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Business Council of Australia

Submission to the Select Committee on Cost of Living inquiry

BCA Submission

April 2023

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1. About this submission

The Business Council welcomes the opportunity to engage with the Senate Select Committee on Cost of Living.

Australian businesses and households have faced sustained pressure responding to extraordinary global events. Having negotiated the challenges of the pandemic and measures to contain it, Australians are now confronted by widespread cost of living challenges, arising from, and in addition to, the pandemic.

Rapid increases in inflation have wreaked havoc globally and central banks have responded by raising interest rates to curb it. Mortgage holders in Australia have experienced the fastest increase of interest rates in a generation following 10 successive increases to the cash rate. While the International Monetary Fund (IMF) has recently flagged that we are past peak inflation globally, inflation continues to run at unacceptably high levels in Australia and economists forecast more interest rate rises.

Such measures, though blunt, are necessary to bring inflation under control and temper the erosion of purchasing power for consumers and businesses alike. Nonetheless, these measures cause real hardship for many in the economy, particularly those on low or fixed incomes, or households with a high degree of debt.

Government must be cautious implementing measures to support those affected by cost of living pressures. There is a risk some measures will do more harm by adding to rather than avoiding inflationary pressure. Relief in the form of narrowly targeted measures are less likely to add fuel to the inflationary fire – including existing measures to alleviate energy costs and childcare costs, and preserve the real value of government social payments.

More importantly, band-aid solutions that deliver short-term relief should not substitute for action that manages the long term, structural issues that are driving inflation.

High inflation reflects very strong demand and constrained supply, impacting economies around the world, much of it arising from the pandemic. Australia's experience is also coloured by high household demand as households on average built up substantial savings buffers during lockdowns, supported by significant government emergency financial supports. It is also affected by significant flood events on the east coast of Australia affecting the availability of food products, including fruit and vegetables.

Importantly, there is no credible evidence of the profitability of businesses contributing to higher inflation. As noted by the Reserve Bank of Australia (RBA), business profitability outside the mining sector remained flat before and since the pandemic as a share of total income¹. Commentary to the contrary is misleading and unhelpful. Further, many businesses rightly offer hardship arrangements to assist customers experiencing financial distress, appreciating the challenging economic times faced by many households.

Australia must do more to increase the living standards of households in the economy by removing unnecessary barriers to competition, making it easier to do business, improving Australia's international competitiveness and dealing with supply-side issues restraining the economy.

The only credible path to sustained increases in real wages over time, and the ability of households to manage cost of living pressures, is higher business investment and faster productivity growth. So, while the challenge is immediate at least some of the solutions must be longer term. Failure to increase investment means business will be less productive and costs will increase. There is also a risk that Australia will see increased unemployment if business is not investing and hiring.

All the while, Australia should be investing in, and nurturing, the emerging industries of the future and those associated with the long-term decarbonisation of the economy. These are the industries that will deliver the high paying jobs of the future. Even more regulation and labour market interventions will not sustain faster real wages growth over time.

¹ Lowe, P. *Monetary Policy, Demand and Supply* (2023), Address at the National Press Club, 5 April 2023.

