

CAN TAX REFORM MAKE US MUCH BETTER OFF?

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THANK YOU VERY MUCH LADIES AND GENTLEMAN. I FEEL HONOURED BY YOUR KIND INVITATION TO TALK WITH YOU TODAY ON THE IMPORTANT SUBJECT TAX REFORM, AN ISSUE THAT CERTAINLY AFFECTS US ALL!

WHEN WE ORIGINALLY ORGANISED THIS TALK, LITTLE DID WE KNOW THAT WE'D BE IN THE MIDDLE OF AN ELECTION CAMPAIGN BY NOW. ISSUES LIKE COMPANY TAX CUTS, NEGATIVE GEARING AND SUPERANNUATION TAX CONCESSIONS ARE ALREADY FRONT-AND-CENTRE IN THAT CAMPAIGN – AND I'LL CERTAINLY TALK ABOUT EACH OF THOSE ISSUES, BUT I'D LIKE TO TAKE US BACK A BIT TO FIRST PRINCIPLES FIRST....

TODAY, I'D LIKE TO TALK ABOUT 3 THINGS IN PARTICULAR:

1. THE LEVEL OF TAXATION; DO WE PAY TOO MUCH – OR TOO LITTLE TAX? NOW, YOU MIGHT WONDER WHY I NEED TO ASK THIS – I SUSPECT THAT IF I TOOK A POLL IN THE ROOM, NOT MANY OF US WOULD SAY WE PAY TOO LITTLE TAX – I CERTAINLY WOULDN'T!;
2. THE MIX OF TAXATION – IF WE HAVE TO PAY TAXES, WHICH TAXES ARE THE LEAST COSTLY TO OUR SOCIETY AS A WHOLE?; AND
3. HOW AND WHY TAX REFORM CAN MAKE OUR SOCIETY BETTER OFF?

I ALWAYS LIKE TO GET TO THE BOTTOM-LINE UP-FRONT IN MY TALKS, SO
HERE IT IS: YES, TAX REFORM AT ALL LEVELS OF GOVERNMENT – FEDERAL,
STATE AND LOCAL – CAN MAKE AUSTRALIAN CITIZENS BETTER OFF IN NET
TERMS BY AT LEAST \$20 BILLION PER YEAR – AND POSSIBLY UP TO \$50
BILLION PER YEAR. THAT’S ABOUT \$800 TO \$2,200 PER MAN, WOMAN AND
CHILD PER YEAR. SO TAX REFORM MATTERS – OR SHOULD MATTER.

TO SEE WHY, LET’S START WITH THE FIRST ISSUE: THE LEVEL OF TAXATION.

OF COURSE, GOVERNMENTS SHOULD TAX THEIR CITIZENS TO SOME EXTENT –
IF SPENDING THE MONEY THEY COLLECT MAKES OUR SOCIETY BETTER OFF
AS A WHOLE – THAT IS, IF IS IN IN THE “PUBLIC INTEREST”. MOST OF US
WOULD AGREE THAT GOVERNMENTS SHOULD PROVIDE SOME “PUBLIC
GOODS” SUCH AS LAW AND ORDER AND DEFENCE THAT MAY NOT
OTHERWISE BE PROVIDED. MOST OF US WOULD AGREE THAT GOVERNMENTS
SHOULD DIRECTLY ASSIST THE MOST DISADVANTAGED MEMBERS OF
SOCIETY.

HOWEVER, I’D HAVE TO SAY THAT OUR GOVERNMENTS SPEND – AND HENCE
TAX US – FAR MORE THAN CAN BE JUSTIFIED BY THE PUBLIC INTEREST.

GROWTH IN GOVERNMENT SPENDING – AND THEREFORE TAXATION – OVER
THE LAST HALF-CENTURY OR SO HAS BEEN ENORMOUS. BETWEEN 1961/62
AND 2014/15, TOTAL (GENERAL) GOVERNMENT SPENDING ACROSS ALL

LEVELS OF GOVERNMENT HAS RISEN IN REAL TERMS – AFTER ADJUSTING FOR INFLATION – BY 940%, TO \$583 BILLION TODAY!

OF COURSE, THERE ARE REASONS WHY GOVERNMENT SPENDING SHOULD HAVE RISEN TO SOME EXTENT. FOR EXAMPLE, OUR POPULATION HAS MORE THAN DOUBLED. BUT GOVERNMENT SPENDING HAS FAR OUTSTRIPPED POPULATION GROWTH – INDEED, PER CAPITA SPENDING HAS RISEN IN REAL TERMS BY 363%M, TO \$24,678 PER MAN, WOMAN AND CHILD PER YEAR.

