



16 January 2025

The Hon Stephen Jones MP  
Assistant Treasurer  
The Treasury  
Langton Crescent  
PARKES ACT 2600

By email: [stephen.jones.mp@aph.gov.au](mailto:stephen.jones.mp@aph.gov.au) & [prebudgetsubs@treasury.gov.au](mailto:prebudgetsubs@treasury.gov.au)

Dear Assistant Treasurer

## **Pre-Budget Submission 2025-26**

### **Introduction**

The Australian Restructuring, Insolvency and Turnaround Association (ARITA) represents around 85% of Australia's insolvency, turnaround and restructuring professionals. We provide professional development for our members, have a statutory role in relation to their professional conduct and undertake policy development and advocacy in relation to insolvency matters in their interests and those of the Australian community.

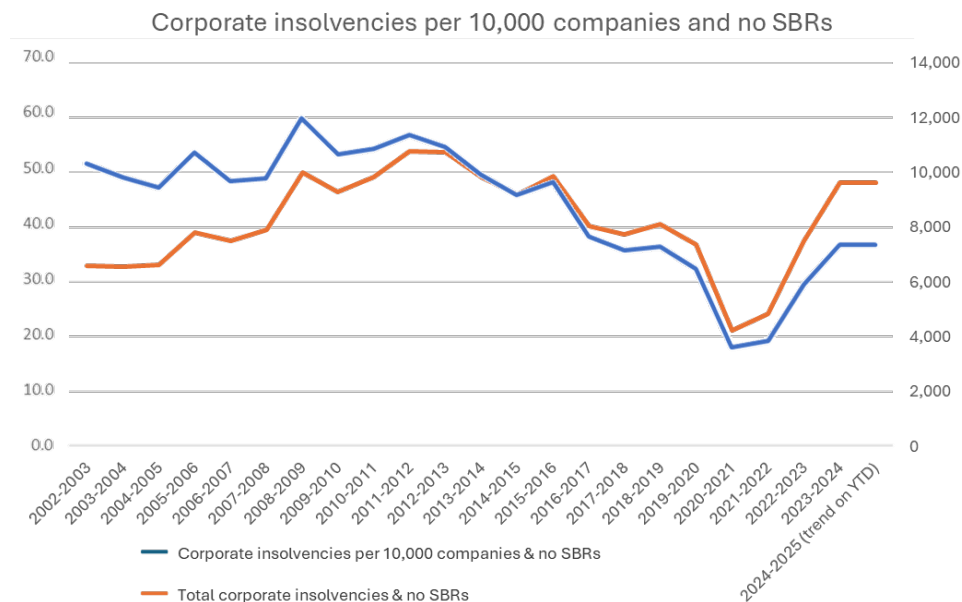
You will note that our proposals are materially no different to those we advanced for inclusion in the last Budget. It is disappointing that despite a growing debate about the level of insolvency in Australia, and the Government's laudable focus on productivity growth, you and the Government have failed to advance in any material way the recommendations of the Parliamentary Joint Committee on Corporations and Financial Services (the PJC) in its report on corporate insolvency in Australia (the PJC Inquiry) that have bipartisan political support and broad support in the insolvency and broader business community.

### **Market context**

In our submission to the Senate Select Committee on the Cost of Living we set out at some length our understanding of current levels of personal and corporate insolvency, their composition and behavioural and economic drivers of these data. We include this submission as an appendix to this document. Whilst it is based on data current in August 2024, we are confident the addition of a few more months of data does not undermine the conclusions of the analysis.

We have noted the arguments advanced by some that the current levels of corporate insolvencies is in some way an indication of government failure. We have agreed with the

Treasurer<sup>1</sup>, and have long argued, that the relevant indicator is not the absolute number of insolvency events but its rate – say the number of insolvency events per 10,000 companies. The reason for this is simple – as the economy grows so does the number of businesses and so do insolvencies. On this basis, as shown in the following graph based on ASIC data, there is no crisis to be seen in the current level of insolvencies in Australia.



## Policy background

Arising from the Productivity Commission’s 2015 Inquiry into *Business Set-up, Transfer and Closure*, the previous Coalition Government legislated with bipartisan support for the safe harbour framework, restriction of enforcement of *ipso facto* clauses and the introduction of Director Identification Numbers, all of which had been ARITA policy positions for some time.

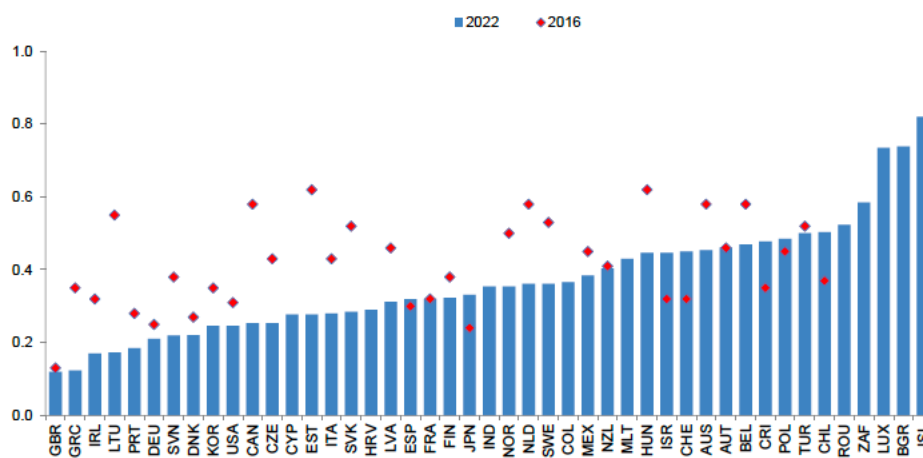
The previous Government also initiated and responded to an Independent Review of the safe harbour regime, which has shown its relative success. However, as a result of Treasury having not consulting properly with industry experts we have Small Business Restructuring and Simplified Liquidations regimes that have proven to be awkward and difficult to implement in practice, with very slow uptake over the first two years although more recent data suggests greater, but still disappointing, take up.

We were delighted when in September 2022, the PJC commenced its inquiry into corporate insolvency in Australia, tabling its excellent report making 28 recommendations for the improvement of Australia’s corporate insolvency system in July 2023. The most significant recommendation arising from the PJC review was that “as soon as practicable the government commission a comprehensive and independent review of Australia’s Insolvency

<sup>1</sup> [https://www.linkedin.com/posts/johnwinteraus\\_restructuring-insolvency-turnaround-activity-7274928791540445185-A2Pb/?utm\\_source=share&utm\\_medium=member\\_ios](https://www.linkedin.com/posts/johnwinteraus_restructuring-insolvency-turnaround-activity-7274928791540445185-A2Pb/?utm_source=share&utm_medium=member_ios)

law, encompassing both corporate and personal insolvency”. This was complemented by a series of near-term actions implementing reforms to safe harbour, small business restructuring, simplified liquidations and trusts.

The OECD observes that “a well-functioning exit margin, which sorts successful market activities from unsuccessful ones, is vital for aggregate productivity growth”.<sup>2</sup> Australia is a laggard in terms of having a well-functioning insolvency system as shown in the following graph from a recent OECD publication.<sup>3</sup> The improvement identified as having occurred between 2016 and 2022 is likely largely attributable to the reforms arising from the 2015 Productivity Commission Report legislated by the previous government.