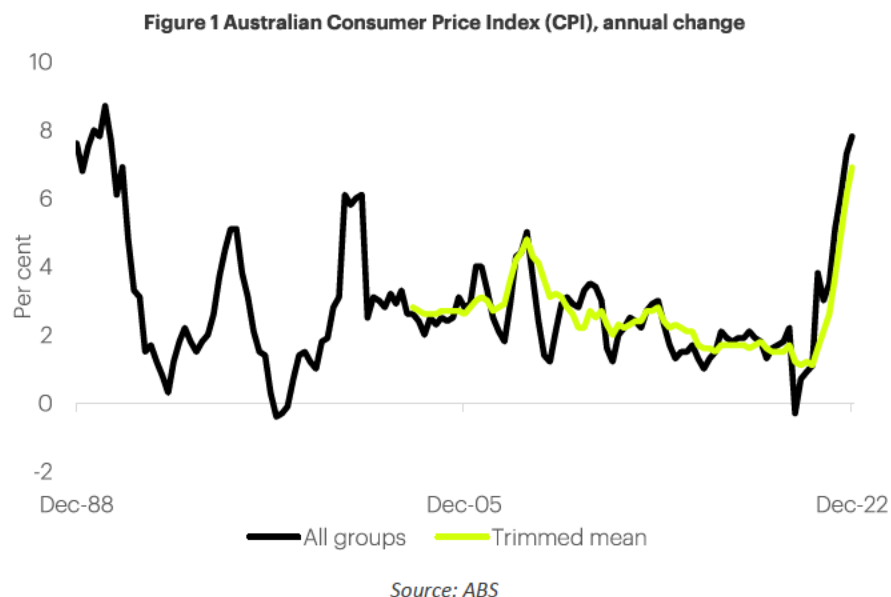
2. Key recommendations

The BCA recommends the federal government urgently implement measures to strengthen the economy by boosting productivity and increasing investment, including:

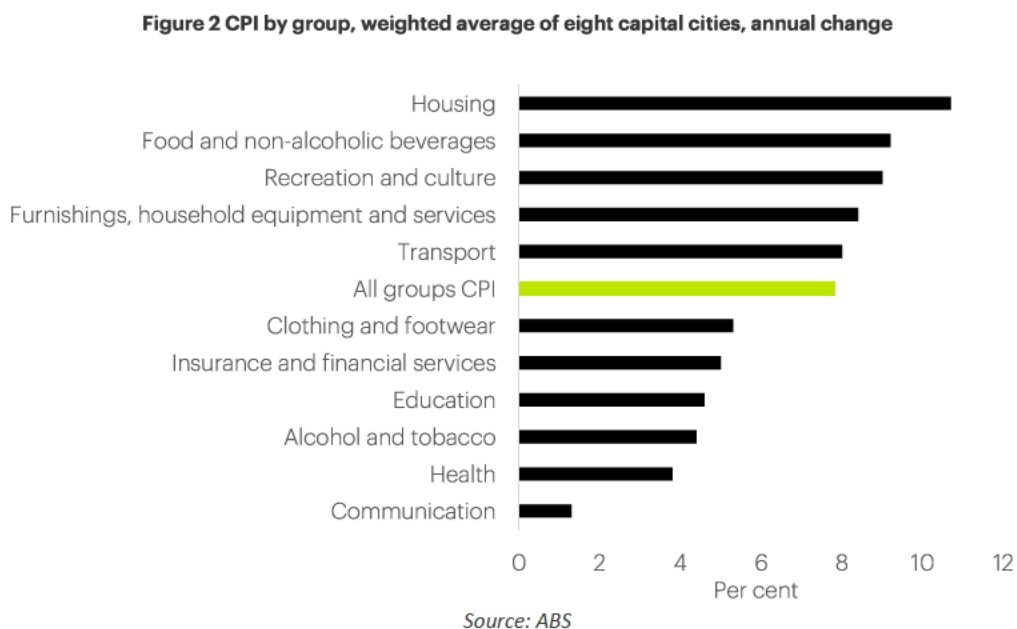
- Carefully targeting any cost of living assistance, the risk being that poorly targeted assistance could make inflation worse, not better. We note existing targeted measures by government to address child care and energy costs and increase social security payments.
- Abolishing remaining tariffs, which add to the cost of imported goods for consumers but raise little revenue.
- Freeing up housing supply by incentivising states to liberalise planning and zoning requirements to take upward pressure off rents and house prices.
- Focusing on improving the quality of government spending and outcomes while also imposing more discipline to curb growth in spending. This includes via the adoption of fiscal rules, including a 2 per cent cap in real spending growth.
- Renewing the focus on microeconomic reform to make it easier and less costly to do business by removing the structural impediments to long-term and sustained economic growth.
- Clarifying clear pathways to grow the economy, including via enhanced productivity, increased economic dynamism, better regulation, enhanced training and skills, better coordination of infrastructure decisions and rebooting a program of long-term tax reform to deliver a system fit for purpose that better incentivises investment, innovation and hiring.
- Adopting measures to help support flagging business investment. Australia's corporate tax rate is high by global standards. This is a disincentive for foreign capital, but investment can be supported in other ways, including through a broad-based, permanent investment allowance.
- Standing by its commitment to deliver the stage three income tax cuts in their legislated form. They are an important reform to the income tax structure that simplifies the system, provides better incentives to work and will hand back bracket creep over time, increasing household disposable income.
- Deciding against the introduction of any new taxes, including forms of super profits taxes on energy and mining companies, as some have advocated. This would have an additional chilling effect on investment on top of already announced changes to energy policy.

