EXECUTIVE BOARD MEETING

SM/20/40
Correction 1

February 20, 2020

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Australia—Staff Report for the 2020 Article IV Consultation**

Board Action:	The attached corrections to SM/20/40 (2/7/20) have been provided by the staff:
Mischaracterizations of the Views of the Authorities	**Page 18**
Typographical Errors	**Page 21**
Questions:	Mr. Finger, APD (ext. 38510)

non-discriminatory measures, such as a general surcharge on vacant property or surcharges on all investor-owned housing transactions.[11,12]

Authorities' Views

37. The authorities saw potential risks linked to a possible reemergence of rapid housing price growth. With population growth projected to remain strong, the ongoing weakness in building approvals following the past decline in housing prices and tighter credit supply for developers could result in a shortage of new housing and renewed rapid housing price growth, with the risk that this would, in turn, lead to stronger growth in household debt.

38. The authorities stressed that they would continue to facilitate housing supply reforms and other measures to improve housing affordability. They highlighted that the Commonwealth government provides annual housing-related funding such as rental subsidy for individuals through the Commonwealth Rent Assistance (CRA), funding to states and territories to improve Australians' access to affordable housing through the National Housing and Homelessness Agreement (NHHA), and the First Home Loan Deposit Scheme to provide loan guarantee to lenders for first-time home buyers. Housing has also been a priority in the City and Regional Deals. The authorities thought that tax policy was not the right tool to address potential speculative behavior in housing markets, as negative gearing applies across investments and investments in residential housing are relatively highly taxed, and that macroprudential policy should instead be employed as needed.

FOSTERING STRONG, INCLUSIVE AND SUSTAINABLE GROWTH

Context

39. Australia has been facing longstanding obstacles to growth. A strong and flexible skill base and favorable product-market indicators point towards a competitive business environment in Australia, but Australia's productivity growth has declined. Non-mining business investment growth has been sluggish, with investment in R&D weakening. There is also continued pressure on infrastructure from rising population in the major cities. The tax system is relatively inefficient with a comparatively large share of direct taxes. Despite significant progress, female employment has remained relatively low compared with other advanced economies and Australian women are

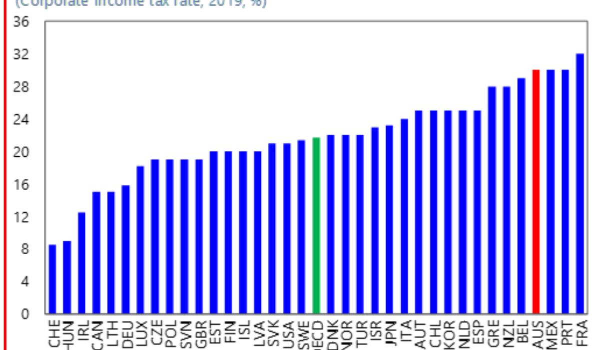
[11] Foreign purchaser duty surcharges on residential property were assessed as capital flow management measures (CFMs) under the IMF's Institutional View. See 2017 Article IV Staff Report, and updates in the 2018 Article IV Staff Report.

[12] The Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures) Bill 2019, adopted by the Senate in December 2019, removes the Capital Gains Tax (CGT) exemption relating to a main residence for foreign residents (with certain exceptions). This bill replaces the previous Treasury Laws Amendment Bill 2018 which had lapsed in July 2019. The withdrawal of the main residency exemption from capital gains taxes of nonresidents was deemed a CFM in the 2017 Article IV Report.

Pursuing ongoing reforms in vocational education and training can help reduce youth underemployment.

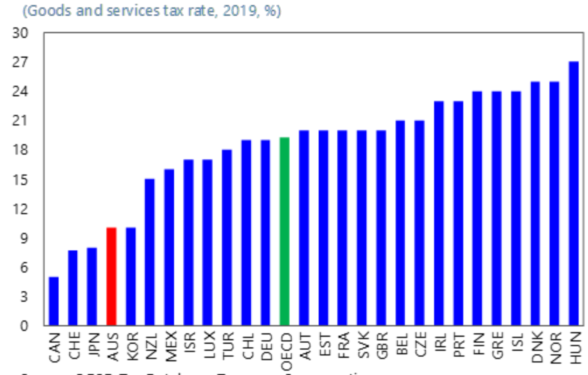
46. Broad fiscal reforms could help promote efficiency and inclusiveness. While the Commonwealth government enacted PIT cuts and lowered CIT rates for SMEs, the share of direct taxes in Australia's tax revenue remains high compared with peers. Australia should continue to work towards shifting from direct to indirect taxes by: (i) broadening the GST base to make the tax system more efficient and (ii) reducing the statutory CIT rate for large firms. Given the potential, adverse distributional consequences of these reforms, there should be emphasis on making their impact less regressive, including by strengthening targeted cash transfers. Tax incentives targeting new investment and innovation could be strengthened (¶43).

Australia's CIT Rate Is Among the Highest in the OECD...
(Corporate income tax rate, 2019, %)



Source: OECD Corporate Income Tax Rate dataset.

...While Its GST Rate is Among the Lowest
(Goods and services tax rate, 2019, %)



Source: OECD Tax Database, Taxes on Consumption.

47. Uncertainty around Australia's climate change mitigation policies may impact investment decisions and sustainable growth. The public debate around Australia's level of ambition in climate change mitigation policies (applying the carryover from past overperformance to the Paris emissions target implies that emissions in 2030 are envisaged to be 4 percent below current levels) has reinforced a sense of policy uncertainty in the energy sector, which is holding back business investment. Developing and implementing an ambitious, national, integrated approach to climate change policy, including long-term goals and strategies, and clarifying how existing and new instruments can be employed to meet the Paris Agreement goals, would help reduce policy uncertainty and catalyze environmentally friendly investment in the energy sector and the broader economy. Price-based measures are generally seen as more cost-effective in reducing emissions than administrative measures, as they provide a robust price signal for mobilizing low-emissions investment. If carbon taxes or similar approaches are not possible in light of political economy considerations, other approaches such as a "feebate system" in power generation, effectively a sliding scale of fees and rebates depending on the intensity of emissions, could be explored.

48. Australia's continued efforts supporting cooperation in international trade and investment are welcome. Staff welcomes the authorities' support to enhance the effectiveness of the WTO and pursuit of the Regional Comprehensive Economic Partnership (RCEP), which aims to