Chapter 2

Key issues

2.1 In order to assess the Business Council of Australia's (BCA) Commitment (the Commitment) to the Senate, it is essential to consider the effects of the government's proposed corporate tax cuts contained in the Treasury Laws Amendment (Enterprise Tax Plan No. 2) Bill 2017 (ETP No. 2 bill).

2.2 As stated in Chapter 1, the Commitment asserts 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; and
- if the government's enterprise tax plan is passed, the signatories will invest more in Australia which will lead to employment of more Australians and therefore stronger wage growth as the tax cut takes effect.[1]

2.3 While agreeing in theory that the government's proposed corporate tax cuts may boost economic activity in the long term, a number of academics and think tanks cautioned that, in the context of the Australian economy, there are uncertainties about the costs and benefits of the proposal.[2]

2.4 The first part of the chapter considers the effects of the ETP No. 2 bill proposed by the government. It examines the evidence received during the inquiry in relation to Australia's headline corporate tax rate, how the government's proposed corporate tax cuts will be paid for, and how they will impact the national income, employment and wages.

2.5 The second part of the chapter outlines the process which led to the Commitment, and the value of its content when assessed against the effects of the proposed corporate tax cuts. It then explores some of the proposed policy alternatives put to the committee regarding the government's proposed corporate tax cuts.

The headline corporate tax rate in Australia

2.6 In their submission to the inquiry, the BCA claim that Australia's corporate tax rate 'has remained at 30% for close to 17 years while other countries have reduced their rates', making Australia's 'the 3rd highest rate in the industrialised world'.[3]

2.7 However, as highlighted by a number of stakeholders, various tax deductions, concessions, offsets and rebates have had the effect of reducing the amount of tax

1 Business Council of Australia, *Our commitment to the Senate*, 21 March 2018, http://www.bca.com.au/media/our-commitment-to-the-senate (accessed 30 April 2018).

2 See, for example, Dr Janine Dixon, *Submission 7*; The Australia Institute, *Submission 11*; Grattan Institute, *Submission 15*.

3 Business Council of Australia, *Submission 10*, p. 4.

Australian businesses actually pay,[4] with Australia being one of only five countries in the Organisation for Economic Co-operation and Development who continue to operate on a full imputation tax system.[5]

2.8 In this regard, the Australian Council of Trade Unions (ACTU) referred to a 2017 United States Congressional Budget Office study, which compared international corporate tax rates and found that:

> …while the headline rate of corporate tax in Australia is 30 per cent, the average rate was substantially less at 17 per cent and after all deductions were considered the effective rate was a mere 10.4 per cent.[6]

2.9 Drawing attention to the fact that the effective tax rate of Australian companies is lower than the statutory tax rate, Dr Shumi Akhtar, from the University of Sydney, suggested that:

> …it is not so much the headline corporate tax rate that matters, but the effective corporate tax rate i.e. the actual rate of tax paid.[7]

2.10 Notwithstanding this, the government plans to reduce the headline corporate tax rate in Australia from 30 per cent to 25 per cent over 10 years.[8]

Investors

2.11 Some submitters emphasised that, due to Australia's dividend imputation system (franking credits regime), a reduction in the headline corporate tax rate will not help domestic investors.[9] Dr Janine Dixon submitted that the cut to the corporate tax rate:

> …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.[10]

2.12 Arguing that a cut in the corporate tax rate provides bigger benefits to foreign rather than domestic investors, the Grattan Institute (Grattan) informed the committee that:

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4 See, for example, Community and Public Sector Union, *Submission* 9; The Australia Institute, *Submission 11*; Australian Council of Social Service, *Submission 14*.

5 Grattan Institute, *Submission 15*, p. 4.

6 Australian Council of Trade Unions, *Submission 5*, p. 3.

7 Dr Shumi Akhtar, *Submission 4*, p. 3.

8 See Treasury Laws Amendment (Enterprise Tax Plan No. 2) Bill 2017.

9 See Grattan Institute, *Submission 15*, p. 4; Professor Peter Swan, *Submission 1*, p. 2.

10 Dr Janine Dixon, *Submission 7*, p. 2.

> Cutting the [corporate] tax rate from 30 per cent to 25 per cent would increase the after-tax rate of return on Australian equity by about 7 per cent for foreign investors. The rate of return would increase both for individuals who own shares in Australian companies and for multinational firms paying Australian company tax.[11]

2.13 In addition, Professor Peter Swan, who suggested that the modelling used by the government to support their corporate tax plan was 'entirely flawed,'[12] argued that:

> This ability of foreign investors to harvest franking credits implies that the cost of capital for Australian and foreign investors in Australia is one of the lowest in the world since portfolio (trading) investors pay close to zero corporate tax.[13]

2.14 Despite this, some submitters suggested that if Australia doesn't decrease its headline corporate tax rate, it will become a less attractive place for foreigners to invest. For example, the Institute of Public Affairs (IPA) maintained that:

> 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.[14]

2.15 However, Grattan explained that foreign investors take a more sophisticated approach to investment than just looking at the headline corporate tax rate. Grattan submitted that:

