

[Moves](#) by President Donald Trump to slash the US corporate tax rate to 20% have been met by [calls](#) for Australia to do the same, or risk losing investment dollars.

But it is [not clear](#) that lower corporate taxes result in more investment, employment and growth – especially as corporate taxes have already fallen significantly in the OECD over the past few decades.

If we want to attract more investment there are [other areas](#) that Australia should address, such as the large time and cost involved in exporting and importing goods, or improving corporate governance regulations.

It has also been [estimated](#) that in OECD countries the rate that maximises revenues from corporate tax is between 26% and 32%. Cutting the corporate tax rate below 26% (and possibly anywhere below 30%) will likely result in smaller government revenues. This would mean either increasing other taxes or cutting expenditure, such as the provision of education, health care and social welfare for the poorer people in the country.

Australia's corporate tax rate is 30%, [the fourth highest](#) among OECD countries – or fifth if state and local taxes are also factored in. At the moment US corporate taxation is the highest of all OECD countries, at 35%. The Trump plan would see this reduced to slightly below the OECD average of 22%.

Location, location, location

In a globalised world, countries compete against each other to attract foreign investment. To the extent that profits are taxed in the country of operation, there is something to the idea that multinational firms prefer to locate their operation in low-taxation countries.

This is at least part of the reason why the average corporate tax rate in OECD countries has dropped from around [50%](#) in the 1980s to 22% now. But now that taxes are much lower, they play a [significantly less important](#) role in business decision-making.

Why Australia doesn't need to match the Trump tax cuts

Written by The Conversation

Businesses do not necessarily relocate to the country where corporate taxes are lowest, but consider a broad set of factors. These include the cost of production and productivity levels in each country.

The cost of production is primarily determined by the cost of labour, meaning that firms tend to [relocate to countries where wages are lower on average](#)

. Regulations also affect the cost of production. For instance, more business-friendly regulations (such as fewer restrictions on working hours and dismissal procedures, or more flexible contracts) and less stringent environmental regulations [tend to attract more foreign direct investment](#)

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Of course, this raises the concern that in an attempt to attract foreign capital, countries (particularly emerging and developing countries) might engage in a “race to the bottom” on labour and environmental standards.

Meanwhile, productivity [depends](#) on the quality of institutions (absence of corruption, political stability, credible enforcement of property rights and contracts), the government’s [economic policies](#)

(adequate infrastructure and a stable macroeconomic framework with low inflation, a stable currency, a sustainable fiscal policy position), and

[the size of the country’s market](#) and distance from other major markets.

While it is difficult to rank these factors in order of importance, it is clear that a business will not simply locate to a country with low taxes if that country does not offer, for instance, good infrastructure, a stable political and economic environment, business-friendly regulations, and/or relatively cheap labour.

This is corroborated by [empirical research](#) showing that lower corporate tax rates do not necessarily boost economic activity. If they do, it is generally

[because the initial tax rate is very high](#) (for instance, a capital income tax rate above 60%).

Doing business in Australia

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Cutting the corporate tax rate to 25% might not therefore be the best way to boost economic activity in Australia. The fact that businesses care about the cost of production and productivity means that there are other policies that can be pursued.

Australia already appears to have several attractive features: a relatively stable macroeconomic environment (at least compared to some other OECD countries); a favourable geographical location (close to some of the largest and fastest-growing markets in the world, with an abundance of natural resources); and a safe political environment (in spite of the recent increase in the frequency of government changes).

There are, however, other areas where policy intervention is desirable. Two in particular are worth a mention.

The first one is industrial policy. Australia needs a more proactive approach to promote and support innovative sectors and industries.

In this respect, the system of incentives and support for innovative entrepreneurs should be extended beyond what is currently included in the [National Innovation and Science Agenda](#) and, at the same time, made conditional on performance.

In particular, this system should include a broad set of financial incentives (including tax concessions, access to credit, subsidies) combined with a mechanism for performance assessment based on transparent benchmarks. The incentives would be provided to any innovative enterprise (in any sector or industry) as long as the performance benchmarks are met.

The second area of intervention is, broadly speaking, the “ease of doing business”. This is determined by the extent to which business regulations and their enforcement support (or not) the activity of firms in the country.

Drawing on [World Bank data](#) , we can see that Australia could improve in two main regulatory areas.

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The first is the time and cost associated with exporting and importing goods. While Australian companies inevitably face a certain amount of time and cost due to our geographic remoteness, it is also true that border compliance in Australia takes three to four times longer than in other high-income OECD countries and costs five times more. More efficient border procedures should be implemented to reduce the time and cost of compliance.

The second area is corporate governance, particularly in terms of protecting minority shareholders' rights. Australia currently ranks 63rd in the world in protecting these rights. Australia should strengthen the regulatory environment to increase corporate transparency, protect shareholders from undue board control and entrenchment, and ensure that shareholders have effective rights and a role in major corporate decisions.

In the end, reducing the corporate tax rate might not be the ideal strategy to achieve sustainable and inclusive long-term economic growth. But there are [plenty of other options](#) .

Fabrizio Carmignani receives funding from the Australian Research Council for a project on the estimation of the piecewise linear continuous model and its applications in macroeconomics.

Read more <http://theconversation.com/why-australia-doesnt-need-to-match-the-trump-tax-cuts-84903>