BUT THERE MAY BE SOME VALID REASONS WHY EVEN GOVERMNET SPEND PER CAPITA SHOULD HAVE RISEN. FOR EXAMPLE, AS OUR INCOMES RISE, WE DESIRE MORE PUBLIC GOODS AND WE MAY BE MORE WILLING TO BETTER SUPPORT OUR MOST DISADVANTAGED CITIZENS – AND DISADVANTAGED PEOPLE IN THE REST OF THE WORLD THROUGH FOREIGN AID, IMMIGRATION, ETC. FURTHERMORE, OUR DEMOGRAPHICS HAVE CHANGED (OUR POPULATION IS AGING).

NEVERTHELESS, IT IS HARD TO JUSTIFY A 363% REAL INCREASE IN SPENDING PER CAPITA ON THOSE GROUNDS.

DESPITE OUR MASSIVE GROWTH IN GROSS DOMESTIC PRODUCT (GDP), GOVERNMENT SPENDING HAS JUMPED FROM 24.6% OF GDP TO 36.2% OF GDP. TODAY, OUR GOVERNMENTS SPEND 36.2% OF ALL THAT WE AS A NATION PRODUCE!

THIS GROWTH IN GOVERNMENT SPENDING HAS RAISED OUR TAX BURDEN ENORMOUSLY. THE TAXES THAT WE PAY HAVE GROWN FROM 22.2% OF GDP TO 27.7% OVER THE LAST HALF-CENTURY.

WE CURRENTLY PAY TAXES OF \$446 BILLION PER YEAR – THAT’S LESS THAN TOTAL GOVERNMENT SPENDING, PARTLY BECAUSE OUR GOVERNMENTS ARE RUNNING BUDGET DEFICITS (WHICH ARE CAUSING GOVERNMENT DEBT TO RISE AND WILL THEREFORE RESULT IN HIGHER FUTURE TAXES). IT’S ALSO PARTLY BECAUSE GOVERNMENTS GET SOME OF THEIR REVENUES FROM NON-TAXATION SOURCES (SUCH AS DIVIDENDS FROM GOVT BUSINESS ENTERPRISES).

OUR TAXES EQUATE TO \$18,888 PER MAN, WOMAN AND CHILD PER YEAR.

MY BIG CONCERN IS THAT GOVERNMENTS IN THEIR SPENDING (AND HENCE TAXATION) DECISIONS DON’T TAKE ACCOUNT OF THE FACT THAT THE COST OF RAISING \$1 OF TAX REVENUE IS ACTUALLY MUCH MORE THAN \$1.

ECONOMISTS ESTIMATE THAT THE REAL COST OF RAISING AN EXTRA \$1 OF TAX REVENUE IS ABOUT \$1.30. THE DIRECT COST TO WE TAXPAYERS OF \$1 TAKEN AWAY IS, OF COURSE, \$1. THE OTHER 30 CENTS – WHICH ECONOMISTS CALL THE “EXCESS BURDEN” OF TAXATION – REFLECTS THE COSTS OF DISTORTIONS THAT TAXES CAUSE TO OUR DECISIONS – SUCH AS OUR WORK, CONSUMPTION, SAVING AND INVESTMENT CHOICES. FOR EXAMPLE, HIGH

PERSONAL TAX RATES ENCOURAGE US TO WORK LESS HOURS OR INVEST LESS IN DEVELOPING OUR OWN “HUMAN CAPITAL”.

TO PUT THIS IN PERSPECTIVE, WHEN WE INCLUDE THE “EXCESS BURDEN” OF TAXATION, THE REAL TOTAL COST OF GOVERNMENT SPENDING ISN’T \$583 BILLION – AS BIG AS THAT IS – BUT ABOUT \$682B.

I WOULD CONSERVATIVELY ESTIMATE THAT IF GOVERNMENTS DID TAKE ACCOUNT OF THE FACT THAT THE REAL COST OF EACH \$1 THEY SPEND IS \$1.30 – NOT \$1 – IN THEIR SPENDING DECISIONS, GOVERNMENT SPENDING WOULD BE AT LEAST ONE-THIRD LOWER. THE BIGGEST SAVING WOULD BE BY REDUCING THE SO-CALLED “TAX CHURN” – THAT IS, GOVERNMENTS TAXING CITIZENS AND THEN GIVING THE MONEY STRAIGHT BACK TO THE SAME CITIZENS IN WHAT IS OFTEN CALLED “MIDDLE-CLASS” WELFARE. EXAMPLES INCLUDE EDUCATION SUBSIDIES AND VARIOUS FAMILY BENEFITS.