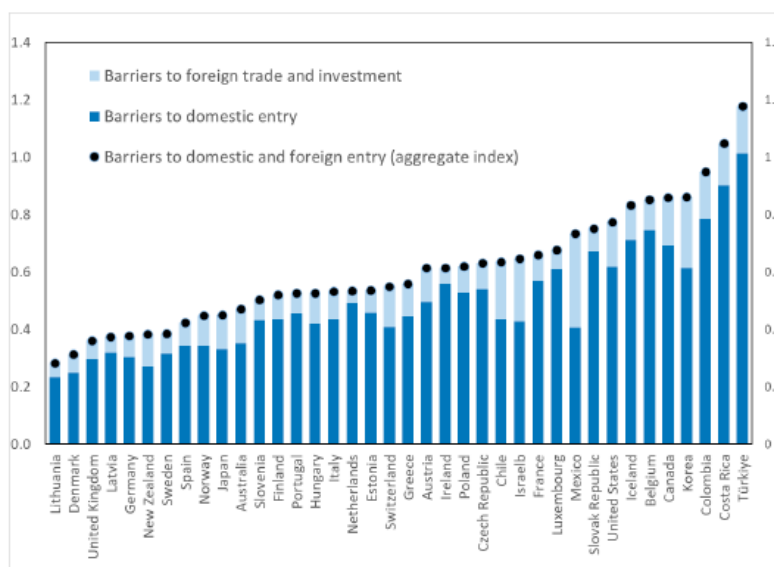
Note: The scores are scaled from zero to one, with lower scores indicating more favourable frameworks.  
 Source: OECD 2016 and 2022 questionnaires on insolvency frameworks (<https://www.oecd.org/economy/growth/oecd-insolvency-indicator.htm>).

By comparison, the same OECD report shows Australia has a relatively well functioning policy framework to support business setup.<sup>4</sup> However, it should be clear that even with a well-functioning business establishment framework, economic dynamism will be reduced if new businesses cannot gain access to resources which in part, may be stuck in failing business due to an inefficient insolvency system.

<sup>2</sup> Muge Adalet McGowan and Dan Andrews (2016) *Insolvency Regimes and Productivity Growth: A Framework for Analysis*, OECD Economics Department Working Paper No. 1309, p7.

<sup>3</sup> Christophe Andre and Peter Gal (2024) *Reviving Productivity Growth: A Review of Policies*, OECD Economics Department Working Paper No. 1822, p56.

<sup>4</sup> Ibid p55.



Note: Barriers to domestic entry are the sum of the "Administrative burden on startups" and "Barriers in services and network sectors" subcomponents. Preliminary results from the latest data collection round for the upcoming 2023 PMR indicators (*forthcoming*) confirm the main qualitative picture presented here which are based on the latest publicly available indicators (see the source).

Given this disparity, and the importance that the OECD has placed on insolvency policy, we find it odd that the Terms of Reference provided to the Productivity Commission by the Treasurer in relation to *Creating a Dynamic and Resilient Economy* directs the Commission to have regards to the House of Representatives Economics inquiry into promoting economic dynamism, competition and business formation but makes no mention of recommendations or report of the PJC inquiry.

We are left to wonder if the government rejects the advice of the OECD, does not understand it, or simply does not care about the economy-wide benefits of insolvency law reform.

## Proposed Budget Measures – the same again

### 1. Comprehensive review of insolvency system

We support the PJC Inquiry recommendation for a comprehensive review of Australia's insolvency law. In fact, ARITA has been calling for a root and branch review of Australia's insolvency laws for many years.

An independent comprehensive review of Australia's insolvency laws is long overdue, the last one having occurred 34 years ago. ARITA on reflection considers that this review be best undertaken by the Productivity Commission from within its existing appropriation – we understand from discussions with your office, and the offices of the Treasurer and the Attorney-General this is the Government's preferred approach. It may need supplementary funding of up to \$0.5 million for legal advice.

If terms of reference could be finalised in the first quarter of 2025, we expect the review would cost \$3.0m over the course of 2025-26 and 2026-27.

If the government would prefer insolvency issues to be included in the broader productivity review mentioned above, as it was by the previous government, we would welcome that and encourage it to provide further Terms of Reference to the Productivity Commission as soon as possible – this administrative decision should not need to wait until the Budget and prompt action would assist both the Productivity Commission and participants in its inquiry.

## *2. Implementation of the PJC Inquiry immediate reforms*

The PJC Inquiry made a number of recommendations for immediate potential reforms that would address clear and broadly recognised failings in the current law that would result in significant improvement to, and reduced cost of, some of Australia's insolvency processes. Specifically, we think the most significant improvements could be realised by:

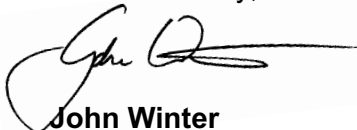
- Completing the implementation of the recommendations of the Safe Harbour Review<sup>5</sup>
- reforms to simplify the small business restructuring pathway and the simplified liquidation pathway<sup>6</sup>
- improving the insolvency process for trusts<sup>7</sup>, and
- assessing potential benefits of a Public Interest Administration Fund<sup>8</sup>.

## *3. Correction of drafting errors and anomalies and implementation of safe harbour review recommendations*

Over time, ARITA and its members have identified a range of anomalies and drafting errors in the current law that should be corrected. These have been provided to your office and to the Treasury previously. Legislation to correct these could also incorporate the drafting changes recommended by the Independent Review of the Safe Harbour Framework. We do not believe such legislation will be contentious and the cost of this reform would be limited to the cost of drafting, much of which has already been discussed by the professions and government agencies.

Should you have any queries concerning this submission please contact me (02 8004 4355 or [jwinter@arita.com.au](mailto:jwinter@arita.com.au)) or our Special Advisor, Dr Warren Mundy (0409 911 554 or [wmundy@arita.com.au](mailto:wmundy@arita.com.au)).

Yours sincerely,



**John Winter**  
Chief Executive Officer

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<sup>5</sup> PJC Inquiry recommendation 7

<sup>6</sup> PJC Inquiry recommendation 8

<sup>7</sup> PJC Inquiry recommendation 28

<sup>8</sup> PJC Inquiry recommendation 17

## ATTACHMENT

30 August 2024

Mr Alan Raine  
Secretary  
Senate Select Committee on the Cost of Living  
PO Box 6100  
Parliament House  
CANBERRA ACT 2600

By email: [costofliving.sen@aph.gov.au](mailto:costofliving.sen@aph.gov.au)

Dear Mr Raine

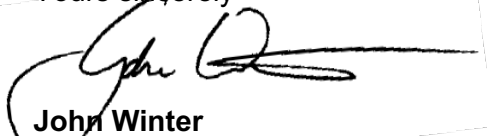
### Cost of Living Inquiry

Thank you for the Committee's invitation to participate in this Inquiry and please accept our apology for not being able to appear at the hearing on 16 August 2024.

We are grateful for the Secretariat's advice on matters that the Committee has an interest in. Given that advice and our review of the conduct of the Inquiry to date, we hope the attached submission is helpful to the Committee.

If you require any further information or wish to arrange a time for us to meet with the Committee, please contact Dr Warren Mundy at [wmundy@arita.com.au](mailto:wmundy@arita.com.au) or on (0409) 911 554.

Yours sincerely



**John Winter**  
Chief Executive Officer



## About ARITA

The Australian Restructuring Insolvency and Turnaround Association (ARITA) represents professionals who specialise in the fields of restructuring, insolvency and turnaround.

We have more than 2,300 members and subscribers including accountants, lawyers and other professionals with an interest in insolvency and restructuring.

Around 85% of Registered Liquidators and Registered Trustees choose to be ARITA members.

ARITA's ambition is to lead and support appropriate and efficient means to expertly manage financial recovery.

We achieve this by providing innovative training and education, upholding world class ethical and professional standards, partnering with government and promoting the ideals of the profession to the public at large. In 2023, ARITA delivered 94 CPE events with over 5000 attendees.

ARITA promotes best practice and provides a forum for debate on key issues facing the profession.

We also engage in thought leadership and public policy advocacy underpinned by our members' knowledge and experience. We represented the profession at 11 inquiries, hearings and public policy consultations during 2023.

# 1 Introduction

ARITA – Australian Restructuring Insolvency and Turnaround Association welcomes the opportunity to participate in this inquiry.

ARITA is Australia’s largest association of insolvency practitioners covering around 85% of registered liquidators and bankruptcy trustees. We are regarded as a world-leading professional body in this industry and the largest provider of education for insolvency practitioners in the world. We are the only body in Australia that is legislated to provide a representative on all liquidator and trustee registrations and disciplinary committees administered by ASIC and AFSA, and our Code of Professional Practice (and our enforcement of its standards) provides the ethical and practical foundations of the operation of the profession in Australia.

As the Australian economy emerges from the rigours of Covid we are seeing insolvencies return to their pre-Covid levels – it is too early to tell if Covid legacy issues have fully worked their way through the insolvency statistics.