> Foreign investors take a number of factors into account in determining where to invest, including the corporate tax rate. Corporate investment decisions don’t just turn on tax rates—they also consider Australia’s stable government, educated workforce and developed economy.[15]

2.16 By way of example, Grattan reminded the committee that:

> Despite a company tax rate of 30 per cent, more money was invested in mining projects in Australia than in any other country in the world for each of the eight years of the mining boom.[16]

Trump tax cuts

2.17 Professor Swan suggested that the 'the government's excuse' for the proposed corporate tax cuts in Australia 'is the Trump reduction in the US [United States] corporate tax rate from 35 per cent to 21 per cent'. Professor Swan argued that:

> …effectively the US tax rates still remains far higher than Australia's, despite our higher headline rate of 30 per cent, since Americans are taxed a

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11 Grattan Institute, *Submission 15*, p. 4

12 Professor Peter Swan, *Submission 1*, p. 1.

13 Professor Peter Swan, *Submission 1*, p. 4.

14 Institute of Public Affairs, *Submission 2*, p. 2.

15 Grattan Institute, *Submission 15*, p. 5.

16 Grattan Institute, *Submission 15*, p. 5.

> second time on company income that has already been subject to tax. This is because, unlike Australia, there is no franking and no imputation benefit and no harvesting of franking credits to reduce their cost of capital down to our much lower rate.[17]

2.18 The Australia Institute (TAI) also considered Trump's business tax cuts in their submission to the inquiry, and explained that the benefits of the cuts 'are much skewed toward the higher income earners'. TAI submitted 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 [per annum].[18]

2.19 Using the United States as an example, Dr Akhtar argued that a reduction in the headline corporate tax rate itself 'is not a necessary or sufficient condition in itself for economic growth'. In particular, Dr Akhtar claimed that her analysis showed:

> …that President Trump's tax cut announcement in January 2018 did not have an immediate positive knock-on effect on the USA's growth rate…while the level of foreign direct investment remained the same as the second quarter of 2017…[19]

Federal budget implications

2.20 Evidence presented to the committee raised concerns about the impact of the government's proposed corporate tax cuts on the federal budget deficit and government debt over time. For example, the Australian Council of Social Service (ACOSS) submitted that the proposed corporate tax cuts are unfunded and costly. ACOSS emphasised that:

> Unlike previous company tax cuts, the proposed cuts are not funded fully or even partly by removal of business tax breaks that are no longer fit for purpose.[20]

2.21 Grattan reminded the committee that according to Treasury estimates, the budgetary costs of the corporate tax cuts are $65 billion over 10 years. However, Ms Danielle Wood, Budget Policy and Institutional Reform Program Director at Grattan, explained:

> The bulk of that will be in the latter years, as the tax cuts for big business come into effect. Our concern, really, is that reducing tax revenue during a period when the budget is still in deficit, as it has been for nine years, will create further pressures. Sustained budget deficits have seen net debt already rise, or it will rise next year to 19.2 per cent of GDP. That limits our

17 Professor Peter Swan, *Submission 1*, p. 2.

18 The Australia Institute, *Submission 11*, p. 40.

19 Dr Shumi Akhtar, *Submission 4*, p. 5.

20 Australian Council of Social Service, *Submission 14*, p. 3.

> capacity for future borrowings and for governments to respond to adverse economic shocks.[21]

2.22 In addition, Grattan submitted that the government had not explicitly stated how it plans to fund the proposed corporate tax cut.[22] Expressing to the committee the importance of understanding how the cuts will be paid for, Ms Wood cautioned that:

> The numbers are baked into the budget estimates, and, if you look at what's driving the return to surplus in 2021, that's largely increases in personal income tax via bracket creep.[23]

2.23 In contrast, Mr Grant King, President of the BCA, suggested that those arguing that Australia cannot afford the corporate tax cuts are comparing 'apples and oranges'. Mr King explained that those arguing that the corporate tax cuts are unaffordable:

> …compare a 10-year budget impact of $65 billion in nominal dollars with a single year of net economic benefit of one per cent of GDP, or $18 billion in today's terms. But if you take 10 years of benefits then the total GDP pay-off is $180 billion over a 10-year period, allowing for a slight lag for implementation. The critical point is that the modelled annual pay-off of one per cent of GDP is a net benefit—that is, the benefit after taking account of the revenue costs. So $18 billion is the measure of the permanent increase in the size of the economy, year in, year out, from cutting company taxes compared with using the money in another way. The modelling is telling us that the company tax cut delivers a higher pay-off than other uses of the same taxpayer dollar. This is because Australia's high company tax is a highly distorted, inefficient tax.[24]

2.24 Mr Daniel Wild, Research Fellow at the IPA agreed with the BCA, and submitted that:

> All up the best available evidence suggests that cutting the corporate tax rate to 25 per cent will increase GDP by around one per cent permanently—about $17 billion in today's dollars each and every year.[25]

Gross National Income

2.25 Many submitters argued that Gross National Income (GNI)—not GDP—was the key measure to determine whether the government's proposed corporate tax cuts were in Australia's best interests.[26]

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21 Ms Danielle Wood, Budget Policy and Institutional Reform Program Director, Grattan Institute, *Proof Committee Hansard*, 26 April 2018, p. 13.

