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// Briefing Note
– *Four for One?*

Are there really four dollars benefit for every one dollar company tax cut?

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Summary

Last year Treasury published a paper which purported to show that there was a four dollar benefit for every dollar cut in company taxes. In the paper accompanying the 2016-17 Budget, a new set of results was published which dealt directly with cutting the company tax rate from 30 to 25 per cent. The latter paper did not put it in terms of benefit per dollar company tax cut but its results can be reworked to obtain the implied answer.

The simple benefit implied in the 2016 paper, in terms of GDP per dollar of company tax cut is within the range $1.40 to $1.70. But in the Treasury 2016 results a good deal of the benefit goes to foreign investors and in each scenario there is either an increase in taxes or a cut in government services, the costs of which need to be taken into account. When these factors are considered, the 'benefit' of a one dollar cut in the corporate tax is under a dollar and ranges from 6 to 95 cents depending on the scenario.

Discussion

On the ABC's *Q&A* of 20 June the PM, Malcolm Turnbull, has said:

> *the Treasury found last year that for every dollar cut in company tax, you got $4 of benefit of growth into the economy, into GDP of which between two-thirds and three-quarters went to labour, went to workers.*[1]

The Treasury reference would have been to a working paper by Cao et al, a group of Treasury officials, called "Understanding the economy-wide efficiency and incidence of major Australian taxes".[2] The officials were members of the Tax White Paper task force.

Cao et al (2015) did indeed say that in their results 'The combined decrease in labour and capital incomes implies a decrease in real and nominal GDP of around four dollars per dollar of revenue raised' (p 18). The paper by Kouparitsas, Prihardini and Beames (2016) (referred to as 'KPB' below) accompanied the budget papers also discussed the claimed benefits of reducing the company tax rate.[3] While KPB did not explicitly frame their results as benefits per dollar of company tax cut, we can however ask what the KPB paper implies about the four-for-one proposition. This brief seeks to answer the question: What did the Treasury modelling released with the budget imply about the benefit per dollar of corporate tax cut?

[1] ABC (2016) 'Prime Minister Malcolm Turnbull', *Q&A*, 20 June.
[2] Cao L, Hosking A, Kouparitsas M, Mullaly D, Rimmer X, Shi Q, Stark W and Wende S (2015) 'Understanding the economy-wide efficiency and incidence of major Australian taxes', *Treasury Working Paper*, 2015-1, April.
[3] Kouparitsas M, Prihardini D and Beames A (2016) 'Analysis of the long term effects of a company tax cut', *Treasury Working Paper,* No 2016-2, May.

Background

In 2014-15 the company tax rate raised $66.17 billion[4] and moving from 30 to 25 per cent would imply a reduction of $11.03 billion or 0.7 per cent of GDP.[5] We can compare the KPB results with those figures. Table 1 below reproduces some of the results of the KPB paper.

Rows 1 and 2 show the estimate of the long run increase in GDP and GNI that KPB found for a cut in the company tax rate from 30 per cent to 25 per cent under the three different funding scenarios they considered.

Row 3 gives the value of the tax cuts expressed as a share of GDP.

The simple benefit for a dollar of tax cut is given in **Row 4,** by dividing the real increase in GDP (Row 1) by the value of the company tax cuts (Row 3) and expressing the result in the form preferred by Mr Turnbull; dollars of benefit per dollar of tax cut. Row 4 overstates the benefit to Australia of any tax cut, however, as GDP overstates the benefits of tax cuts to the Australian population. For example, Australian workers will pay additional tax under two scenarios and lose government services under the third scenario of the KPB paper. In addition, many of the benefits go to foreign investors rather than domestic investors. So we need to adjust for those complications.

Row 5 calculates the after-tax benefits going to workers with the calculations based on KPB estimates of the baseline average tax rate. That is, Row 5 factors in the additional lump sum and personal income taxes that KPB assume will be required to offset the cost of the corporate tax cuts. This is important because clearly any taxes imposed on workers should be deducted from any claimed benefit for workers.

In **Row 6** we calculate the benefit going to domestic capital, which is calculated by deducting the gross benefits to workers (wage increases and employment increases) from the increase in the gross national income (GNI).[6] That is, in the KPB model there are only three possible beneficiaries; domestic workers, domestic shareholders and foreign shareholders. Given that GNI is GDP adjusted for benefits to foreign shareholders, if we deduct the benefit to domestic workers from GNI the result must be the benefit to domestic shareholders.

Row 7 gives the total domestic benefit by the benefits to domestic workers (Row 5) and the benefits to domestic shareholders (Row 6). The final column of Row 7 includes in brackets the net figure if the value of the government expenditure tax is deducted from the estimated domestic benefit.[7] So far all the figures used are in terms of percentages of GDP and represent movements as a result of the company tax cuts.

Given all of that, we are in a position to calculate the figures in **Row 8**, the net benefit to Australians in dollar values for every $1 cut in company taxes. Recall from earlier that the company tax cut is worth $11.03 billion based on collections in 2014-15 (or 0.7 per cent of GDP). If the benefits of the

[4] Australian Government (2016) *2016-17 Budget Papers*, May.
[5] Based on 2014-15 GDP of $1,610 billion. ABS Cat no 5204.0.
[6] GNI is equal to GDP less the income attributable to non-residents.
[7] KPB report a 1.7 per cent reduction in spending which is compared with the present government share of GDP to give the percentage point deviation from baseline which is then used in subsequent calculations.

tax cuts were four-to-one then the benefits in Row 7, when divided by 0.7 per cent of GDP, should be approximately 2.8 per cent of GDP. But that can also be expressed as dollar value, per dollar of tax cut as it is presented in Row 8.

Table 1: Modelling results as a share of GDP (deviations from baseline, except Rows 4 and 8).

		Scenario 1	Scenario 2	Scenario 3
		Company tax cut financed by lump sum tax	**Company tax cut financed by personal income tax increase**	**Company tax cut financed by reduced Govt spending**
1	Real GDP	1.2	1.0	1.1
2	Real GNI (GNE deflator)	0.8	0.6	0.7
3	Company tax cuts	0.7	0.7	0.7
4	Simple benefit for $1 company tax cut	$1.7	$1.4	$1.6
5	After-tax ‘benefit’ going to workers	0.7	0.1	0.5
6	‘Benefit’ going to domestic capital	0.0	-0.1	0.1
7	Total benefit to Australian workers and capital	0.7	0.0	0.6 (0.2)
8	Domestic benefit for $1 company tax cut	$0.95	$0.06	$0.84($0.34)

It is quite apparent that even the simple benefit, in terms of increased GDP, for a $1 tax cut is much less than the $4 quoted by Mr Turnbull. The KPB results released with the budget by Treasury range from $1.4 to $1.7. These figures are well under half the claimed $4 ‘benefit’.

However, even these significantly lower results are complicated by the fact that many of the benefits of a cut in the corporate tax rate will go to foreigners, and that the wages ‘benefits’ described in the KPB paper are not adjusted for the tax increases, or the impact of cuts in government services assumed to accompany any reduction in the corporate tax rate.

In each scenario the benefits are under the dollar value of the cut in company taxes, with a domestic benefit of 95 cents in the scenario of a lump sum tax used to finance the company tax cut. The income tax increase scenario results in only a six cent increase in ‘benefits’, which is much less than a dollar cut in company tax. Finally, Row 8 scenario 3 shows the dollar ‘benefit’ of the company tax cut at 84 cents. However, this falls to 34 cents when the estimate is adjusted for the loss of government services.