Productivity - it's what every galah in the pet shop is talking about, as Paul Keating might say, and will be the economic focus of the newly re-elected Albanese government this parliament.
The Productivity Commission, tasked with figuring out how to get Australia's sluggish productivity back on track, is pushing hard for corporate tax cuts as a key part of their plan for building a "dynamic and resilient economy." The idea? Lower taxes will attract more foreign investment, get businesses spending again, and eventually boost how productive our workers are.

Right in theory

The theory makes sense: make capital cheaper, and you should get more of it flowing in. And looking overseas, the evidence mostly backs this up. A meta-analysis of 25 studies by Ruud de Mooij and Sjef Ederveen found that every percentage point you slice off the corporate tax rate brings in about 3.3% more foreign direct investment.

Other research shows that multinational companies really do move their operations to places with lower tax rates - which explains why we're seeing this race to the bottom across Europe and North America, with countries constantly trying to undercut each other. Michael Devereux and Rachel Griffith's work on location decisions shows how multinationals reshuffle their operations based on effective average tax rates. Even within the US, a study by Alexander Ljungqvist and Michael Smolyansky found that increases in corporate tax rates lead to significant reductions in employment and wage income, while corporate tax cuts only boost economic activity if implemented during recessions.

The unlucky country?

However, here in Australia we don't have much local evidence to go on, and what we do have is pretty puzzling. This matters because Australia's corporate tax system has some unique features that may make overseas evidence less reliable: we have dividend imputation (franking credits), different treatment of capital gains, immediate expensing rules for small businesses, and complex thin capitalisation rules that limit debt deductions for multinationals.

One relevant study is a recent paper by Nu Nu Win, Jonathan Hambur and Robert Breunig - a group of ANU economists - examining the impact of temporary investment allowances. But hidden deep in an appendix C (see below) they examined the 2015 and 2016 small business tax rate cuts as a robustness test to their main results.

Appendix C: Testing for the Effect of Corporate Tax Changes

To explore the possible effect of the corporate tax cuts, we re-estimate the DD models using buildings & structures investment from the CAPEX data described above. This asset class is ineligible for the investment incentives that we study in this paper.

Looking at the results for the GFC policy period, we can see there is no significant increase in investment in buildings & structures either on the intensive or extensive margins. There appears to be no complementarity between investment in these asset types (i.e. increases in eligible machinery & equipment have no effect on investment in buildings & structures). This suggests that looking at buildings & structures can be a useful placebo test for other ITB policies.

In contrast, for the 2015, and to a lesser extent 2016, policies there is evidence of an increase in buildings & structures investment, suggesting that firms reacted to the corporate tax cuts.[17] As firms appear to be responding to the corporate tax cuts, we should be cautious about interpreting our findings regarding the effects of the 2015 and 2016 ITB.

Table C1: DD Regression Results for Building & Structures

	Intensive margin			Extensive margin		
	All firms	Companies	Unincorporated	All firms	Companies	Unincorporated
GFC 2009	–0.017	–0.074		–0.242	–0.182	–0.449
	(0.440)	(0.526)		(0.173)	(0.172)	(0.285)
Observations	1,250	734		25,880	13,330	12,518
Small 2015	0.665**	0.829*		0.010	–0.157	0.070
	(0.312)	(0.448)		(0.226)	(0.269)	(0.333)
Observations	1,317	761		16,808	9,040	4,008
Medium 2016	0.171	0.294		0.219*	0.156	0.277
	(0.323)	(0.351)		(0.125)	(0.134)	(0.181)
Observations	1,897	1,493		10,612	7,651	2,908

Notes: Results exclude mining. Regressions do not include controls due to small sample size. ***, ** and * denote statistical significance at the 1, 5 and 10 per cent levels, respectively. Cluster robust standard errors in parentheses.

The results were decidedly mixed. In 2015, a tax cut caused spending by companies to rise, but only on the intensive margin (bigger dollar amounts among firms that would have invested anyway). The lack of a statistically clear extensive-margin effect suggests it did not entice many new firms to start building projects. Another tax cut was rolled out in 2016, but the effect was so small it might have been noise. It's unclear why the cut in corporate tax rates failed to measurably boost investment. Perhaps the tax cut was just too small, or the data too noisy. But it should give us pause for thought.

For politicians thinking about another round of corporate tax cuts, this creates an uncomfortable situation. We've got solid evidence from overseas that it works, but only one weak data point from Australia, plus a lot of head-scratching about why the second cut didn't do much.

Fortunately, we have a large, well-staffed agency of boffins who are well placed to figure out the answer to this question – the hint is in the name – the Productivity Commission! Before we go down the path of further cuts to the company tax rate, we should have an in-depth study of these two tax cuts replicating and extending the work done by Nu Nu Win, Jonathan Hambur and Robert Breunig to see what effect – if any! – they had on investment, productivity and Australian living standards. While Win, Hambur and Breunig limited their research to business investment, in theory a lower corporate tax rate should also incentives employment & hiring among the companies. Testing this theory with the same method should help us discover if a company tax cut is worth the squeeze.

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