22 Grattan Institute, *Submission 15*, p. 10.

23 Ms Danielle Wood, Budget Policy and Institutional Reform Program Director, Grattan Institute, *Proof Committee Hansard*, 26 April 2018, p. 13.

24 Mr Grant King, President, Business Council of Australia, *Proof Committee Hansard*, 26 April 2018, p. 51.

25 Mr Daniel Wild, Research Fellow, Institute of Public Affairs, *Proof Committee Hansard*, 24 April 2018, p. 14.

2.26 For example, Dr Dixon submitted that even though economic growth will be stimulated by the proposed corporate tax cuts, GNI will be reduced because foreign investors will contribute less to the nation's income through taxation. In this context, Dr Dixon maintained that in considering the government's proposed corporate tax cuts, GNI was the measure that really mattered:

> Immediately when taxes are cut, as a nation, we will lose a chunk of tax revenue that we otherwise would have collected from foreign investors. This has a negative impact not only on government revenue but on our income as a nation. Over time, some but not all of this loss to the nation will be offset by higher wages, but we'll never catch up. National income will remain permanently lower than it would have been without the tax cut.[27]

2.27 Grattan agreed with Dr Dixon that cutting the corporate tax rate in the short run would reduce GNI and suggested that:

> …cutting the company tax rate will see national incomes go backwards for six years before the cuts start to make a contribution to national incomes, or even longer under the Government's phased approach.[28]

2.28 While there is a degree of contention among economists about the income effects of the government's proposed corporate tax cuts, Dr Dixon explained why the conclusions of her modelling differ to those of Treasury:

> …the Treasury's results—are based on long-run, comparative static modelling. That is modelling that simply asks: how would the economy look if the company tax rate were five per cent lower? It ignores the transition costs of getting there. We already have a large foreign investment presence in Australia which has voted with its feet for the 30 per cent tax rate. A tax cut is a gift to these investors. For the policy to be a success, the investment expansion has to beat this initial giveaway. The Treasury modelling correctly accounts for the repatriation of profits earned on new investment but does not account for the initial windfall gain to foreign owners of existing investments.[29]

2.29 Dr Dixon also clarified for the committee why her modelling differed from that undertaken by independent economist, Mr Chris Murphy. Dr Dixon explained that, in her opinion, Mr Murphy's economic modelling of the proposed tax cuts takes into account a gain that he attributes to reduced profit shifting. According to Dr Dixon, Mr Murphy's argument is that:

> …with a lower tax rate, companies are less motivated to incur the costs and risks associated with reducing taxes by shifting profits to tax havens. I won't go as far as to say that this doesn't happen, but I didn't take it into

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26 See, for example, Dr Janine Dixon, *Submission 7*; Grattan Institute, *Submission 15*.

27 Dr Janine Dixon, Private capacity, *Proof Committee Hansard*, 26 April 2018, p. 1.

28 Grattan Institute, *Submission 15*, p. 8.

29 Dr Janine Dixon, Private capacity, *Proof Committee Hansard*, 26 April 2018, pp. 1–2.

> account in my modelling of the tax cut because I didn't think it relevant with taxes in the range of 25 to 30 per cent. The committee might not be aware that, in earlier versions of his modelling, the basis of this spectacular estimate estimated $2.39 consumer benefit for every $1 of tax revenue forgone. The reduced profit-shifting accounted for a significant proportion of that benefit. This estimate has since been revised downwards.[30]

2.30 In contrast, Mr Murphy submitted that his modelling used the consensus in recent literature on the sensitivity of accounting profits to the corporate tax rate, as opposed to Dr Dixon's modelling, which assumes profit shifting away. Specifically, Mr Murphy suggested that his work identifies the role of profit shifting which demonstrates that:

> …reducing my profit shifting elasticity from a consensus value of 0.73 to a low value of 0.5, has only a small effect on the results. The estimated gain in consumer welfare from reducing the corporate tax rate from 30 to 25 per cent declines only slightly from $4.9 billion to $4.4 billion.[31]

2.31 With regard to the different modelling of the proposed corporate tax reforms by economists, Dr Dixon reminded the committee of the importance of 'parameter assumptions'. Dr Dixon highlighted to the committee that:

> We need to have some idea of how much additional capital can be absorbed by a labour force of a particular size. This determines how quickly wage growth chokes off the investment possibilities that open up under a company tax cut. The governance modellers have chosen to use a top-of-the-range parameter value, meaning that they conclude that a relatively large amount of capital is absorbed before wage growth chokes it off. These technical concerns may not be of great interest, but they do illustrate that, although the case for a company tax card carries the imprimatur of government-appointed economic modellers, varying just a few assumptions can turn the outcome from positive to negative.[32]

2.32 Dr Jim Minifie, Productivity Growth Program Director at Grattan, also provided evidence around the range of parameter assumptions relevant to Dr Dixon and Mr Murphy's modelling. Specifically, Dr Minifie understood that implicit in Dr Dixon's modelling:

> …would be, once you take into account dynamics, the proposition that potentially the tax rate is too low. And, if you look at the work by Chris Murphy, that would imply potentially an optimal tax rate that might be around 20 or a little bit lower, so it becomes a feature of being not so far off the optimal tax rate that the uncertainties about the parameters…can dominate the discussion.[33]

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30 Dr Janine Dixon, Private capacity, *Proof Committee Hansard*, 26 April 2018, p. 2.