3. How much has the cost of living increased?

Australian households are being confronted by widespread increases to their cost of living. Inflation has hit 7.8 per cent over the 12 months to December 2022; the highest in 33 years. This is well in excess of the RBA's targeted range of 2 to 3 per cent. While monthly data suggests Australia is potentially past the peak, inflation is expected to run at persistently high levels throughout 2023.



Cost pressures are widespread with housing (including energy, rent and construction), food and non-alcoholic beverages, and recreation and culture impacted the most.



The Australian Bureau of Statistics (ABS) has published detailed Living Cost Indexes (LCI) for a range of household types, providing greater insight into the cost of living pressures for different households.

Figure 3 Living Cost Indexes by group, annual change



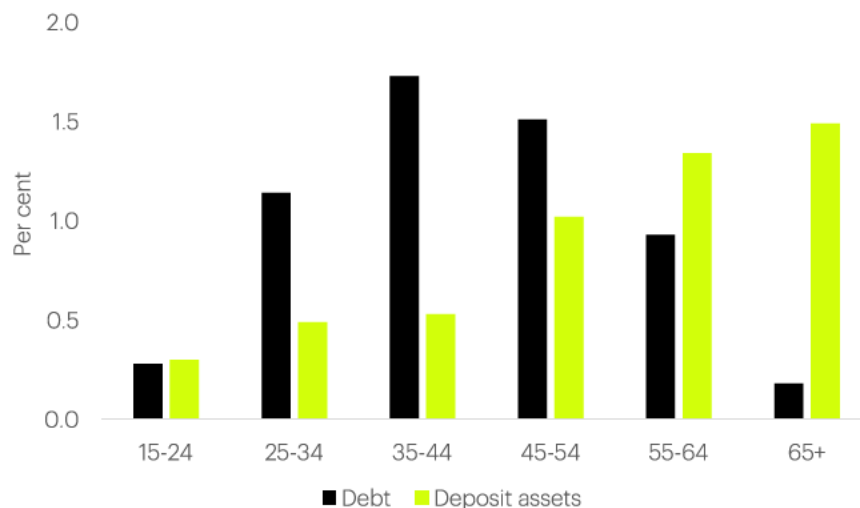
Source: ABS

- All LCIs show substantial cost of living pressure, with annual rates ranging from 7.3 to 9.3 per cent for the 12 months to December 2022.
- Employee households, who tend to carry higher amounts of housing debt and are younger, face a higher rate of inflation compared to other groups who own their own home outright or carry smaller amounts of debt.

Many borrowers are yet to feel the impact of the RBA's 10 rate hikes from 0.1 to 3.6 per cent and counting, as they are on fixed rate mortgages. Around half of these, approximately 880,000 loans, are estimated to expire in 2023. This so-called "mortgage cliff", where borrowers jump to significantly high variable rates, will only add to the cost of living pressures many consumers face.

Australians aged 25 to 44 years are more likely to experience this additional cost pressure as they have higher debt levels and fewer savings compared to other age groups. They typically have higher home mortgages having more recently purchased their properties and more likely to have younger children in education (for example, child care).

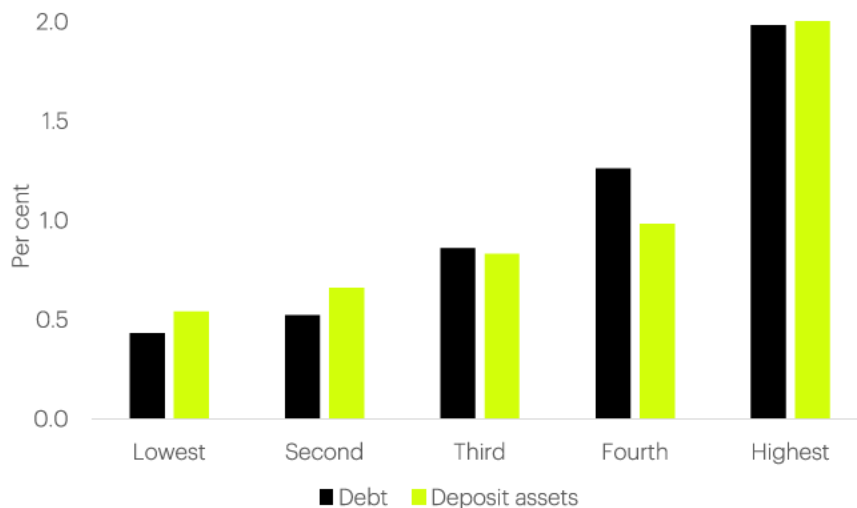
Figure 4 Age of reference person, Debt and Deposit assets, Ratio of the average to all households, 2021-22



