Inquiry into the BCA Commitment to the Senate

Submission from The Australia Institute and Centre for Future Work

Discussion paper

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Summary

The present submission questions the Business Council of Australia's (BCA) Commitment to increasing investment, employment and wages in the event that the outstanding tax cuts are legislated. We looked specifically at the 10 corporate CEOs who made the commitment on behalf of their companies and found some half of those paid no tax. One wonders what their commitment could possibly mean.

We then examine the logic of the tax cuts, issues to do with dividend imputation, problems with the theory, and problems in the modelling exercises as well as the evidence from cross-country data and he evidence from Australia's own history. Much of this has been covered in earlier TAI papers but there is a new treatment of the modelling problems. However, we were able to add a new section that examines the early indicators following the Trump tax cuts.

Many of the same arguments were used by the US promoters of corporate tax cuts as were used in the Australian context. The main difference of course was that the US does not have the complications of dividend imputation. Nevertheless the early indicators are that very little is going to the workers with the bulk of the gains being spent in unproductive activities such as share buybacks and mergers and acquisitions.

This submission makes the following specific recommendations in relation to the BCA Commitment.

Recommendation 1

That the Senate take note of the overwhelming evidence, including that summarised here, that suggests the proposed company tax cut would have little or no impact on employment, wages, investment, productivity, growth or living standards.

Recommendation 2

That the Senate Economics References Committee call for an annual document from each relevant company that in the first instance specifies the nature of the commitment and thereafter a report on progress against the commitment. These documents should make clear a base-case scenario against which future performance is to be judged.

Recommendation 3

That the Senate Economics References Committee call for the CEOs to appear before the Committee to clarify and amplify their understanding of the commitments.

Recommendation 4

Where the Senate Economics References Committee has used the word 'investment' any final requirement should make it clear that 'investment' refers not to financial investments nor retaining funds in the company but instead the addition of actual productive capacity including physical plant and equipment, software and the like.

Recommendation 5

The CEOs should make clear in their plans the nature of any future commitment and/or likely scenario involving distributions to shareholders.

Recommendation 6

All companies presently required to produce an annual report should also report on how any tax change under the legislated schedule will affect their behaviour and how their behaviour changed after the fact.

Recommendation 7

Companies report on the financial implications of any benefits received by foreign shareholders.

Recommendation 8

Any obligations imposed on the signatories or other CEOs apply to their successors and, in the event of a change in the identity of the relevant company, the obligations apply to successor companies, merged entities and the like.

For many of the reasons outlines in this paper and TAI's earlier work we do not believe there is a good case made out for company tax cuts. The cuts would be received by good and bad companies alike. It would be better to actually provide an incentive for good behaviour rather than give benefits to all companies. Nevertheless, as a minimum we suggest something similar to the Japanese approach:

Recommendation 9

If the tax cuts pass the Senate the bill should be amended so that the tax cuts would be denied for companies that do not achieve increases in employment, wages and productive investment.

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Introduction

The Australia Institute is pleased to respond to the invitation to make a submission to the Senate on the inquiry into the *Commitment to the Senate*.

The Coalition Government has a plan to reduce company tax rates down to 25 per cent for all companies by 2026-27. In this it has had enthusiastic support from the Business Council of Australia (BCA) as well as a few prominent business identities. The BCA published the Commitment made by 10 of its members as well as the BCA's own president (Grant King) and its CEO (Jennifer Westacott).

TERMS OF REFERENCE

On 26 March 2018 the following matter was referred to the Economics References Committee for inquiry and report by **7 May 2018.**

The 'Commitment to the Senate' (the Commitment) issued by the Business Council of Australia (BCA) on 21 March 2018, and commitments to stronger wages and employment, with particular reference to:

(a) annually measurable benchmarks, for the period of the proposed Enterprise Tax Plan, for the companies that have co-signed the Commitment and other senior members of the BCA membership, including:

- (i) company wage growth estimates,
- (ii) employment estimates, and
- (iii) schedules of investment by state and territory;

and in each case how they vary if the Treasury Laws Amendment (Enterprise Tax Plan No. 2) Bill 2017 is enacted, or there is no change to the existing tax law;

(b) corporate tax data for the companies that have co-signed the Commitment, and other senior members of the BCA membership, including:

- (i) the total tax paid over the past five years, and
- (ii) the expected tax benefit from the Enterprise Tax Plan; and

(c) other related matters.

THE BCA COMMITMENT

The BCA Commitment reads:

> We believe that a reduction in the corporate tax rate, as proposed through the Government's enterprise tax plan, is urgent and vital to keep Australia competitive.
>
> If the Senate passes this important legislation we, as some of the nation's largest employers, commit to invest more in Australia which will lead to employing more Australians and therefore stronger wage growth as the tax cut takes effect (BCA 2018).

The signatories to the document were:

Andrew Mackenzie
Chief Executive Officer, BHP

Catherine Tanna
Managing Director, EnergyAustralia

Andrew Forrest
Chairman, Fortescue Metals Group Limited

Brent Eastwood
Chief Executive Officer, JBS Australia Pty Limited

Tim Reed
Chief Executive Officer, MYOB

Frank Calabria
Managing Director and Chief Executive Officer, Origin Energy Limited

Alan Joyce
Chief Executive Officer, Qantas Airways Limited

Rob Scott
Managing Director and Chief Executive Officer, Wesfarmers Limited

Peter Coleman
Managing Director and Chief Executive Officer, Woodside Energy Limited

Brad Banducci
Chief Executive Officer and Managing Director, Woolworths Limited

Grant King
President, Business Council of Australia

Jennifer Westacott
Chief Executive Officer, Business Council of Australia

What can we say about those who made the Commitment?

The most obvious thing to say is that the list of CEOs making the commitment included just 10 of the BCA members. The BCA has a membership of 132 being the CEOs of some of Australia's megacorporations. (The other two signatories were the BCA's President, Grant King and CEO Jennifer Westacott.)

The Financial Review reported on an unreleased 'secret' survey the BCA took of its own members (Tingle and Coorey 2018). The report said that less than one in five of the respondents say they would use the tax cuts to increase wages or employ more staff. On the other hand more than 80 per cent said they 'would either use the proceeds to boost returns to shareholders or invest in the company'.

Remuneration and company tax

Given the commitments related to taxation we present some of the tax and other affairs of the companies concerned. Half of the CEOs that were prepared to make the "Commitment" did not pay company tax last year. The majority – four out of five – of those CEOs lead companies that also did not pay company tax the year before that. Despite this, eight of the "Commitment" CEOs collectively received $73.2 million in remuneration last year (the remaining two do not have public remuneration information available).

This information comes from the Australian Tax Office's yearly reporting of company total income, taxable income and tax paid. The most recent data (released in December 2017) is for the period 2015–16. It shows that five of the "Commitment" CEOs lead companies that paid no company tax in 2015–16: EnergyAustralia, JBS Australia, MYOB, Origin Energy and Qantas. Four of these companies also paid no company tax in 2014–15: EnergyAustralia, MYOB, Origin Energy and Qantas.