31 Mr Chris Murphy, *Submission 16*, p. 3.

32 Dr Janine Dixon, Private capacity, *Proof Committee Hansard*, 26 April 2018, pp. 1–2.

33 Dr Jim Minifie, Productivity Growth Program Director, Grattan Institute, *Proof Committee Hansard*, 26 April 2018, p. 14.

2.33 On this point, Dr Minifie suggested that 'if you're within a few percentage points, a change really won't make much difference to net national income'.[34]

2.34 Regardless of the technicalities associated with economic modelling, Dr Dixon asserted that as 'national income will be lower…there is no way that all Australians can be better off' because:

> If no attempt is made to recoup the lost taxation revenue, then government spending on essential services will be less than it otherwise could have been. If attempts are made to recoup the lost taxation revenue through bracket creep or a higher GST, then post-tax wage gains to employees will be eliminated.[35]

Employment and wages

2.35 Arguing against the government's proposed corporate tax cuts, the ACTU maintained that:

> …the modelling that the Government is relying on to assert that workers will receive a significant benefit from corporate tax cuts assumes that businesses will pass the benefits of corporate tax cuts <u>in full</u> to creating new jobs and wage increases.[36]

2.36 The ACTU submitted that the government's proposed corporate tax cuts:

> …will not fix youth unemployment, they will not make secure, fairly paid jobs available to Australian workers, they will not address growing inequality and they will not give workers the pay rise they need.[37]

2.37 Ms Wood of Grattan expressed scepticism about Treasury's projections concerning wage growth, informing the committee that Grattan had looked 'at the numbers' and considered that 'the wage growth numbers look particularly optimistic'.[38]

2.38 Noting that business profits in 2017 were up by 22 per cent, and that wages did not increase proportionally, Per Capita Australia (Per Capita) suggested that the proposed corporate tax cuts 'will not lead to significant increased investment or higher wages for Australian workers'.[39] Per Capita highlighted that:

> There is a real discord between the fiscal and monetary policy settings of the Australian economy and the behaviour of business—one which is

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34 Dr Jim Minifie, Productivity Growth Program Director, Grattan Institute, *Proof Committee Hansard*, 26 April 2018, p. 14.

35 Dr Janine Dixon, Private Capacity, *Proof Committee Hansard*, 26 April 2018, p. 2.

36 Australian Council of Trade Unions, *Submission 5*, pp. 1–2 (emphasis in original).

37 Australian Council of Trade Unions, *Submission 5*, p. 1.

38 Ms Danielle Wood, Budget Policy and Institutional Reform Program Director, Grattan Institute, *Proof Committee Hansard*, 26 April 2018, p. 18.

39 Per Capita Australia, *Submission 8*, p. 1.

> directly responsible for weak wage growth and low investment in the Australian economy.[40]

2.39 In contrast, the BCA argued that the proposed corporate tax cuts will have the overall effect of increasing investment which will be 'vital for underpinning jobs and wages growth'. Specifically, the BCA submitted that:

> Over half the benefits from a tax cut flow to Australian workers. Real wages would be more than 1% higher—in today's economy, around $750 extra per year for an average wage earner.[41]

2.40 However, when questioned by the committee about the impact of corporate tax cuts on wages, the BCA was unable to provide the committee with an example of a country where company tax cuts had led to higher wages.[42] Indeed, when asked 'can you give us an example of another country where the tax cuts have resulted in wage rises?'—Ms Westacott answered, 'We'll take it on notice'.[43]

Relationship between wages and labour productivity

2.41 Citing the 'seriously weakened' relationship between wages and labour productivity in Australia, TAI suggested that:

> 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.[44]

2.42 Mr Warwick Smith, Senior Economist at Per Capita, agreed, and suggested to the committee that in recent years the relationship between labour productivity and wages has been broken. Based on recent data, Mr Smith explained that even if the corporate tax cuts result in investment and increased labour productivity 'it's likely that that will result simply in greater profits rather than a flow-through, necessarily, to wages'.[45] Mr Smith stated:

> …even if we assume that everything the Business Council says is correct and the Treasury modelling is also all correct—and there are lots of reasons to suggest that the Treasury modelling is overly optimistic—there will be a

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40 Per Capita Australia, *Submission 8*, p. 2.