Source: ABS

More broadly, households with fixed and low incomes and little savings will experience the biggest challenges managing rising prices. While they may have lower debt, they also have lower liquidity buffers to manage price increases for essential goods and services.

Figure 5 Equivalised disposable income quintiles, Debt and Deposit assets, Ratio of the average to all households, 2021-22



Source: ABS

4. Why has the cost of living increased?

The COVID-19 pandemic and measures to contain its spread set off chain reactions impacting both the demand and supply sides of the domestic and global economies.

- Lockdowns, particularly those in China, meant manufacturing dramatically slowed, reducing the supply of goods, while workers stuck at home changed their spending habits, buying couches, for example, rather than going on a holiday, adding to demand for a narrower range of goods. This pushed up prices of goods relative to services. Supply chains struggled to accommodate this rapid shift in the composition of consumer demand – alongside challenges from the spread of COVID and the related restrictions.

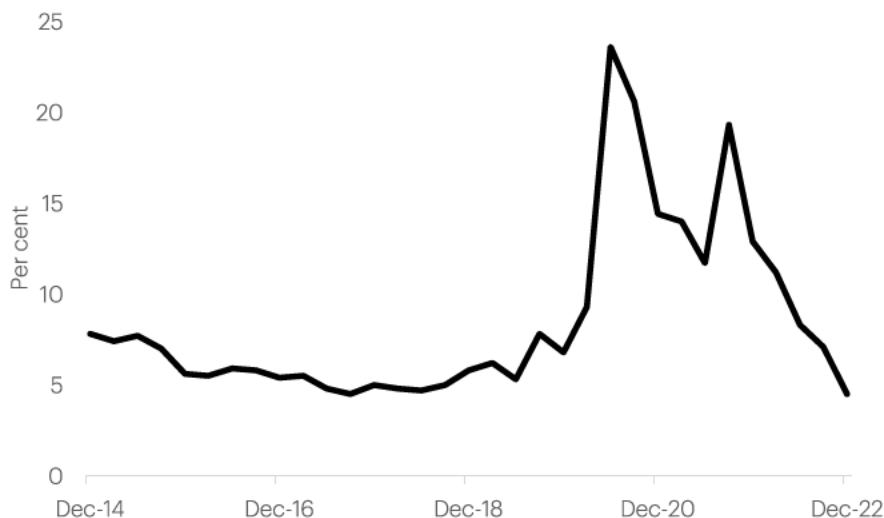
Figure 6 Household spending on goods and services



Source: ABS

- In Australia, significant emergency financial support and fewer things to do during lockdowns allowed many Australians to increase their cash reserves. The household saving ratio peaked at 23.6 per cent in June 2020 and remained elevated throughout 2021. In fact, even now, Australian households are sitting on extra cash reserves of around \$360 billion since the start of the pandemic – though, as shown in Figure 4, much of this sits with Australians aged 45 years and older.

