

# Is big tax reform still possible?

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# What is tax reform?

- ▶ Getting closer to tax 'axioms' – adequacy efficiency, equity, etc
- ▶ Three 'interpretations' in Australia –
  - fiscal discipline
  - tax neutrality ('broad base, low rate')
  - 'Haig Simon' economic income
- ▶ Policy repair focus
- ▶ Changing responses to the new
  - Technology
  - Social needs or problems
  - Economic competition – 'globalisation'
- ▶ Problem focus such as ageing, participation, investment attraction
- ▶ Policy adaptation focus

Idealised reform  
'narrative'

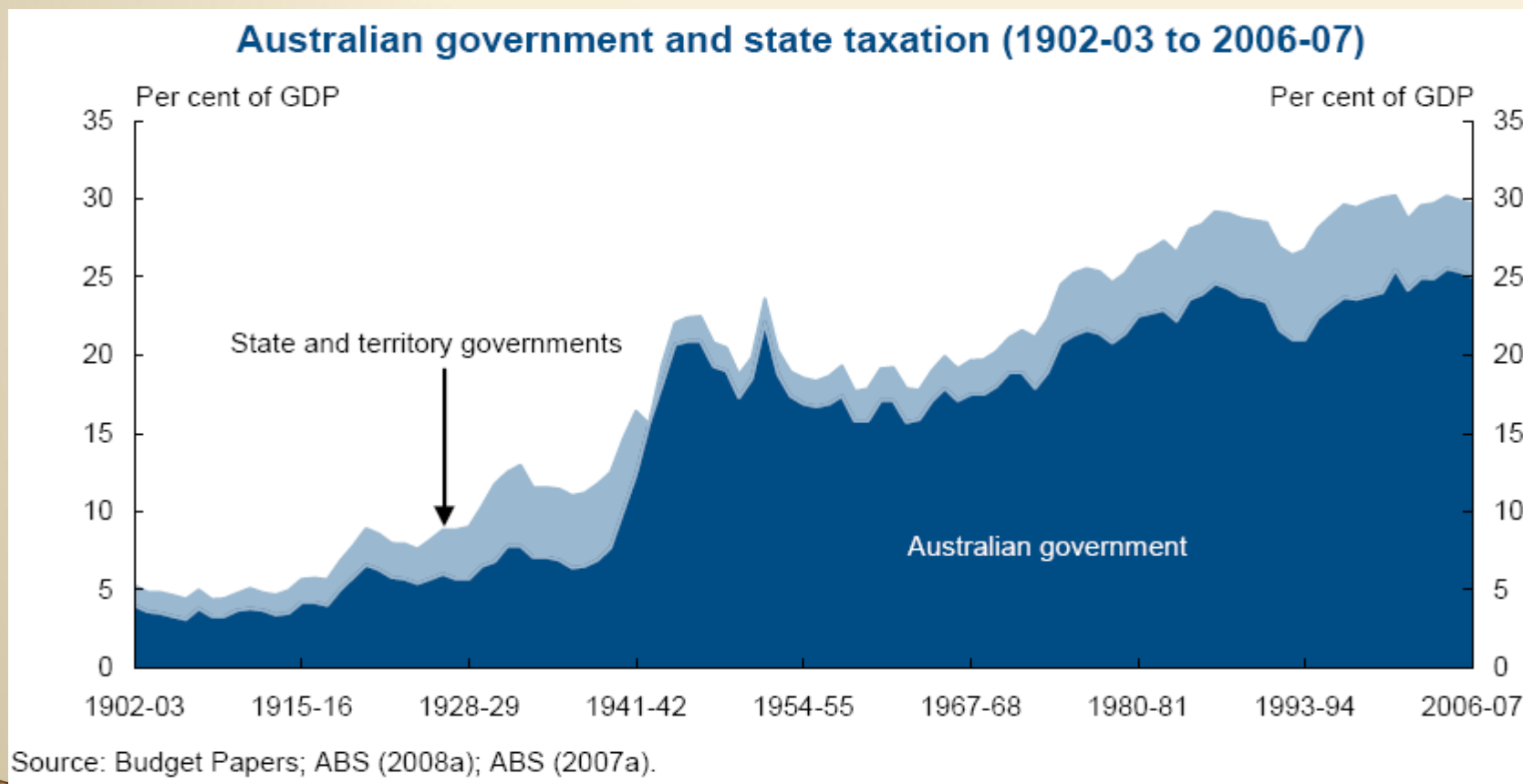
Responsive reform  
'narrative'