41 Business Council of Australia, *Submission 10*, p. 11.

42 Mr Grant King, President, and Ms Jennifer Westacott, Chief Executive, Business Council of Australia, *Proof Committee Hansard*, 26 April 2018, pp. 81–82.

43 Ms Jennifer Westacott, Chief Executive, Business Council of Australia, *Proof Committee Hansard*, 24 April 2018, p. 55.

44 The Australia Institute, *Submission 11*, p. 23.

45 Mr Warwick Smith, Senior Economist, Per Capita Australia, *Proof Committee Hansard*, 26 April 2018, p. 25.

> very modest increase in wages and GDP over the long term as a result of these tax cuts.[46]

2.43 The ACTU also questioned the optimism of the assumptions within Treasury's modelling about what proportion of the tax cuts will be passed onto workers as increased wages. Mr Christopher Watts, Social Policy Officer from the ACTU, suggested that:

> It appears to us the Treasury modelling assumes a large proportion will be passed on. We don't believe that's backed up by any kind of observation of corporate behaviour either domestically or internationally when they get more money.[47]

The industrial system

2.44 Mr Tom Roberts, Director of Industrial and Social Policy at the ACTU, also noted that the signatories to the Commitment were 'some of the hardest-bargaining companies in the country'. Mr Roberts stated:

> Our union affiliates deal with them on a day-to-day basis, and it seems to me that, no matter how profitable these companies are, they're not in the business of giving away wage rises, at least to the broad base of their employees.[48]

2.45 Tax Justice Network Australia (TJN) also emphasised the importance of the industrial system as a mechanism to transfer company profits to employees via wage increases. TJN submitted that:

> The vast majority of MNEs [multinational enterprises] do not give away profits to employees as wage increases. Many only increase wages when they are forced to, be it through needing specific skill sets for which there is a shortage and for which they must compete or through industrial action by their employees.[49]

2.46 ACOSS also raised questions about whether or not the proposed corporate tax cuts will flow through to greater wages 'in an environment where workers have very limited bargaining power'.[50]

Executive remuneration

2.47 Given the nature of business in Australia, some submitters reminded the committee that the proposed corporate tax cuts will likely flow through to greater remuneration for executives. For example, Ms Emma Dawson, Executive Director of

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46 Mr Warwick Smith, Senior Economist, Per Capita Australia, *Proof Committee Hansard*, 26 April 2018, pp. 25–26.

47 Mr Christopher Watts, Social Policy Officer, Australian Council of Trade Unions, *Proof Committee Hansard*, 26 April 2018, p. 44.

48 Mr Tom Roberts, Director of Industrial and Social Policy, Australian Council of Trade Unions, *Proof Committee Hansard,* 26 April 2018, p. 39.

49 Tax Justice Network Australia, *Submission 13*, p. 5.

50 Australian Council of Social Service, *Submission 14*, p. 7.

Per Capita, informed the committee that, as the Australia Industry Group's *Business Prospects* report released in January 2018 makes clear:

> …business leaders regard weak wage growth as an essential factor in their increased profitability and growth, the results of which they will, on all behavioural evidence, continue to return to shareholders in increased dividends and to themselves in executive remuneration. In short, there is simply no evidence, based on recent business behaviour, that a tax cut would necessarily be passed through to workers through increased investment or wages.[51]

2.48 TJN also brought to attention a survey conducted by Morgan Stanley analysts of the Trump tax cuts in the United States, which found that 13 per cent of the tax 'give away' will go to pay rises, bonuses and employee benefits. However, TJN highlighted that:

> Even here, there are questions of the distribution of the benefits, with no reported analysis of what proportion of these increases in wages and bonuses will go to highly paid executives and what portion will go to workers on minimum wages.[52]

Committee view

2.49 Tax reform is not as simple as effecting a change to the headline corporate tax rate, and the committee is of the view that a reduction in the headline corporate tax rate in Australia is neither a necessary nor sufficient condition in itself for economic growth. The committee notes that the headline corporate tax rate in Australia is currently 30 per cent and based on the Congressional Budget Office (CBO) analysis, the average rate is substantially less at approximately 17 per cent, and the CBO states that after all deductions the effective rate is approximately 10.4 per cent.

2.50 The committee notes concerns raised by some stakeholders that Australia has the third highest headline corporate tax rate in the industrialised world, and that if it does not decrease, Australia will become a less attractive place for foreigners to invest. However, noting the evidence received regarding the benefits to foreign investors from the Australia's dividend imputation system (franking credits regime), and the various deductions, concessions, offsets and rebates which reduce the amount of company tax actually paid, the committee considers that Australia remains very competitive for both foreign and domestic investors. Indeed, the committee understands that investors take a more sophisticated approach to investment than just looking at the headline corporate tax rate. For example, some of the factors investors may take into account in determining where to invest include whether a country has a stable government, an educated workforce and a developed economy.

2.51 The committee is cognisant that while the proposed corporate tax cuts may incentivise some new investment, it will also provide a windfall gain for existing

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51 Ms Emma Dawson, Executive Director, Per Capita Australia, *Proof Committee Hansard*, 26 April 2018, p. 25.

