that. It's a National Press Club clock. Thank you very much.

[Applause]

**END**