Beyond Covid, deteriorating domestic and international economic conditions are placing businesses<sup>9</sup>, small and large, under pressures which will exacerbate this trend, if they haven’t already, especially if there is a recession in the global and/or domestic economies.

It is not necessary for this submission to set out the evidence and commentary surrounding the stubbornly persistent inflation outside of the RBA’s target band since June 2021. The Committee has received significant commentary from individuals, civil society and business as to the impact on the Australian community and a wide range of analyses as to the cause of this phenomena from people far more expert in macroeconomic analysis than us.

The primary objective of this submission is to set out some longer-term trends and characteristics we see in the statistical material published by a range of government agencies (primarily ASIC, ASFA and the ABS), some recent market behaviour, some thoughts on why a level of insolvency is critically important to the efficiency of the economic and why insolvency law reform remains a great but unaddressed microeconomic reform opportunity.

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<sup>9</sup> In this submission, we use the words “business” and “firm” interchangeably to mean an economic entity, or a group of associated economic entities, undertaking the production of goods and/or services. “Company” is used to refer to an entity incorporated under the *Corporations Act*.

## 2 Evidence of economic distress

### 2.1 Personal Insolvency

General inflationary pressures in the economy (“cost of living” pressures) through increases in prices for goods and services, and increased borrowing costs from elevated interest rates, place financial pressures on individuals and households. If they are unable to increase their incomes commensurate with the increases in prices, their real incomes fall and they must adjust their consumption and savings behaviour. This may result in them “doing without”, saving less, eating into their savings or borrowing to feed themselves and their families.

The restrictions in household consumption that accompanied the Covid lockdown led to an increase in household savings. Figure 1 shows recent evidence suggests that those “extra” savings have now been exhausted.

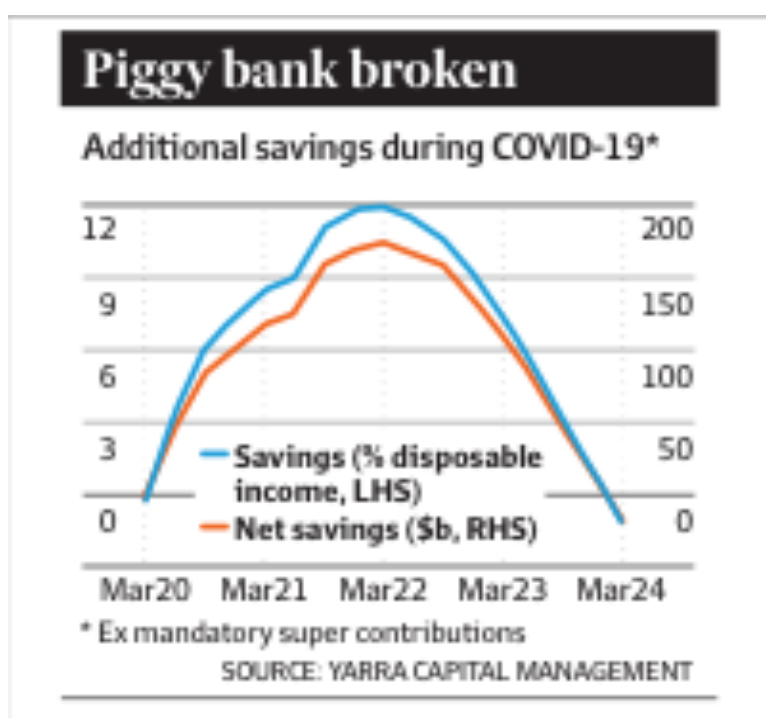


Figure 1: Extra Household Savings<sup>10</sup>

<sup>10</sup> Read, Michael (2024) “Households “deplete pandemic savings”, *Australian Financial Review*, 28 August 2024, p3.

But in extremis, a small number of people simply can't make ends meet – they become insolvent.<sup>11</sup> Simply, insolvency is a circumstance where an economic entity (a person, company, trust, partnership or other organisation) can't pay their debts as and when they fall due. When a business fails, especially a small business, it is often the case that the owners of the business (and possibly their associates) may also experience personal insolvency issues. Indeed, some “businesses” are not corporate entities at all but rather are “sole traders” – businesses that carry on without a corporate structure. When sole traders fail, their owners becoming personally bankrupt – these account for about a third of bankruptcies. In Australia the *Bankruptcy Act 1966* (Cth) provides a number of mechanisms by which people can put in place arrangements so that after a period of time, they can get “a fresh start”.

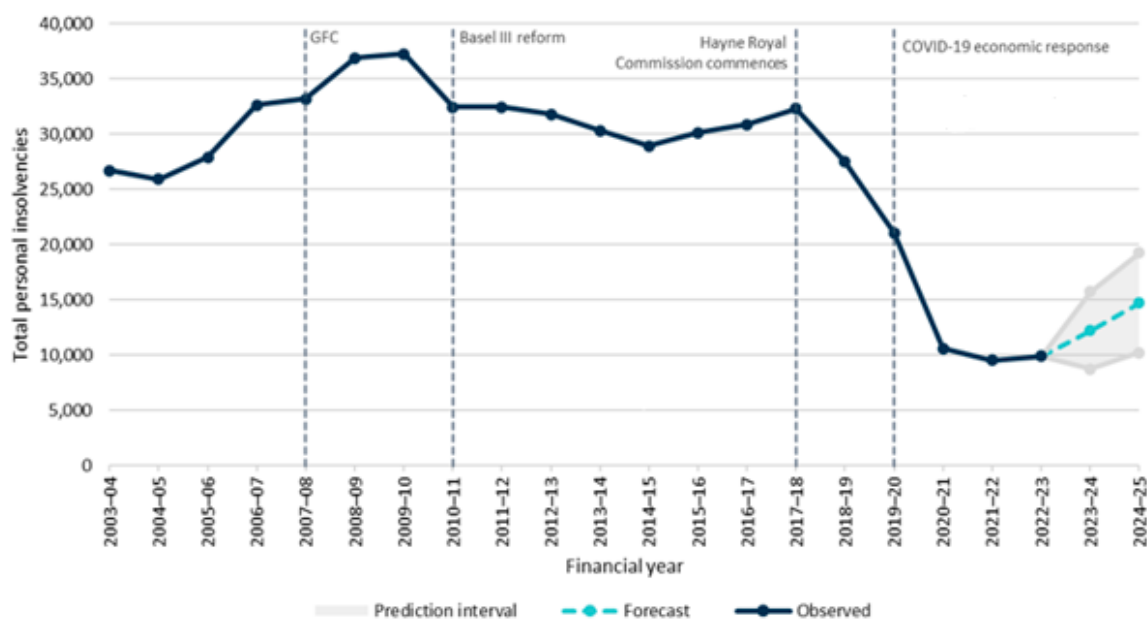


Figure 2: Personal Insolvencies in Australia<sup>12</sup>

Figure 2 provides a long run view of the level of personal insolvency in Australia and some short-term forecasts produced by ASFA. Recently released data shows personal insolvencies in the year ending 30 June 2024 were 11,663, some 17% higher than in the year ending 30 June 2023 but broadly in line with ASFA’s forecast. It is difficult at this stage to determine the cause of this – it may be due to the macroeconomic trend that ASFA has modelled or alternative, it may be the “buffer” that was built up on household balance sheets is starting to unwind – only time will tell.

<sup>11</sup> It should be understood that there are reasons other than inflationary pressures that cause bankruptcy such as family violence related financial exploitation, calling of guarantees provided to others (usually family members), misadventure, and a general inability to manage personal finances.

<sup>12</sup> Australian Financial Securities Authority (2023) *State of the Personal Insolvency System*

The rate of personal insolvencies seems much less correlated to the level of interest rates than is the rate of corporate insolvencies (as discussed below). Also, we would note from Figure 6 that since the start of 2023, the ATO has resumed commencing proceedings for bankruptcy although not at the level seen in 2019.

In the period 2008-2019, annual personal insolvencies averaged around 32,000. In some sense, when the economy is in a steady state, the number of insolvencies should go roughly in line with the population. In the period mentioned, the average number of personal insolvencies per million Australians was 1,370. In 2023 it was 368. It is difficult to conclude that the current inflationary environment has led to a significant increase in bankruptcies.