Table 1: CEO remuneration and company tax paid

CEO	Company	Remuneration	2015–16		2014–15	
			Company tax paid as a % of			
			Total income	Taxable income	Total income	Taxable income
Andrew Mackenzie	BHP	$9,210,390	5%	25%	5%	27%
Catherine Tanna	EnergyAustralia	$6,170,000	No tax paid		No tax paid	
Andrew Forrest	Fortescue Metals Group	0	4%	26%	<1%	6%
Brent Eastwood	JBS Australia	Not known	No tax paid		4%	22%
Tim Reed	MYOB	$1,330,938	No tax paid		No tax paid	
Frank Calabria	Origin Energy	$3,695,278	No tax paid		No tax paid	
Alan Joyce	Qantas	$24,584,000	No tax paid		No tax paid	
Rob Scott	Wesfarmers	$12,097,459	1%	29%	1%	29%
Peter Coleman	Woodside Energy	$10,266,600	1%	5%	10%	22%
Brad Banducci	Woolworths	$5,874,825	1%	27%	2%	29%
Total remuneration		*$73,229,490*				
Average tax paid			12.35%			

Sources (remuneration): The most recent annual report of each company, where available.

Sources (company tax paid): ATO (2017) *2015-16 report of entity tax information* and *2014-15 report of entity tax information,* https://data.gov.au/dataset/corporate-transparency; Liddy (2016) *Who pays what? ATO names large companies that paid zero tax in 2014-15,* http://www.abc.net.au/news/2016-12-09/tax-data-transparency-ato/8106178

Note: Figures in other currencies converted to Australian dollars, where appropriate. Catherine Tanna's remuneration is estimated based on the half year to 30 June 2017. Rob Scott's remuneration is estimated based on that of his predecessor R Goyder.

The last row in the table gives the average tax paid as a proportion of taxable income by all the companies in the table over the two years, 2014-15 and 2015-16. That figure is 12.35 per cent, suggesting the companies concerned already pay well below the statutory 30 per cent company tax rate.

The “Commitment” includes a statement that the signatories are “some of the nation’s largest employers”. According to *The Australian,* the 10 companies employ 493,600 people between them.[1] This represents less than 4% of all employment in Australia.[2]

The CEO of Qantas, Alan Joyce, is interesting. His appearance on the list and his recent public comments sit awkwardly with the fact that Qantas has not paid tax for a number of years. Perhaps he got it right when he reflected on Qantas’s experience in 2016 and said:

> I think we were on the list of companies that didn't pay tax back in 2014…Yes, we lost $2.8 billion back then, and a corporation tax is a tax on profits, and we didn't make profits, but we paid a billion dollars in tax on tickets. We collected well over one and a half billion dollars of GST which was a tax on our product. We paid payroll tax. We paid carbon tax. We paid all sorts of other taxes…I hope, now that we are making money, we will be paying a lot of corporation tax in the future.[3]

Joyce has gone from looking forward to paying company tax to joining the bandwagon for lower company taxes.

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[1] Figures not provided for MYOB. Packham (2018) *CEO’s pitch to senators: Cut will lift wages,* https://www.theaustralian.com.au/national-affairs/ceos-pitch-to-senators-cut-will-lift-wages/news-story/c69c273da93795986d75847d1baf4a7f

[2] ABS (2018) *Labour force, Australia, Feb 2018,* http://www.abs.gov.au/ausstats/abs@.nsf/mf/6202.0

[3] Hewett J (2016) ‘Business wakes up to reform mirage’, The Australia Financial Review 2 March

Legislation: where are we up to?

The following table gives the original schedule of tax changes. Recall the 2015 budget had already reduced the tax rate to 28.5 per cent for companies with a turnover under $2 million. The cells coloured in yellow are those that have been legislated. So while we have the rates cuts continuing as per the original schedule they will only apply to companies with a turnover less than $50 million.

Table 2: Legislated company tax changes to date

Income year	Annual aggregated turnover threshold	Annual aggregated turnover threshold Corporate tax rate
2016-17	$10 million	27.5
2017-18	$25 million	27.5
2018-19	$50 million	27.5
2019-20	$100 million	27.5
2020-21	$250 million	27.5
2021-22	$500 million	27.5
2022-23	$1 billion	27.5
2023-24	unlimited	27.5
2024-25	unlimited	27
2025-26	unlimited	26
2026-27	unlimited	25

Source: ATO https://www.ato.gov.au/general/new-legislation/in-detail/direct-taxes/income-tax-for-businesses/reducing-the-corporate-tax-rate/

As can be appreciated from Table 1, the tax cuts presently legislated only apply to companies with a turnover of up to $50 million as of July 2018 and will tax profits at 27.5 per cent in 2018-19 to 2023-24 after which they decline to 27, 26 and 25 per cent in 2024-25, 2025-26 and 2026-27 respectively. The BCA's agenda now is to fill in the white cells which would be the effect of the Senate passing the legislation in question the *Treasury Laws Amendment (Enterprise Tax Plan No. 2) Bill 2017*.

In evidence to the Senate in 2016 the Treasury Secretary, John Fraser, said the cost would be $48.2 billion over the 10 year period to 2026-27. Now the Treasurer has revised that to $65.4 billion for the decade starting 1 July 2017 (2017-28). (Nobody seems to have noticed but these are both 11 year periods.) Either way in the 2017 estimate the small impact in 2016-17 drops out and is replaced by the full cut across all sized businesses applying from 2026-27. The full year effect would be something above $15 billion per annum.

Dividend imputation nullifies company tax cuts for domestic shareholders

It is important that dividend imputation be incorporated into the analysis of company tax rates in Australia. For example, the Henry tax review published a graph that showed Australia's 30 per cent company tax rate was one of the highest among OECD countries. Of course those comparisons do not include the effects of imputation.

What is 'imputation'?

The design of Australia's company and personal taxation systems aims to prevent the so-called double taxation of dividends. The double taxation of dividends occurred before imputation as a result of the interaction of the company and the personal income tax systems. A company that earns a profit is liable to pay company tax. It may then pay a dividend to its shareholders who are also liable to pay tax. That meant that the final after-tax income of the shareholder might be a small proportion of the original profit.

The imputation system makes refunds to individual taxpayers to reflect the tax paid by the company and imputed to the individual. In practice every $70 received as a dividend by an Australian income taxpayer is taken to be $100 in working out the personal tax liability but $30 is credited against the individual's tax liability. That may well entitle the taxpayer to a cash rebate. But it effectively means that the company income is ultimately taxed at just the individual taxpayer's marginal tax rate.

The amount credited against the individual's tax liability is referred to as a franking credit. Companies that pay tax maintain a franking credit account out of which they can declare a franked dividend, so long as the franking credit account maintains a positive balance.

In addition to individuals, trusts, partnerships and super funds are also eligible to claim franking credits. Companies too can earn imputation credits on any franked dividends they receive.

Note that franking credits are only available to offset against Australian tax liabilities.

TAI provided figures to the Senate showing the effective tax rate applying to company income by the time it is received in the hands of the individual shareholder. For some countries full or partial imputation applies and there are other mechanisms used to reduce the combined impact of company and personal tax. For example, many countries have preferential tax rates for dividend income. When ranked by company tax rates Australia was equal seventh highest out of 34 countries with a 30 per cent tax rate and there were 25 countries with lower rates. However, the data were entirely different if we examine the implied personal tax on company income, the overall top personal income tax rate plus company tax rate. On that basis Australia ranked 15th highest with 19 countries below Australia. Of those 19 countries six are within 5 percentage points of Australia. Countries which are a major source of foreign investment in Australia, such as the UK and US, had much higher taxation on company profits by the time they are taxed in the hands of the taxpayer. That remains the case despite the reductions in the UK and US since that was written. The perception that Australia taxes company profits relatively highly disappears if imputation is taken into account.

In the rest of this paper it is important to keep the role of dividend imputation firmly in sight.

Stiglitz on company tax

In this section we look at the analytic argument involved when considering tax cuts. As an abstract argument we here abstract from the real-world complications of dividend imputation.