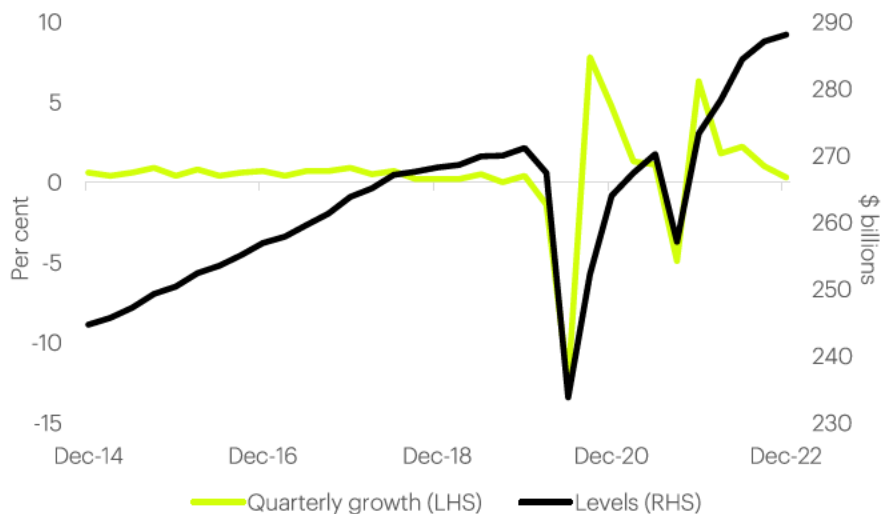
Figure 7 Household saving ratio



Source: ABS

- Pent-up demand following lockdowns meant that there was a surge of demand for activities Australians had missed out on like holidays, restaurant meals, and music festivals.

Figure 8 Household consumption

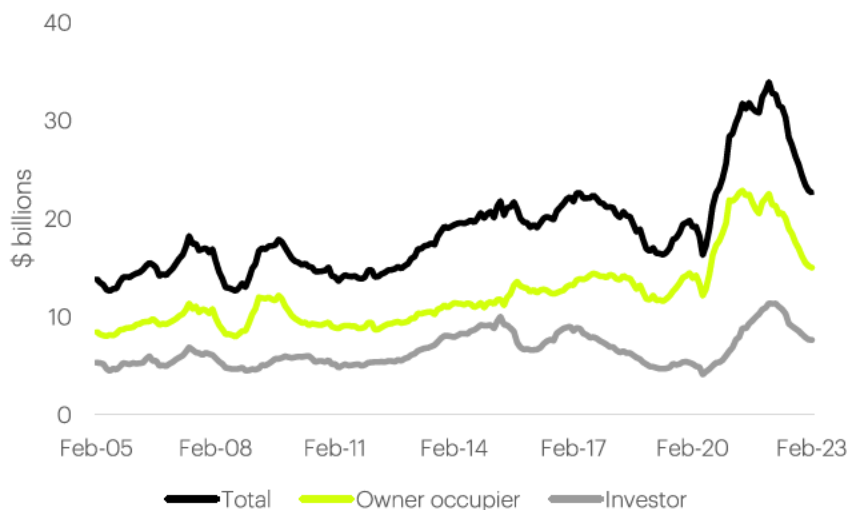


Source: ABS

- Labour shortages arising from the pause to migration during the pandemic, business closures and the standing down of many workers in front-facing roles impacted industry's capacity to meet post-lockdown demand and increased labour costs. Unemployment fell to record lows of 3.4 per cent last October and remains historically low at 3.5 per cent in March 2023.

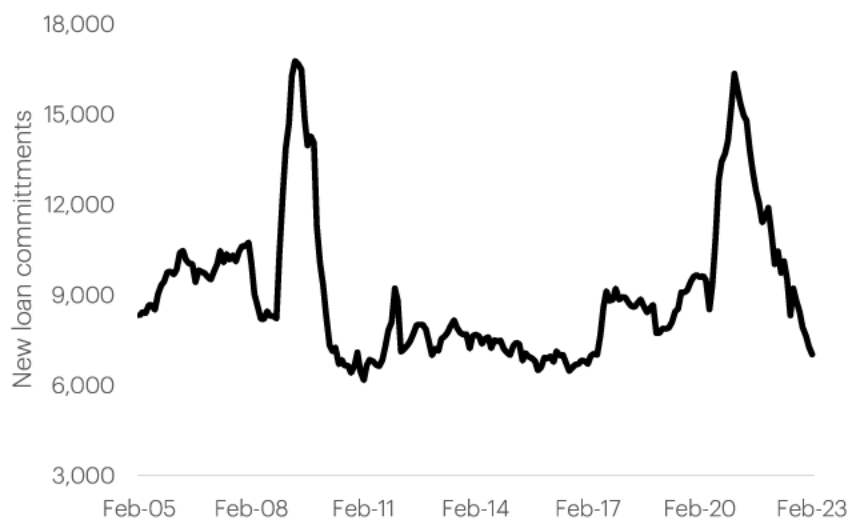
- Short term supply chain disruptions arising from the spread of COVID throughout the community and isolation protocols affecting sectors including transport and logistics, food manufacturing, hospitality and tourism.
- Record low emergency interest rates, alongside support for housing construction, led to a spike in borrowing, including huge numbers of first-home buyers.