52 Tax Justice Network Australia, *Submission 13*, p. 6.

investments held by foreign investors. At this stage, it is very uncertain to the committee how much new investment will begin, and how much of the windfall will find its way back to foreign investors through increased dividends or share buy backs, should the ETP Bill No. 2 bill be passed.

2.52 The committee is mindful that the government has not explicitly stated how the corporate tax cuts will be paid for, and notes that most academics believe that the cuts will be paid for through income tax bracket creep. The committee is of the opinion that how the government will pay for its proposed tax cuts is of paramount importance, and the committee is particularly concerned that the corporate tax cut proposals could be paid for through bracket creep, thereby reducing the after tax income of many Australian families.

2.53 The committee notes Treasury analysis which indicates that GDP would grow as a result of the government's proposed corporate tax cuts. However, it considers that GNI is the more important economic measure. The committee is persuaded by Dr Dixon's modelling which indicates that national income will fall if the tax cuts are passed, as more profits flow off shore for foreign investors. The committee is alarmed that in the short term, the government's proposed cut to the corporate tax rate will see national incomes go backwards for six years (or longer under the government's proposed phased approach) before the cuts even begin to make a contribution to national income.

2.54 The committee is deeply concerned that when questioned about the impact of corporate tax cuts on wages, the BCA was unable to provide an example of a country where corporate tax cuts had led to higher wages. The committee understands the importance of the industrial system as a mechanism to transfer company profits to employees via wage increases, and is concerned that the signatories to the Commitment are some of the hardest bargaining companies in Australia, with a history of engaging in practices to drive down wages. In this regard, the committee also notes recent data which indicates there is dwindling bargaining power of workers and their representatives.

2.55 Given the nature of business in Australia, the committee considers that there is a real risk that the proposed corporate tax cuts will flow through to greater remuneration for executives and not workers. The committee notes that while wages outcomes of the proposed corporate tax cuts are uncertain, it is undoubtedly possible that directors stand to gain immediately if the ETP Bill No. 2 is passed, by way of short and long term incentives linked to shares or options.

2.56 The committee is of the view that—even if the proposed company tax cuts led to an increase in real capital investment, and that led to an increase in the capital stock (relative to the number of workers employed), which automatically produced an increase in labour productivity—the assumption that workers' wages would automatically and fully rise to reflect higher productivity is thoroughly misplaced. In this context, the committee notes that, even if one assumes that the optimistic Treasury modelling is correct, there will only be a very modest increase in wages over the long term as a result of the government's proposed corporate tax cuts.

Recommendation 1

2.57 The committee recommends that the Treasury Laws Amendment (Enterprise Tax Plan No. 2) Bill 2017 not be passed.

The BCA Commitment

2.58 The BCA Commitment to the Senate was 'one document that took 24 hours'.[53] It was circulated only to selected BCA members for signature.[54] The big four banks and AMP were not given the opportunity to sign the Commitment.[55] Ms Jennifer Westacott, Chief Executive of the BCA, explained that in order to get members to sign the Commitment:

> People were approached. Some people could not be contacted. We did this in 24-hours because senators were asking for a commitment and that's what the commitment went to.[56]

2.59 When questioned by the committee about the process the BCA undertook to find signatories to the Commitment, Mr King of the BCA, stated:

> We did not begin the day with a list. We began the day by calling a number of companies… not everybody was available to take that call at that point in time. Many were overseas…
>
> At the end of the day, we didn't begin by saying, 'Here's 10.' We began by working through with our members who was available and who would be willing to make that commitment in the time frame that we had available.[57]

2.60 Noting that 'the BCA has been one of the leading bodies arguing for a reduction in corporate income tax, making all sorts of claims about the benefits', TJN commented that:

> It is disappointing that a mere 10 CEOs were willing to sign the joint voluntary non-binding pledge to the Senate, out of the 132 corporate members listed on the BCA website, or less than 8% of the membership. It is hardly a ringing endorsement from the BCA membership for the pledge.[58]

2.61 With regard to the substance of the Commitment, the Centre for Independent Studies (CIS) suggested that it was 'not surprising' that the Commitment was cast in

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53 Ms Jennifer Westacott, Chief Executive, Business Council of Australia, *Proof Committee Hansard*, 24 April 2018, p. 36.

54 Mr Grant King, President, and Ms Jennifer Westacott, Chief Executive, Business Council of Australia, *Proof Committee Hansard*, 24 April 2018, p. 36.

55 Mr Grant King, President, and Ms Jennifer Westacott, Chief Executive, Business Council of Australia, *Proof Committee Hansard*, 26 April 2018, pp. 70–71.

56 Ms Jennifer Westacott, Chief Executive, Business Council of Australia, *Proof Committee Hansard*, 24 April 2018, p. 36.