The obvious point to make about company tax is that it is levied on profits. Before being liable for any tax the company has to have covered all expenses including notional expenses such as the allowance for depreciation and amortisation as well as any capital write downs. So no matter what the rate of company tax, it is only paid when the business has covered expenses and that has important implications. As Stiglitz puts it 'if it were profitable to hire a worker or buy a new machine before the [company] tax, it would still be profitable to do so after the tax…what is so striking about claims to the contrary is that they fly in the face of elementary economics: no investment, no job that was profitable before the tax increase, will be unprofitable afterward' (Stiglitz 1973). That of course is fundamentally different from, say, an increase in the cost of capital through an increase in the rate of interest which will increase the cost of borrowing as well as increasing the opportunity cost of capital.

By contrast many other taxes and government charges are payable whether or not the company makes a profit. For example, the iron ore royalty rate in WA is 7.5 per cent of the value of the iron ore mined. If the mining company receives $100 a tonne, pays $7.50 in royalties and has expenses of $90/tonne it will run at a loss. There is no way a profit-related tax can do that.

In the case of a corporate entity, the essential argument is that investment will take place until the return on the marginal investment is just equal to the cost of capital and that will be true whether or not the company needs to borrow or can meet the investment cost out of retained earnings. Increases in the company tax rate will reduce the after tax return on the investment but will increase the value of interest deductions (or increase the tax on returns from keeping retained earnings in the bank). It is still profitable for the company to keep investing until that point. Hence Stiglitz says that the company tax 'is an infra-marginal tax on the return to capital (or pure profits) in the corporate sector' (Stiglitz 1973 p 26).

The marginal condition (invest until returns just equal the cost of capital) is unaffected by the company tax rate. In principle that means the company tax rate can be increased substantially without altering corporate behaviour. Stiglitz criticises those who assert that the corporate tax rate introduces a distortion by increasing pre-tax target rates of return on the part of investors. As he says 'they confuse the average with marginal cost of capital' (Stiglitz 1973 p 33). It is this confusion that is behind claims that the company tax is inefficient compared with other possible taxes.

The review of the Australian Tax system by the then Secretary of Treasury, Ken Henry (2008)[4] saw the tax on economic rent as being a 'good' tax because it taxes not the ordinary commercial returns being earned in the industry but the inherent profitability of a particular resource. However, the review seems unaware that the analogous argument applies to profit earned in the corporate sector. Just like a resource rent the company tax rate can be quite high without affecting the incentive to invest and, hence, without affecting behaviour.

[4] Henry K (2008) *Architecture of Australia's tax and transfer system*, August.

Modeling Taxes, Investment, and Wages

Traditional neoclassical economic models treat investment as the result of the clearing of a market for "capital." Investment represents net increases in the stock of capital, which are held to be determined by profit-maximising choices by firms about how much capital to use in production. That "market for capital" is endowed with a supply of capital (which can be measured both in loanable funds, or in terms of real capital assets) thanks to the autonomous decisions of savers to set aside more of their income.[5]

The neoclassical approach to understanding investment, curiously, actually downplays the importance of autonomous factors in determining the flow of capital spending (such as business confidence, aggregate demand conditions, and other causal factors commonly discussed by business analysts). Fundamentally, there is nothing "special" about investment in the neoclassical theoretical framework: it is simply the outcome of yet another automatic and presumably efficient market-clearing process. This explanation of investment is always situated within an overall "general equilibrium" framework, according to which all other markets (for both factors of production and for final products) normally clear, and the economy should settle at an optimal resting point: with all available resources used in production, allocated to the most desirable end uses.

It is important to keep this underlying theoretical perspective in mind, when evaluating the optimistic predictions of neoclassical economic models regarding the benefits of company tax cuts. Models such as those cited by the Commonwealth Treasury[6] predict that lower company taxes will generate more investment by lowering the relative cost of capital facing companies, as they make decisions about the profit-maximising combinations of inputs they will use to produce desired output of the goods and services they produce and sell. The models use a computable general equilibrium (CGE) methodology, to attach numbers to relationships whose basis structure are determined a priori by the assumptions of the modelers.

[5] Junankar (2002) provides a useful summary of the neoclassical theory of investment and its shortcomings;

[6] See, for example, Treasury (2012), Appendix B, or Kouparitsas et al. (2016).

The techniques of CGE modeling are not well understood by non-specialists; they are hence likely to interpret the numerical findings of CGE analysis (such as those invoked by Treasury) as “empirical evidence” in support of the claim that company tax cuts will boost the economy. In fact, however, a CGE model is not an empirical investigation at all: it is an elaborate simulation model, whose results are fully dependent on the *a priori* theoretical specifications and quantitative parameters built into the model by its designers. Numbers can be attached to any such set of theoretical specifications, but the mere act of attaching numbers to arbitrarily specified theoretical relationships in no way makes it grounded or reliable as a quantitative depiction of the real world economy.[7]

The economic adjustments portrayed by CGE models, including those used by Treasury to simulate the effects of company tax cuts, depend entirely on the assumed behavior of the various relationships embedded in the model. In the context of the debate over company taxes, the most critical assumptions that are built into the models include:

- The assumption that all available factors of production (including labour) will be fully employed in production, guided by the movement of flexible factor prices which ensure that demand for each factor equals its supply. In the present context, this assume that all additional capital supplied by savers, will be productively invested by firms. It also assumes that all workers are employed, both before and after the policy change (lower company taxes).[8]
- All economic decisions are perfectly rational, made with perfect foresight and certainty. In this context, it means that even a moderate improvement in the after-tax return on new investment, will predictably and directly lead to a desire by firms to use more capital. In the real word, the relationship between profitability and investment is more indirect and weaker. (And the observed relationship between investment and tax rates, in particular, is non-existent in empirical data.)
- Since all factors of production are gainfully employed (whether company taxes are cut or not), there is no macroeconomic “problem” faced in the model. Any gains in income are assumed to result purely from incremental improvements in the efficiency of resource allocations, incremental shifts in consumer

[7] See Stanford (2003) for a more detailed critique of the methodology and miss-use of CGE models.
[8] In some cases the models assume constant employment, rather than full employment per se, which is equivalent; it prevents a policy change from having the effect of increasing or decreasing the total amount of jobs.

behavior (including their autonomous decisions to save), and other marginal changes. Ironically, this approach actually would miss the main economic benefits that, in practice, can result from periods of very strong business investment; these benefits result mostly from job-creation and reduced unemployment, not from incremental shifts in factor ratios.[9] In the current context, it means that businesses do not worry about the overall state of the economy, the level of consumer purchasing power, or other macroeconomic factors in making their investment decisions; if capital is cheaper, they will invest more … end of story.

- The CGE models also assume that each factor of production is paid, as a result of this autonomous market clearing process, a return that is equivalent to its marginal productivity. This assumption relies on additional sub-assumptions (including perfect competition in both factor and product markets, constant returns to scale, and more). It is convenient for modeling purposes, since it ensures that any increase in output is automatically (and seemingly "fairly") shared between the factors that produced it. In the current context, this represents an assumption that wages will increase after a company tax cut, as an automatic result of the increase in capital/labour ratios (assumed to) result from a reduction in the relative cost of capital. It is important to understand the peculiar nature of this assumed adjustment process. Higher wages are not seen to result from strong job-creation and a consequent tightening of labour markets; rather, they are an automatic and incremental adjustment reflecting an increase in the amount of capital employed alongside each worker.