A ONE-THIRD REDUCTION IN GOVERNMENT SPEND WOULD STILL LEAVE GOVT SPEND AT OVER 24% OF GDP – ABOUT THE SAME AS IT WAS HALF-A-CENTURY AGO. BUT GIVEN OUR SUBSTANTIAL GROWTH IN GDP, REAL GOVERNMENT SPENDING PER CAPITA WOULD STILL BE \$16,452 – MORE THAN THREE-TIMES WHAT IT WAS THEN. AND VERY IMPORTANTLY, OUR SOCIETY WOULD BE MUCH BETTER OFF BECAUSE THE EXCESS BURDEN OF TAXATION WOULD BE REDUCED BY \$33 BILLION – THAT’S \$1,400 PER MAN, WOMAN AND CHILD PER YEAR.

SO CUTTING THE LEVEL GOVERNMENT SPEND – AND HENCE TAXATION – WOULD MAKE US MUCH BETTER OFF. BUT SO TOO WOULD CHANGING THE MIX OF TAXES.

WE HAVE AN INCREDIBLY COMPLEX TAX SYSTEM. ABOUT 125 DIFFERENT TYPES OF TAXES ARE LVEVIED ON US. BUT THE TOP 10 TAXES ACCOUNT FOR 90% OF TAX REVENUES. SO THERE IS GREAT SCOPE FOR SIMPLIFICATION. EVEN MORE IMPORTANTLY, ECONOMIC RESEARCH SHOWS THAT SOME TAXES DISTORT OUR DECISIONS BY MUCH MORE THAN OTHERS.

STAMP DUTIES ON PROPERTIES TRANSFERS ARE ABOUT THE MOST INEFFICIENT TAX THERE IS – THEY IMPOSE A VERY HIGH EXCESS BURDEN. THE REAL COST OF RAISING \$1 OF TAX REVENUE THROUGH STAMP DUTIES IS ABOUT \$1.80. TAKE ME AS AN EXAMPLE. AS MY KIDS ARE NOW GROWN UP, I'D PROBABLY DOWNSIZE TO A SMALLER HOME IF IT WASN'T FOR STAMP DUTIES. STAMP DUTIES REDUCE THE PRICE THAT BUYERS ARE WILLING TO PAY FOR MY HOUSE AND INCREASE TO COST TO ME OF PURCHASING A MORE SUITABLE HOME. I'D HAVE TO ADMIT THAT A YOUNG FAMILY WITH KIDS WOULD GET MORE BENEFITS OUT OF OWNING MY HOME THAN I DO. BUT STAMP DUTIES STAND IN THE WAY OF HOUSING BEING ALLOCATED TO THOSE WHO VALUE IT MOST.

COMPANY TAXES ARE ANOTHER RELATIVELY COSTLY TAX. THE COST OF RAISING \$1 OF TAX REVENUE THROUGH COMPANY INCOME TAXES IS ABOUT

\$1.50. PAYROLL TAXES AND INCOME TAXES ARE NEXT IN LINE (COSTING ABOUT \$1.25 TO \$1.30 PER \$1 RAISED). GST IS REASONABLY EFFICIENT (COSTING \$1.20).

BUT WHAT ARE THE LEAST-COSTLY TAXES OF ALL?: TAXES ON IMMOBILE ASSETS – SUCH AS LAND TAXES AND MINERAL RESOURCE RENT TAXES. BECAUSE THOSE ASSETS ARE IMMOBILE, TAXES ON THEM TEND TO DISTORT OUR DECISIONS LEAST AND TAX AVOIDANCE IS VERY DIFFICULT.

UNFORTUNATELY, THE LEAST-COSTLY TAXES ARE NOT THE MOST POLITICALLY POPULAR – AT LEAST WHEN THEY'RE CONSIDERED IN ISOLATION. BUT WE REALLY NEED TO CONSIDER TAX REFORM PACKAGES, RATHER THAN JUST CONSIDER ONE TAX AT A TIME. FOR EXAMPLE, A PACKAGE THAT REPLACES STAMP DUTIES WITH LAND TAXES MAY BE LESS UNPOPULAR.

CURRENTLY, THE TOTAL EXCESS BURDEN OF TAXATION IS ABOUT \$76 BILLION – OR OVER \$3,200 PER MAN, WOMAN AND CHILD PER YEAR. WE CAN'T ELIMINATE ALL OF THAT EXCESS BURDEN – AS WE DO NEED TO RAISE TAXES TO FUND SOME GOVERNMENT EXPENDITURES – BUT WE CAN REDUCE THE EXCESS BURDEN SIGNIFICANTLY BY CHANGING OUR TAX MIX TOWARDS THE LEAST-COSTLY TAXES.

FOR EXAMPLE, MY COLLEAGUE CHRISTOPHER FINDLAY AND I WROTE IN *THE AUSTRALIAN* LAST YEAR THAT TWO RELATIVELY SIMPLE TAX REFORMS

ALONE – ABOLITION OF STAMP DUTIES FUNDED BY REMOVING EXISTING LAND TAX EXEMPTIONS (WHICH DISTORT LAND USE) AND A HALVING OF THE COMPANY TAX RATE FUNDED BY A 0.6% LAND TAX – WOULD MAKE US BETTER OFF AT LEAST \$20 BILLION PER YEAR – THAT’S MORE THAN \$800 PER MAN, WOMAN AND CHILD PER YEAR.

