

HOW TO SOLVE AUSTRALIA'S SMALL BUSINESS CRISIS

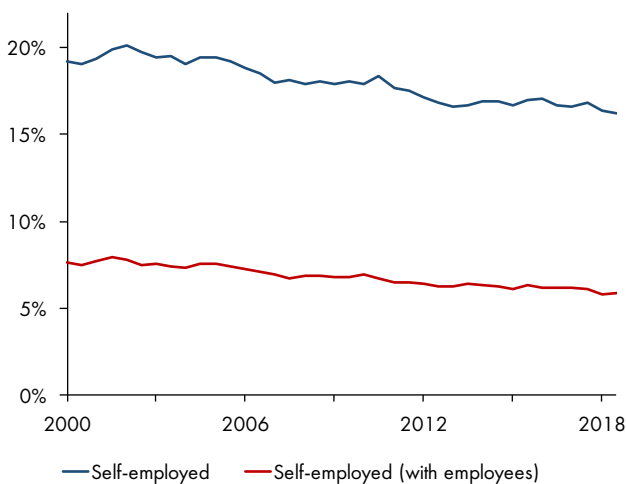
Kurt Wallace, Research Fellow

Small businesses and entrepreneurs play a critical role in aligning resources to meet consumer preferences, increasing productivity, and creating jobs. However, government red tape, high taxes, and a rigid industrial relations system have created an economic environment hostile to small business. This is reflected in declining rates of self-employment, rising rates of incumbency, and declining small business growth.

1. Self-employment is in decline

60 per cent of young Australians would one day like to start their own business.¹ However, rates of self-employment are in decline. Owner-management rates provide a good proxy for entrepreneurship by showing the proportion of workers who run their own business.

Figure 1: Self-employed (% of total employed)



- In 2000, 20 per cent of total employment was comprised of owner-managers. That rate dropped to just 16 per cent in 2018.²
- Similarly, the percentage of total employment comprised of owner-managers with employees has declined from eight per cent to six per cent.

2. Rates of incumbency are rising

Since 2012 the business entry rate has gradually recovered after a decade of decline, but remains well below the rates experienced in the early 2000s.³ The exit rate on the other hand has continued on a downward trend. While these trends have resulted in an increase in the number of businesses, declining exit rates may also indicate:

- A less dynamic economy through truncation of the “creative destruction” process.
- Larger rates of incumbency.
- A less efficient economy, with the effect of lower productivity and economic growth.

Figure 2: Business entry and exit rates

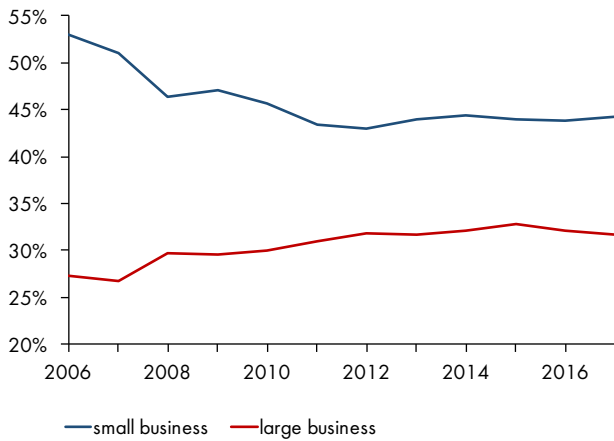


3. Fewer Australians are working in small businesses

A declining percentage of Australians are working in small businesses with less than 20 employees.

- The percentage of workers employed in small businesses has declined to 44 per cent in 2017 from over 50 per cent a decade ago.⁴
- While employment in businesses with more than 200 employees increased to 32 per cent from 27 per cent.