## 2.2 Business distress

### 2.2.1 Trends in corporate insolvency

Part 5 of the *Corporations Act 2001* (Cth) is Australia's primary corporate insolvency law. It provides for a range of forms of restructuring and external administration.

ASIC publishes statistics for the number of companies entering external administration for the first time (series 1) and the total number of external administration (series 2). We consider series 1 is a better indicator of broad insolvency trends.

Figure 3 shows the number of insolvencies per 10,000 registered companies since the early part of this century. We prefer this measure to the raw insolvency statistics as it better shows the prevalence of insolvent companies over the longer term as there is a tendency for the number of businesses to grow over time – the rate of company formation generally slightly exceeds the rate of company closures. We have also excluded small business restructurings from the last few years of the series as those businesses (hopefully) continue to exist after the process.

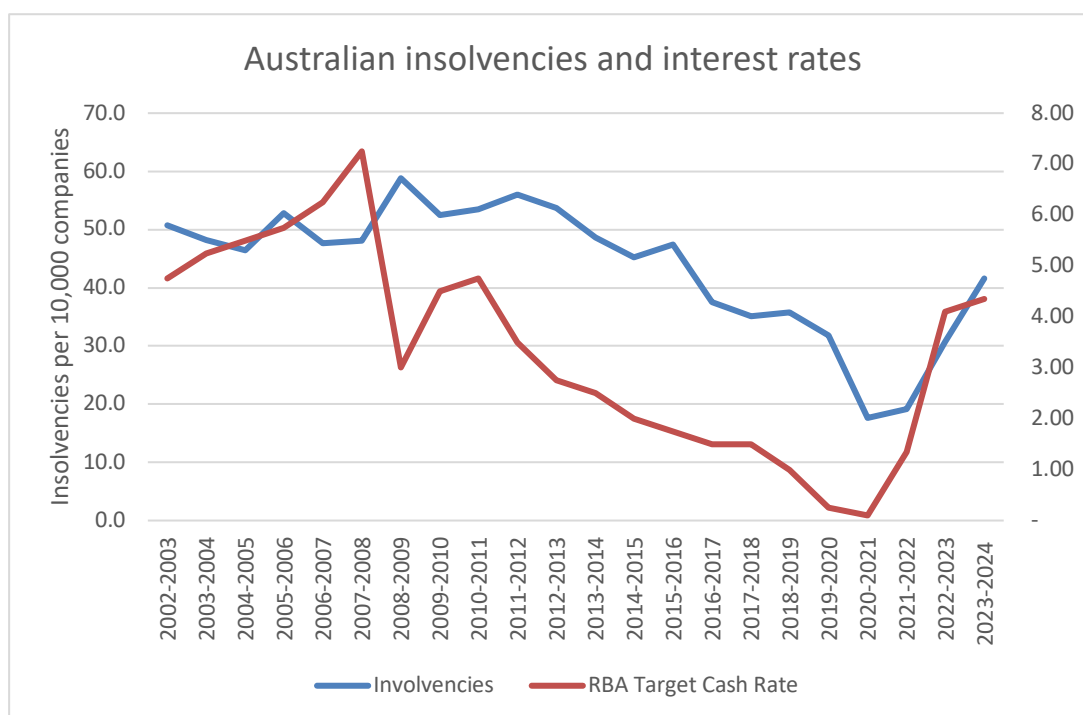


Figure 3: Corporate Insolvencies and interest rates in Australia<sup>13</sup>

Despite the recent increase in insolvencies, the rate of insolvencies today is around its pre-Covid levels. What is also of interest is that Covid came at the end of a decade long trend of declining rates of insolvency that we suspect is largely a reflection of a long period of relatively loose monetary policy. What is clear is that the recent increase in corporate insolvencies is largely a result of three factors:

- the ending of the moratorium on insolvent trading prosecutions of directors;
- increased debt collection by the ATO; and
- a tightening of credit conditions both in terms of increased interest rates but also more vigorous recovery activities by large banks.

It is very difficult to unpick these factors and the last two are inter-related to an extent. What is probably true is that absent Covid related policies, some of the firms currently entering insolvency, for whatever reason, would have been insolvent earlier and the tightening in monetary policy in recent years would have seen an uptick in insolvencies, but a smaller one than has been experienced in recent years – we touch on this issue briefly in section 2.4.

## 2.2.2 Industry composition of insolvencies

<sup>13</sup> Australian Securities and Investment Commission (various) *ASIC's Corporate Insolvency Statistics*, Reserve Bank of Australia (2024) *Cash Rate Target*, <https://www.rba.gov.au/statistics/cash-rate/>, accessed 24 August 2024.

There has been significant discussion about the preponderance of insolvencies in certain industries, particularly construction and hospitality. Figures 4 and 5 show recent trends in the industry composition of insolvencies.

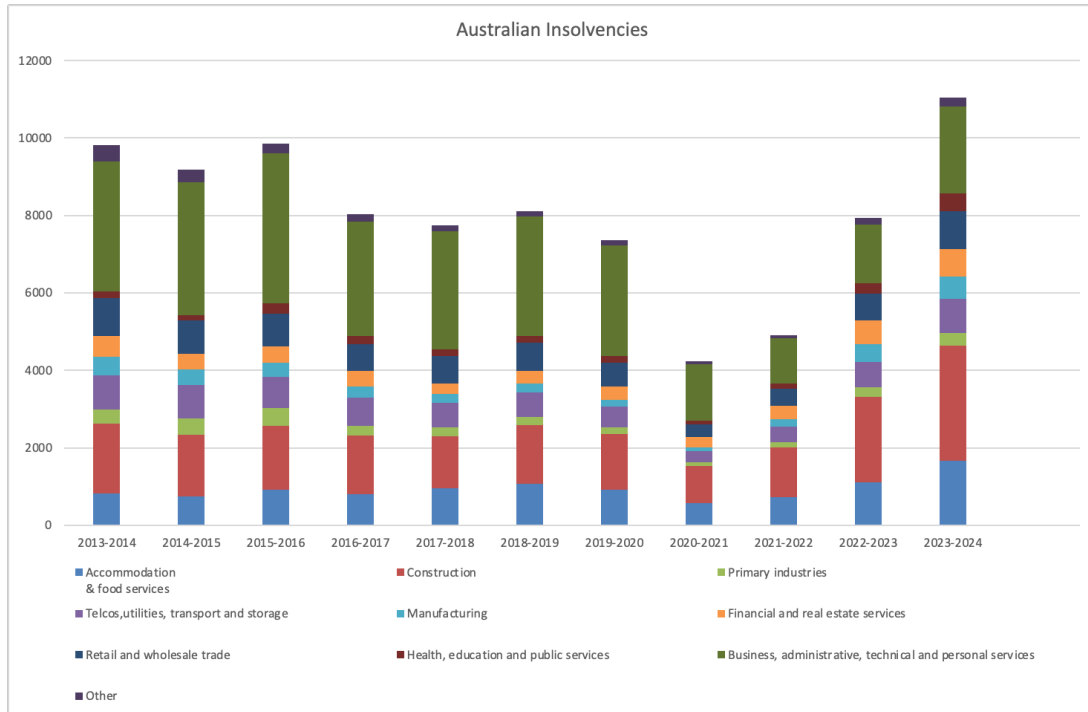


Figure 4: Corporate Insolvencies in Australia by industry sector<sup>14</sup>

<sup>14</sup> Australian Securities and Investment Commission (various) *ASIC's Corporate Insolvency Statistics*, some small categories have been consolidated to improve clarity.

