AUSTRALIAN INVESTMENT COUNCIL

11 March 2020

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Email: economics.sen@aph.gov.au

Dear Sir/Madam,

Submission to the Senate Standing Committees on Economics on the *Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019*

The Australian Investment Council welcomes the opportunity to provide a submission to the Senate Standing Committee on Economics. While we support some of the initiatives in the Bill, given the current economic conditions and broader uncertainties facing Australia, and the world, we recommend any changes to Australia's research and development (**R&D**) regime be put on hold.

The economic, social and health benefits of investment in innovation and innovative technologies is well documented. These benefits range from the creating high value jobs, helping businesses grow and become more efficient, to the discovery and commercialisation of life saving technological advancements. The private capital industry has for many years been a supporter of highly innovative Australian businesses.

Right now, the Australian economy is facing some very significant risks on the back of a sustained downturn in consumer confidence and business investment, which will be exacerbated by the impact of COVID-19 and comes on the back of devastating bushfires, droughts and floods. The Government should be looking at all options to help maintain growth across the economy, to incentivise business investment and to support innovation. Changing the R&D regime at this point in time would act as an inhibitor to investment and innovation.

We look forward to participating in any future discussion about the themes set out in this submission, and our previous submissions, as part of the Committee's work. If you have any questions about specific points made in our submission, please do not hesitate to contact me or Brendon Harper, the Australian Investment Council's Head of Policy and Research, on 02 8243 7000.

Yours sincerely

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About the Australian Investment Council

The Australian Investment Council is the voice of private capital in Australia. Private capital investment has played a central role in the growth and expansion of thousands of businesses and represents a multi-billion-dollar contribution to the Australian economy each year. Our members are the standard-bearers of professional investment and include: private equity (**PE**), venture capital (**VC**) and private credit (**PC**) funds, alongside institutional investors such as superannuation and sovereign wealth funds, as well as leading financial, legal and operational advisers. Our members are comprised of both Australian domestic and offshore-based firms.

Private capital fund managers invest billions of dollars into Australian companies every year. For the first time in history, Australian-based PE and VC funds under management reached $30 billion in 2018, testament to the growth in available capital to support investment into businesses across every industry sector of the economy. Fund managers secured a total of $6.6 billion in new investment commitments in 2018, which means the industry now has a combined total of around $11 billion in equity capital available to be invested in the short-term.

The Australian Investment Council is supportive of policy initiatives and reforms that encourage investment in innovation, promote productivity gains and help to ensure our economy is competitive. In particular, we believe that priority should be given to policies that help Australian businesses grow and expand, and become world leaders through investing in new and innovative technologies.

Introduction

The economic, social and health benefits of investment in innovation and innovative technologies is well documented. These benefits range from creating high value jobs, helping businesses grow and become more efficient, to the discovery and commercialisation of life saving technological advancements. The private capital industry has for many years been a supporter of highly innovative Australian businesses.

R&D is a key component in the success of many Australian businesses and their ability to grow and prosper. Businesses supported by private capital are more likely to be involved in R&D activities – over 85% of Australian PE investee portfolio companies reported introducing some type of innovation in a recent survey[1]. In fact, businesses who partner with private capital firms grow faster and increase their workforce quicker than firms that do not partner with private capital investment firms (**Figure 1**).[2] A survey of Australian PE firm found that in FY2016, the average increase in workforce in Australian PE investee portfolio companies was 24%, compared to the wider economy at 0.3%.[3] This is as a result of a focus on innovation and technology coupled with leveraging private capital firms' expertise, guidance and networks.

A supportive R&D regime is increasingly important in times of economic uncertainty. In a downturn or in times of heighten uncertainty, when markets and investors typically become increasingly risk adverse, investment in innovation reduces.[4] OECD research has found that during such times, "firms face difficulties in tapping into external sources of funding to support their investments in R&D" and that R&D investment is "re-oriented towards short-term, low-risk innovations, while longer term, high risk innovation projects are… cut

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[1] Deloitte Access Economics (April 2018) *Private equity: Growth and innovation Australian Private Equity and Venture Capital Association Limited*

[2] Wilhelmus and Lee (2019) *Milken Institute: Private Equity IPOs – Generating Faster Job Growth and More Investment*

This relationship holds true even when comparing within sectors and holding firm characteristics, such as size, constant. Logically, the same relationship would hold true for firms that partner with VC and PC firms.

