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April 10, 2018

Dear Committee Secretariat,

RE: The 'Commitment to the Senate' (the Commitment) issued by the Business Council of Australia (BCA) on 21 March 2018

Thank you for the invitation to make a submission to the Senate Economics References Committee. I am an economist working at the Centre of Policy Studies at Victoria University, specialising in the field of detailed economy-wide economic modelling. In 2016 I was an author of an economic modelling study¹ which illustrated that average incomes would fall in Australia if the company tax rate was cut. This work is summarised in several published opinion pieces, of which two are attached.^{2,3}

It is likely that the Commitment, made by ten BCA members with almost half a million employees collectively, can be upheld if the company tax rate is cut. As profit-maximising entities and beneficiaries of a substantial tax cut, it is plausible to expect that the signatories to the Commitment will expand. As part of the expansion, they will require more workers, and following the tax cut, these businesses will be in a position to pay higher wages in order to attract more workers. However, it does not follow that the proposed cut to the company tax rate is good policy when assessed on the basis of its impact on average incomes in Australia.

¹ Dixon, J., & Nassios, J. (2016). Modelling the Impacts of a Cut to Company Tax in Australia. *Centre of Policy Studies Working Paper G-260*. Available at <http://www.copsmodels.com/elecpr/g-260.htm>

² Dixon, J.M. and J. Nassios (2017, August 6) Company tax cuts aren't the only growth tool in the box. *Australian Financial Review*. Available at <http://www.afr.com/opinion/columnists/company-tax-cuts-arent-the-only-growth-tool-in-the-box-20170806-gxq8l3>

³ Dixon, J.M. (2016, April 20) Big business doesn't want to talk about it, but SMEs lose from a company tax cut. *The Conversation*. Available at <https://theconversation.com/big-business-doesnt-want-to-talk-about-it-but-smes-lose-from-a-company-tax-cut-57965>

Wider ramifications

Over 95 per cent of Australians with jobs are not employed by signatories to the Commitment, and the impact on a select few is not satisfactory grounds on which to assess the merits of a company tax rate cut. I therefore urge the Committee to consider the implications of a company tax cut beyond the impact on Australia's largest businesses and their employees, as assessed by our economic modelling and summarised in this submission.

Many economists, including a team at The Treasury, have undertaken to model the impacts of a cut to the company tax rate; none of them has found that there will be a substantial impact on aggregate employment.

If there is no increase in employment overall, yet there is an increase in employment at some of Australia's largest businesses, then it is clear that there will be a reduction in employment in other parts of the economy. This will play out as follows:

- When the tax cuts are fully implemented, large businesses will be able to take up opportunities for expansion that were not profitable at a 30 per cent tax rate, but are profitable at a 25 per cent tax rate.
- As these businesses expand, they will require more workers.
- To attract workers, these businesses will pay higher wages. As such, the benefits of tax cut will be distributed between workers and shareholders, but this is not the end of the story (see below for more on wage growth).
- Employers who do not receive the tax cut will be obliged to compete for workers. If large businesses pay higher wages, other employers will inevitably need to follow suit. These employers will decline in size, or in some cases, cease operations.
- This closes the loop: large businesses will expand, employing more people and paying higher wages, but other employers will decline, losing workers, so that aggregate employment remains unaffected.

Who are the employers who do not receive the tax cut? They can be categorised into three groups:

- Australian-owned incorporated companies: the owners of these businesses typically receive franked dividends, meaning that company tax paid by the business is treated as a credit against their owners' tax obligations. As such, these business owners receive no benefit from a cut to the rate of company tax.
- Unincorporated businesses: these businesses are not subject to company tax.
- Government: as major employers, federal, state and local governments will also be subject to pressure from higher wage costs, which will have implications for budgets at all levels of government.

A cut to the company tax rate will therefore have a profound impact on the nature of business in Australia. It will dilute the home-ground advantage of dividend imputation currently enjoyed by Australian investors in Australian business – the overwhelming majority of small and medium-sized enterprises. This system has shaped the nature of the Australian economy as it is today. In other words, relative to the present system, company tax cuts will confer an advantage on foreign investors, typically shareholders in large businesses such as the signatories to the Commitment.

If the company tax rate cut passes into law, Australian consumers may expect to shop more at Bunnings and Woolworths, and less at the small local hardware store or grocer.

Wage growth: pre-tax wage growth is believable, but how much will be left for the workers?

The Commitment makes the case that Australia's largest businesses will pay higher wages. However, higher *pre-tax* wages do not necessarily lead to higher *post-tax* wages when the wage rise is accompanied by a revenue problem.

A cut to the company tax rate will have a negative impact on government revenue, but more broadly, it will also have a negative impact on national income. Unlike a cut, for example, to personal income tax, where the revenue lost by the government is handed back to Australian households, revenue lost under the company tax rate cut will go to foreign shareholders. This is particularly important in the short term. (In the longer term, businesses will complete their expansions – as promised in the Commitment – and higher wages will help the domestic economy to absorb some of the lost revenue. This may take a decade or longer.)

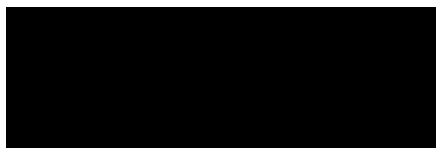
I draw this to the attention of the Committee because the loss of revenue, particularly in the short term, was simply assumed away in the modelling used by the government, which focuses exclusively on the long run.

Taking into account the transition costs, our modelling finds that *national income will be lower* as a result of a company tax cut. This finding is not inconsistent with findings that GDP will increase; GDP accounts for all economic activity taking place in Australia, but national income is adjusted to account for profits going off-shore to foreign investors.

If national income is lower, there is no way that all Australians can be better off. If no attempt is made to recoup the lost taxation revenue, the government will need to balance its budget by cutting spending – for example, by cutting funding to schools or hospitals. If attempts are made to recoup the lost taxation revenue through bracket creep or a higher GST, then the post-tax wage gains to employees will be eliminated.

In conclusion, I reiterate that while the Commitment is plausible, the Committee must look beyond the benefits to large business and its employees and assess the company tax rate cut on a broader basis. No economist has found that company tax rate cuts will lead to higher employment in aggregate. It is clear, therefore, that if employment is higher at some of Australia's largest businesses, it will be lower elsewhere, and we may expect many small job losses from small and medium businesses to counteract the expansions foreshadowed by the Commitment.

Yours sincerely,



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