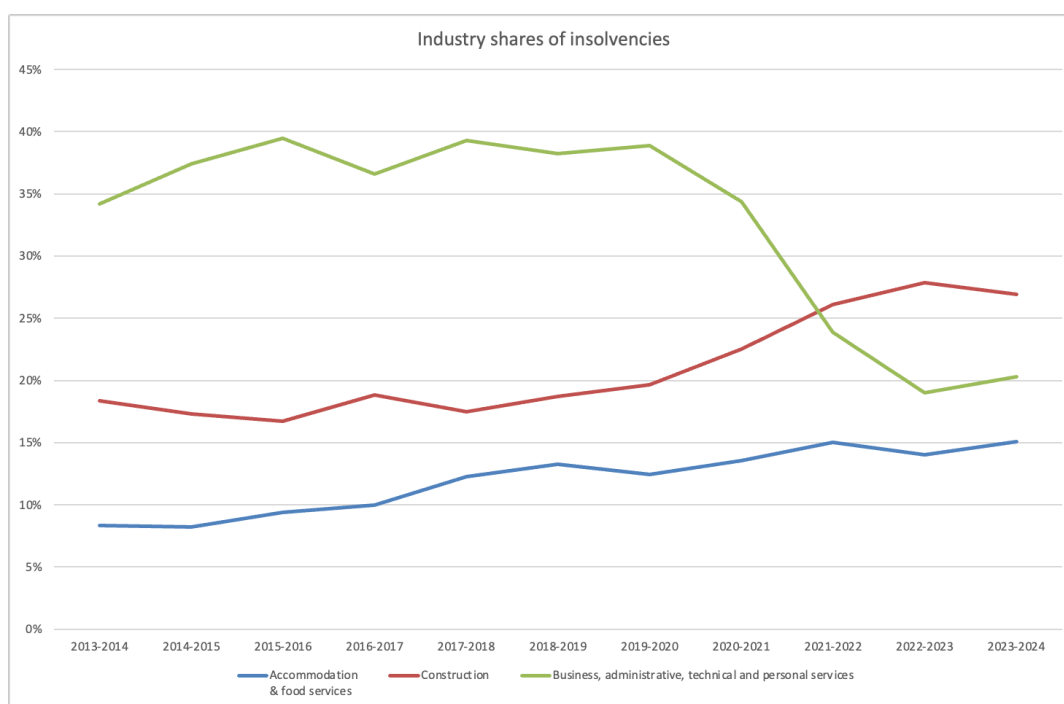


Figure 5: Share of corporate Insolvencies in Australia by industry sector<sup>15</sup>

Whilst the number of insolvent firms has increased across in all sectors since Covid, this has been disproportionately the case in food and accommodation and construction. In relation to food and accommodation, changes in work practices since Covid, and in particular increases in working from home, has certainly impacted food outlets in central business areas although there is some evidence that this is being partially offset by increased demand in some suburban areas. It is also likely that this sector is more exposed to discretionary spending by households and therefore more likely to be affected by household responses to inflationary pressures. This sector will also be being impacted by the relatively slow recovery of the international and tourism sectors, the latter largely reflecting general pressures on demand in the household sector.

The construction sector has experienced significant disruption and cost pressures in materials supply chains from Covid and the war in Ukraine and more recently from the conflict in the Middle East leading some shipping lines to bypass Suez in preference to rounding the Cape of Good Hope thus increasing both shipping times and costs.

The labour market for construction works has also contracted as foreign workers who left the country as a result of Covid have not returned in the same numbers. There has been some commentary that major infrastructure projects are causing issues in the labour market. This should not be overstated as workers who work on major rail and transmission projects, for

<sup>15</sup> Australian Securities and Investment Commission (various) *ASIC's Corporate Insolvency Statistics*, some small categories have been consolidated to improve clarity.

example, have very different skills to those who work in residential construction but to the extent that some labour is substitutable in this way, it might lead to an increase in the number of insolvent construction companies as the direction of travel of workers will be from smaller firms (say in household and small commercial construction) to larger major project firms.

Construction projects, be they for new homes, apartments, shopping centres or transmission lines, are multi-year endeavours and in the period immediately pre-Covid, it was normal practice for constructors to enter into fixed price contracts with their clients. So, in the face of the cost pressures mentioned above, and because final contract prices were fixed, margins (which were set in very competitive conditions pre-Covid) have been squeezed to the point where it was not economic for some constructors to continue with projects. This has been the case for small and large firms – perhaps the most notable of the latter was the collapse of Clough<sup>16</sup>. The highly stratified sub-contracting nature of the construction sector tends to lead to a cascading effect where when a primary contractor fails, small subcontractors may lose their only source of revenue and fail, leading then to solvency issues with suppliers and so on.

There are seven industry categories in this data set that are not displayed in Figure 5. The reason for this is that over the period, their shares of insolvencies have varied only by a percent or two. The one sector that has lost share is personal, business and professional services and this seems to have occurred since the start of the pandemic. This may be due to the fact that these businesses were able to continue to provide services during lockdown as a result of being able to work remotely and as service providers, they are not as affected by changes to input raw materials prices in the way construction is, they are not exposed to discretionary spending and increasing levels of working at home to the same extent of hospitality, and they have relatively little debt so are less exposed to increases in interest rates.

### **2.2.3 Drivers of recent insolvency trends**

*Alares* is a credit monitoring firm. In addition to providing credit information on individual firms, it publishes aggregate data on recent credit market activities. Figure 6 shows monthly applications to wind up companies.

The first point to note about Figure 6 is the strong correlation between the rate of insolvencies in Figure 3 and this chart. The second thing to note is the virtual absence of ATO applications during 2020 and 2021 and the first half of 2022 and quite low levels in the remainder of 2022.

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<sup>16</sup> For more details of the Clough collapse see <https://www.afr.com/companies/infrastructure/collapsed-clough-owes-creditors-248-million-20230122-p5cejk>.

The level of ATO applications increases substantially in 2023 and 2024 in those months for which data is available and seems to be approaching levels seen pre-Covid. Figure 7 provides a broader view of the ATO’s recovery activities showing in addition to winding up applications, filings for bankruptcy and other debt recovery activities. In a number of cases, the debt recovery activities may lead to subsequent applications to wind up companies or have individuals declared bankrupt.

The Committee will be well aware of the policies and approaches in relation to tax debts adopted by government and the ATO during and after Covid and the winding back of these. That said, Figure 6 seems to suggest that the ATO’s current level of activity is a bit less intense than it was in 2019. It is hard to tell, but this would suggest that the ATO’s current level of activity may not contain an element of post-covid catchup as is often suggested, but rather a return to pre-covid norms.

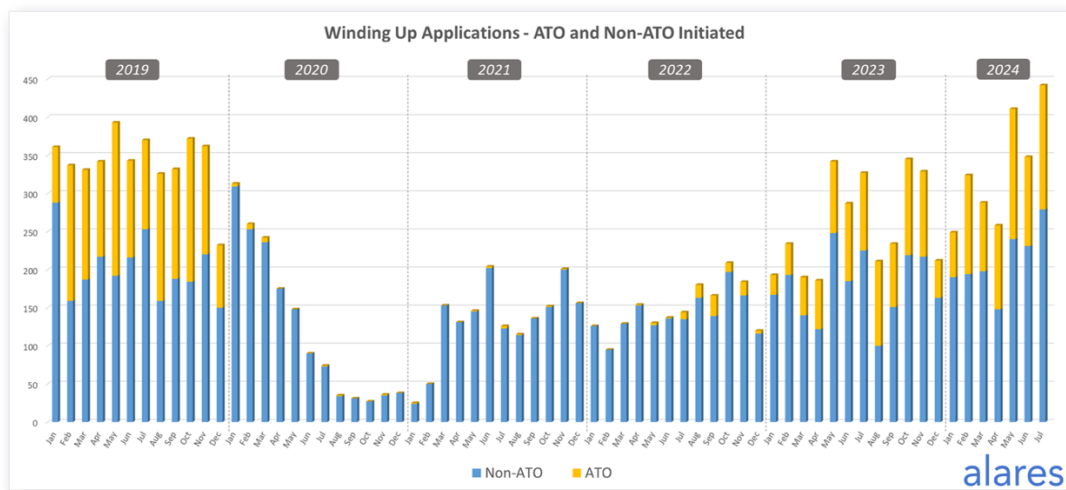


Figure 6: Court-based winding up applications in Australia<sup>17</sup>

<sup>17</sup> <https://alaresystems.cmail19.com/t/t-e-sllouk-jrkhujdii-m/> note excludes applications in Supreme Court of Tasmania