SO WHAT ABOUT THE TAX ISSUES THAT HAVE BEEN FLOATED IN THE CURRENT ELECTION CAMPAIGN?

LET’S TAKE NEGATIVE GEARING FIRST. ECONOMISTS WOULD GENERALLY ARGUE THAT GIVEN THAT COMPANIES CAN DEDUCT LOSSES ON NON-HOUSING INVESTMENTS AGAINST THEIR OTHER INCOME, INVESTORS IN HOUSING SHOULD ALSO BE ABLE TO DO SO. THEREFORE, IN THIS CASE, REMOVING NEGATIVE GEARING ON HOUSING WOULD CAUSE A DISTORTION IN INVESTMENT AWAY FROM HOUSING.

THERE IS MUCH CONTROVERSY ABOUT THE IMPACTS OF NEGATIVE GEARING ON HOUSE PRICES AND RENTS – WITH POLITICAL PARTIES MAKING COMPLETELY OPPOSITE CLAIMS – SO LET ME GIVE YOU MY VIEW ON WHAT WOULD HAPPEN IF NEGATIVE GEARING WAS MADE LESS GENEROUS:

- HOUSE PRICES WOULD FALL BECAUSE THIS WOULD REDUCE THE DEMAND – AND THE PRICES THAT INVESTORS ARE WILLING TO PAY – FOR HOUSES AND LAND. GOVERNMENTS, OF COURSE, CONTROL THE SUPPLY OF LAND.

- RENTS WOULD, IF ANYTHING, RISE IN THE SHORT-TERM, BECAUSE SOME INVESTORS MAY CHOOSE TO TAKE PROPERTIES OFF THE RENTAL MARKET (E.G., SELL THEM OR USE THEM FOR OTHER PURPOSES). HOWEVER, IN THE LONGER-TERM, RENTS NOT CHANGE MUCH. TO INVEST IN HOUSING, INVESTORS NEED TO GET A COMPARABLE AFTER-TAX RETURN TO ALTERNATIVE SIMILAR-RISK INVESTMENTS, SO HOUSE PRICES WILL FALL UNTIL THEY DO SO; THIS WILL TEND TO OFFSET THE INITIAL UPWARD PRESSURE ON RENTS.

REDUCING COMPANY TAX RATES IS A SENSIBLE REFORM – BECAUSE, AS I MENTIONED EARLIER, COMPANY TAX IS A RELATIVELY HIGH-COST TAX (\$1.50 PER \$1).

WHAT ABOUT SUPER? AS SOMEONE NEARING RETIREMENT – AND SOMEONE WHO HAS BENEFITED SUBSTANTIALLY FROM SUPER TAX CONCESSIONS – I HAVE TO ADMIT THAT THOSE CONCESSIONS HAVE BEEN FAR TOO GENEROUS. TO BE CLEAR, I WOULD NOT RECOMMEND AND RETROSPECTIVE SUPER TAX CHANGES, BUT I DO BELIEVE THAT LOOKING FORWARD, WE SHOULD REDUCE SUPER TAX CONCESSIONS ON VOLUNTARY SUPERANNUATION CONTRIBUTIONS, PARTICULARLY FOR HIGH-INCOME EARNERS.

FINALLY, A REFLECTION ON THE ROLE OF GOVERNMENT. OVER THE LAST COUPLE OF YEARS, BOTH OUR FEDERAL AND STATE GOVERNMENTS HAVE CONDUCTED TAX REVIEWS. THESE ARE BUT THE LATEST IN A PLETHORA OF TAX REVIEWS OVER THE YEARS. MOST OF US WOULD REMEMBER THE HENRY

TAX REVIEW THAT WAS DONE ONLY 5 YEARS AGO. ALL OF THESE REVIEWS HAVE BASICALLY REACHED THE SAME CONCLUSIONS: THERE ARE SUBSTANTIAL GAINS AVAILABLE THROUGH TAX REFORM. YET THOSE REVIEWS HAVE LARGELY SAT ON MINISTERS' SHELVES AND GATHERED DUST. WE DON'T REALLY NEED ANY MORE TAX REVIEWS. WE JUST NEED GOVERNMENTS TO PLUCK UP THE COURAGE TO GET ON WITH TAX REFORM IN THE PUBLIC INTEREST.

ON THAT NOTE, I'D LIKE TO THANK YOU AGAIN LADIES AND GENTLEMEN. AND NOW I'D BE DELIGHTED TO ANSWER ANY QUESTIONS THAT YOU MAY HAVE.