// Briefing Note – Taking an ‘educated guess’

The relationship between living standards and cuts in company tax rates and the provision of better education services

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The following graphs show the relationship between living standards and other variables that are at the centre of the disputes about the future direction of economic policy; cuts in company tax rates and the provision of better education services.

By examining OECD data it is a relatively simple matter to compare how country to country differences in these variables show up in perhaps one of the most important economic indicators, living standards. To measure living standards we use GDP per capita measured using the OECD's purchasing power parity (PPP) estimates. Essentially PPPs correct for market foreign exchange rate movements that may give misleading measures of relative living standards across countries.

Figure 1 compares company tax rates and living standards using the measure described above. All tables below use the latest OECD and IMF data for the variables in question.[1] Because many countries have recently been reducing company tax rates and they can be expected to take a long time to have an effect if any, the average company tax over the last 10 years was used for each country and that is compared with living standards in 2015. The Australian observation is presented as the red observation in each graph.

Figure 1

[1] All data come from Organisation for Economic Co-operation and Development (2016) OECD.Stat at http://stats.oecd.org/Index.aspx?DataSetCode=IDD# accessed 12 February 2016 and the IMF World Economic Outlook database at http://www.imf.org/external/pubs/ft/weo/2015/02/weodata/index.aspx accessed 12 February. Variables related to education were accessed on 18 to 20 June 2016.

It is apparent from Figure 1 that there is no relationship between company tax rates and living standards. There is nothing in Figure 1 to support the notion that company tax cuts increase the living standards of the population generally.

The next variable we have chosen to examine is public spending on education at all levels as a share of GDP. The spending reported here goes from primary through to higher education. The results are shown in Figure 2. Note that of the data the OECD makes available Luxembourg was excluded being a clear outlier with a massive per cap GDP. That appears to have more to do with its tax haven status.

Figure 2

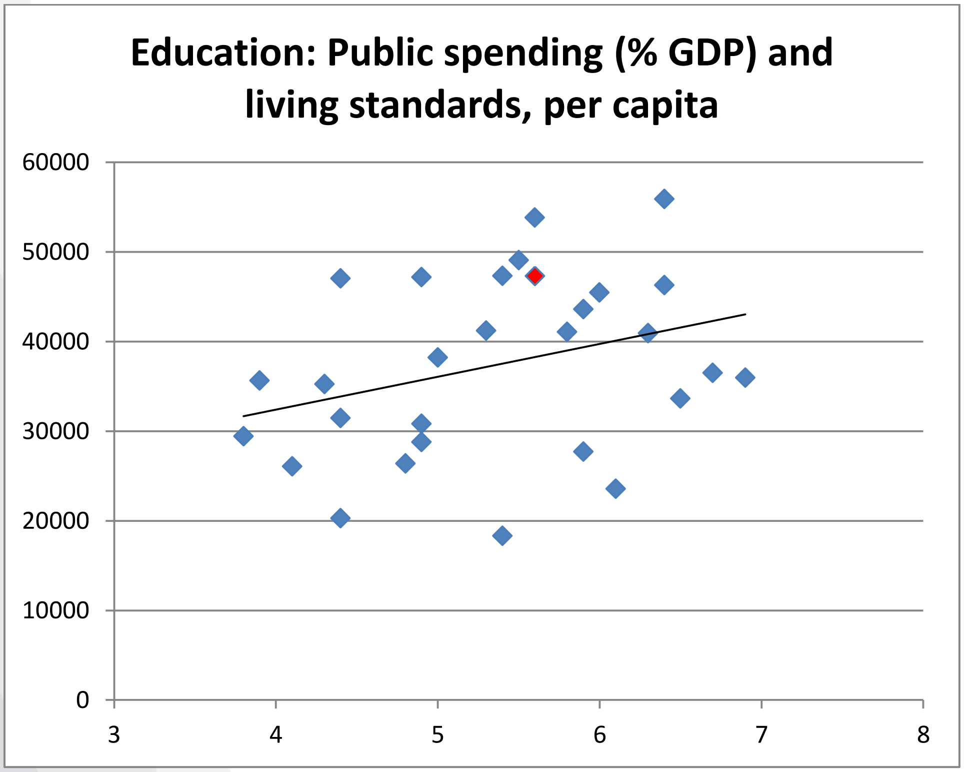

Figure 2 clearly shows a strong relationship between public spending on education and living standards as defined above. More spending on public education is correlated with higher living standards.