- The model assumes a single "representative household" as a proxy for the whole Australian population. That household owns all capital, labour, and other factors of production. This model cannot take any account of inequality and in particular the uneven distribution of income from capital (which is heavily concentrated among the minority of Australians which own the majority of business wealth). In essence, every Australian is assumed to benefit to an equal degree from the additional after-tax income received by capital.[10]

[9] The temporary investment boom experienced in Australia in the late 2000s (driven by global resource prices, not by tax policy) had clear positive impacts on Australian labour markets for exactly these reasons: job-creation, falling unemployment, and a resulting improvement in the bargaining power of workers to demand higher wages. Curiously, all of these real-world mechanisms are excluded by design from the abstract theoretical models invoked by the government to justify its tax policy.

[10] However, even the Treasury models project that most of the new investment presumed to result predictably from lower taxes is undertaken by foreign investors.

- The model treats government spending as “waste,” with no impact at all on the welfare of society. This incredible assumption underplays the costs of future austerity that would result from such a significant revenue reduction.

All told, the findings of the government’s simulation models that lower company tax rates will result in higher wages, are not an “empirical finding” based on real-world observed experience. They are, rather, hypothetical simulations which depend entirely on the behavioural structure and numerical parameters which their neoclassical designers have embedded within the model. The positive result is pre-determined by a theoretical structure which assumes all available resources are used in production, and each factor is automatically paid according to its marginal productivity.

In more concrete terms, the prediction that lower company taxes will result in higher wages depends on a lengthy chain of theoretical, and far-fetched, assumptions, including:

1. A lower before-tax cost of capital will spur companies to use more capital in production, regardless of macroeconomic or demand conditions (which are not relevant to investment decisions).

2. Greater demand for capital will be met with real savings from individuals who agree to set aside more of their income to fund the resulting increase in investment.[11]

3. Increased investment will translate into a larger stock of real capital employed in production (with no concerns regarding depreciation, shifts in the capital-intensity of production across sectors, or other real-world complications).

4. The amount of labour employed does not change, since efficient factor markets ensured all willing workers were employed before and after the policy change.

5. More capital used in production, with a constant amount of labour, means an increase in the overall capital-labour ratio.

6. Assuming a “well-behaved” production function, this higher capital-output ratio will lead to an increase in the marginal productivity of labour.[12]

[11] In Australia’s case, this assumption usually takes the form of a “small country” assumption that Australia can borrow as much capital as it needs from savers in other countries, with no impact on the cost of capital. That is an equally unrealistic assumption.

[12] It is not necessarily the case that marginal productivity of a particular factor varies predictably with factor ratios, but the equations built into CGE models assume that this will be the case.

7. An increase in marginal productivity of labour will lead to an automatic increase in the wages paid to labour, by virtue of the efficient operation of competitive labour markets. Wage gains will not be held back by unemployment or underemployment, institutional factors (such as the erosion of enterprise bargaining or penalty rates), or by increases in temporary migrant labour – because none of these factors matter in the abstract theoretical world of CGE models.

If each of these links in the chain of logic embedded within CGE models was spelled out by the politicians citing their optimistic results, few Australians would grant any credibility to the resulting predictions. But in fact, *every one* of those seven assumptions must hold, for the relationship between company tax cuts and higher wages to be realised in practice. It could be plausibly argued, in contrast, that *none* of them are realistic.

In summary, the theoretical models cited by advocates of company tax cuts in support of their claim that workers will in fact be the main beneficiaries of the policy change, are not realistic, and are not supported with empirical evidence.

INVESTMENT, LABOUR PRODUCTIVITY, AND WAGES

One of the most far-fetched of the neoclassical assumptions underpinning the CGE models used to justify the proposed company tax cuts, is the claim that wages will automatically increase if the productivity of labour increases. As discussed above, the treatment of the relationship between productivity and wages in neoclassical models is rather peculiar: it is the marginal productivity of workers (not the average output per head) that matters, and that is seen to be an automatic outcome of the ratios in which factors of production are combined (rather than the more concrete factors which determined productivity in the real-world, such as innovation, economies of scale, and work organisation).

But even in a more pragmatic sense, the relationship between labour productivity (most commonly measured by real output per worker or per hour of work) and labour compensation has largely broken down in recent years. The "decoupling" of wages from productivity growth has elicited great concern among many economists and labour advocates.

Figure 1: Real Wages and Real Labour Productivity, 2000-2017, 2000 = 100

Source: Authors' calculations from ABS Catalogues 6345.0, 6401.0, and RBA Statistical Table H4.

Real labour compensation in Australia has been growing more slowly than productivity for many years. Figure 1 illustrates the long-run trend in real hourly wages (represented by the ABS wage price index deflated by CPI growth), compared to increases in real hourly productivity (output per hour of labour input). From 2000 through 2013, real wages grew less than half as quickly as productivity: by a cumulative total of 10 percent, versus a 20 percent cumulative improvement in productivity. And the gap between the two series is now widening at a faster rate, in light of the marked slowdown in real wage growth in Australia since 2013, to near-zero.

Even if company tax cuts led to an increase in real capital investment, and even if that investment led to an increase in the capital stock (relative to the number of workers employed), and even if that higher capital-labour ratio automatically produced an increase in labour productivity, the assumption that workers' wages would automatically and fully rise to reflect that higher productivity is thoroughly misplaced. For a range of reasons – including chronic unemployment and underemployment, the rise of informal and insecure work arrangements, and the erosion of traditional institutional supports for wages (like minimum wages, awards, and enterprise bargaining)[13] – the relationship between wages and labour productivity has been seriously weakened, if not broken altogether.

[13] Not coincidentally, all of these real-word factors explaining the slowdown in Australian wage growth are excluded by definition from the theoretical CGE models which are used to simulate the wage benefits of company tax cuts.

CORPORATE CASH FLOW, WAGES, AND INVESTMENT

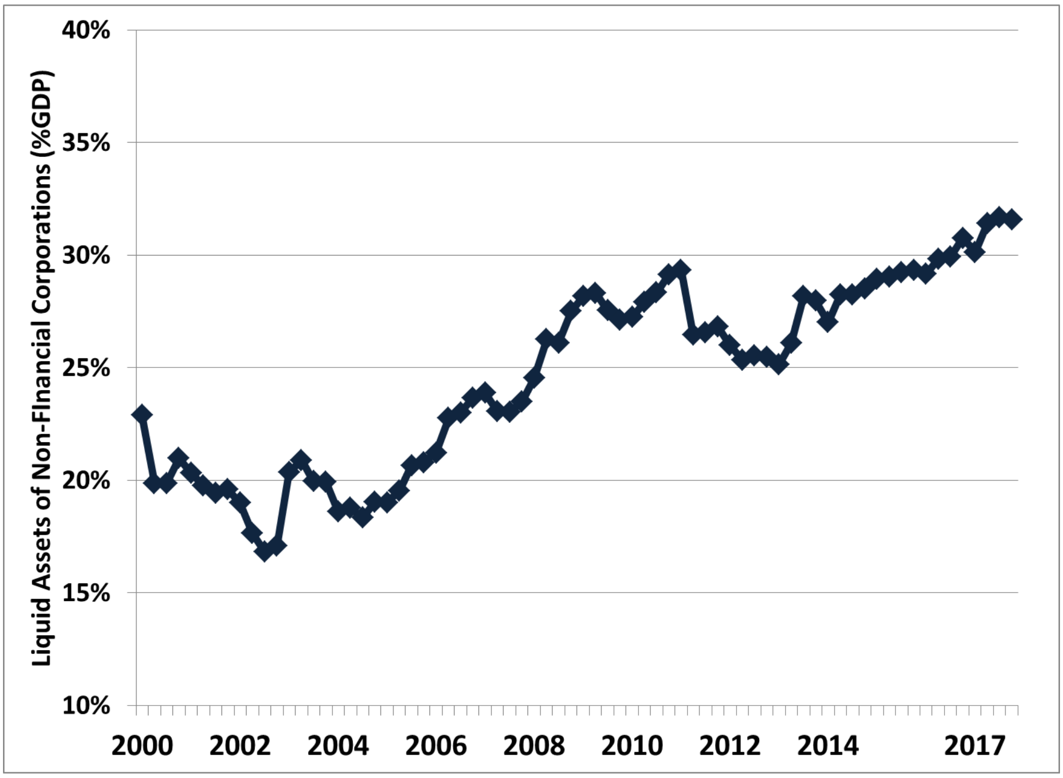
Another assumption in traditional CGE modeling approaches that must be challenged, is the idea that the amount of investment forthcoming in the economy is somehow constrained by the availability of resources (whether ultimately provided by Australian savers or by the global capital market). Only by attracting more real capital with the promise of a higher return, it is argued, can an increase in capital investment be achieved. A similar twist on the same "scarcity" argument is also invoked in reference to the claim that lower company taxes (by boosting profit margins and hence available cash flow of businesses) will allow them to pay higher wages.

