

Taxation and Australia's future prosperity

CEDA Council on Economic Policy
Summary from meeting held 18 March, 2013

Guest presentation:

- Alan Kohler and Stephen Bartholomeusz from Business Spectator

Presentation by CCEP member:

- Australian Catholic University, Adjunct Professor, Professor Greg Smith

Funding the future

At the March 2013 meeting of CEDA's Council on Economic Policy (CEEP), Alan Kohler and Stephen Bartholomeusz presented on current business conditions and business perspectives on the development of good public policy. Additionally, Professor Greg Smith presented on tax reform and public policy post the Henry Tax Review.

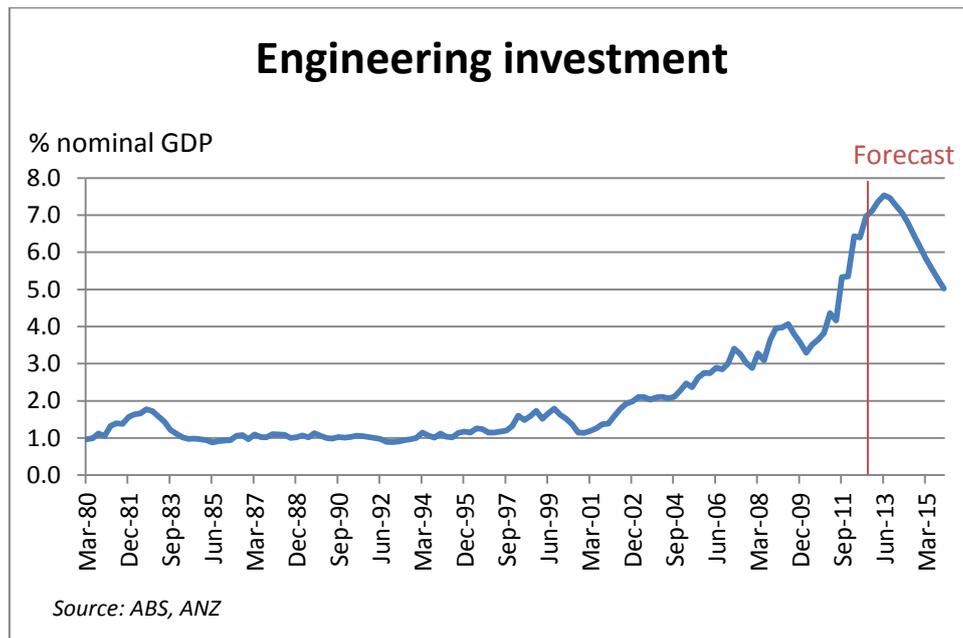
Three matters in particular were the focus of the subsequent informed and enthusiastic discussion:

- The Australian economy is in transition as the influence of high commodity prices, the terms of trade and investment in mining and associated activities starts declining;
- A pronounced lack of policy certainty exists that undermines confidence and sees political solutions substituted for good public policy; and
- There is a general lack of policy debate from Government and Opposition on what will drive Australia's long term economic growth.

The Australian economy

A pronounced state of pessimism exists in the business community and the public more broadly, despite relatively robust economic conditions in Australia. Economic statistics continue to indicate a healthy Australian economy - GDP, unemployment rate, inflation.

The discrepancy between business attitudes and economic statistics could be partially explained by examining the business investment pipeline. The business investment pipeline suggests that the previous source of growth, the strong international stimulus prompting significant investment, is subsiding (as demonstrated by the proxy for resource - related activity by engineering investment below). While the terms of trade will continue to underpin a strong Australian dollar and a difficult trading environment for many sectors, it is not likely to result in continuing economic growth.



Furthermore, the focus of business investment was described as shifting from risk-taking, value-adding investment to cost-saving projects in the current business cycle. Business investment was not perceived to be a source of future economic expansion. Likewise, household savings and consumption rates were at levels that were unlikely to change.

A point of inflection

It was observed that the Australian economy is at a point of inflection. While the nation is healthy, its economic structure is that of a third world country. Australia's high reliance on commodities for economic growth, agriculture and foreign income places it within the developing world rather than the developed.