Figure 9 New loans, housing ex-refinancing



Source: ABS

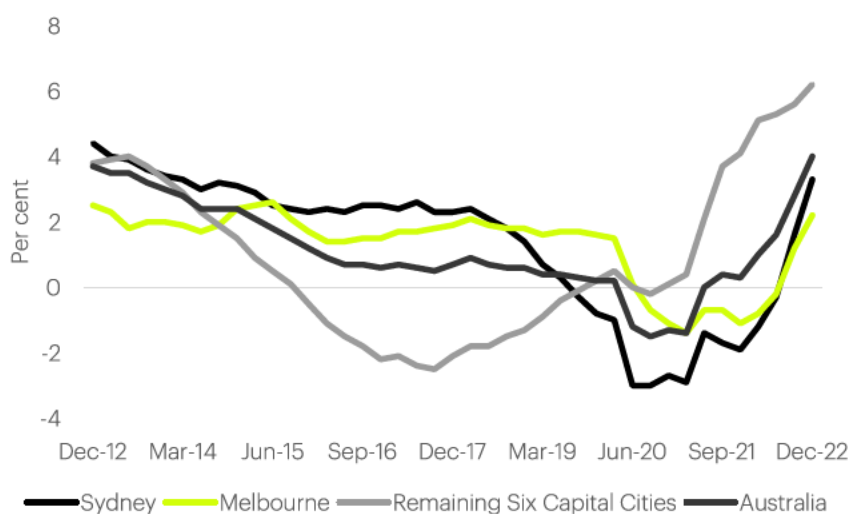
Figure 10 New loans, First-home buyers, ex-refinancing



Source: ABS

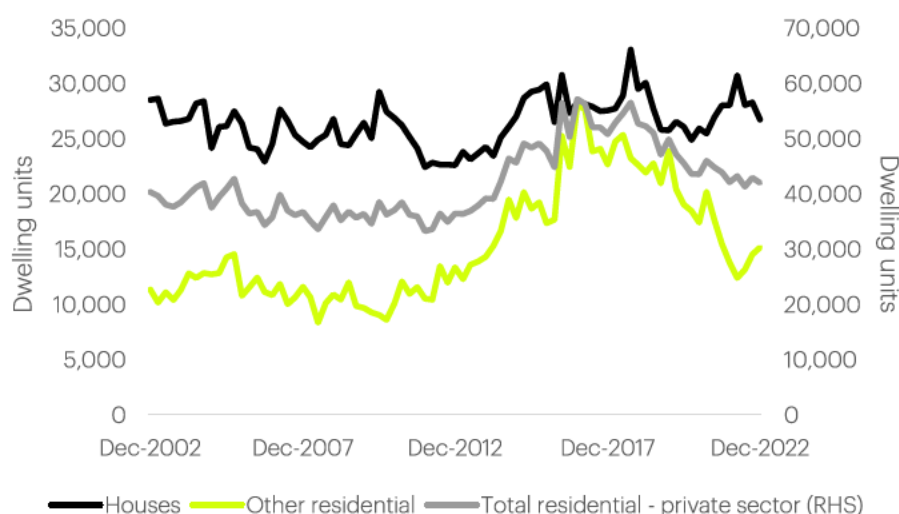
- The Australian rental market has also come under pressure as household formation changes led to around 120,000 additional households forming locally, along with many households relocating to regional areas or interstate to avoid lockdowns, all increasing demand in local markets. The return to normal migration settings following pandemic border closures (inducing a catch-up/return of cohorts that fell substantially during COVID-19) have also added to the demand for dwellings. Cumulatively, this has compounded Australia's pre-existing housing supply shortage and increased cost of living pressure for renters.