In practice, neither capital investment nor wage levels are meaningfully constrained in Australia today by the availability of liquid resources. The gross surpluses received by businesses (including depreciation allowances) exceeds their gross reinvestments in real capital assets. The result is that non-financial companies are accumulating a growing hoard of idle liquid resources.

This perverse phenomenon of "corporate hoarding" is illustrated in Figure 2, based on data from the ABS national income accounts. Corporate liquid assets include currency, deposits, bills of exchange, and bonds issued by national governments and central banks. Holdings of these liquid assets grew steadily over most of the past 15 years, reflecting the growth of profit margins, the slowdown in investment (aside from the temporary surge during the mining boom), and the impact of financialisation on company behavior. During the peak years of the mining boom, liquid holdings declined temporarily, but began to surge again as the pace of real capital investment slowed down. In 2017, liquid assets held by non-financial corporations reached an all-time high: $570 billion, or over 30 percent of annual GDP.

The assumption that business somehow "needs more money" in order to finance more investment, and even to pay higher wages, is disproven by the real-world experience of excess corporate savings. Quite literally, Australian corporations are already receiving more money than they know what to do with. Some of it is being siphoned off in the form of higher dividends, share buy-backs, and other gifts to shareholders. But the idle accumulation of liquid assets by a sector of the economy – non-financial corporations – which is charged with mobilizing those assets in real production is a sure sign that the traditional relationships between profitability and investment have been broken.

Figure 2: Accumulation of Liquid Assets by Non-Financial Corporations in Australia



Source: Author's calculations from ABS Catalogues 5206.0 Table 3 and 5232.0 Table 6.

Corporate hoarding has many negative macroeconomic effects, including acting as an ongoing brake on spending power and economic growth. Further supplementing the after-tax cash flow of corporations in Australia by lowering their taxes is more likely to fatten those hoards of idle cash, than lead to faster investment and higher wages.

Who would get the company tax cut?

If public policy is to properly examine a proposal it should identify the winners and whether those winners are likely to be influenced by the policy change being proposed. There is no evidence that the government has performed that exercise. Yet every such change will give benefits to infra-marginal recipients who are not going to change their behaviour at all and to those who may well change their behaviour (if we provisionally accept the claim that some recipients are sensitive to such changes). The latter are the marginal recipients whose behaviour may be influenced. Clearly a policy that gives all the benefits to infra-marginal companies is going to be relatively ineffective.[14]

In December 2015 we published *Cutting the company tax rate: Why would you?* (Richardson 2015) which examined which companies would get the company tax cut and how their behaviour is likely to change. At that time the tax cut was being widely anticipated. For example the *Australian Financial Review* suggested 'Malcolm Turnbull has all but confirmed company tax will be cut as part of the government's reform package' (Coorey 2015).

Cutting the company tax rate estimated that an immediate reduction in company tax to 25 per cent for the big four banks would mean a benefit of $2,019 million in 2016-17 and $29,711 million for the decade starting that year. The Commonwealth Bank alone would have received benefits worth around $623 million in 2016- 17 and a staggering $9,159 million over the decade. The big 15 companies would have received a $58,075 million gift. They are unlikely to be big innovators or investors and it is hard to see what investment or any other return Australians in return for the gift.

We reported Treasury estimates that suggest the finance sector as a whole derived rents worth a massive $36,820 million in 2011-12. Rents are profits over and above 'normal profits' which we can think of as the profit that would obtain if competition were working properly in this sector. The fact that competition is not working properly will imply that the additional after-tax income is unlikely to be competed away by more vigorous competition.

[14] By contrast a well-designed incentive that rewards changed behaviour would include mainly marginal recipients.

Going through the rest of the list of the top 15 companies it was clear they were megacorps, generally profitable monopolies, duopolies and oligopolies and there is little to suggest they would spend the tax cuts on increased investment and/or innovation. International competitiveness arguments are sometimes used but it is hard to see how they would apply to Australia's big 15 companies.

Earlier we reported that any tax cut in Australia would have increased American companies' liabilities to the Internal Revenue Service.[15] However, the changes introduced by President Trump included a switch to a territorial tax system under which companies are taxed only on the profits derived from the US. From now on we can be fairly unambiguous and suggest all foreign investors would benefit from the reduction in Australian company tax. However the benefits would not go to Australian investors because of dividend imputation.

[15] The argument is spelt out in Richardson (2015)

Other economic outcomes

In this section we briefly review some of the earlier work on company tax cuts.

COY TAX AND ECONOMIC OUTPUTS; INTERNATIONAL COMPARISONS

Advocates claim that lower company tax rates result in higher economic growth. However, data for OECD countries does not support this claim. In (Richardson 2015a) we showed there is no clear relationship between company tax rates and the rates of economic growth in OECD countries. We found that despite the variation in corporate tax rates, from less than 10% (in Switzerland) to 35% (in the US at the Federal level at that time); there is no correlation between company tax rates and economic growth. This data gives no support to the claim that lowering company taxes increases economic growth.

Another claim is that lower company tax rates lead to higher living standards. As high living standards should be one of the major objectives of economic policy it is important to examine if there is any link between living standards and company tax rates. The evidence shows that the relationship between company tax rates and living standards is positive –higher corporate tax rates are associated with higher living standards. If the proponents of company tax cuts were correct, then we would expect to see countries with lower company tax rates experiencing higher living standards - the trend in Figure 2 should be downward. While we are not arguing that there is any causal link between higher company taxes and higher living standards, we point out that the low tax and higher living standards argument is contradicted by the facts. We can conclude this section by noting that there seems to be little international evidence in favour of lower company tax rates. At the very least we can say that if there is any link between lower company tax rates and economic growth, it is weak enough to be offset by other factors.

COY TAX AND ECONOMIC OUTPUTS; EVIDENCE FROM AUSTRALIA'S PAST

Richardson (2015a) also examined national accounts data back to financial year 1959-60 and compared the data with company tax rates.[16] Although we have decided to use the standard rate, it must be borne in mind that for much of the first couple of decades covered by this study undistributed profits were taxed at a higher rate. Company tax rates would have been around 50 per cent for much of the time if this was taken in to account.