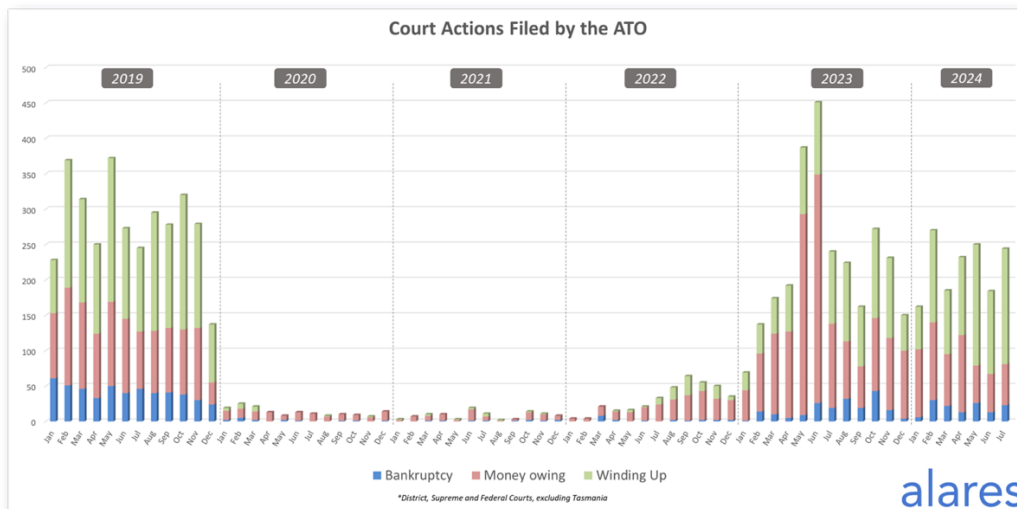
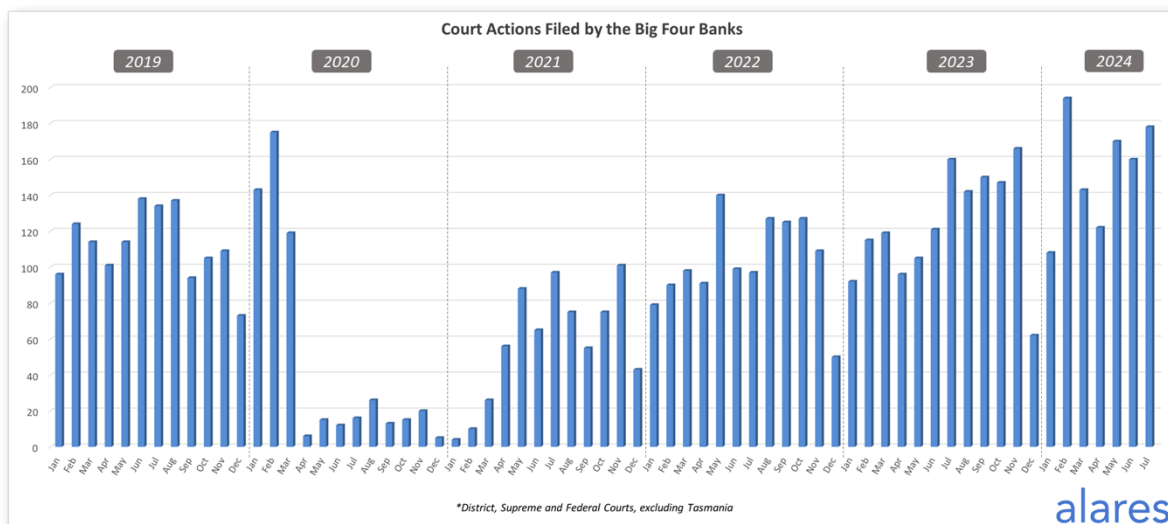


Figure 7: Court Actions filed by the ATO<sup>18</sup>

Figure 8 shows the number of actions brought by the large banks – these constituted virtually all filings during the Covid period. As can be seen also from Figure 6, whilst winding-up proceedings by creditors other than the ATO fell dramatically over the course of 2020 they recovered much more rapidly through the course of 2021 and 2022. Indeed, it seems that the number of actions brought by the big banks in 2022 exceeded those in 2018 and currently they exceed those in the immediate post Covid period.



<sup>18</sup> Ibid.

Figure 8: Court Actions filed by Major Banks<sup>19</sup>

We do not have access to the data sets underlying these figures but a very rough analysis (by drawing lines to establish numeric estimates) strongly suggests that the number of winding ups brought by organisations other than the ATO and major banks – namely general trade creditors, FEG and smaller financial institutions has not recovered in the same way as proceedings brought by the major banks and the ATO. Indeed, our rough analysis suggests that actions by these general creditors in the six quarters up to June 2024 are about half what occurred in the six quarters from the start of 2019. There is no reason apparent to us for this but it is a matter worthy of investigation, and as we say, our analysis is quite rudimentary.

## 2.3 Other indicators of business distress

In its landmark 2015 inquiry report on Business Set-up, Transfer and Closure, which is the headwater of most meaningful insolvency reform in Australia over the last decade, the Productivity Commission observed that beyond insolvency, there are many reasons why businesses exit the market including:

- retirement
- an opportunity for a merger which may provide benefits from increased market power, diversity or taxation arrangements
- the owner wishes to seek a different lifestyle
- it is time to pass the business on to family members
- increased competition has reduced (or is expected to reduce) business profitability
- concern that falling profit may in the future lead to bankruptcy or insolvency
- the owner has new plans and wants to generate capital, sell the business and use the cash for other purposes
- changes in family circumstances, such as illness or divorce
- the owner is moving out of the area
- listing the business on the share market is viewed as the next logical step to achieve business growth
- an opportunity for a start-up to sell the business 'idea' to an established business.<sup>20</sup>

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<sup>19</sup> Ibid.

<sup>20</sup> Productivity Commission (2015) *Business Set-up, Transfer and Closure Inquiry Report 75*, p292

So “voluntary exit” includes businesses that are sold or closed because of poor market performance and financial difficulties (but not yet failure). It follows that the corporate insolvency data discussed above is likely to underestimate the level of corporate financial distress in the economy. The ABS publishes data on business closures that captures these companies as well as exiting unincorporated businesses and these are presented in Figure 9.

However, the decision for a business to voluntarily exit does not always relate to financial performance. Many businesses exit for ‘lifestyle’ reasons — for example, when the owner retires, relocates, or seeks different opportunities. So, it is likely that business exit data provides an overestimate of the level of business financial distress in the economy. Similarly, because of these non-cyclical reasons for business closure, business closure statistics can be expected to be less volatile and less correlated to underlying levels of economic activity than insolvency statistics.

