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Federal election 2016: workers ultimately benefit from tax cut

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If you believe its opponents, the only thing cutting company income tax rates won't do is cause cholera. Then again, absolute perfection, even in evil, is not of this world. As far as policy proposals go, however, this one apparently comes close, with the critics portraying it as a giveaway whose benefits, if any, are trivially small, long deferred and mainly for the "billionaire class", while its costs are immediate and material.

One might have thought Labor's support for reducing the company tax rate when it was in office would make it reticent to echo those accusations, much less lead the charge.

No such luck. Cunningly disguised as Barabas from Marlowe's *The Jew of Malta*, Wayne Swan returned to centre stage last week, with Chris Bowen and Andrew Leigh clinging to his pantaloons. Yes, in a previous incarnation, he had advocated lowering company taxes; but "that was in another country,/And besides, the wench is dead." Now, he said, the situation was "entirely different".

Unfortunately, quite how was left shrouded in mystery. After all, basic economic realities have not changed. Australia remains a small economy that relies heavily on foreign investment.

And it is still true that if we are to attract that investment, the after-tax rate of return on foreign capital cannot be less here than overseas.

It is therefore an illusion to believe foreign shareholders bear the burden of paying our relatively high company tax rate: rather, if they are to invest in Australia, their pre-tax incomes must rise to compensate them for that penalty, ensuring they are no worse off than they would have been had they invested elsewhere.

Since that added income has to come from somewhere, Australian wages are lower than they would be were the company tax rate more internationally

competitive.

And because the high tax rate nonetheless discourages some foreign investment, our capital stock is smaller, reducing productivity and national output.

Calculating the quantum of those effects is obviously complex. But the latest analysis by Independent Economics, which undertook the modelling for the Henry tax review, finds that reducing the company tax rate from 30 to 25 per cent would make Australian consumers better off by between $4 billion and $8.7bn dollars, depending on how the cut was financed. Averaged across the alternative financing options, consumers' gain is $6.7bn.

Is that amount insubstantial? Those who regard billions of dollars as small change will claim it is. But in bang for the buck terms, it's a corker.

On a gross basis, the company tax cut involves a direct cost to government budgets of $8.2bn. However, because the economy expands (boosting tax receipts), other taxes only need to increase by $3.7bn to fully fund it. Yet even with those other tax increases, consumers are $3bn better off after tax, yielding a pure gain of 80 cents per dollar of tax switch.

Moreover, the greater the extent to which the cut can be financed by slashing waste, instead of raising other taxes, the larger that dividend will be.

Would the gains take so long to materialise as to make them virtually irrelevant, as the Grattan Institute's John Daley has argued? For sure, the reductions are being phased in gradually: nearly half the effect on tax collections occurs in the last two years of the 10-year transition.

But that phasing means we get the benefit of being more attractive to the next round of investment without having to reduce tax rates very much on assets that are already in place. As for the 15 years it might take for the benefits to be fully realised, it would be absurd to require immediate sugar hits from long-term economic reforms.

What about Andrew Leigh's claim that it is foreign shareholders who will be the winners, along with the much reviled "1 per cent"? Nothing could be further from the truth.

The after-tax return foreign shareholders obtain is already that set in world capital markets; they will continue to earn exactly that return once the company tax rate is reduced. Rather, the effect of the tax cut is that those shareholders' pre-tax returns, which must now be higher to offset our too high tax rates, will decline, reducing the cost to the Australian economy of attracting inward investment.

As for "the 1 per cent", a moment's analysis would have shown that far from raking it in, any gains to domestic capital owners would be transient.

That is not to deny that asset prices might rise in the short run, although to an extent limited by the gradual phasing in of the tax reductions. The long run picture, however, is very different.

In effect, the high company tax rate increases pre-tax returns to all investors, regardless of where they reside; but our dividend imputation system refunds to Australian residents the company tax they have paid, lifting their net income. When company tax rates fall, and pre-tax returns with them, that benefit to domestic owners is reduced.

Put slightly differently, because dividend imputation shields Australian investors from the high company tax rate, that tax rate acts like a tariff, raising the return to domestic suppliers — in this case, of capital — above that to foreign suppliers. Since the reduction in the tax rate lowers that tariff, domestic capital owners are ultimately no better off, with all the gains flowing to other parts of the community.

Why then would Labor oppose a tax reform which increases workers' incomes? Because it would rather squander $8.2bn on its boondoggles than give Australians $11.2bn to spend for themselves. So much for fairness. So much for efficiency.

And so much for Australia's economic future.