Generally company tax rates increased between the 1960s and 1988 and then gradually fell to the present rate of 30 per cent. Proponents insist that investment will increase with a cut in the corporate tax rate. Yet business investment as a share of GDP fell over the period. Business investment accounted for a higher share of GDP in the decade beginning 1959-60 than it has been ever since. This is inconsistent with the 'tax-cuts-are-good' thesis. The results also show that foreign investment increased as a share of GDP in the period to the late 1980s when company tax rates were relatively high. After that, the level of foreign investment remains steady, even as the company tax rate was gradually reduced.

When examining the relationship between the company tax rate and economic growth in Australia we find that growth has declined over the period. Our analysis of this data shows that economic growth averaged 3.8 per cent in the period to 1988 when corporate tax rates were relatively high, but fell to just 3.0 per cent in the period from 2001-02 when they were significantly lower. Economic growth was almost a full percent higher when company tax rates were 10 per cent higher. Growth in GDP per capita also appears to have been on a slightly downward trend. This of course is inconsistent with the proposition that lower company tax rates produce higher living standards. Growth in GDP per capital/living standard has/have gradually slowed as the company tax rate has fallen. The average growth in per capita GDP to 1988 was 2.1 per cent, but just 1.4 per cent from 2002 to 2015. Differences of that order mean a 7 per cent differential in ten years or 15 per cent in 20 years.

Company-tax-cutters suggest wages are affected by changes to the company tax rate. This evidence is particularly important because proponents of lower company tax rates

[16] It should be noted that in Australia both the rates of company tax payable and how they apply to different companies changed over time. For much of the period, the company tax rate was different for small and non-resident companies, while retained profits attracted a higher rate.

routinely argue that a reduction in company tax will lead to increased wages (See Khadem 2015; Deloitte 2015 and Westacott 2015). Despite the steady reduction in company tax rates over the period since the 1980s, the wages share of GDP has steadily fallen by approximately 13 per cent. That evidence suggests the opposite of the thesis that it is workers who would benefit from the reduction in the corporate tax rate. Indeed one might wonder why the business sector would be so concerned about reducing company tax rates if it is workers that would primarily benefit.

Other data adds further weight to the argument that lower company tax rates are have not been good for wages. For example between 1950 and 1987, when the company tax rate was 40 to 49 per cent, the average unemployment rate was 3.3 per cent. In the period of 30 per cent tax rates since 1 July 2001 unemployment has averaged 5.4 per cent.

INVESTMENT IS THE DRIVER, OR IS IT

The relationship between company tax and investment is extremely important. Models of the Australian economy that are used to simulate the impact of cutting company taxes all assume that there is a well-defined relationship between after-tax rates of return and investment. The model builders seem ignorant of the point Stiglitz insists on and we discussed above.

The sensitivity of corporate behaviour to company tax rates is problematic in other respects. The Reserve Bank of Australia published a paper that points out that the private sector is assessing projects using hurdle rates of return that are much higher than the cost of capital in Australia.[17] This is reinforced by the OECD which said:

> For some reason the 'hurdle' rate of return required to undertake new capital spending is so high that, despite historically low interest rates, economic growth is stagnating in many regions due in part to the lack of investment (OECD 2015).

This interpretation is reinforced by for example the governor of the Reserve Bank of Australia, Phillip Lowe (2018), who said:

> Over recent times there has also been quite a lot of discussion about the effect of tax on the investment climate and international competitiveness....As we have this discussion, it is also important that we keep focused on the other

[17] Lane K and Rosewall T (2015)'Firms' investment decisions and interest rates', *RBA Bulletin*, June Quarter, pp. 1-7.

> issues I just touched on, as these areas play an important role in building durable comparative advantage and prosperity (Lowe 2018).[18]

There are also doubts among the corporate elite. According to the Financial Review, ‘corporate Australia is split over Malcolm Turnbull's company tax cut plan, with two of the country's most prominent business leaders warning that the move may not stimulate investment by big companies and calling on the federal government to formulate a wider reform package to stimulate economic growth’ (Smith 2017).[19] David Gonski continued ‘If you ask me whether it is going to make a difference for big companies, I think things like accelerated depreciation and so on would make a bigger difference than reducing the tax rate’ (Smith 2017). The point of this is that changing incentives at the moment is unlikely to produce any discernible change in the volume of investment.

The US Congressional Research Service has more extensively reviewed the empirical evidence that might or might not support claims to the effect that lower company tax rates increase economic growth, boost employment and the like. It concludes that most of the evidence does not support the notion that lower company taxes are beneficial in the ways usually suggested (Gravelle and Hunderford 2011).

Even if growth could be stimulated by company and individual tax rate reductions, there is a large associated cost in terms of the increased inequality likely to result. That of course runs up against another important issue; the IMF finds higher inequality reduces economic growth. The IMF Managing Director, Christine Lagarde, said if you lift the income share of the rich by 1 percentage point, then GDP growth decreases by 0.08 percentage points (Lagarde 2015).

The IMF has done a good deal of work on income inequality and growth to the extent that the empirical relationships are relatively well-known. A recent research paper said in regard to the emphasis on economic growth that ‘it would still be a mistake to focus on growth and let inequality take care of itself, not only because inequality may be ethically undesirable but also because the resulting growth may be low and unsustainable’ (Ostry et al 2014 p 27).

[18] Those other issues included ‘Australia's long record of economic and financial stability…our strong legal system and our well-established institutions.…our links to the fastest-growing part of the global economy and our skilled, diverse and flexible workforce…innovation, creativity and ingenuity. And … investing in information technology and the skills of our labour force’.

[19] The two business leaders mentioned were ANZ Banking Group chairman David Gonski and Australian Institute of Company Directors (AICD) chair Elizabeth Proust.

Foreign investment

In recent years there has been a large backlash against the globalisation of the world economic system and the influence of big business in political and economic decision-making. Foreign investment is one of the chief channels of globalisation so it too should be the subject of a good deal of debate. Most Australians would be horrified to know that foreign investment in Australian corporations is now 43.3 per cent of total equity and 56.5 per cent of listed corporations in Australia (Richardson 2018).

As such foreign investment in Australia becomes an issue when particularly sensitive issues arise such as Shell's attempted takeover of Woodside; the rejected takeover of GrainCorp; or when farmland and housing is being purchased by foreigners.

In late 2017 the Australian Treasury published a paper that brought a new argument in favour of the government's company-tax-cut plan (Henty et al 2017). Treasury accepts the proposition that the Trump tax cuts insofar as they lower the headline company tax rates would in fact work and that the other changes in the Trump package are inconsequential. As we saw above there is a host of opinion in the US to the effect that the tax cuts would not work. Nevertheless we provisionally accept this thesis to see where the Treasury analysis will take us.

We can take as our starting point the proposition;

> *if a substantial cut in the US corporate income tax rate does result in an investment boom in the US, the rest of the world is likely to experience reduced foreign investment and, as a consequence, lower GDP and real wages than might otherwise be the case (p 7).*

Of course an investment boom in the US would boost world trade generating benefits throughout the world just as the investment phase in China resulted in additional Australian exports of goods and services. The Treasury paper even cites the IMF to the effect that it would welcome an American fiscal stimulus. But rather than boosting world economic activity through economic growth in America the paper asserts that the impact will be negative.