57 Mr Grant King, President, Business Council of Australia, *Proof Committee Hansard*, 26 April 2018, p. 70.

58 Tax Justine Network Australia, *Submission 13*, p. 1.

very general terms and warned against legislators making such a Commitment a pre-condition for company tax cuts. CIS maintained that:

> Tax cuts should enhance economic freedom. Conditional cuts would be a step in the other direction, towards central economic planning, corporatist economic management and a social contract between business and government based on the notion that business will invest more only if it is pressured into doing so by government regulation.[59]

2.62 The committee questioned witnesses about the value of the BCA's Commitment to increase investment which will lead to employment of more Australians and stronger wage growth, if the ETP No. 2 bill is passed.

2.63 Mr Breheny of the IPA stated:

> …does it [the Commitment] help or hinder the case for tax cuts? I think it's neither here nor there. There are a number of different ways that the BCA could've gone. They could've made an ironclad, concrete commitment about increasing the wages of every one of their employees by 10 per cent.[60]

2.64 Professor Swan told the committee that he thought the Commitment was 'a pile of rubbish'.[61] However, this was disputed by the only signatory to the Commitment who appeared before the committee, Mr Frank Calabria, Managing Director and Chief Executive Officer of Origin Energy. That said, in speaking to the committee about the outcomes of the Commitment, Mr Calabria clarified:

> I wouldn't leave you with a message that we wouldn't invest without a tax cut. We would invest. We made a commitment that we would invest more. With a more attractive cost of capital and our ability to introduce more projects that are viable, it will lead to more investment. By leading to more investment, we will see job growth, and we believe that will flow through to wage growth.[62]

2.65 Indicating that it was in the public interest for the Senate to inquire into what the Commitment actually means, Mr Simon Cowan, Research Manager at CIS, suggested that:

> …the mechanisms to measure any commitment or performance by particular companies in the economy are not a strong indicator of whether or not company tax cuts are a good policy or indeed whether or not the tax cuts are a success or failure…[63]

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59 The Centre for Independent Studies, *Submission 3,* [p. 3].

60 Mr Simon Breheny, Director of Policy, Institute of Public Affairs, *Proof Committee Hansard*, 24 April 2018, p. 18.

61 Professor Peter Swan, Private capacity, *Proof Committee Hansard*, 24 April 2018, p. 3.

62 Mr Frank Calabria, Managing Director and Chief Executive Officer, Origin Energy, *Proof Committee Hansard*, 24 April 2018, p. 60.

63 Mr Simon Cowan, Research Manager, The Centre for Independent Studies, *Proof Committee Hansard*, 24 April 2018, p. 8.

2.66 With specific reference to the substance of the BCA Commitment, Mr Cowan explained that:

> It will be very difficult, if not impossible, to separate out the global economic impacts and all of the other factors that are at play here in addition to the factors that would have occurred had the company tax cut not happened. So there's no counterfactual to assess this against, and there's no way to be certain that any positive benefits from investment or wages come from company tax cuts or, indeed, that, if there are no changes, the company tax cut didn't provide a benefit that we would not have otherwise received.[64]

2.67 With regard to the element of the Commitment concerning employment and wages, the ACTU submitted that the promise to spend any extra funds provided by a tax cut on employment and workers' wages:

> …might be credible if the companies concerned had a long history of being stellar employers, passing on the profits earned by their company to their workers. Unfortunately, this has not been the case with several of the signatories.[65]

2.68 ACOSS maintained that 'there is no evidence that the corporate tax cut will deliver the investment or wage growth outcomes implied by the BCA'.[66] Similarly, GetUp stated that they 'believe the BCA's so-called commitment on wages and employment has zero credibility'.[67]

2.69 Put plainly, Mr McCallum of the ACTU told the committee:

> When you boil it down, the core of the BCA's statement to the Senate is big business saying, 'Trust us,' but people don't. Trust in corporations is at a real low at the moment, and for good reasons. They don't, because corporations already don't pay their fair share of tax. They don't, because there has been no increase in wages while business profits have been growing. They don't, because we have been seeing shocking revelations from the banking royal commission about the conduct of big banks who alone stand to benefit from a windfall of over $10 billion under these tax cuts.[68]

Committee view

2.70 The committee disagrees with the BCA that 'senators were asking for a commitment'.[69] However, the committee considers that once the Commitment was

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64 Mr Simon Cowan, Research Manager, The Centre for Independent Studies, *Proof Committee Hansard*, 24 April 2018, p. 8.

65 Australian Council of Trade Unions, *Submission 5*, p. 7.

66 Australian Council of Social Service, *Submission 9*, p. 1.

67 GetUp, *Submission 6*, [p. 2].

68 Mr Lance McCallum, National Campaign Coordinator, Australian Council of Trade Unions, *Proof Committee Hansard*, 26 April 2018, p. 38.

69 Ms Jennifer Westacott, Chief Executive, Business Council of Australia, *Proof Committee Hansard*, 24 April 2018, p. 36

received it was important for the Senate to inquire into its meaning and veracity, to ensure it fully understood its significance in considering the corporate tax cuts proposed in the ETP No. 2 bill.