# ‘Big reform’ in the past – Australia after 1983

- ▶ Emerging from global economic recession, local drought
- ▶ Entrenched ‘stagflation’
- ▶ Mood for change – Australia falling behind
  - Tax part of a broader reform agenda
- ▶ Ideal blueprints: Asprey and Campbell reports
- ▶ New federal government with concerns about past economic reputation

# System stressed by growth...

- War and the welfare state: from 5% to 30% of GDP



# State of the tax system 1983

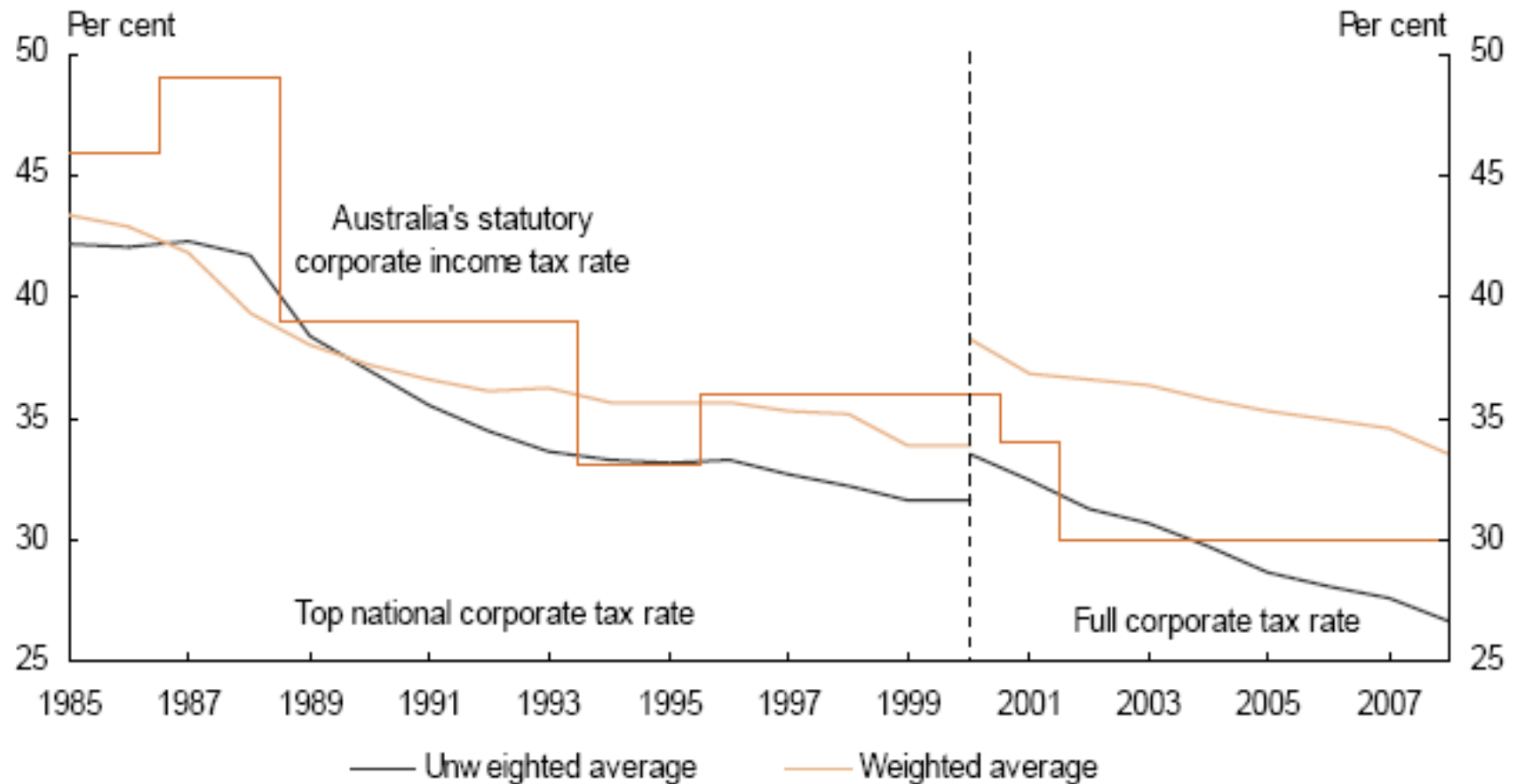
- ▶ Income tax under stress
  - Narrow base – widespread tax avoidance
  - High rates: 60% top personal, 46% company
- ▶ Substantial budget deficit
  - 3.3 percent of GDP (underlying) in 1983–84
- ▶ No general consumption tax
  - Inefficient/inequitable excises and wholesale tax
- ▶ No social security tax