It is useful to double check such a result by using a completely different measure of education and in this case we have decided to examine the link between education among the labour force and the earlier measure of living standards. In this case educational attainment is measured by the proportion of the labour force of those aged 25 to 65 who have completed high school or beyond. Those results are presented in Figure 3.

Figure 3

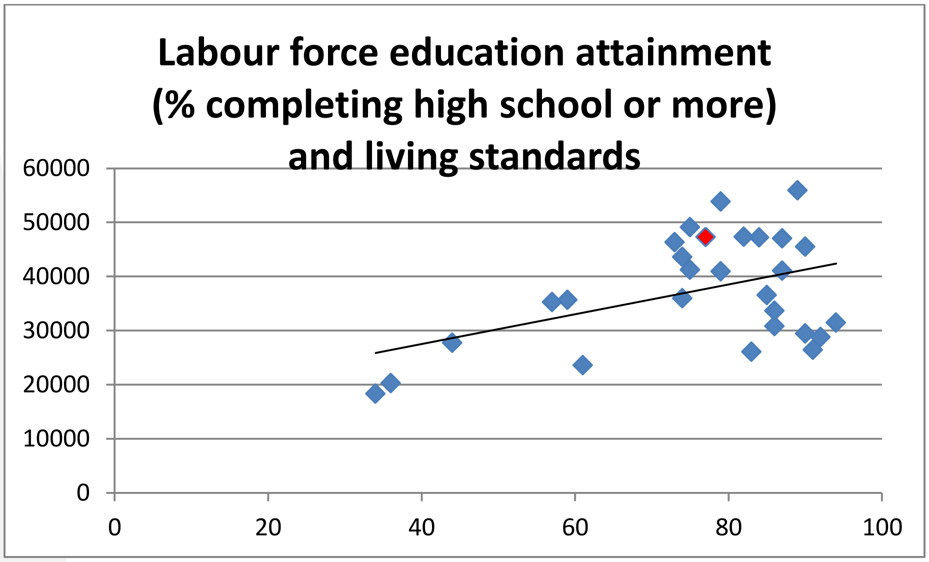

Figure 3 shows a strong relationship between living standards and the education attainment of the labour force. When preparing the data it was apparent that there were a number of former Eastern Bloc countries; Estonia, Hungary, Poland, Slovak Republic, and Slovenia, that had high educational attainment levels but relatively low living standards. Figure 4 was presented to show the impact of excluding those countries.

Figure 4

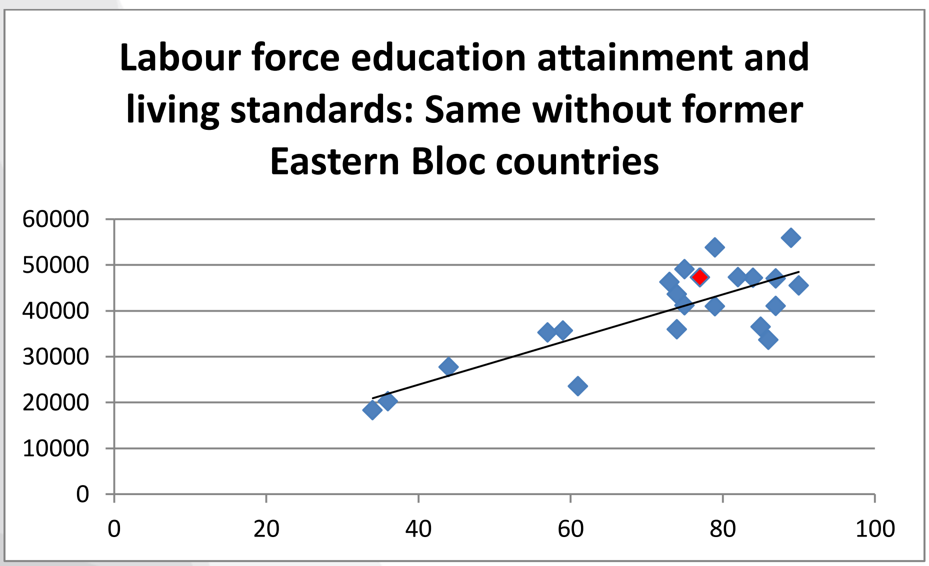

Figure 4 shows that by excluding the former Eastern Bloc countries from the OECD data the relationship between education attainment and living standards is even stronger.

The data presented here clearly suggest that if there were a choice between funding company tax cuts or more education spending governments would be well-advised to concentrate on the latter.