Submission to Commission of Audit

The structural budget position of Australian Governments is clearly unsustainable. The implications for Commonwealth, State and Territory governments are serious. In particular, the aging of the Australian population, increasing longevity and increasing demands for medical care are interrelated and jointly problematic for expenditures. Parallel problems exist for revenues. Globalisation (resulting in reduced margins for an increasing range of Australian industries) and structural change brought about by the macroeconomic impact of the recent boom in mining investment have resulted in reduced taxation revenues.

Set against these unavoidable macro forces the Australian population suffers from a sense of entitlement in respect of both the provision of services and the use of tax benefits. The sense of entitlement includes persons, households and businesses.

Policy Principles

Expenditure for households and persons

The only feasible way to restrain the growth of expenditures (direct and via taxation benefits) as a proportion of GDP is to better focus programs to those who are least able to fend for themselves. Despite the current Government's reluctance to means test entitlements, this is inevitable if budgets are to be placed on a sustainable basis. Politicians get caught up in arguments as to whether a particular level of income is "high" or evidence of the recipient as being "wealthy". To avoid these diversionary discourses, it is proposed that redistribution of tax revenues to individuals and households be based on income quartiles. These points in the income distribution are objectively available from the ABS. A moment's contemplation of the mathematics of who pays for whom illustrates that you cannot assist everyone by taxing everyone. Churning money just creates deadweight losses and often only creates the illusion of benefits flowing to most of the population.

It is proposed that as a general principle that benefits and access to tax expenditure benefits be distributed as follows:

- The highest concessional access or rate of benefit go to those in the bottom quartile of income,
- Benefits or concessional access generally not be available to those in the top quartile; and
- Rates of access or benefits be tapered between the bottom and top quartiles of income.

Trying to assist everyone is a mathematical nonsense and just creates deadweight losses and higher overall taxes. Only clear cases of externalities, where behavior modification is an objective of policy, (eg tobacco excise) should be exempt from these principles.

The largest areas of tax expenditures which increasingly threaten the growth of personal taxation revenue include superannuation, negative gearing of private investment, concessional treatment of capital gains and private health insurance rebates. A serious look at budget sustainability cannot ignore these problematic areas of policy. One possibility would be to limit the tax benefits of a range of tax deductions to a rate of 15% thereby making for equal treatment for all tax payers.

Assistance to industries

As a matter of principle all industries should be treated equally. All industries claim special circumstances and special benefits to the national economy. In reality, there is no free lunch from industry assistance and assistance or special treatment for one industry is inevitably a tax on other industries. Again the entitlement mentality is very widespread.

The problems faced by many industries are the result of structural change in the economy and government intervention merely delays the inevitable. Better to facilitate structural change rather than waste government money or increase consumer prices through protectionism. Much policy work by government is trying to help ministers to appear to be doing something. A well expressed policy of a level playing field for all industries (between industries within Australia) would much reduce the cost of government administration and policy development. Industries would then focus more on being productive rather than extracting special deals from government.

The recent boom in mining investment has been a key factor in driving the restructuring of Australian industry. These pressures have been transmitted via a strong Australian dollar (AUD) but have been fundamentally caused by the strength of domestic investment relative to domestic savings. To understand this we need to look at some basic national accounting identities. The current account deficit (CAD) is, of course, simultaneously equal to both:

Investment minus Savings; and

Exports minus Imports (plus net foreign income flows).

The exchange rate is a key price which keeps these two equalities in balance.

In practical terms a huge mining invest boom not able to be fully serviced by an increase in domestic savings will lead to a higher CAD and a higher AUD. The AUD is not overvalued if its value is at a level necessary to facilitate the foreign capital inflow necessary to fund profitable domestic investment over and above domestic savings. A consequence of the investment boom is that imports must rise relative to exports. Consequently, a range of import competing industries and export industries will decline in absolute or relative size as the mining sector expands.

From a national perspective it is only possible to shield certain industries from these adjustment pressures by exacerbating the adjustment pressures being felt by other industries. This is the context in which further assistance to industries needs to be assessed. There is no free lunch in industry assistance. To the extent to which the adjustment pressures being faced by the motor vehicle industry, for example, are offset by further assistance it will only increase those pressures faced by other industries. Any “saving” of jobs in the motor vehicle industry are likely to be offset in job losses in other industries including for example other manufacturing industries, agriculture, education and tourism.

Retailers complain because of declining sales when there is a shift in consumer demand to services from goods and an increasingly goods are conveniently available offshore at lower prices. These trends will continue and government intervention would provide no economic benefit and could only act as an off-balance sheet tax on consumers.

If governments accepted these inevitable trends as part of a public discourse it would be far easier to reject calls for assistance with consequent benefit to the budget. Governments need to be better at deflecting the claims of special interest groups.

More generally policies like fuel excise rebates make no sense and only serve to make businesses think they are getting a benefit when a benefit to all is economically equal to no benefit to anyone.

Rebalancing taxation revenue

The increasing importance of multinational industries, the narrowing of domestic margins though structural pressures and the growing resort to taxation benefits by individuals is reducing the growth of taxation receipts. Even the growth of the GST is restrained by the pressure on business margins. These trends will continue. A return to a boom in company tax receipts in highly unlikely.

The key beneficiaries of these broad economic trends have been consumers. Price inflation has been low and is unlikely to increase if only because of international competition. Despite recent modest rises, unemployment has remained low by international standards.   Real incomes have grown strongly on average.

In these circumstances an increase in the rate of GST and a broadening of the base would seem justified in combination with a winding back on tax concessions for business and persons.

Garry White

19 November 2013