Does Enterprise Tax Plan get more than 2 out of 10?

Speaking at the National Press Club in Canberra, Janine Dixon, from our Centre of Policy Studies analysed the Government Enterprise Tax Plan 2. The post-Budget forum was telecast on Sky News and the ABC. Here's an excerpt from her speech:

Like this year's budget, Treasurer Scott Morrison's first budget in 2016, contained measures that would not be implemented for many years. The centrepiece of the coalition's jobs and growth plan was a program of cuts to the rate of company tax from 30 per cent to 25 per cent, to be phased in for all companies over a 10-year period.

Fast forward to now, and only a reduced version of the plan has passed the Senate – Enterprise Tax Plan 1. Companies with turnover of up to $50 million will be eligible for the cut to the company tax rate, but the profits of big businesses, those above the $50 million threshold for turnover, will continue to be taxed at 30 per cent.

The full plan, now known as Enterprise Tax Plan 2, has failed to garner the support of the Australian public or the Senate, but it's still alive and very relevant to a discussion about the budget in 2018.

You don't need to be a very radical economist to conclude that the economic case for a cut to the company tax rate is not positive. Those mistrustful of the government's motives might suspect that rich foreign investors will simply trouser the tax cut and give us nothing in return. But you don't actually need to subscribe to that point of view to come to the conclusion that to cut the company tax rate for Australia's largest business will leave us worse off.

At the Centre of Policy Studies, our economy-wide, market-based modelling of short-run and long-run effects finds that a cut to the company tax rate will stimulate investment and wages. The tax cut creates the incentive to expand investment by giving viability to investments that are profitable at a 25 per cent tax rate but not at a 30 per cent tax rate. This facilitates a small positive stimulus to economic growth.

But what sort of growth are we looking at?

Gross Domestic Product, GDP, is a measure of all things produced in this country. With more investment, GDP will be larger – this is the economic growth dividend from company tax rate cuts. Despite many flaws, usually GDP is a pretty good proxy for welfare, but on this point, proceed with caution! A much better measure is Gross National Income, which subtracts the part of GDP that accrues to foreign owners of labour and capital.

Under Australia's system of dividend imputation, it's the foreign investors who are most responsive to a change in the company tax rate. This points to a widening gap between GDP and national income for two important reasons. The first is that foreign-financed investment will add to GDP, but the profits will accrue to non-resident investors and not add to national income. The second – and this hasn't been recognised in the economic modelling favoured by the government – is that, as a nation, we'll collect less tax revenue from existing foreign-owned investment, and that is significant.

As the lower company tax rates are phased in, each year as a nation we will miss out a chunk of tax revenue that we otherwise would have collected from foreign investors. This has a negative impact not only on government revenue, but on our income as a nation. Over time some, but not all, of this loss to the nation will be offset by higher wages. But we'll never catch up. National income will remain permanently lower than it would have been without the tax cut – and it's not just me saying that. A recent Brookings Institution report has come to the same conclusion about the company tax cuts in the United States.

Let's talk a bit more about wage growth.

When the big businesses expand, they will do so by investing and by drawing resources – employment – away from the rest of the economy. I remind you that no economist, including any at the Treasury, has said that company tax cuts will lead to a long term, significant increase in employment.

The big businesses will be in a position to offer higher wages; and to compete, the other employers will need to offer higher wages too. The small businesses, the unincorporated businesses, the Australian-owned companies paying fully-franked dividends, and the government – will face higher wage costs and no compensation on their tax bills.

Faced with higher wage costs, some small businesses will cease to operate. Others may never come into being. This is not a policy that cares about small business.

Workers benefiting from wage growth sounds great, but it's an illusion.

We've shown that national income will be lower overall, so there is no way that all Australians can be better off. If no attempt is made to recoup the lost taxation revenue, then government spending on essential services will be less than it otherwise could have been. If attempts are made to recoup the lost taxation revenue, say through bracket creep, then post-tax, wage gains to employees will be eliminated.

Now, plenty of people at the Business Council of Australia and the government disagree with these conclusions. Let's unpack that a little. We all agree that GDP and pre-tax wages will be larger as a result of a company tax rate cut.

Where we really differ is that they also believe that gross national income will be larger, although to a lesser extent than GDP, whereas we find that it will fall. This is fundamental, as it is the more suitable measure of economic welfare.

We already have a large foreign investment presence in Australia, which has voted with its feet for the 30 per cent tax rate. A tax cut is a gift to these investors – for the policy to be a success, the investment expansion has to beat this initial giveaway. The government's long-run modelling missed this significant short-run effect.

The government modelling takes into account a gain attributed to reduced profit shifting – the idea that, with a lower tax rate, companies are less motivated to incur the costs and risks associated with reducing taxes by shifting profits offshore to tax havens. I won't go as far as to say that this doesn't happen, but I doubt that a cut from 30 per cent to 25 per cent would result in any significant behavioural changes. Companies will still try to find havens and shift profits where they can and this requires a broader solution than a simple reduction to the tax rate.

Although the case for a company tax cut carries a stamp of approval from government-appointed economic modellers, varying just a few assumptions can turn the outcome from positive to negative.

I want to finish up with a look at company tax cuts from a gender perspective. The fiscal cost of the tax cuts, and its implications for delivery of government services are already acknowledged by the National Foundation for Australian Women in its comprehensive response to the budget, which was released this week.

For a slightly different perspective, I'll talk about the industry impacts of a cut to the company tax rate. The cut will affect industries differently, and consequently it will have different implications for men and women in our rather gender-segregated job market.
In a bigger economy with a larger component of foreign ownership, we will own less of what we produce. For this to be sustainable, households and governments will need to consume a smaller proportion of what we produce. This means that we will employ fewer people producing the types of goods that we consume, and more on producing the types of goods that we export.

In Australia, the industries with the most strongly female workforces are health care and social assistance and education, followed by retail and accommodation and food services – all service industries selling primarily to the domestic economy.

With less domestic expenditure – and we are yet to see just how it will be distributed between the government and household sectors – these industries will undoubtedly continue to grow, but less quickly than they otherwise would have.

So in the long term, if the company tax cuts are implemented, all four of these industries that are important employers of women will be smaller than they otherwise would have been – and will therefore offer fewer employment opportunities. This is particularly bad news for women working in low-paid occupations.

On the other hand, the industries offering more opportunities – including manufacturing, mining, agriculture and transport – all currently have male-dominated employment.
The only sector to expand significantly that has a fairly gender-neutral workforce is the business services sector. This sector will provide opportunities for both men and women, but caters to more highly-qualified workers.

Overall, company tax cuts may subdue the growth we've been seeing in female workforce participation by weakening the main industries that employ women, and particularly women in low-paid occupations.

I'll conclude by saying that sometimes we implement policies and accept the economic cost because we are trying to achieve other aims – the carbon tax could have been an example of this. But the very aim of Enterprise Tax Plan 2 is surely to improve domestic incomes, and in this, it will not succeed.