2.71 It is of particular concern to the committee that the evidence received during the course of the inquiry revealed that the Commitment was drafted, and selected companies from BCA's membership were approached to sign it, within a 24 hour period. In this context, the committee notes that BCA's members from the banking and financial services sector, specifically the big four banks and AMP, were not provided with the opportunity to sign the Commitment. The committee finds this alarming, noting the significant part the financial sector plays in Australia's economy.

2.72 The committee notes the evidence received from submitters about the value of the BCA Commitment, such as 'it's a pile of rubbish' and 'neither here nor there' and that it would be difficult, if not impossible, to determine what new investment would come from the proposed company tax cuts and those investments which may occur regardless of any such intervention. Indeed, the committee observes that the signatories to the Commitment would most probably continue to invest without the proposed tax cut.

2.73 In light of past practices, the committee agrees with stakeholders that the BCA's Commitment on wages and employment has little credibility. Overall, the committee is of the view that the signatories to the BCA Commitment are saying pass the ETP bill No. 2 bill and 'trust us' to increase investment which will lead to greater employment of more Australians and stronger wage growth. The committee again notes the US Congressional Budget Office analysis that the effective corporate tax rate is 10.4 per cent. Therefore, based on the evidence received, the committee is not persuaded that the proposed corporate tax cuts are warranted, nor that the suggested benefits would flow through to greater employment and greater wages for Australian workers.

Alternatives to a corporate tax cut

2.74 Dr Richard Denniss, Chief Economist at TAI, informed the committee that in a recent survey of members of the Australian Institute of Company Directors, the overwhelming majority of them thought that the company tax cuts weren't a high priority.[70]

2.75 Mr Smith of Per Capita suggested to the committee that it was important to think about the opportunity cost of the proposed corporate tax cuts:

> What could we have done instead with government expenditure or tax reform rather than have these corporate tax cuts? If the goal is increased investment, increased employment and increased wages, which is the implication of the BCA's letter, then corporate tax cuts are probably a pretty poor choice because they are only going to really spur investment from

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70 Dr Richard Denniss, Chief Economist, The Australia Institute, *Proof Committee Hansard*, 24 April 2018, p. 27.

> foreign investors because of dividend imputation, and they do very, very little in terms of domestic investment decisions.[71]

2.76 Ms Dawson of Per Capita expressed the view that forgoing revenue due to corporate tax cuts was a bad decision, when it could be used:

> …for budget repair or, in our view, used to invest in lifting people out of poverty and educating the future citizens of Australia or in building infrastructure that would otherwise contribute.[72]

2.77 Some submitters were also of the strong view that there were more preferable approaches that would better target new investment. For example, Grattan submitted that:

> Alternatives to the company tax cut that apply only to new investments—such as an investment allowance or faster depreciation rates—could provide an equivalent boost to investment, but at lower long-term budgetary cost. These approaches would not provide a 'free kick' to existing shareholders, but could prove more difficult to administer.[73]

2.78 Ms Wood of Grattan explained these policy alternatives to the government's proposed corporate tax cuts in more detail:

> Accelerated depreciation schemes or investment allowances are a lower cost way of reducing effective tax rates. This is because they only subsidise new investments and don't give a tax break to those incomes occurring from investments that firms have already made. We think these are an alternative worth exploring to boost investment and wages in the current budget-constrained environment.[74]

2.79 Dr Dixon considered that 'a company tax cut doesn't actually beat just doing nothing' and maintaining the status quo.[75] Dr Dixon was adamant that there were other policies would more directly increase investment than a corporate tax cut:

> …policy to increase investment along the lines of an investment allowance, instant deductions—those types of policies—based on modelling that I have done more recently, an investment allowance would be more effective. It suffers the same problem in that investments that would have taken place anyway now get a little free kick, but we think that loss is less relative to the gain that you would get.[76]

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71 Mr Warwick Smith, Senior Economist, Per Capita Australia, *Proof Committee Hansard*, 26 April 2018, p. 25

72 Ms Emma Dawson, Executive Director, Per Capita Australia, *Proof Committee Hansard*, 26 April 2018, p. 37.

73 Grattan Institute, *Submission 15*, p. 1.

74 Ms Danielle Wood, Budget Policy and Institutional Reform Program Director, Grattan Institute, *Proof Committee Hansard*, p. 13.

75 Dr Janine Dixon, Private capacity, *Proof Committee Hansard*, 26 April 2018, p. 4.

76 Dr Janine Dixon, Private capacity, *Proof Committee Hansard*, 26 April 2018, p. 4.

Committee view

2.80 It is apparent to the committee that while the government's proposed corporate tax cuts may boost economic activity in the long term, in the context of the Australian economy, there remain genuine uncertainties about the costs and benefits of the cuts. The committee notes that policy alternatives to the proposed cuts suggested by stakeholders would result in an equivalent boost to investment, but at lower long-term budgetary cost. Given the seriousness of the current budget deficit and the reduction of tax revenue that would result from the proposed corporate tax cut, the committee has formed the view that it should continue this inquiry into the near future.

Recommendation 2

2.81 The committee recommends that the inquiry be extended until 18 October 2018.

Senator Chris Ketter

Chair