

Should the GST be on the Tax Reform Agenda?

John Freebairn

University of Melbourne

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Context of Debate, and Some GST Reform Package Options

- Changes to GST off the current Australian reform agenda:
 - Excluded from Henry terms of reference
 - Main political parties say no
- But, logic says yes:
 - Mirrlees review (2010 and 2011) for UK
 - Rate increases in NZ and UK in 2010
 - Grattan Institute (2012) ranks as most productive economic reform option for a country with negligible productivity growth.
- Reform options considered:
 - Broader base, a la NZ, for efficiency and simplicity, and/or
 - Higher rate to replace more distorting taxes
 - State stamp duties
 - Some income tax
 - Recycle GST revenue gain for approximate equity neutrality

Current GST

- Collected by commonwealth, and then redistributed to states according to HFE as untied grants
- Base about 60% of comprehensive consumption base
- Destination base. X exempt, M taxed
- Flat 10% rate
- 2009-10 revenue of \$48.2 billion, or 13% of all tax revenue
- Generally agreed that GST is fully passed forward to households, who bear the economic incidence

GST Tax Base Exemptions and Revenue Loss (Treasury)

Items Exempt	Revenue Cost (\$ billion 2010-11)
Food	5.9
Water, sewage and drainage	0.7
Health	3.8
Education	2.6
Child care	0.6
Financial services	3.2
Imports	1.2
Total	18.3

Arguments for a Broader Base, a la NZ (Mirrlees Review)

- Efficiency gains
 - Remove distortions to mix of consumer products purchased
 - Remove incentives for largely exempt industries (health and education) to provide in-house GST taxed services
 - Neutrality of treatment of private, not-for-profit and government providers
- Greater simplicity
- Equity
 - Requires that all revenue be recycled to households and government. Contrary to Grattan (2012) proposal.
 - Relative to the income tax and social security systems, GST exemptions are a blunter, and less effective, redistributive system.
- Likely more revenue integrity.

Larger GST To Replace State Stamp Duties

- Reform package
 - Increase GST rate to fund
 - Replace stamp duty on insurance
 - Part of package to replace conveyance duty (together with reform to land tax)
 - Requires negotiation of federal-state financial arrangements
- Efficiency gains
- Distributional or equity effects
 - Extra GST increases costs and CPI
 - Less stamp duties reduce costs and CPI
 - Over time, package will have small net effects. But, short term winners and losers
- Simplicity gains
- More stable revenue stream

Larger GST to Replace Other State Taxes

- Stamp duties on motor vehicles
 - Better to treat as separate reform package on charges for the use of motor vehicles. Henry Review
- Payroll tax
 - In long run, comprehensive GST and payroll tax at flat rate have similar economic effects
 - But, quite different short term effects
 - A reformed, comprehensive payroll tax would improve VFI and offer a “harder” state budget constraint

Larger GST for Income Tax Mix Change Package

- Precedents
 - A part of the ANTS package in 2000
 - NZ and UK in 2010
- Approximate revenue neutral and distribution neutral package
 - Larger GST
 - Recycle revenue to directly offset higher CPI and for macro stability
 - Increase social security pay rates
 - Reduce income tax, including raise tax-free threshold and reduce marginal tax rates
 - One-off compensation for self-funded retirees
 - Recycle some revenue as lower corporate income tax rate. Then, must sustain Henry Review argument of increases in investment, labour productivity and market wages.

Efficiency Effects of GST for Income Tax Mix Change Package

1. Work verses leisure (and market verses home production) choices
 - Labour tax wedge = $T_y (1 - T_y) T_c$
With package, increase in $T_c = \Delta \text{GST}$
balanced by reduction in T_y . Negligible effects on labour supply.
 - Questions
 - Estimate by Henry Review that marginal cost of GST only 8 cents/\$ relative to labour income tax of 26 cents/\$
 - Estimate of large gains of GST reform by Grattan Institute (2012)

Efficiency Effects of GST for Income Tax Mix Change Package

2. Reduce inter-temporal consumption and saving decision distortions of income tax.
3. Reduce magnitude of distortions to the composition of saving and investment under current hybrid tax treatment of different options.
4. GST has a destination base, compared with a production base of income tax, and more so if reducing corporate income tax
 - Shifts tax burden from internationally mobile capital inputs, and to a lesser extent skilled labour, to the much less mobile consumption
 - Optimal tax theory: The ensuing increase of capital and associated technology per worker leads to a larger economy, higher market wages and disposable incomes

Equity Effects of GST for Income Tax Mix Change Package

- First round effects
 - GST raises cost of living by revenue increase (if 100% pass through, as for ANTS)
 - Social security increases and personal income tax cuts raise disposable incomes
 - Can design neutral net outcome if use all revenue and careful design only for broad socio-economic groups. There will be some winners and losers within each group
- Second round and longer term effects
 - Higher market wages, and more so for reductions to corporate tax rate
 - A positive sum game from efficiency gains
 - Avoid adverse inflationary wage-price spiral via compensation and explanation

Conclusions

- A NZ type broader base and higher rate GST with net indirect tax revenue gain recycled as higher disposable incomes offers:
 - Greater efficiency and a more productive economy
 - Greater simplicity and lower costs
 - Similar aggregate income transfer system equity outcomes
 - Revenue neutrality

For More

- Freebairn, J (2011), “A Better and Larger GST?”, The Economic and Labour Relations Review, 22(3), 85-100.
- Mirrlees J et al. (2010), Dimensions of Tax Design, Oxford University Press.
- Mirrlees J et al. (2011), Tax by Design, Oxford University Press.
- Daley, J et al. (2012), Game-changers: Economic Reform Priorities for Australia, Grattan Institute, Melbourne.