# Tax reform 1985–2000

- ▶ Business tax base closer to economic income
- ▶ Lower rates – no substantive change in effective tax rate
- ▶ Dividend imputation
- ▶ Similar pattern for personal tax: CGT and FBT
- ▶ Hybrid retirement income system
- ▶ Eventually... GST
  - Mainly an indirect tax reform – little tax–mix switch

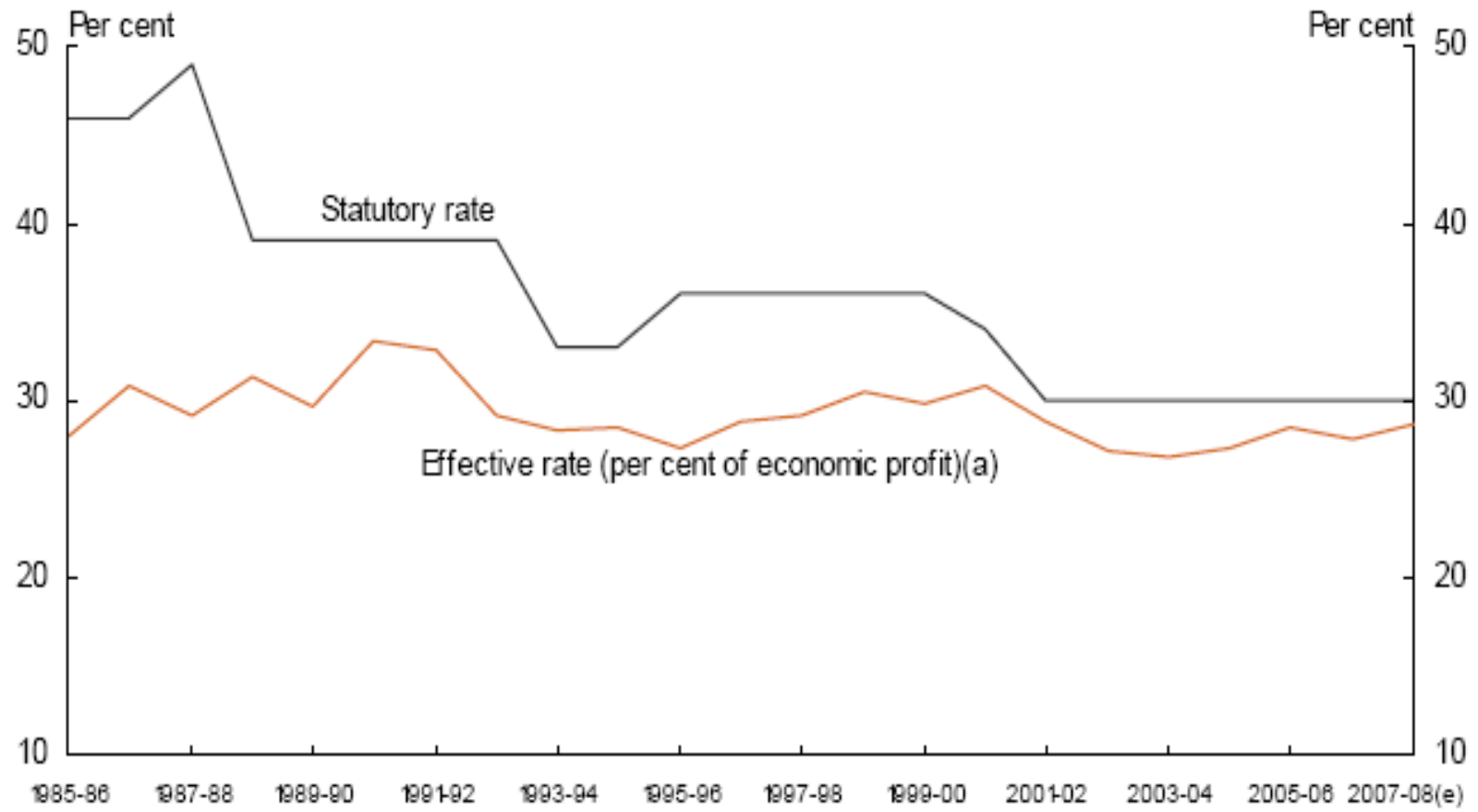
# Business taxes – statutory rates

Chart 1.1: Statutory company income tax rates of OECD countries (1985 to 2008)