Figure 11 Rent, CPI, annual movement, capital cities (per cent)



Source: ABS

Figure 12 Number of dwelling unit completions (new), residential sector (quarterly)

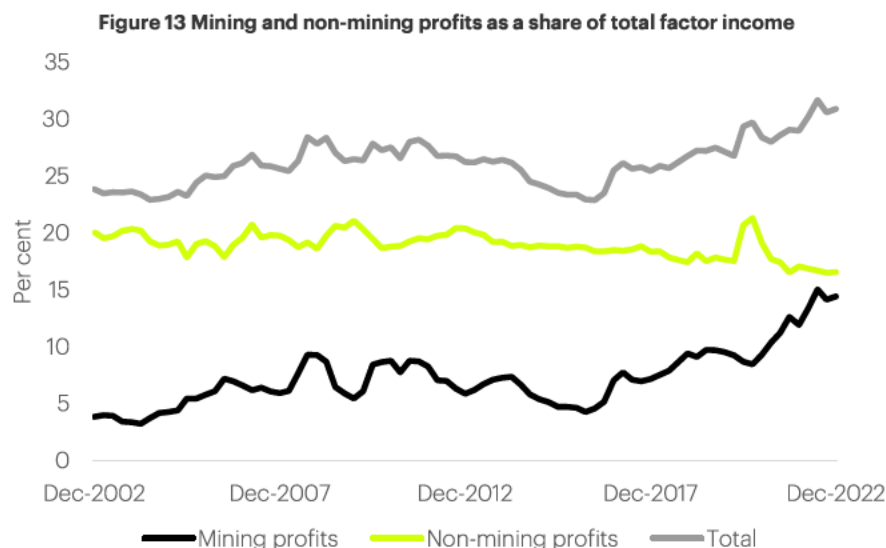


Source: ABS

Further, the severe flood events in New South Wales impacted the availability of meat, fruit and vegetables, and the Russian invasion of Ukraine pushed up global energy and fertiliser costs.

The suggestion that business profiteering is to blame for cost of living pressures is simply not supported by economic data, most recently noted by RBA Governor Philip Lowe². Clearly, mining profits have improved steadily over the last decade due to higher prices for our exports in international markets, but profits in the non-mining sector as a share of the economy have steadily fallen the past couple of decades. Australia's terms of trade have never been higher and so it is not surprising that the mining sector is profitable.

² Lowe, P. *Monetary Policy, Demand and Supply* (2023), Address at the National Press Club, 5 April 2023.



Source: ABS

5. What can be done to tackle cost of living pressures?

Improving productivity (output per hour worked) is the most enduring means to improve wages and increase living standards without adding to inflationary pressure.

Governor Lowe recently pointed out the dangers of failing to address inflation noting that even ‘higher interest rates and a large increase in unemployment’ would be required to bring inflation down if inflation became ingrained.³ Measures that add to existing demand will only serve to add fuel to the inflationary fire if wage increases without productivity gains are provided. Such actions would only make the work of the RBA harder, risking further interest rate rises, and in turn exacerbating cost of living pressures for households - including those with large mortgages or other debts.

Narrowly targeted measures are a better means of providing cost of living relief while minimising the likelihood of causing greater cost of living pain. Many measures meeting this brief have already been implemented or are in train, for example:

- Legislated changes to the Child Care Subsidy will provide significant relief for many households in that 25 to 44 age bracket affected by high debt and comparatively lower savings.
- Six-monthly indexation of government benefits to indexation will preserve the real value of payments for vulnerable households on payments including JobSeeker.
- Measures to support low-income households manage rising energy costs, including the government’s Energy Bill Relief Fund in partnership with states and territories.

Many BCA members also offer hardship arrangements for key services for customers in financial distress and recognise the challenges of the present economic situation.