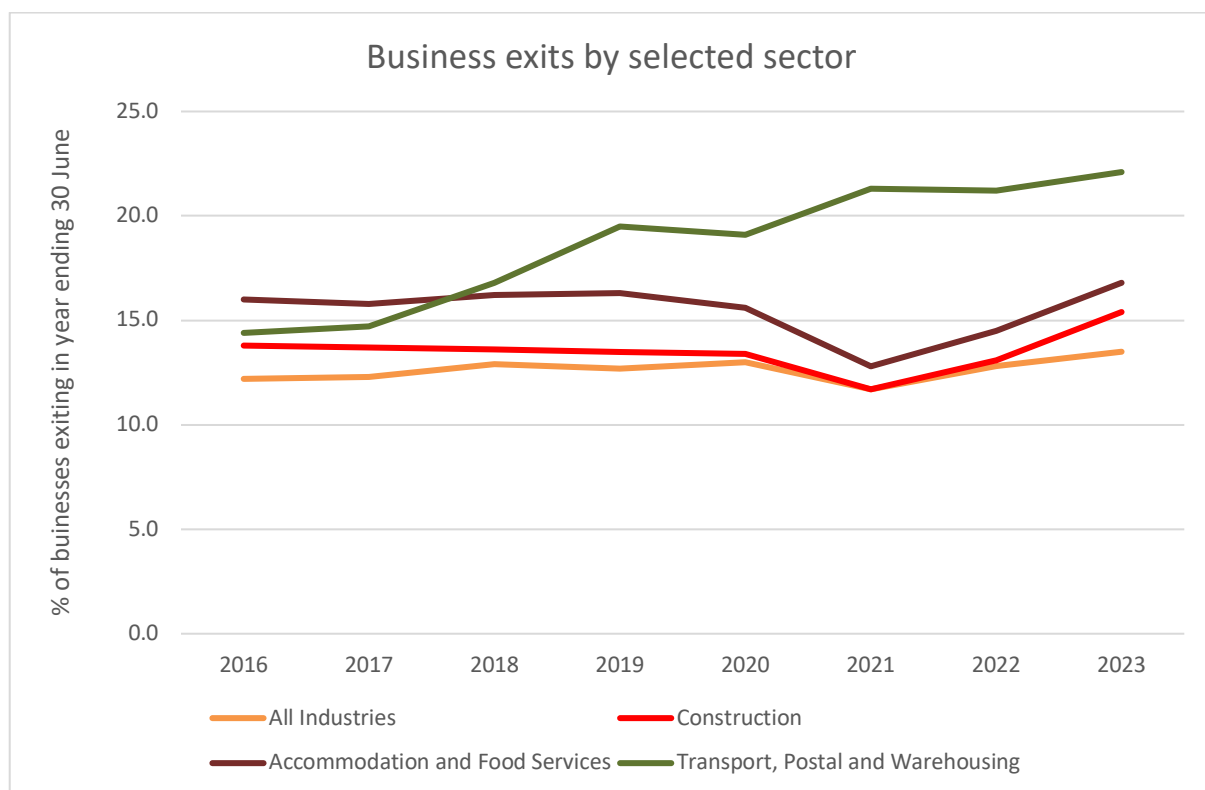


Figure 9: Rates of Business Closure in Australia<sup>21</sup>

As was the case with corporate insolvencies, the level of business closures dipped in the COVID period but has returned to what on simple inspection is a slightly rising trend since. In the earlier period 2006-2012, exit rates in Australia were 8-10%. Israel and Canada

<sup>21</sup> Australian Bureau of Statistics (various) *Counts of Australian Businesses, including Entries and Exits*, Catalogue Number 8165.0

experienced lower rates, Italy and the United States around the same, and Korea, Spain and New Zealand higher.<sup>22</sup>

Again, as was the case with corporate insolvency, construction and hospitality businesses exit at a higher rate than businesses as a whole and with a more rapid growth rate than average. Transport businesses show strong trend for increasing closures – we suspect this is largely driven by the exit of aging owner drivers (whose average age is over 55) in the face of hyper competition suppressing rates and inflated fuel costs that cannot be passed on to customers. As exit from the industry is relatively easy (trucks and trailers are easily sold) owners tend to wind up their businesses rather than end up insolvent.

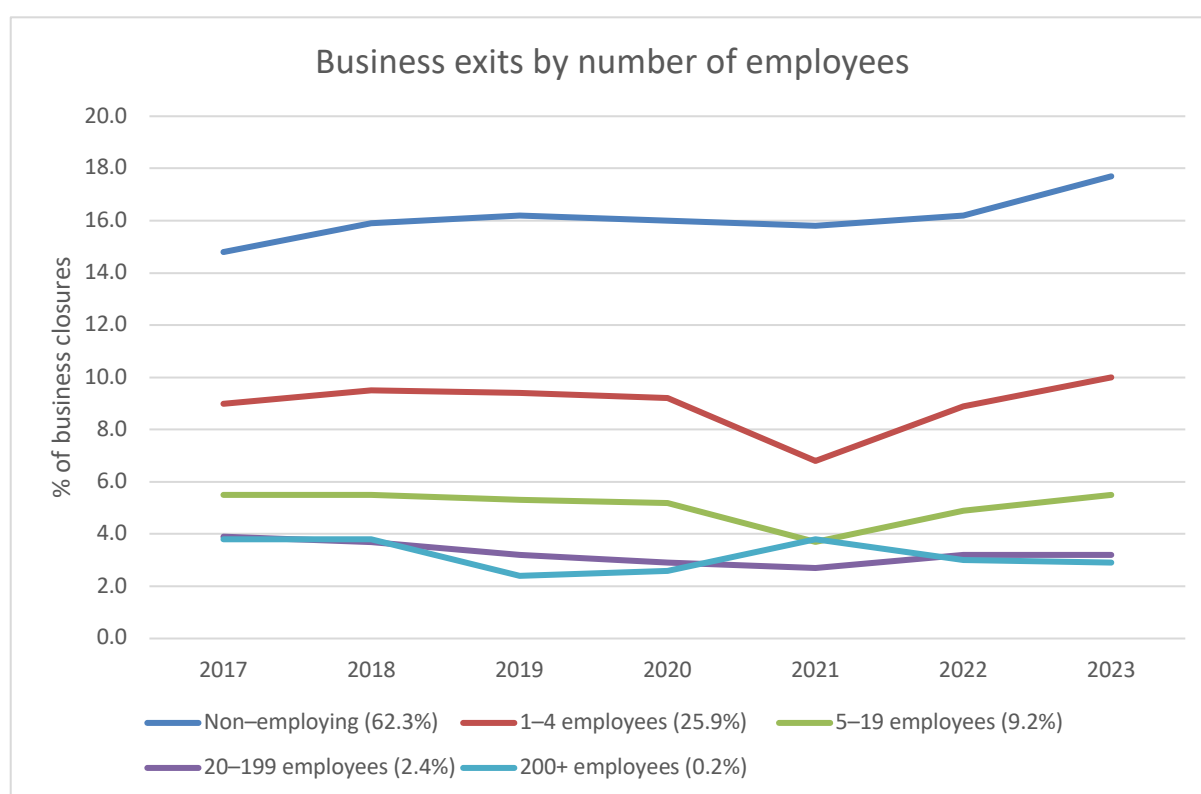


Figure 10: Rates of Business Closure in Australia<sup>23</sup>

Figure 10 shows that the level of business exits is strongly correlated with size. Again, this is likely to be, at least in part, due to the fact that the non-financial reasons for closure mentioned above are more likely to be found in micro and non-employing businesses than in

<sup>22</sup> Ibid p61.

<sup>23</sup> Australian Bureau of Statistics (various) *Counts of Australian Businesses, including Entries and Exits*, Catalogue Number 8165.0

ASX listed companies. Again, to the extent levels of business exits are rising at all, they largely appear to be returning to pre-Covid levels and trends.

## 2.4 International trends

We understand from our members and international peers that in many countries construction and real estate are experiencing similar challenges to what we have seen in Australia with supply chain and borrowing costs also being common causes of problems. Changes in work locations seem to have similar impacts on the hospitality sector in New Zealand and the United Kingdom.

Comparable statistics on international rates and trends of insolvencies are difficult to lay ones hands on until several years after the event. That said, earlier this year global insurer Allianz published some data and commentary on developments during 2023 – we would recommend the report to the Committee as a helpful source. Figure 11 shows some data for developed economies.