There is absolutely no empirical evidence or theoretical argument given to support the proposition that the negative effects would outweigh the positive effects. The mechanism between higher investment in the US and lower in Australia assumes Australia is based on the view that 'a US investment boom would increase the demand for funds, causing interest rates to rise'. This is the argument that there is a limited global supply of funds and if more of those are invested in the US then the US will drain capital from the rest of the world with a rise in interest rates. Treasury says:

> *To the extent that the boom is not financed by US domestic saving, it would initially need to be funded from the existing global supply of funds, meaning the rest of the world gets less (p 9).*

The result is the rest of the world 'will experience higher capital outflows' (p 9). It is that effect that reduces investment in Australia and so contributes to a lower GDP, lower wages and so forth. Countries will lose investment to the US;

> *if other countries do not respond by cutting their own corporate taxes or by introducing other competitiveness enhancing policies (pp 9 - 10).*

The idea that a US investment boom will harm Australia certainly seems counterintuitive. We have a recent example to compare with that scenario. It has now been many years since Australia has received the benefit of the Chinese investment boom and there is still no sign of the Chinese economy inducing a massive capital outflow from Australia to China. Indeed, in the case of China over the last decade Australian investment in China increased from $1.1 billion to $68.7 billion while Chinese investment in Australia increased from $3.0 billion to $87.9 billion (ABS 2017). The net effect was an increase in Chinese investment in Australia from $1.9 billion to $19.2 billion. So far from the Chinese investment boom draining capital from Australia the opposite happened. If the effect posited by Treasury does exist it is not large enough to nullify the benefits to Australia of the Chinese investment boom.

The Chinese example may not support the thesis that US investment boom will be at the expense of Australia's economy. Apart from the empirical evidence we have theoretical reasons for doubting the proposition that higher US investment reduces Australian investment which is really a variant of the 'crowding out' thesis (Smith 2017).

The essence of the crowding out thesis is the proposition quoted above to the effect that there is a fixed global supply of funds[20] and if the US takes more the rest get less. However, this proposition is what economists call 'stock-flow inconsistent'.[21] When someone invests they may draw down their own liquid assets or borrow from someone. When that money is spent on investment it is simultaneously received as income on the part of the suppliers of the investment goods. The consequence of spending by the investor is to reduce the investor's net financial assets while the

[20] By 'fixed' here we mean not necessarily a fixed quantum but a fixed relationship between the quantity of funds and the interest rate.

[21] The following argument is put more formally in Richardson (2015).

recipient, the supplier, builds up financial assets. If the suppliers merely pocket the extra income that is the end of the story; investment has increased and the recipients of the additional income have saved the additional spending. Savings have *expanded* to match the increased investment. Of course increased income on the part of investment goods suppliers may well be spent in turn. If it is, then the new spending is received as new money by the recipients who may save it or spend it or a bit of both. The important thing is that new investment spending creates the extra savings without any need to draw on some fixed supply as Treasury assume. After the investment the investor will have a net reduction in financial assets balanced by an increase in capital assets. The recipients of the spending will experience an increase in their financial assets. And without the need to draw on some fixed supply of assets, 'the existing supply of global funds', there need be no implications for the rate of interest or any other strain on third parties.

This is just the ordinary workings of the Keynesian multiplier but with the added acknowledgement that any additional income received is received as additional financial assets. The flow of investment has to be matched by a reduction in financial assets on the part of the investor and an accumulation of financial assets on the part of the supplier. New flows of income have to be and will be reflected in the addition of new financial assets on the part of the recipients of the income. The new financial assets may just be new debt issued by the investor, or equity in the investor's company. In the normal course of events the new income is received simply as an increase in the balance in some account with a financial institution.

Interest rates may well rise if there is an investment boom in the US. However, the interest rate increase will not be through the mechanisms mentioned by the Treasury paper but will reflect the actions of the US central bank – the Federal Reserve System. Central banks throughout the world may then react to follow the US action.

If the investment boom does not itself induce an increase in interest rates then there cannot be a consequential induced flow of capital out of Australia to the US through this mechanism. But even if we did believe that it would surely be in Australia's interests to argue to the Americans and others that they should not be reducing corporate taxes to take capital from Australia and other countries. Indeed, as suggested above we should be joining the IMF's call for countries to stop the race to the bottom.

Meanwhile Morrison has favourably quoted research performed on German data in a study undertaken by Clemens Fuest et al (2018) from German universities; the University of Munich and University of Mannheim. However, the interest in Australia was sparked by interpretations by Richard Holden as reported in the Australian

Financial Review (Greber 2018). Morrison favourably cited the paper (Murphy 2018). Holden makes the point that on the German experience 51 per cent of a company tax cut winds up as increases in wages. Translating these results to Australia is obviously difficult but the Fuest et al paper has some interesting observations that are relevant for foreign investment. The study apparently involved some 15,000 employers yet the authors note that despite large differences and large changes in tax rates 'very few firms move between municipalities in the data'. German businesses do not change municipalities in response to differentials and changing differentials within the otherwise relatively uniform conditions in Germany. One would have to suggest it would be even harder to get them to shift in response to changes in international business tax relativities. Hence this study could well be cited in order to criticise the views of the Business Council and the Treasurer insofar as they suggest Australia needs lower company taxes to attract foreign investment.

Reactions in America to Trump's company tax rate cut

Market commentary:

we expect no significant short-term effect of tax reform on average hourly earnings – Goldman Sachs

we do not expect a meaningful boost to business investment – Moody's

While considering possible tax cuts in Australia and despite the differences (eg dividend imputation) it is nevertheless important to look at how the aftermath of the Trump tax cuts has panned out.

WORKERS BENEFIT?

One prominent American economist and commentator said "many major companies announced one-time bonuses. In almost all cases the bonuses were just a small fraction of the money received from the tax cut....AT&T is looking at annual tax savings of more than US$2.3 billion. Their one-time bonus of US$1,000 for 200,000 workers would come to US$200 million or less than one-tenth of their tax savings in a single year. Apple's one-time bonus would come to less than 5 percent of its annual savings" (Baker 2018).

The Australian Financial Review ran a prominent story on Wesfarmers that was inspired by Walmart's increase in wages (Mather et al 2018).[22] Walmart is now offering a minimum wage of US$11 per hour but it has been having trouble finding and retaining workers and, in any case, had to pay US$11/hour in many states given their minimum wage laws (Townsend and Popina). Meanwhile at the time we saw reports of Walmart cutting 1,000 office jobs and 11,000 warehouse jobs (Nassauer 2018). Newspapers speculated that Walmart was responding to min wage increases in various states, the tighter labour markets but wanted to make a political point. Two days

[22] As it happened the Wesfarmers' CEO said little more than the tax cut would increase the likelihood of wage and employment growth.

before the wage increase announcement (US$400 million in bonuses and US$300 million in wage increases) Walmart announced a debt buyback of US$4 billion.

Following the announcement by more than 70 major U.S. companies Townsend and Popina (2018) said:

> That's not all that many -- there are over 3,500 publicly traded corporations in the U.S., after all. And to some, they amount to little more than well-timed PR stunts designed to curry favor with the public and the president.

So far just 6 per cent of the corporate windfall from the tax cuts have gone to workers in the form of pay hikes, bonuses and other investments, according to an analysis by JUST Capital. That is even worse than the 13% that analysts polled by Morgan Stanley expect to go to workers (Egan 2018).

Goldman Sachs forecasts 'In practice, we expect no significant short-term effect of tax reform on average hourly earnings — as it excludes irregular bonuses — and only a marginal boost to the employment cost index — as irregular bonuses are smoothed out' (Linnane 2018).