# Statutory and effective rate

Chart 3.5: Measures of the company tax rate in Australia (1985-86 to 2007-08)





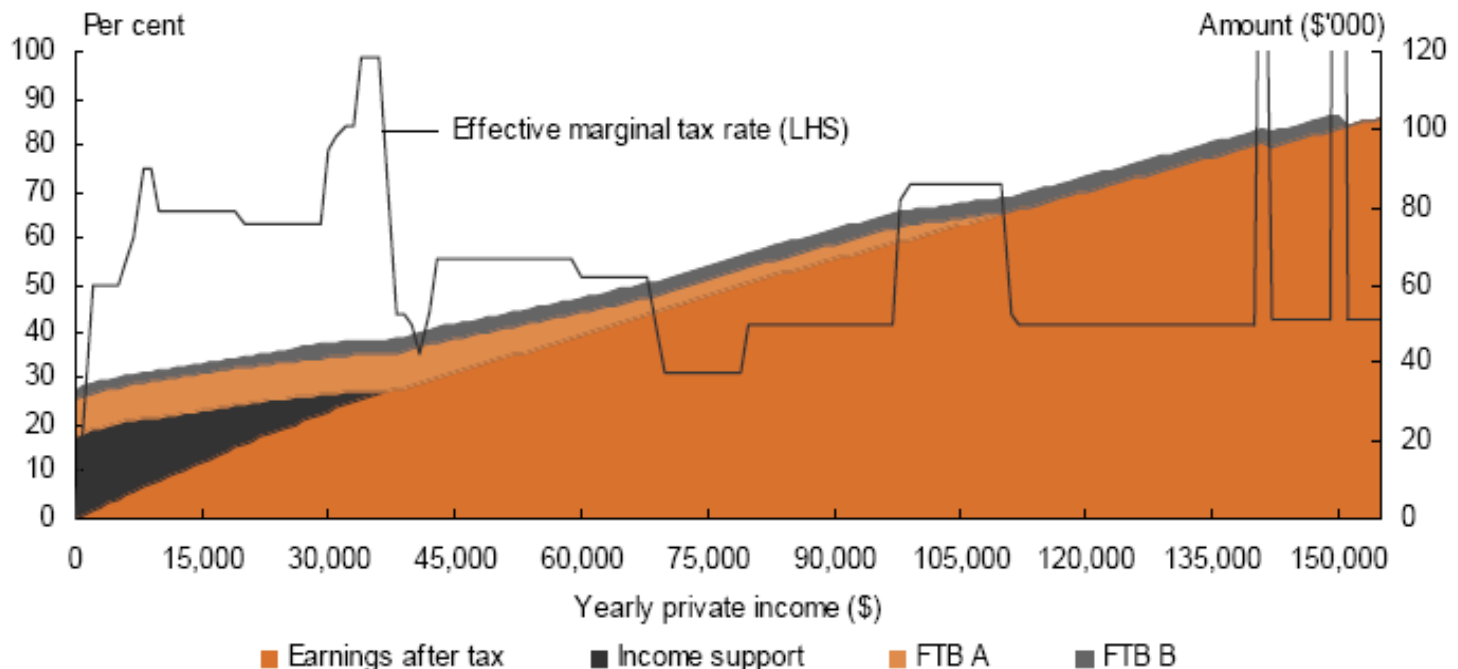
# Personal taxes & transfers

- ▶ Top rate reduced from 60% to 45%
  - Top threshold effectively doubled relative to average earnings (\$180,000)
- ▶ But at average earnings – effectively now a marginal rate of 35½% – little changed
  - And higher marginal rates for many families
- ▶ Base broadening:
  - fringe benefits, entertainment, capital gains
  - And some increase in indirect taxes as well
- ▶ Large transfers for families
  - allowances, child care, \$5,000 ‘baby bonus’
  - means tested

# Horizontal and vertical confusions

## ► Tax and means tests combined (family)

**Chart 4.5: Effective marginal tax rates and disposable incomes<sup>(a)</sup>**  
By yearly private income, single earner couple with two children



(a) Effective marginal tax rates (EMTRs) are calculated using a \$1000 income increment. Spikes in EMTRs at \$140,000 and \$150,000 reflect the imposition of the Medicare levy surcharge and the loss of FTB Part B respectively.