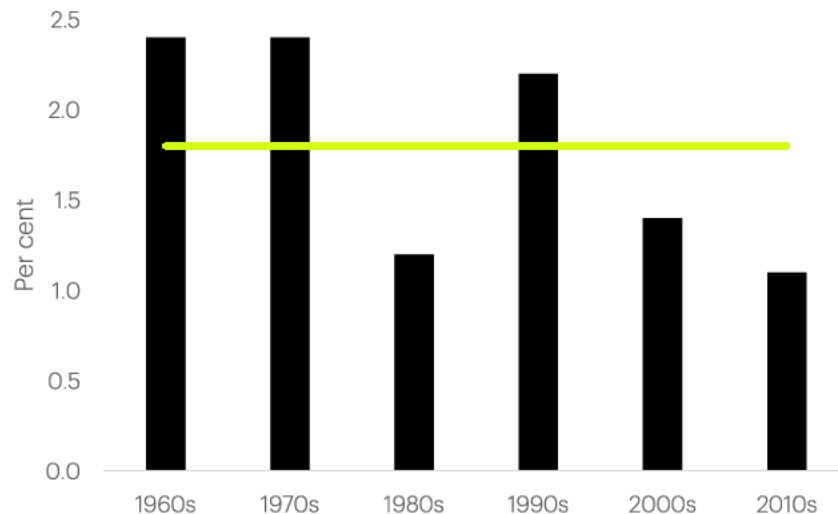
More can be done to manage this challenge. Over time, wage growth is tied closely to labour productivity growth so measures that boost productivity, particularly over the long term, will create the most sustained boost

³ Lowe, P. *Inflation and recent economic data* (2023), Keynote address to the Financial Review Business Summit, 8 March 2023.

to wages and living standards of any measure. Productivity growth is also disinflationary, allowing firms to produce more at lower cost.

Yet, Australia's productivity is tracking at historic lows. Average productivity growth over the last decade was the lowest of the last 60 years. This risks leaving Australian households behind without an urgent and renewed commitment to do better.

Figure 14 Lowest decade of productivity growth in the last 60 years



Source: Productivity Commission

Rebooting business investment is critical to lifting productivity and real wages growth. Boosting productivity requires addressing Australia's consistently weak historical investment. Business investment has slipped to around 30-year lows as a share of GDP. Last year, it dwindled to just 11 per cent of the economy, well down on the long-term average of 14 per cent.

There are a number of reasons for this decline, including increased economic and policy uncertainty, a higher cost of capital, increased difficulty doing business given the heavy regulatory burden, shortages of skilled labour and rising energy prices.

The BCA has previously identified several key policy measures that could be implemented by the federal government to boost productivity, increase investment and enable a private sector led recovery, including:

- Carefully targeting any cost of living assistance, the risk being that poorly targeted assistance could make inflation worse, not better. We note existing targeted measures by government to address child care and energy costs and increase social security payments.
- Abolishing remaining tariffs, which add to the cost of imported goods for consumers but raise little revenue.
- Freeing up housing supply by incentivising states to liberalise planning and zoning requirements to take upward pressure off rents and house prices.
- Focusing on improving the quality of government spending and outcomes while also imposing more discipline to curb growth in spending. This includes via the adoption of fiscal rules, including a 2 per cent cap in real spending growth.
- Renewing the focus on microeconomic reform to make it easier and less costly to do business by removing the structural impediments to long-term and sustained economic growth.
- Clarifying clear pathways to grow the economy, including via enhanced productivity, increased economic dynamism, better regulation, enhanced training and skills, better coordination of infrastructure decisions

and rebooting a program of long-term tax reform to deliver a system fit for purpose that better incentivises investment, innovation and hiring.

- Adopting measures to help support flagging business investment. Australia's corporate tax rate is high by global standards. This is a disincentive for foreign capital, but investment can be supported in other ways, including through a broad-based, permanent investment allowance.
- Standing by its commitment to deliver the stage three income tax cuts in their legislated form. They are an important reform to the income tax structure that simplifies the system, provides better incentives to work and will hand back bracket creep over time, increasing household disposable income.
- Deciding against the introduction of any new taxes, including forms of super profits taxes on energy and mining companies, as some have advocated. This would have an additional chilling effect on investment on top of already announced changes to energy policy.

Further information of these and other productivity improving measures are detailed in the BCA's *Pre-Budget Submission 2023-24*⁴, *Releasing the handbrakes on growth* paper⁵ and *Australia's investment drought and what to do about it*⁶.

⁴ Business Council of Australia, *Pre-Budget Submission 2023-2024* (2023), https://www.bca.com.au/pre_budget_submission_2023_24

⁵ Business Council of Australia, *Releasing the handbrakes on growth – Common-sense reform wins* (2022), https://www.bca.com.au/bca_releases_checklist_of_quick_wins_to_take_the_handbrake_off_growth

⁶ Business Council of Australia, *Australia's investment drought and what to do about it* (2023), https://www.bca.com.au/australia_s_investment_drought

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