Institute of Public Affairs
THE VOICE FOR FREEDOM
ESTABLISHED – 1943

Senate Standing Committees on Economics

PO Box 6100

Parliament House

Canberra ACT 2600

Inquiry into the 'Commitment to the Senate' issued by the Business Council of Australia

Committee Secretary,

I refer to the above inquiry and provide a submission on behalf of the Institute of Public Affairs ('IPA'). The IPA is an independent, non-profit public policy think tank, dedicated to preserving and strengthening the foundations of economic and political freedom. Since 1943, the IPA has been at the forefront of the political and policy debate, defining the contemporary political landscape.

The IPA supports the free market of ideas, the free flow of capital, a limited and efficient government, evidence-based public policy, the rule of law, and representative democracy. Throughout human history, these ideas have proven themselves to be the most dynamic, liberating and exciting. Our researchers apply these ideas to the public policy questions which matter today.

Comments on the Senate Inquiry

This Senate Inquiry is highly questionable. It refers to an undertaking made by private companies in relation to a public policy. Decisions which companies make around remuneration, pricing, and investment are the preserve of those companies. Businesses are not communal property to be intervened with at will by government. They are privately run, owned, and managed, and should remain so. This Inquiry, by demanding that businesses appear before Senate, is an abuse of government power. Management of businesses should be directing their time on how to improve the quality of their products and services, rather answering to government. Businesses should not have to answer to politicians. They should only answer to customers, shareholders, employees and suppliers.

Indeed, the free enterprise system, which entails the free market, the rule of law, private property, and free trade, is the basis of any prosperous nation. Government oversight and intervention in the internal operations of private businesses inevitably undermines the operation of the free enterprise system, which jeopordises the ability of businesses to respond to consumer demand, grow, and provide employment and wages to millions of Australians. Every minute that representatives of a business spend before the Senate is a minute that is not dedicated to the core functions of that business, the costs of which are felt most heavily by customers, workers, and shareholders.

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Analysis of the Benefits of a Reduction to Australia's High Business Tax Rate

Australia's top marginal business tax rate of 30 per cent is one of the highest in the developed world. This would still be the case even if the Government's proposed cut to 25 per cent for all businesses were enacted. The average tax rate across the OECD is 24 per cent. It is much lower in other comparable nations such as the U.K. (17 per cent by 2020), the U.S. (21 per cent), and Singapore (17 per cent). The Commonwealth government also has an abnormally high reliance on the business tax. In 2015, the Australian government take of the business tax was 4.3 per cent of GDP. This is substantially higher than the OECD average of 2.7 per cent.[i]

Australia's high business tax rate – combined with a $176 billion red tape burden and rigid industrial relations system – is causing business investment to decline. Business investment is just 12 per cent of GDP, which is lower than what it was under Whitlam.[ii] Low levels of business investment are contributing to below trend rates of labour productivity growth, which in turn is making workers less valuable than they otherwise would be, which is holding wages growth down. A lower business tax rate, by contrast, will encourage investment, productivity, job creation, and wages growth.

The key questions for policy-makers is to what extent will the benefits of a business tax cut materialise, over what time frame, and to whom? The best available evidence suggests that the benefits will be modest in size, but not insignificant; that at least some of these benefits will materialise immediately; and the majority of those benefits will flow to workers. The reason why the magnitude of the benefits will be modest is that the proposed size of the tax cut, combined with the graduated implementation timeframe, is modest. A far superior policy would be to implement a dramatic reduction to the tax rate immediately. This would ensure the aforementioned benefits materialise in a more substantial manner and in a shorter time frame.

In understanding how a company tax cut will benefit Australians, it is important to first understand what a business is. A business is an entity which does not exist independent of the workers, customers, and shareholders of which it is comprised. It is these groups of people who pay the business tax, and it is these groups who will benefit from a lower tax rate.

Firstly, workers benefit through higher wages. Higher wages result from higher levels of business investment which raises worker productive. This includes CEO's and senior management within large businesses whose pay is partly determined by the businesses share value, which will increase following a tax cut (discussed below). There is nothing nefarious about CEO's earning a higher income. Successful businesses which can afford to employ more staff and pay higher wages need high

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quality leadership. A recent Productivity Commission report found the quality of senior management in Australia is low compared to counterparts such as the US.[iii]

Secondly, shareholders benefit due to higher after-tax profits, which flows through as higher share earnings and dividend payments. Shareholders include the 15 million Australians who own a superannuation account.

Thirdly, customers benefit through lower prices. Lower prices result from more competition. More competition results from a lower business tax rate creating a greater incentive for more people to start their own business and more businesses choosing to invest in Australia rather than elsewhere. Lower prices disproportionately benefit people on a lower income who in effect would receive a relatively larger real wage increase than higher income earners.