Source: DEEWR estimates.

# Retirement income policy

- ▶ 3 policy concerns
  - Adequacy of age pension
  - Sustainability of age pension and other aged spending
  - National saving shortfall
- ▶ 3 'pillars' response
  1. Age pension 'social insurance safety net'
  2. Compulsory retirement saving (asset, not insurance)
  3. Voluntary retirement saving (asset)
- ▶ 3 'taxing points'
  - Contributions
  - Fund earnings
  - Benefits (tax free, but means tests)

# Background to Tax System Review

- ▶ Australia 2020 Summit (April 2008)
  - ...to reach the top 5 in world per capita income
  - A tax review one of the requirements
- ▶ Australia's Future Tax System Review
  - taxes and transfers
  - pension adequacy
- ▶ Interim reports (retirement) for 2009 Budget
- ▶ Final report December 2009

# Legacies of past reform

- ▶ Unchanged total tax burden –30% of GDP
- ▶ Heavy focus on income – economic income tax and means test bases
- ▶ High progressivity (and low churn)
- ▶ High share of capital taxes
- ▶ High complexity and operating costs
- ▶ Little reform of state taxes or federal imbalance

# Competing responses to legacy

- ▶ Investment attraction following terms of trade decline
- ▶ economic infrastructure
- ▶ skilled labour
- ▶ Possible re-emergence of concerns about financial imbalances
- ▶ Social infrastructure
- ▶ Housing affordability
- ▶ Household debt
- ▶ Social program demand and costs
- ▶ Ageing, pensions and the loss of savings

Growth concerns

Distributional concerns

# Growth, taxes and political economy

- ▶ Can tax reform induce higher growth?
- ▶ Switch from capital to labour/ consumption
- ▶ Political economy requires demonstrable, quick reward for this to be sustainable?
- ▶ Population ageing alone – 4% of GDP
- ▶ 10 percentage points on either the GST or personal tax base
- ▶ On top of a tax mix switch?

A lower tax future

A higher tax future

# Opposing big tax reform in 2010+

- ▶ Terms of reference – GST, tax-exempt super
- ▶ Fiscal, economic damage of GFC/and its aftermath
- ▶ Political economy
  - Conflict of vision is not unusual (1985 tax summit)
  - Absence of clear, authoritative blueprint
  - Reform competition and exhaustion



# Supporting big tax reform 2010+

- ▶ Short–medium economic (investment) recovery imperative
- ▶ Long term demographic imperative
- ▶ Stress fractures in the Australian federation and distributional and welfare models
- ▶ Political economy challenge – capturing the above as foundation for a motivating vision

