

Australian Business Economists



Furthering tax reform in Australia

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The views expressed in this presentation are those of the author alone and not of any other person or organisation

Australian tax in 2010-11

- General Govt tax revenue: \$357 billion
 - 26% of GDP and 85% of total revenues
 - \$67 b borrowing requirement (nearly 5% of GDP)
- AFTSR (Henry) – on existing tax architecture
 - “reflects sound policy frameworks and Australian social values and will still serve us well”*
 - Adequate (in medium term)
 - Progressive (including means tests on transfers)
 - Generally broad bases

The tax trajectory to 2014-15

- Commonwealth tax revenue + \$112 billion (39%)
 - Increase of 2.5% of GDP
 - Projected cash surplus still only \$5.8 billion
 - Individual income: + \$55 b
 - Company tax + \$25 b
 - GST + \$12 b
 - New mining rent tax + \$ 5 b
 - Carbon price (non tax) + \$ 9 b
- State taxes/royalties may match GDP growth (25%)

Beyond 2014-15

- Medium term Commonwealth goal is to maintain 'real payment' growth at 2% pa until budget surplus reaches 1 percent of GDP (\$20b) in 2017-18
 - 8 years of declining relative size of government
- Assumptions are not clear, but implication is limited fiscal room for tax relief
- Implied size of Commonwealth payments will be lowest since 1975
 - This is current policy – what of Opposition?

Long term: Strategic drivers

Strategic Driver	Implications
Economic - factor mobility - growth imperative - 2 speed economy (structural change)	<ul style="list-style-type: none"> • More immobile rent, consumption • Lower income taxes • Productivity reforms, infrastructure, housing and roads
Socio-Demographic -Ageing and late ageing - Progressivity/targeting needs	<ul style="list-style-type: none"> • Longevity, aged care and disability • Bigger govt: 5-6%+ of GDP 2040s • Participation policies • Unmet needs
Technological (digital age)	<ul style="list-style-type: none"> • New tax-transfer delivery models • Client focus
Environmental/energy	<ul style="list-style-type: none"> • Pace of fossil fuel replacement? (including as a tax base)

International: company tax rates

- Asia: China, HK, Singapore, Korea 15-25%
- Little change in US and Japan (fiscal crises)
- UK company rate 23% by 2014
- EU27 achieved considerable change before GFC

EU27	2001	2010
Company rate	30	23
Top Personal	44	38
Standard VAT	19	21

International: UK Mirrlees Review

“...a progressive, neutral tax system” (IFS Tax by Design 2010)

	Mirrlees	Henry
Progressive	Income, rents, wealth transfer	Income, rents
Neutral	Exceptions – R&D, Retirement	Exceptions – R&D, Retirement
Capital	RRA and ACE exempt normal return	Imputation and 40% savings discount
Consumption	Comprehensive VAT inc housing	Cash flow and land rent tax
Regulatory	Sin, roads, etc	Sin, roads, etc