To continue to experience improvements in national prosperity Australia will need to find new sources of foreign income growth to replace that which commodities has provided. This will require examining the nation's role in the global economy. Unfortunately there is a lack of policy coherence at the federal and state government levels and this is further undermining business confidence.

At the federal level there is a profound lack of political certainty. The current Government is unstable and given to suboptimal policy while the Opposition is focused on overturning what policy settings have been put in place. This situation will not create a stable operating environment necessary to encourage business activity.

While the Labor Party has implemented significant, and often bipartisan, reforms in the past it appears that the current Labor government does not know how to develop good public policy. There has been no decent public policy in this country in more than a decade. The last major reform was the GST. Recent major reforms such as the National Broadband Network, the mining tax and carbon tax were not bipartisan and face an uncertain future.

The processes involved in developing public policy are important. In recent years, there has been a move away from evidence-based policy processes. Good public policy process usually involves defining the problem, announcing it to the public, releasing a green paper to gauge the public's and interest groups' reactions, amending the green paper into a white paper, and finally, implementing the reform. The process should be transparent as public policy is not a suitable environment for secrets.

It was noted that many of the significant reforms that opened up the Australian economy in the past did not follow this policy process. However, they were implemented during periods of perceived national crises and also at a time when dissenting voices were not heard as easily. They were also championed by strong leaders. The greatest enemy of economic reform is that most policies have concentrated losers and dispersed winners. As a consequence, it is easy to identify and quantify the cost of a reform but more difficult to promote its benefits.

Good processes alone are not enough. Policy makers need to explain to the general public what policies are about and why reform is important. Policy making and leadership includes communicating with the public at large, not just vested interested groups.

To continue to enjoy ongoing improvements in national prosperity, Australia needs to have a robust debate about its positioning in the global economy, what services government will provide and how those services will be funded.

Public sector finances

The only point of policy coherence between Federal Government and Opposition pertains to fiscal policy. There the attention is on addressing the bottom line of the Federal Government's budget. But the central challenge is that it is not clear how this can be done without significant changes to the services government delivers or major reform of Australia's tax system.

There is substantial focus from the Federal Opposition on cutting costs but it is unclear how government expenditure could be reduced without influencing the capacity to deliver services. While the public service numbers have risen by over 50,000 in the last six years, the largest source of growth has been in the military. The Department of Immigration & Citizenship and those services focused on internal security have also experienced significant growth. Other departments have already experienced staff reductions.

Fiscal constraints are only going to grow as major expansions of public funding, such as those proposed for the education sector and the National Disability Insurance Scheme, expand the demands on the public purse. Meanwhile, the tax system experiences an erosion of performance as technological advances and changing patterns of economic activity alter its efficiency. The challenge for the tax system is how to pay for these newly conceptualised social needs while maintaining economic growth.

Taxation reform

The Henry Tax Review proposed changes to taxes on four bases, with increases to be offset by the removal of a number of state taxes. It was explicitly an economic-focused reform program rather than attempting to meet any social objectives.

A number of countries have managed to meet rising community expectations about government service delivery while maintaining an internationally competitive tax system by adopting a relatively consistent approach. This involves having a totally broad-based goods and services tax (GST or consumption tax) rate that funds the delivery of domestic services while maintaining an internationally competitive corporate tax rate. As a consequence, community expectations for government services are explicitly linked with funds raised from the community itself.

The proposals for reforming corporate tax rates were pro-business investment. As such they were designed to make Australia a more attractive place to do business. In this context, the key issue for attracting foreign investors is how the corporate tax rate compares internationally.

There is substantial opportunity to increase the base and rate of the GST. When the GST was introduced, all the revenue raised was returned to households. Reforming the GST would need to be explicitly linked with maintaining the welfare state.

Professor Greg Smith's paper outlines the objectives of the Henry Tax Review and a detailed discussion of tax reform options.

It is important for the public to recognise that tax reform is not a zero-sum game; reform will bring about a bigger economy. However, it does require a considered reflection on the future of Australia in the global economy.

[**Australian tax reform: Post-Henry by Professor Greg Smith, Adjunct Professor, Australian Catholic University**](#)

[**Taxation and social security system reform by Professor John Freebairn, University of Melbourne**](#)