# Business tax reform

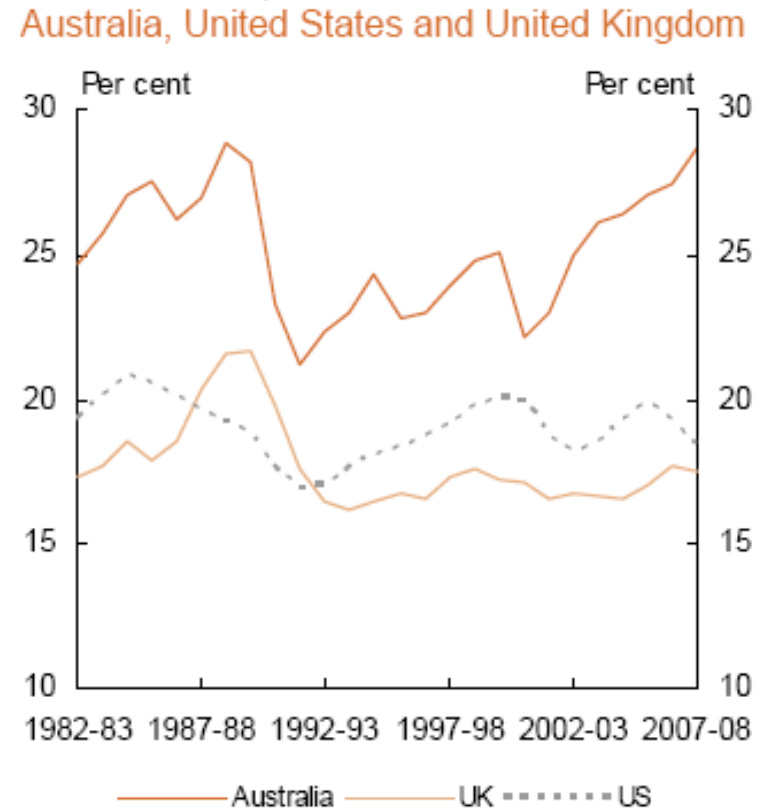
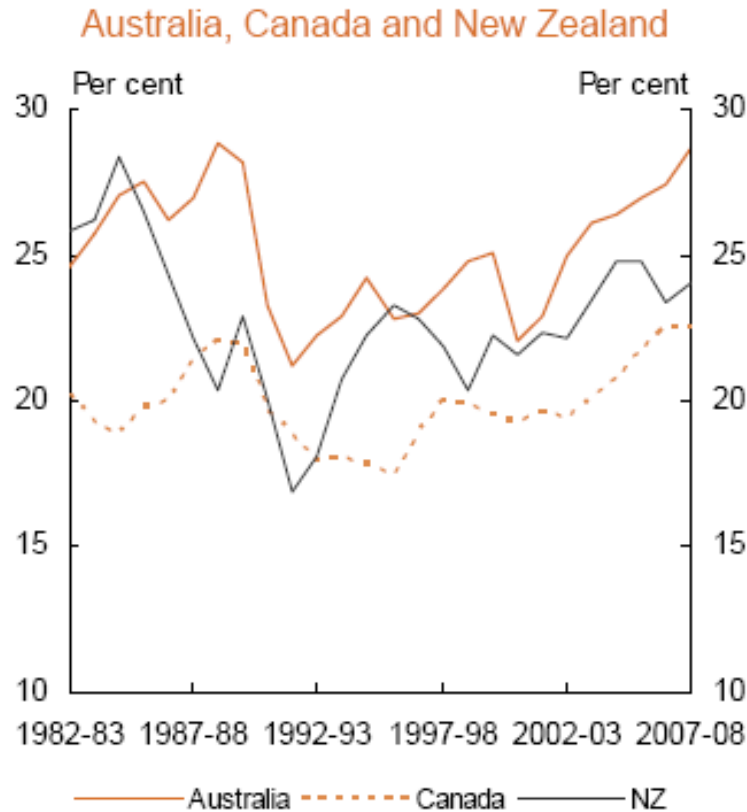
- ▶ Strong push to reduce capital taxes overall
- ▶ Business tax base
  - Fundamental questions: cash flow taxes and ACE options
  - Underlying long list of specific base concerns
- ▶ Tax rate
  - one way downward pressure, drives base concerns
  - Uncertain which rates matter most – statutory, effective average, effective marginal, debt–equity etc
- ▶ Distributions
  - Imputation still supported by many
  - But increasing anomalies in global setting
  - Not consistent with radical base reforms

# Economic Rents

- ▶ Petroleum Resource Rent tax – offshore oilfields
  - State royalties on other minerals
- ▶ Business economic income taxes imposed both on normal returns and economic rents
  - Efficiency/growth benefits of reducing former generating interest in systems that differentiate these returns
- ▶ Location rents (resources, financial system) have long been very significant in Australia
- ▶ Greater emphasis on the problems of profit shifting than investment attraction

# Can national investment be higher?

**Chart 6.2: Gross national investment**  
Per cent of GDP (1982-83 to 2007-08)



Source: ABS (2008a), IMF (2008), Statistics New Zealand (2008).

# Radical simplification

- ▶ Tax-transfer system highly complex
- ▶ 72% of taxpayers seek professional help
- ▶ Two strategies:
  - New technology – the IT fix
  - New policy: simplified schedular bases
- ▶ Simpler business taxation – may rely more on a large reduction in role of capital taxes
  - Or further simplification only for small business

# Some sectoral issues

- ▶ Federal tax reform
  - Limited prospects for new state tax bases
  - Harmonisation and removal of the least efficient taxes
- ▶ Reform of housing markets
  - Property, transactions, income, capital gains, means tests, GST all highly non-neutral taxes by tenure
- ▶ Reform of the land transport market
  - Possible shift of land transport (roads) from a public service model to a commercial market model