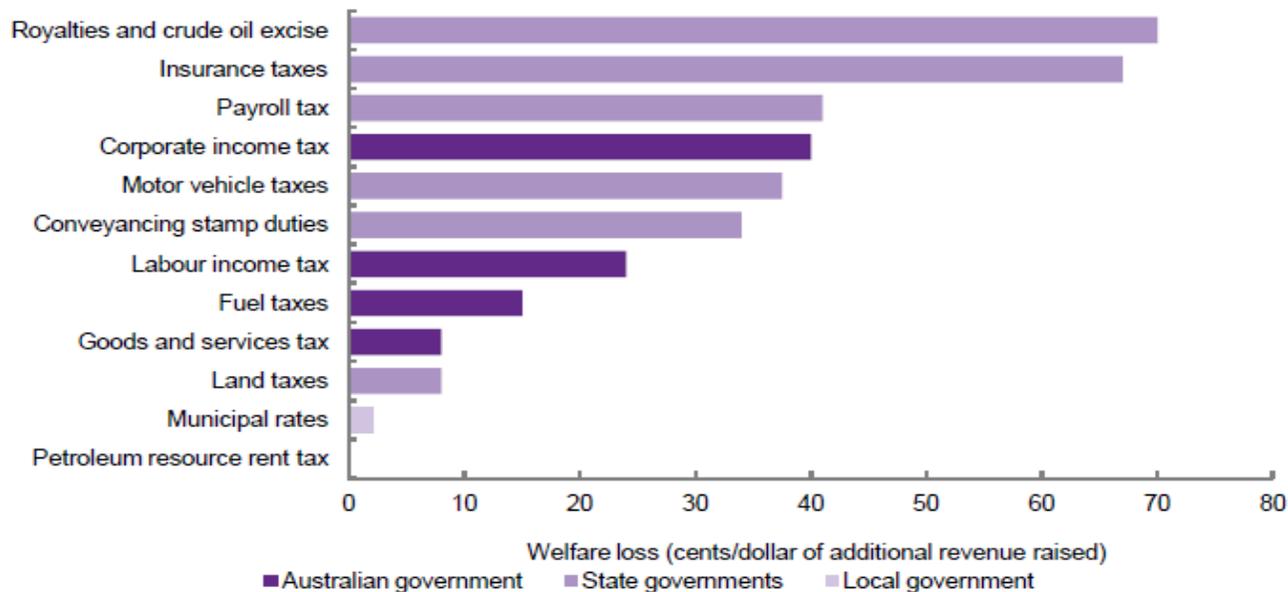
The AFTSR architecture

- Concentrate on four broad, efficient tax bases
 - Personal Income
 - Business Income
 - Consumption
 - Immobile rents (land and natural resources)
- Abolish other revenue taxes (mainly state taxes)
- Rebalance: less business income, more rent and consumption
- Comprehensive personal income tax/transfer reform
 - Simplified structure with new delivery platform
 - Complementary means tests and other transfer design reform
 - More neutral tax treatment of savings
- Efficient Pigovian taxes and user charges
- Retirement income policy reconfigured to address equity, longevity, aged care and disability/carer needs

Federal Fiscal Imbalance

- ❖ Each state “...should have access to tax revenue it can use to finance significant marginal expenditure decisions”

Chart 1: Marginal welfare loss from a small increase in selected Australian taxes



Source: KPMG Econtech (2009), *CGE Analysis of the Current Australian Tax System*. Reproduced from AFTS.

Abolish and replace

Tax base	Revenue \$b 2009-10	Proposal	Possible replacement
Payroll	16.8	abolish	consumption
Insurance	4.6	abolish	consumption
Property transfers	12.3	abolish	land
Land	5.8	retain/reform	-
Royalties	6.6	abolish	Resource rent
Motor vehicles	7.0	Abolish tax component	Road user charges
Gambling	5.0	Retain/reform	-

2010-2011 post-Henry measures

- Limited version of resource rent tax
- Company tax cut to 29%
- Partial moves towards personal tax reforms
 - Including as part of carbon price compensation (minor switch from income to consumption)
- 12 percent SG (delayed budget cost)
 - On top of \$4b pa increase in age pensions

Lessons from the past?

- Large packages, many winners and losers
 - Requires extensive development and modelling
 - We usually already knew broadly what to do
- Return of fiscal drag, giving impression of large net tax cuts
 - Not available under existing fiscal strategy, until late in second half of 20-teens decade
- Extensive campaign in advance of commitments to establish the case (if not majority support)
 - Not tried in recent years, nor easy in current political circumstances
- Conclusion? Extended policy development and discussion within a broad strategic commitment, before most major decisions are possible
 - Hopefully with a more open possibility set

Medium term strategic constraints

- Fiscal – no room to move?
- Household disposable income – unavoidable policy induced slowing
 - Restoration/increases personal income tax levels by bracket creep
 - Superannuation guarantee up 3%
 - Insurance models for disability and aged care gaps
 - Impact of relatively smaller government?
- Community expectations in the face of slowing spending power growth
 - After the long boom , GFC protection and unaffordable tax cuts?
- Federal – a model in disrepair, future fiscal crisis
- Economic Uncertainty
 - Terms of trade, Multi-speed
- Institutions and information – a new transparency needed
 - Alternative fiscal strategies
 - Cities, roads and housing
 - Tax and transfer reform

