13 August 2020

COSBOA Communique

Beyond COVID – some thoughts on economic recovery

SYNOPSIS

COSBOA's COVID-19 Roundtable seeks to engage SME representative industry bodies and related stakeholders in a discussion of about specific initiatives needed to support economic recovery and support job creation from an SME perspective. This latest meeting was conducted on **Friday, 7 August 2020** and was conducted at a time when the Greater Melbourne area was in stage 4 lockdown, regional Victoria was operating with stage 3 restrictions and border restrictions were progressively being implemented by the NSW, QLD and SA state governments**.**

The meeting included a discussion with Senator Andrew Bragg on Australia's superannuation mechanism and a presentation from ANU economics professor, Bruce Chapman, on the concept of revenue contingent loans for SMEs in the wake of the COVID-19 economic downturn.

The subsequent roundtable discussion discussed issues associated with Australia's superannuation system, the potential role of revenue contingent loans for SMEs, and changes to the Federal Government's JobKeeper program that were announced by the Federal Treasurer (The Hon. Josh Frydenberg) earlier in the morning. A brief summary of the key themes arising from this discussion is presented below.

KEY THEMES

The following key themes were discussed at this latest meeting:

1. **The changes to JobKeeper announced by the Federal Treasurer (the Hon. Josh Frydenberg) on 7 August 2020 are timely and warmly welcomed by Australia's SMEs, given the uncertainty created by the COVID-19 situation in Victoria.**
    - Earlier in the morning, the Federal Treasurer announced changes to JobKeeper stages 1, 2 and 3. These changes reset employee eligibility for JobKeeper Stage 1 (from 1 March 2020 to 1 July 2020), while also lowering the revenue drop threshold for business eligibility for stages 2 and 3 of the JobKeeper program.
    - The changes appear consistent with the growing SME concern about the potential economic impact of the unforeseen virus outbreak (and lockdown restrictions) in Victoria – and the flow on consequences to the Australian economy as a whole – as discussed at the COSBOA COVID-19 Roundtable meeting on 31 July 2020.

- Accordingly, the JobKeeper changes announced on 7 August are very welcome. They provide necessary 'breathing space' for SME owners, particularly those operating in Victoria.

2. **Now is the time for Australia to review its current approach to superannuation and the operation of the Superannuation Guarantee (administration) Act 1992.**
   - The economic disruption created by COVID-19 creates an opportunity to re-examine Australia's approach to superannuation in the future.
   - A high- level analysis of Australia's existing superannuation system reveals that the current operation of the scheme costs Australian taxpayers an estimated $36B in foregone tax revenue. This cost, coupled with the fact that the nearly 30-year operation of the SGAA (1992) has not reduced the proportion of Australian retirees who use the pension, suggests that the scheme is potentially costing the Australian economy more than it saves. In fact, the only beneficiaries appear to be the administrators of Australia's superannuation funds – including the large unions and employer bodies that administer industry superannuation funds (large unions, for example, are estimated to have earned around $13M in fund administration last year and this figure is projected to balloon to $30M in 2050).
   - With an increase in the SGA rate scheduled to occur on 1 July 2021 – effectively increasing the cost of employment for SME's at a critical juncture – now is the time to review both the objectives and operation of Australia's superannuation guarantee mechanism. Such a review might seek to:
     a) Establish a formal objective for the future operation of Australia's superannuation system. Such an objective might be developed around the objectives first tabled in an Intergenerational Treasury Report released by Treasurer Peter Costello in May 1992, including a specific target around reduced rate of reliance of retirees on the pension (i.e. reducing the cost of the pension to Australian taxpayers).
     b) Examining the opportunity for the introduction of a superannuation default fund administered by the Australian Government, possibly by way of a slight re-tasking of the Future Fund, as a means of reducing the costs of administration and putting more into the pockets of superannuation contributors.

3. **There appears to be significant potential for the Australian Government to advance a new business recovery initiative for SMEs that is developed around the concept of a HECS-style loan scheme for eligible businesses – commonly referred to as revenue contingent loans (RCLs).**
   - There is growing evidence that the Federal Governments Coronavirus SME Guarantee Scheme is not working for SMEs. Member organisations are reporting very low take-up rates amongst SMEs. Much of this appears to be an apparent disinterest in this program by tier one lenders. In fact, businesses are reporting that initial approaches by SMEs to tier one lenders are resulting in strong 'recommendations' by tier one lenders that the business owner pursue an alternate mechanism such as an expanded overdraft.
   - To date, less than 4% of the $40B that has been made available under the SME Loan Guarantee Scheme has been accessed. Most of the loans approved to date are understood to have been accessed prior to the commencement of the JobKeeper

program and/or utilised to secure the cash needed to pay JobKeeper payments to staff in advance (i.e. reduced relevance since that time).

- The central challenge for SMEs at the present time is securing affordable finance in the face of extreme uncertainty about the near-term economic outlook. In the face of this uncertainty, it is likely to be challenging for financial institutions to provide loans to SMEs while still ensuring full compliance with APRA requirements relating to responsible lending practices. These difficulties are further exacerbated as lending institutions, particularly tier one institutions, grapple with accommodation of the recommendations of the Financial Services Royal Commission
- A potential response to this challenge of supporting SME borrowings in the face of extreme economic uncertainty could be an alternate lending mechanism known as *Revenue Contingent Loans* for SMEs. This concept has been developed by ANU economics professor Bruce Chapman and works in much the same way as the Higher Education Contribution Scheme, by advancing funds to SMEs on the understanding that the business would commence repayment of these funds once annual revenues exceed an agreed revenue threshold. Repayments would be based on a percentage of revenue only and no payments would be required until the annual revenues of the business are achieved.
- There are some obvious issues associated with the implementation and administration of any such scheme in the future. These issues relate to the need to guard against SMEs managing their business in such a way as to minimise exceeding an agreed threshold, the treatment of the loans from a tax perspective, the potential to incentivise increased unreported cash transactions, and quantification of an acceptable level of likely loan defaults to be borne by the Australian Government (best estimates suggest that around 18% of outstanding HECS loans are considered to be unrecoverable and that percentage will likely be higher for a similar scheme).
- COSBOA believes, however, that the apparent implementation issues are not showstoppers. It is therefore worth devising solutions to the issues noted above, given that an RCL mechanism appears to address the substantial challenges of how to float funds to viable SMEs to fast-track the recovery of the Australian economy in a post COVID-19 world. Such a scheme might be funded by a re-purposing of the substantial balance of the SME Coronavirus Loan Scheme with governments fully underwriting loan balances.

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