# Retirement income

- ▶ Pillar 1 (age pension and services)
  - Conflicting pressure on adequacy and sustainability
- ▶ Role and scale of compulsory employee superannuation (pillar 2)
  - Little relief on pillar 1
  - anomalous (and complex) asset and income means tests
  - Fails nearly all design tests
- ▶ Defining retirement: different age rules
- ▶ Consumption deferral only to retirement date
  - concern about longevity risk

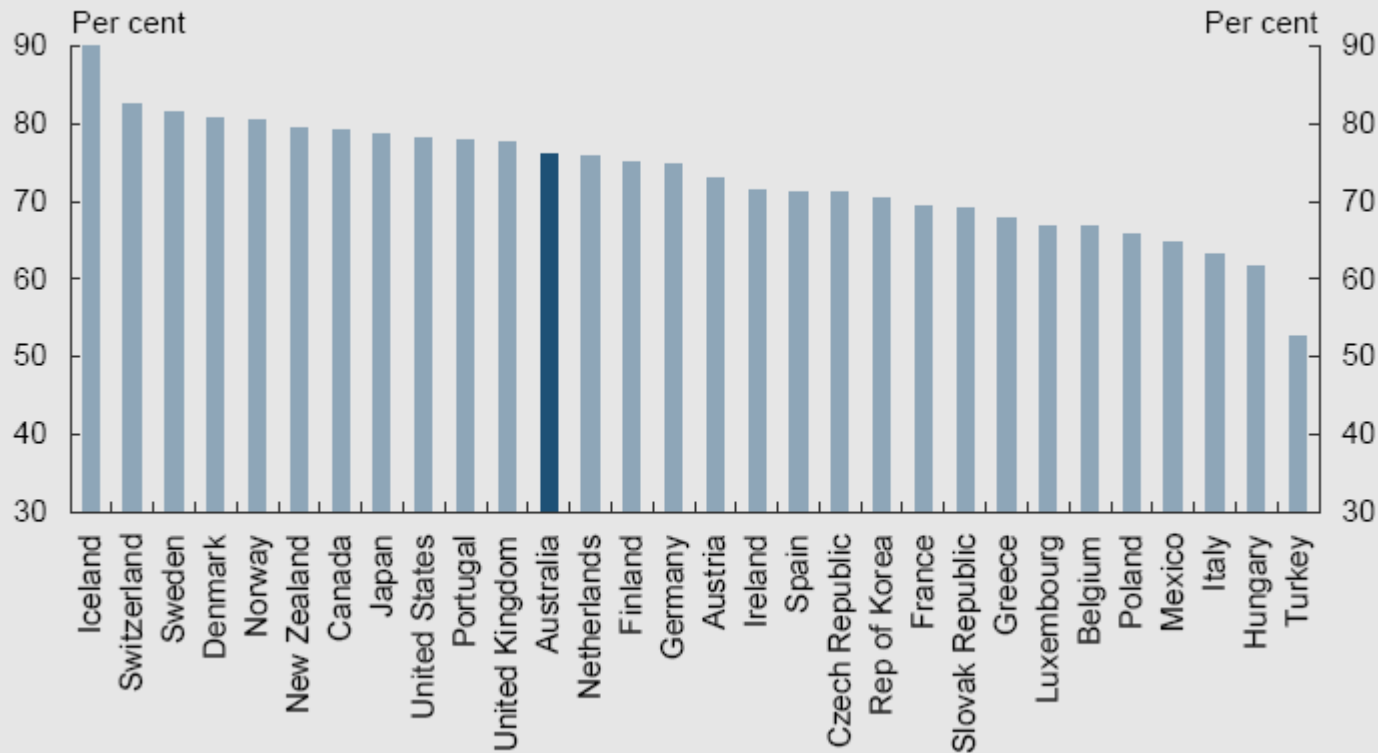
# Tax-transfers and Participation

- ▶ High effective marginal (and lifetime) tax rates
- ▶ Desire to shift Australia towards the higher end of participation rates (at least catch NZ)
  - Some concern also about lifetime savings incentives
- ▶ Tension in means test and offset design
  - Steep tapers claimed to affect fewer people



# Australia's labour force participation lags the US, Japan, UK

Chart 2.12: OECD participation rates 2006, people aged 15-64



Source: OECD Employment Outlook 2006, Australian Bureau of Statistics data.

# Concluding Comments

- ▶ How can a 'review' promote change?
  - Better understanding
  - Renewed systemic vision
  - Lengthened policy time horizon
- ▶ The current economic crisis initially conspires against each of these
  - Yet past change motivated by crisis