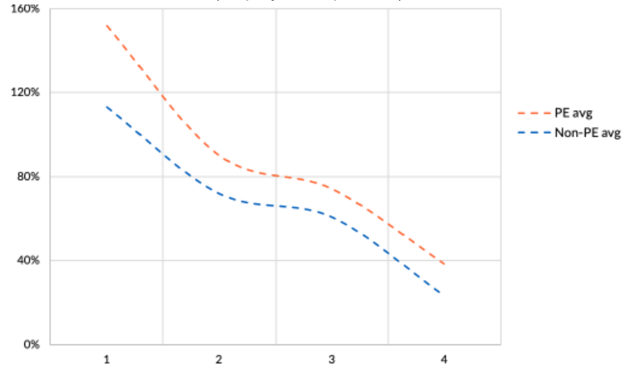
[3] Deloitte Access Economics (April 2018) *Private equity: Growth and innovation Australian Private Equity and Venture Capital Association Limited*

[4] Guellec, D. and S. Wunsch-Vincent (2009), *Policy Responses to the Economic Crisis: Investing in Innovation for Long-Term Growth*, *OECD Digital Economy Papers*, No. 159, OECD

first".[5] This affect is compounded by innovation becoming increasing concentration in a smaller pool of firms in a crisis.[6] With such uncertainties facing the Australian and global economy, now is not the time to implement changes to our R&D regime.

Figure 1: Employment growth by company size: PE vs non-PE firms

(employment quartiles)



Source: Wilhelmus and Lee (2019)

Australia's current economic conditions

Consultation regarding *Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019*, and its previous iterations, has been ongoing for some time. At the inception of this consultation, our economy was in a very different state.

Right now, the Australian economy is facing some very significant risks on the back of a sustained downturn in consumer confidence and business investment, which will be exacerbated by the impact of COVID-19 and comes on the back of devastating bushfires, droughts and floods. The Government should be looking at all options to help maintain growth across the economy, to incentivise business investment and to support innovation. It is in this context that we should now be considering the proposals put forward in the Bill.

Introducing changes that disincentives Australia's R&D investment at this point in the economic cycle would, in our opinion, be harmful to the Australian economy. Given the current economic conditions and challenges, we should be incentivising our SMEs to expand their investment in R&D, which will lead directly to productivity and employment growth.

We also note that other nations in our region have more supportive programs, such as New Zealand and Singapore.[7] Rather than creating uncertainty or inhibiting innovation, we should be leveraging our R&D regime to support Australian businesses and to position Australia as a stable and attractive destination for offshore investors in the period ahead.

Australia in a global context

Despite a record run of continual economic growth and our high standard of living, Australia still has much work to do to transition into a more knowledge-based, high value-adding economy.

On economic complexity, Australia ranked 93rd globally – the lowest ranked of all developed economies and lower than many developing countries – according to the latest rankings developed by Harvard University's Center for International Development. Since 1996, when Australia was ranked 57th globally for economic

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[5] Guellec, D. and S. Wunsch-Vincent (2009), Policy Responses to the Economic Crisis: Investing in Innovation for Long-Term Growth, *OECD Digital Economy Papers*, No. 159, OECD

[6] Archibugi, D., Filippetti, A., and Frenz, M. (2012) Economic crisis and innovation: is destruction prevailing over accumulation?, CIMR Research Working Paper Series, Working Paper No. 6, April

[7] We are able to provide further information regarding offshore regimes if this would be useful to the Committee.

complexity, we have dropped 36 places. Furthermore, Harvard University concludes that “Australia is less complex than expected for its income level. As a result, its economy is projected to grow slowly”[8], with Australia’s growth projection to 2027 ranked 111th out of the 133 countries assessed.

This result is backed by the 2019 Global Innovation Index (**GII**), which ranked Australia 22nd globally, down from 20th in 2018, behind nations such as the USA, Republic of Korea, China and Iceland. “The 2019 GII found Australia to be weak across knowledge and technology outputs, creative outputs, and business sophistication, relative to the top 25 innovation nations globally.”[9] This shows that we need to do much more if we want to build and future-proof a sustainable and growing economy that can maintain our prosperity.

It is therefore important that the economic challenges that Australia faces are recognised and tackled through leadership in long-term and visionary policy reforms; R&D reforms are an important component of this and, optimally, should act as an enabler.

Previous submissions

As the current Bill is almost identical to the *Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018*, we have attached our previous submissions (made under our previous name of AVCAL).

In summary, we support those proposals that encourage business investment and growth, such as:

- Increasing the R&D expenditure threshold to $150 million from $100 million; and
- Not counting offset amounts that relate to expenditure on clinical trials towards the annual cap.

We are also supportive of the proposed $4 million annual cap as a pragmatic and well-considered approach that strikes an appropriate balance between managing the growing costs of the R&D program, while preserving the ability for critical high-value R&D to be conducted in Australia.

We do not support the proposed measures that would inhibit and disincentive growth and investment, such as:

- Applying the changes retrospectively;
- The proposed definition of ‘clinical trial’; and
- The proposed adjustments to the intensity threshold.

We are available to provide further information regarding our submission if this would be useful to the Committee**.**

Conclusion

We encourage the Committee to carefully consider the implications of the proposals, Australia’s current economic pressures and the recommendations made by the Senate Economics Legislation Committee in relation to the proposals before taking any further action.

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[8] Harvard University’s Center for International Development (2019) *Atlas of Economic Complexity*

[9] Senate Select Committee on Financial Technology and Regulatory Technology, (2019) *Issue Paper*, p.3