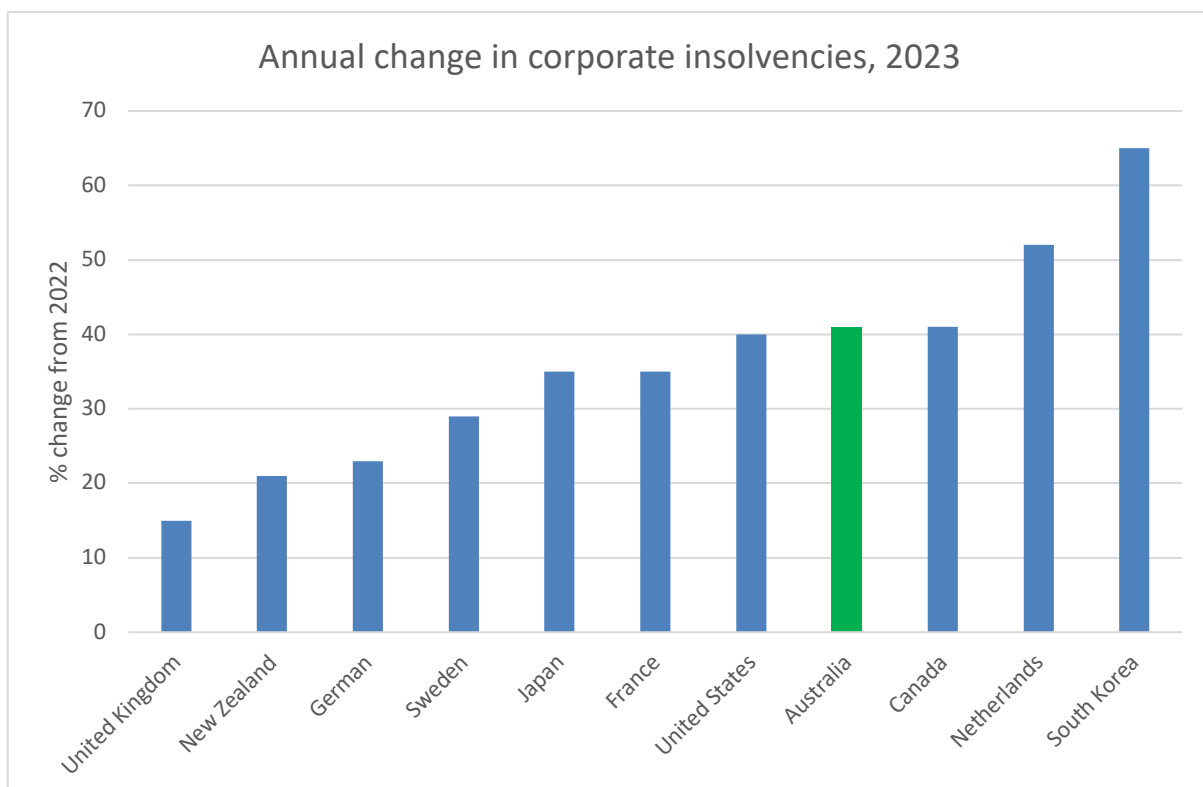


Figure 11: Rates of Business Closure in Australia<sup>24</sup>

In discussing the broader data set Allianz said:

<sup>24</sup> Allianz Research (2024) *Global Insolvency Outlook: Reality Check*

*A quick comparison with 2016-2019 levels shows that, between 2020 and 2022, support measures spared the equivalent of three-quarters of insolvencies in countries such as the US, Germany, Austria, Norway, Portugal and New Zealand, and the equivalent of one year of insolvencies usually reported in Australia, the Netherlands, France, Ireland and Italy. In this context, a ‘normalization’ was expected in 2023 amid weaker global demand, prolonged pressure on profitability due to higher input and financing costs – impacting mainly small and medium enterprises (SMEs) – and the ending of support measures in certain countries adding an additional constraint, for example via the repayment of state-guaranteed loans.*

This suggests to us that in many developed countries that adopted anti-cyclical policies to deal with Covid, that increases in insolvency rates in the short run are common and to a substantial degree, differences can be explained by differences in the extent of business support policies during the Covid period.

### 3 The economics of insolvency

Insolvency is one way in which businesses exit the economy – merger, takeover and voluntary closure are the main others. Despite the negative impacts that insolvency can have on a range of stakeholders – employees, creditors, customers, shareholders and the broader economy, it nevertheless plays an important role in increasing average levels of productivity in the economy by facilitating structural change within and between businesses and sectors, allowing entrepreneurs and others to learn and experiment, and transferring skills and information between businesses.

The OECD observes that “a well-functioning exit margin, which sorts successful market activities from unsuccessful ones, is vital for aggregate productivity growth”.<sup>25</sup> Various empirical studies have identified links between the cost of business closures - a key

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<sup>25</sup> Muge Adalet McGowan and Dan Andrews (2016) *Insolvency Regimes and Productivity Growth: A Framework for Analysis*, OECD Economics Department Working Paper No. 1309, p7.

measure of the effectiveness of an insolvency regime - to productivity spillovers<sup>26</sup>, labour misallocation<sup>27</sup>, capital misallocation<sup>28</sup> and skills mismatches.<sup>29</sup>

Within the insolvency framework, restructuring via mechanisms such as safe harbour, small business restructuring and voluntary administration represent particular opportunities to avoid transaction costs and intellectual property destruction that necessarily accompany business liquidation, in addition to the obvious benefits of maintenance of employment and continuity of service to customers. It is likely that following restructuring, creditors will receive greater returns than under the counterfactual of liquidation as they will share in the firm value that is preserved.

But in circumstances where the business cannot be saved, it is critical that the insolvency framework enables efficient (in terms of both time and cost) redeployment of employees and capital. In the case of the collapse of Ansett, for example, prompt action by the administrators and airport operators (who effectively were secured creditors in relation to Ansett's domestic terminals) enabled the return of the majority of Ansett's terminals to the economy which allowed the continued operation of regional services under the Regional Express brand and facilitated the expansion of (then) Virgin Blue into a meaningful competitor to Qantas.

## 4 Insolvency law reform

As we said to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Corporate Insolvency, whilst Australia's insolvency regime is not broken, it is far from international best practice. What is required is wholesale reform that will deliver:

- A clear statement of objectives for Australia's insolvency laws that are consistent with the growth and structure of the Australian economy.
- Best practice legislative drafting along the lines of that recently proposed by the ALRC in relation to the financial services provisions of the *Corporations Act*, that makes the law accessible and understandable to the majority of regulatees, namely the owners and operators of small and medium sized businesses.

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<sup>26</sup> Westmore, B. (2013), "R&D, Patenting and Productivity: The Role of Public Policy", OECD Economics Department Working Paper, No. 1046; Saia, A., D. Andrews and S. Albrizio (2015), "Productivity Spillovers from the Global Frontier and Public Policy: Industry Level Evidence", OECD Economics Department Working Paper, No. 1238.

<sup>27</sup> Andrews, D. and F. Cingano (2014), "Public Policy and Resource Allocation: Evidence from Firms in OECD Countries", Economic Policy, No. 29(78), pp. 253-296.p

<sup>28</sup> Andrews, D., C. Criscuolo and C. Menon (2014), "Do Resources Flow to Patenting Firms?: Cross-Country Evidence from Firm Level Data", OECD Economics Department Working Papers, No. 1127.

<sup>29</sup> Adalet McGowan, M. and D. Andrews (2015), "Skill Mismatch and Public Policy in OECD countries", OECD Economics Department Working Paper, No. 1210.

- Consistent with general and growing international practice, a single insolvency law addressing companies, partnerships, trusts and individuals.
- A single, stand-alone government agency committed to the best practice regulation of businesses and individuals experiencing financial difficulty and insolvency, and the insolvency profession.

It is fair to say that there is very little that can be done to allow the insolvency system to better support businesses, individuals and households during this period of inflationary pressure other than for regulators and government agencies to lift their games. For example, we recently had occasion to write to the Minister for Industry and Science drawing his attention to incomplete and potentially misleading information about business closures on the *business.gov.au* website that is administered by his department.

However, what is required is real reform of our insolvency system. This will reduce costs, improve timeliness, save businesses, improve returns to creditors and enhance productivity of the economy as a whole. To this end, we support the unanimous and bi-partisan recommendations of the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Corporate Insolvency that was tabled in July 2023.

These recommendations include some high priority and relatively simple reforms which could certainly have been implemented in the early months of this year that would have helped businesses in the current macroeconomic environment – the Treasury is currently consulting on these but it seems likely a bill will not be seen by this Parliament, despite us providing detailed drafting notes at the beginning of this year.

Equally disappointing is that the Government is yet to act on the recommendation of a comprehensive review of the Australian insolvency system (the terms of reference which are largely set out in that Committee’s detailed recommendations) by an organisation like the Productivity Commission. This disappointment is compounded by the fact that the Productivity Commission’s current workload is, and has been for a number of years, manifestly below its inquiry capacity.

We do note that the Attorney General’s Department is consulting on a limited set of relatively simple reforms to the Bankruptcy Act which with some suggested enhancements we and many others support. But again, these largely reflects the consensus position of a roundtable held in March 2023 with the profession, other stakeholders and the Attorney General himself. Earlier implementation of these would have helped some individuals currently experiencing personal distress.