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Company tax is close to highest

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THE government's failure to win support of the Greens and the Coalition for its one percentage point cut to the company tax is being shrugged off, with the reduction seen as so small that it scarcely matters.

The Henry review wanted a much more substantial cut, lowering the company tax rate from 30 per cent to 25 per cent but, like so many of the review's proposed reforms, there was never a political constituency for it and the government did nothing to build one.

Without the numbers in the Senate, any company tax cut now appears doomed.

The review had been a bright idea at Kevin Rudd's 2020 summit, where it was argued that the budget would never be in a better position to fund tax reform, if only we had a vision of what to do.

As Wayne Swan ruefully noted last week, the biggest problem he confronted at the time was what to do with massive budget surpluses.

By the time the Henry review was delivered over the summer of 2009-10, the budget was deep in deficit. At Labor headquarters, where planning was under way for the 2010 election, the Henry review was seen as 1000 pages of bad ideas. When unveiling the government's response in May 2010, the Treasurer claimed that using mining tax revenue to cut the company tax rate from 30 per cent to 28 per cent would improve Australia's standing in world tax competitiveness from 22nd to 17th.

That was two years ago. Australia's standing is now 28th, and the government's proposed 1 per cent cut would improve its rank to only 26th. If the Coalition were to impose its surcharge to cover the cost of paid parental leave, Australia would leapfrog Germany to become the fifth highest taxing country for business in the developed world. Out of 34 OECD countries, we would rank 29th.

Last year's tax forum achieved little but did highlight the complete lack of understanding of the case for the reform as one union leader after another stood up to denounce the planned one percentage point company tax cut.

"We're not convinced that cutting company tax actually will benefit our community or, indeed, the economy," United Voice secretary Louise Tarrant said.

She argued that companies were highly profitable and if they didn't pay their fair share of tax, then somebody else - her low-paid members for example - would have to "pick up the tab".

To Ken Henry's protestations that public finance theory had shown since the 1960s that the burden of company tax ultimately fell on wage earners anyway, the then ACTU secretary Jeff Lawrence said he was not convinced by "some sort of a theoretical model".

It was all, in fact, "a self-serving business agenda which is really about increasing profits as against the benefits to the economy", he said. The theory is simple enough. Money is mobile. It will go to whichever part of the world delivers the best final return after allowing for risk.

In countries with higher taxes, investors will demand a higher pre-tax return. As most unionists in the private sector would recognise, when a company comes under pressure to increase the level of profit, it tries to cut back its wage costs and its investment. Across an economy, the effect of higher company tax is reduced investment, lower productivity and lower wages.

The Henry review put some numbers to this. Academic research showed that a five percentage point reduction in the company tax rate would result in a 1.9 per cent increase in investment and a 0.4 per cent improvement in productivity.

Studies have shown that a 10 per cent increase in the company tax rate results in a 7 per cent to 10 per cent cut in wages.

In the mining industry, the rewards flowing from the China boom are so large that there is abundant incentive to invest, notwithstanding the new mining tax. The last investment survey by the Australian Bureau of Statistics found that miners were planning to lift investment next financial year by 50 per cent.

But elsewhere in the economy, investment is falling. In manufacturing, companies expect to cut investment by 8 per cent, while in the rest of the non-mining economy a 4 per cent fall is in prospect.

Australia will not get investment in the non-mining economy with one of the world's highest company tax rates.

Yet the thought that our high company tax rate is depressing our productivity, our real wages and our future prosperity has formed no part of the debate.

The Coalition has made a narrow argument to reject lower company taxes because it forms part of a package with the mining tax, which it also rejects. It regards its company tax surcharge to pay for its parental leave scheme as a temporary inconvenience.

The government decided at the outset that the mining tax would be the sole new revenue-raising response to the Henry review and that the proceeds had to be spread more widely than just cutting the company tax rate.

Only a token 2 per cent company tax cut could be afforded, whittled back to 1 per cent when the mining tax was scaled back. Now, in the teeth of Greens opposition, no change seems possible.

Swan said last week it was the change in the budget that limited the scope of the government's tax reform agenda. "Gone are the days when when tax reform is accompanied by big bribes that get communities or industries on board," he told the Tax Institute.

Arguably, the compensation package accompanying the carbon tax has done just that. However, Henry never imagined that his report's recommendations could be implemented at once.

"Reforms should not be pursued in one big-bang package," Henry told last year's tax forum. "Good policy outcomes are more likely where there has been high-quality debate."

That is what has been missing. The government should have issued a green paper, outlining the issues it was considering and seeking broad comment, to be followed by a white paper, detailing its plans. Instead, the government's response was presented as fait accompli. The resource super-profits tax was a debacle, bringing down then prime minister Rudd, and progress on critical areas of tax reform, such as our extraordinary level of company tax, has been lost.