The talk of benefits to workers has influenced contract negotiations between unions and companies with unions such as the Communications Workers of America, Service Employees International Union, the Teamsters and the American Federation of Teachers seeking information on how the tax cut will affect their employers' profits and what they plan to do with the windfall. An observer says unions are 'demanding that the companies specify the portion of the gains that will be used to boost wages, bring back jobs from overseas and make capital investments' (Davidson 2018). Failure to comply with these requests could lead to complaints with the National Labor Relations Board which can require companies to provide information relevant to their collective bargaining (Eidelson 2018).

INVESTMENT BOOMS?

Economist Dean Baker has made the point that historically, there has been no between the after-tax rates of profit and investment. For example in 1986 the corporate tax rate was lowered from 48 percent to 36 percent. Rather than an increase in investment, as a share of GDP investment actually fell slightly (Baker 2018). Something similar may be happening now and Baker notes that following the Trump tax cut, the data on monthly capital goods orders for both December and January 'go the wrong way'; down 0.3 percent in December and 1.6 percent in January (Baker 2018).

Moody's analysts are reported as saying 'We do not expect a meaningful boost to business investment because U.S. nonfinancial companies will likely prioritize share buybacks, M&A [mergers and acquisitions] and paying down existing debt … Much of the tax cut for individuals will go to high earners, who are less likely to spend it on current consumption (Linnane 2018).

One would expect that instead of investment activity cashed up companies might spend some of it on mergers and acquisitions. Reports from the UK suggest that has indeed happened with American companies targeting UK companies (Rees 2018).

BUYBACKS

It has been reported that corporate stock buybacks are booming as a result of the Republican tax cuts. Buybacks are the practice of companies spending their own cash on buying back their own stock. This is in order to raise share prices overall—that have truly skyrocketed" (Palladino 2018)

One report said 'over the next few months [following the tax cuts], the real winners from the corporate tax cut became clear — not workers and consumers, but shareholders.' (Stewart 2018). Bloomberg estimated that about 60 percent of tax cut gains will go to shareholders and to 15 percent for employees. A Morgan Stanley survey of analysts suggested 43 percent of the tax cut will go to buybacks and dividends (Stewart 2018). A Bloomberg report said 'that simply transfers money from one set of hands to another -- from the corporate entity to the shareholders' (Cowen 2018). But these make the rich richer.

David Ruccio (2018) has documented some of the main share buybacks which amount to US$94 billion. Another estimate put the value of share buybacks at US$214 billion (Egan 2018). The Senate Democrats put the value at nearly US$100 billion at 7 February (Senate Democrats 2018).

The merits of buybacks have been criticised. Former Labor Secretary Robert Reich said 'There is no reason buybacks should be considered anything but illegal manipulation of stock' and William Lazonick, a professor at University of Massachusetts 'argued that banning buybacks would not hurt long-term investors because it would force companies to invest in the future, instead of catering to short-term shareholders' (Egan 2018).

The biggest buyback was by Wells Fargo at US$22 billion. Wells Fargo also gave a wage increase and President Trump touted Wells Fargo's actions at the signing of the tax bill as evidence that the tax bill was working (Senate Democrats 2018). That wage increase (together with its charitable giving) was estimated at US$215 million (Business Wire 2018) or one hundredth of the value of the buyback.

DIVIDENDS

As this is being written we have had a quarter of the Trump tax cuts and the finance press is reporting a record high for US dividends and no dividend cuts in the S&P 500 index. The latter is a first for the benchmark, according to Howard Silverblatt, senior index analyst for S&P Dow Jones (Rooney 2018).

OVERALL

Dean Baker concludes ‘We now have good preliminary evidence that the investment boom exists only in the realm of political propaganda. Workers will not be getting any big dividends from this tax cut’ (Baker 2018).

Many of the wage increases were bonuses which apply just for one year. By contrast mechanisms such as buybacks will increase the expected value of the relevant shares in perpetuity. Sen Sheldon Whitehouse (D-RI) said: ‘They want us to believe this tax bill is a boon for workers because corporations will use their tax windfalls to expand their workforces and give their employees raises. Instead we’ve seen a wave of stock buybacks—payouts to executives and shareholders—which dwarf the modest bonuses some companies have announced. That $1.5 trillion bonanza isn’t trickling very far’ (Senate Democrats 2018).

The Tax Policy Centre (2018) has estimated the impact on US taxpayers of the Trump package and we have summarised the impact in Table 3. Table 3 just includes the provisions that affect business entities and we have excluded those provision that affect individuals alone. That allows Table 3 to focus on the business tax cuts. Of the business tax cuts the most important are the company tax cuts and so the data in Table 3 can be taken as a proxy for the implied impact on individuals of the company tax cuts.

Table 3: Impact of non-individual Trump changes

	$/taxpayer
lowest quintile	-20
second quintile	-60
Middle quintile	-150
Fourth quintile	-330
top quintile	-1,850
All	-350
top 5 per cent	-5,988
top 1 per cent	-18,490
top 0.1 per cent	-104,320

Source: Tax Policy Center (2018) and authors' calculations.

Table 3 shows that the Trump tax cuts are modest for most people but increase very rapidly as we go higher and higher up the income distribution. The top 0.1 per cent gets an average of US$104,320. Clearly the benefits are much skewed toward the higher income earners.

All in all the evidence on the Trump tax cut so far is that companies are using the gains for the benefit of the shareholders. That of course is to be expected. As the rest of this report has made clear, there is precious little by way of theoretical or empirical evidence to suggest otherwise.

Conclusions and recommendations

We note here that the Senate already exercises the power to order documents. For example under the list of Procedural orders of continuing effect there are 13 types of orders for documents. One of those is under the heading *Agency advertising and public information projects* and requires Ministers to table a statement on advertising and public information projects worth $100,000 or more.

We also note that the Senate's terms of reference are already drafted as a set of possible instructions for the companies whose CEOs made commitments to invest and employ and increase wages. Of course the Commitment is written with a good deal of 'wiggle room'.

Recommendation 1

That the Senate take note of the overwhelming evidence, including that summarised here, that suggests the proposed company tax cut would have little or no impact on employment, wages, investment, productivity, growth or living standards.

Recommendation 2

That the Senate Economics References Committee call for an annual document from each relevant company that in the first instance specifies the nature of the commitment and thereafter a report on progress against the commitment. These documents should make clear a base-case scenario against which future performance is to be judged.

Recommendation 3

That the Senate Economics References Committee calls for the CEOs to appear before the Committee to clarify and amplify their understanding of the commitments.

Recommendation 4

Where the Senate Economics References Committee has used the word 'investment' any final requirement should make it clear that 'investment' refers not to financial investments nor retaining funds in the company but instead the addition of actual productive capacity including physical plant and equipment, software and the like.

Recommendation 5

The CEOs should make clear in their plans the nature of any future commitment and/or likely scenario involving distributions to shareholders.

Recommendation 6

All companies presently required to produce an annual report should also report on how any tax change under the legislated schedule will affect their behaviour and how their behaviour changed after the fact.

Recommendation 7

Companies report on the financial implications of any benefits received by foreign shareholders.

Recommendation 8

Any obligations imposed on the signatories or other CEOs apply to their successors and, in the event of a change in the identity of the relevant company, the obligations apply to successor companies, merged entities and the like.

For many of the reasons outlines in this paper and TAI's earlier work we do not believe there is a good case made out for company tax cuts. The cuts would be received by good and bad companies alike. It would be better to actually provide an incentive for good behaviour rather than give benefits to all companies. Nevertheless, as a minimum we suggest something similar to the Japanese approach:

Recommendation 9

If the tax cuts pass the Senate the bill should be amended so that the tax cuts would be denied for companies that do not achieve increases in employment, wages and productive investment.

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