Timetable and prospects

- AFTSR had no timetable
- A 10+ year strategy needed (regardless of politics):
 - Reforming tax/transfer law and administration
 - Investing in reform institutions – fiscal, tax and cities
 - A fiscal and federal reform agenda
 - Recasting
 - The intergenerational problem
 - The balance of resource rent and business income taxes
 - Consumption and inefficient state taxes

1 Low cost tax system reform

- Tax-transfer system improvement and consolidation
- Including minor policy change to achieve simplification and integration
- Many areas: small business structures, capital gains tax, simplified means tests etc
- Focused on simplifying client experience, particularly small business, individuals, transfers
 - Taxpayers/transfer clients should have direct access to Government-held information, allowing pre-filing etc
- Standing body to lead, monitor, promote this work

2 Investing in reform institutions

- The right institutions are needed to deliver fiscal, federal and tax reform in the longer term
- Key priority to find new federal fiscal model
- Henry recommendations, including:
 - 107,108 Productivity Commission reviews of major funding and delivery options (and concessions)
 - 119 New intergovernmental agreements
 - 131 High level taskforce on client experience
 - 134 Funded independent tax-transfer research
- Essentially, post-Forum, bi-partisan commitment to institutions, process and transparency

3 An agenda: fiscal & tax research

Issue	Wider contexts
Funding and delivery models for public services	Disability care and support, housing assistance case studies
Efficiency of government and federal duplication audits	Government and federal reform, weak of activity based costing
Mainstream savings	Requires housing supply reform
Land and Transfer taxes	Housing and cities
Alcohol, gambling tax reform	Inadequate empirical evidence
Road pricing and funding	Cities and transport
Financial value add	Inadequate study

4 Intergenerational & transfers

- Part of a broader recasting of the transfer system
 - reducing support for the working aged (except childcare) – maximising participation
 - to higher and unmet needs in disability, ageing, caring and longevity
- Reconfigure SG increase into a longevity and care insurance model, with universal coverage
- Address the unsustainable promise: SG as enhanced lifestyle retirement for age 60-80

5 Rent and business tax

- Replace royalties under a new Commonwealth state revenue sharing agreement
- Longer term company rate and base strategy
 - Beyond the period of extreme investment stress
- Need first to resolve key contexts:
 - Resource rent tax model
 - Allowance for corporate capital
 - Dividend imputation
 - The model for taxing household savings
 - The business tax base

6 Consumption and state taxes

- Too hard for current politics on all sides – and that is reasonable, the case has to be made and properly justified:
 - So commit now only to an independent study covering all scenarios
 - Reform with no change to general consumption taxes
 - Reform with consumption tax limited to replacing inefficient narrow taxes
 - Unconstrained longer term reform towards a preferred tax structure
- Two problems, one solution
 - Replacing state taxes (payroll, insurance)
 - Reducing long run increase in personal income tax
- Rate and base issues
 - GST effective rate on consumption is under 7% (including dwellings)
 - Need to review rate and base and consider destination cash flow tax
- Ultimate Timing: not before late decade or beyond: possible linking of income tax, payroll tax, SG and consumption tax initiatives

Conclusion: opening to future reform

- Economic, social, fiscal and tax challenges will be faced by any and all future governments
- Response requires a major policy investment
 - unless an unprecedented minimisation of government is attempted in the face of strategic trends
- Building community understanding and commitment needs a new style transparent and less top down political approach
- Most issues beyond tax alone, especially
 - Alternative fiscal, institutional, service delivery models
 - The federation – assignment and financing
 - Infrastructure markets, cities and land

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Structural change and policy responses

David Murray, Chairman, Future Fund

David Gruen, Executive Director Macroeconomic, The Treasury

Ross Gittins, Economics Editor, *The Sydney Morning Herald*

Thursday 24 November - Sofitel Wentworth

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