Non-technical summary for 'Are Investment Tax Breaks Effective? Australian Evidence'

By Nu Nu Win, Jonathan Hambur and Robert Breunig

What did we set out to do?

Business investment is crucial for economic growth and prosperity. It contributes to productivity – the key driver of living standards – by raising the amount and quality of equipment in the economy. It also plays an important role in driving economic cycles. It is unsurprising then that Australian policymakers have used various tax policies to promote additional business investment both during 'normal' times and in response to economic downturns.

There are two reasons why it is important to understand whether these policies promote additional investment:

1. These policies are costly to the government as they mean less tax revenue, so it is important to understand if they are having the intended benefits.
2. If they do affect investment, this will influence overall economic activity. So, understanding these policies can help us to forecast what is going to happen in the economy after they are implemented or removed, which is particularly important during downturns.

Our research examined several investment tax break (ITB) policies used over the past two decades to see whether they increased investment. We considered policies used during the global financial crisis (GFC) and the COVID-19 pandemic, as well as several others used in the 2010s.

A key difficulty in measuring the effect of these policies is that other factors may also be at play. For example, investment may have been low during the pandemic due to economic shutdowns, however it might have been even lower without the ITB. But how can we tell? To get around this issue, we use the fact that not all firms were eligible for the ITB. All the policies we consider only applied to firms with revenue below certain levels. So we use various techniques to compare firms that were and were not eligible, based on their revenue, to tease out the effects of the policies.

What did we learn?

Our research revealed three key findings:

- The ITB used during the GFC increased investment significantly. However, we found no substantial evidence that other policies, including those implemented during the pandemic, increased investment. This may reflect:
  - differences in the policies themselves – for example, many of the policies introduced in the 2010s gave small benefits, and so may not have led to a large and detectable response
  - differences in the economic environment – for example, the pandemic policies were brought in when there were large economic disruptions, so businesses may not have wanted to invest, or may have had difficulty getting equipment installed.
- Unincorporated businesses appear to be more responsive to ITBs than incorporated companies. This is consistent with Australia's tax system, where shareholders can lower their tax bill to reflect taxes already paid by the company. This makes ITBs less valuable for companies, particularly domestically owned small companies.

- While not the focus of this research, there is some very tentative evidence that corporate tax cuts for small businesses in the mid-2010s led to some additional investment. However, further detailed work is needed to properly assess this policy.

What was our key takeaway?

ITBs can be effective tools for stimulating the economy during a downturn – but this is highly dependent on the nature of that downturn. Outside of this, smaller policies targeted at 'structurally' raising the level of investment during normal times seem to have very limited effects and so future policies might require different features to achieve their intended benefits.