Figure 3: Employment by business size

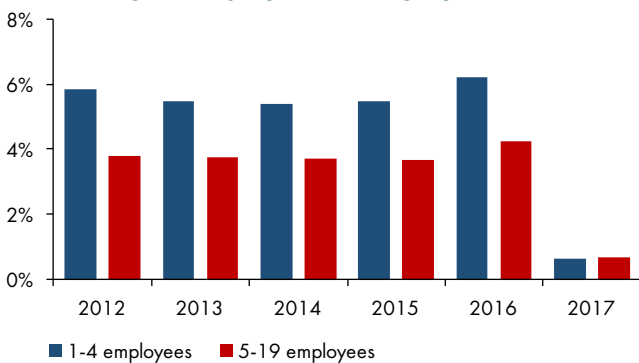


4. Small business growth is in free fall

There has been a sharp drop in the percentage of small businesses expanding in terms of employment.

- Less than one per cent of businesses with one to four employees in 2017 transitioned into employing more than four employees in 2018. This is well below the historical transition rate of around six per cent.
- Similarly, less than one per cent of firms with 5-19 employees in 2017 transition into employing more than 19 employees in 2018. This is well below the historical transition rate of around four per cent.⁵

Figure 4: Percentage of firms transitioning to higher employment category



Reducing barriers to business creation and growth

There are three policies that should be implemented to encourage small business growth.

1. Cut red tape

Red tape creates a barrier to business entry and growth. The World Economic Forum (WEF) ranks Australia 77th out of 140 countries for the burden of government regulation.⁶ The IPA has found that red tape costs the Australian economy \$176 billion a year.⁷ Red tape is particularly burdensome on small businesses that lack the economies of scale to devote resources toward regulatory compliance.

2. Make it easier to create jobs

Australia's Labour market regulation has consistently been ranked as "the most problematic factor for doing business" according to WEF surveys.⁸ Australia ranks 110th in the world for hiring flexibility due to a highly centralised industrial relations system that restricts the ability of businesses to create jobs.⁹

3. Cut taxes that discourage growth

Australia's effective marginal corporate tax rate is the third highest in the OECD.¹⁰ And the reliance on corporate tax revenue is almost double the OECD average.¹¹ The small business rate of 27.5 per cent (soon to drop to 25 per cent in 2021) remains internationally uncompetitive, and the two tiered tax rate system discourages business growth.

Conclusion

Entrepreneurships in Australia is in decline and small business employment growth has collapsed. To achieve its goal of overseeing the creation of 250,000 new small businesses over the next five years, the government must cut red tape, reduce the corporate tax rate, remove the two-tiered corporate tax schedule by reducing the top rate to 25 per cent, and liberalise Australia's industrial relations system so more Australians can experience the dignity of work.

Endnotes

1 Simon Breheny, "Growing Freedom: Survey of Young Australians", Institute of Public Affairs, Melbourne, Australia, (2016)
 2 Calculated from: Australian Bureau of Statistics, "Labour Force, Australia, Detailed", Canberra, Australia, (2019)
 3 Australian Bureau of Statistics, "Counts of Australian Businesses, including Entries and Exits", Canberra, Australia, (2019)
 4 Calculated from: Australian Bureau of Statistics, "Australian Industry", Canberra, Australia, (2019)

5 Calculated from: Australian Bureau of Statistics, "Counts of Australian Businesses, including Entries and Exits", Canberra, Australia, (2019)
 6 World Economic Forum, "Global Competitiveness Report 2018", Geneva, Switzerland, (2018)
 7 Mikayla Novak, "The \$176 Billion Tax On Our Prosperity", Institute of Public Affairs, Melbourne, Australia, (May 2016)

8 Kurt Wallace, "Expanding Economic Opportunity: An International Comparison of Australia's Labour Market Regulation", Institute of Public Affairs, Melbourne, Australia, (2019)

9 World Economic Forum, "Global Competitiveness Report 2018".

10 Organisation for Economic Co-operation and Development, "Corporate Tax Statistics", accessed 17 June, 2019, <https://www.oecd.org/tax/tax-policy/corporate-tax-statistics-database-first-edition.pdf>.

11 Organisation for Economic Co-operation and Development, "Revenue Statistics 2018 –Australia", accessed 17 June, 2019, <https://www.oecd.org/tax/revenue-statistics-australia.pdf>.