The best empirical evidence that is available is from the Treasury which estimated that a reduction to the business tax rate from 30 per cent to 25 per cent would create a permanent increase to GDP of 1 per cent.[iv] This equates to around $17 billion each year, in today's dollars. A separate Treasury report estimated that two-thirds of the benefit of a company tax cut flows through to households, primarily through rises in real wages. The remaining one-third would flow to shareholders.[v]

The benefits of a cut to the business tax rate are not just theoretical. The recent reduction to the business tax rate in the US from 35 per cent to 21 per cent has resulted in a number of benefits. According to *Americans for Tax Reform*, more than 500 companies in the US have provided pay rises, bonuses, and other employee benefits to more than 4 million American workers as a direct result of the tax cut.[vi] These include: AT&T, the world's largest telecommunications company, paid a $1,000 bonus to 200,000 workers; Boeing invested an additional $300 million on employee related and charitable activities. Walmart, the world's largest company, announced it would also spend $300 million on wage increases, including bonuses of up to $1,000 per employee.

I would also like to address two further claims. The first is that the efficacy of a tax cut is negated by widespread profit shifting, and the second that the tax cut is unaffordable.

Some claim multinational firms avoid tax and shift profits to overseas destinations which reduces their effective tax rate.[vii] The effect of this would be to erode the business tax base, which would be revealed through a lower ratio of business tax to GDP, and a lower ratio of business tax to revenue. However, the best available evidence suggests the extent of profit shifting is low and the business tax base in Australia has grown overtime. Recent empirical work suggests that multinational firms operating in high-tax jurisdictions shift only between 2 per cent and 4 per cent of their profits to lower

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tax jurisdictions.[viii] Moreover, one of the key reasons for this profit shifting is the relatively high tax rate in the jurisdiction from which profits are being shifted. Hence, reducing the disparity in relative tax rates is one of the more reliable tax integrity measures.

Secondly, some argue the proposed tax cut is unaffordable.[ix] However, this assumes that a tax cut is equivalent to additional expenditure. This is false. Australian workers, businesses, and shareholders own their pre-tax income, not the government. A tax cut means the government is taking fewer resources from Australians, not spending more revenue. Nonetheless, revenue will decrease if the company tax rate is cut. The Treasury estimated 50 per cent of the direct revenue loss is recouped through secondary effects such as higher wages.[x] To achieve revenue neutrality, the remaining 50 per cent should come from reducing government spending. The Treasury found reducing spending and lowering corporate tax provided a much larger boost to national income than offsetting company revenue losses with higher personal income taxes.

Australia's high business tax rate must be reduced in order to encourage higher levels of business investment, which is currently at a near-record low. The Government's proposed reduction to 25 per cent over a ten-year period is a modest proposal which would still result in Australia having one of the highest business tax rates in the developed world. At a bare minimum the Senate should pass the Government's preferred tax reduction, despite its lack of ambition.

The IPA trusts that our contributions will be of assistance to the Committee. We would be pleased to answer any questions. Please do not hesitate to contact us: in writing to [redacted] by telephone on [redacted] or by email to [redacted]

Regards,

Daniel Wild

[redacted]

Research Fellow,

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[i] Organisation for Economic Cooperation and Development, “Revenue Statistics – OECD Countries: Comparative Tables: Tax

[ii] Wild, Daniel, “Business Investment now Lower than Whitlam”, Institute of Public Affairs, Melbourne, Australia (2017)

[iii] Productivity Commission, “Productivity Review”, Discussion Paper, Canberra, Australia (7 November, 2016)

[iv] Kouparitsas, Michael; Prihardini, Dinar; and Beames, Alexander, “Analysis of the Long Term Effects of a Company Tax Cut”, The Treasury, Canberra, Australia, (2016)

[v] Rimmer, Xavier, Smith, Jazmine, and Sebastian, Wende, “The Incidence of Company Tax in Australia”, The Treasury, Canberra, Australia, (2017)

[vi] See https://www.atr.org/list

[vii] Jericho, Greg, “Cutting company tax costs money, and middle income earners will pay”, The Guardian, (19 October, 2017)

[viii] Dharmapala, Dhammika, “What Do We Know About Base Erosion and Profit Shifting? A Review of the Empirical Literature”, Coase-Sandor Institute for Law and Economics Working Paper 702, University of Chicago, (2014)

[ix] Denniss, Richard, “How will the corporate tax cut be funded”, The Australia Institute, (May 2016), pg. 2

[x] Kouparitsas, Michael; Prihardini, Dinar; and Beames, Alexander, “Analysis of the Long Term Effects of a Company Tax Cut”, The Treasury, Canberra, Australia, (2016)