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blog
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DEATH BY A THOUSAND (NON) CUTS

When the government released its discussion paper on tax it said "lower, simpler, fairer". Ever since we have been flooded with demands for taxes that are higher, more complicated, and less economic.

Treasurer Hockey has foreshadowed a new bank tax. Assistant Treasurer Frydenberg wants more tax from multinationals. Labor's Senator Dastyari wants more tax from the miners. The Greens' Senator Milne wants more tax from News Corporation. Labor wants higher tax on superannuation. Possibly, so too, does the Liberal Party.

The Treasury wants to cut franking credits to raise tax on Australian investors (including superannuation funds). The left-wing think-tanks like the Australia Institute and the Grattan Institute want higher taxes on property investment and capital gains.

"Lower, simpler, fairer" is looking like some kind of morbid joke.

None of the above proposals is for lower tax. None would make our tax system simpler.

Some claim they would make it fairer but that's only if you think higher taxes are "fairer" taxes. Once upon a time, in the olden days, when Labor was doing tax reform (Reform of the Tax system 1985) or the Coalition was doing it (A New Tax System 1998) fairer taxes meant lower taxes. In particular it meant lowering the reach or rate of top marginal income tax rates because, yes, high taxes can be unfair taxes when they take away a person's justly earned income and reduce the reward for effort.

Sometimes tax reforms involved lower income earners paying more — like the introduction of the GST — but we were always clear that the welfare system could be used to compensate for that. The welfare system is the way to redistribute income. That is not the role of the tax system. The tax system is there to raise revenue at the lowest cost in the most efficient way doing the least damage to the economy.

If you try to use both the tax and the welfare system to redistribute income you get punishing rates of income

... It heightens the incentive to "hide" additional income

withdrawal as a person's income rises. This is called the effective marginal tax rate (EMTR). As people lose benefits and pay higher taxes they can lose 60, 70 per cent, sometimes 100 per cent of every extra dollar they earn. This creates a huge disincentive to work. It creates poverty traps. And,it heightens the incentive to "hide" additional income.

Australia has one of the steepest income and tax withdrawal systems in the world.

Most of the proposals being floated to increase taper rates and introduce new income thresholds will make the EMTR problem significantly worse. We used to worry about that. We used to have debates about the issue. The fact that now no-one argues about it shows how debased this tax "conversation" has become. This is not a conversation about fairer tax. It is about more tax.

Another thing curiously absent from this "conversation" is any assessment of how these new taxes will affect economic growth and job creation. Taxes reduce economic activity. Tax reform should therefore involve switching from those taxes which cost economic growth the most to those which cost it the least.

Higher taxes on a slower economy won't do nearly as much as lower rates on a growing economy. We get a lot of envy talk about the need for new taxes but very little effort to think through the consequences for jobs and growth. Higher taxes aren't going to help much if they are gobbled up trying to support more people out of work.

Remember the Abbott government has already increased the top marginal tax rate to its highest level in 25 years. That did nothing for the economy. It made no difference to the budget deficit. It didn't persuade the big government advocates to support a reduction in spending. It didn't appease the envy industry. All it did was sharpen their appetite for more tax rises.

Every time you increase one rate of income tax you open up arbitrage opportunities elsewhere. Increasing income tax rates make negative gearing and superannuation more attractive. Increasing superannuation tax will make negative gearing more attractive again. As Australia's rates of tax become higher that will make investment overseas more attractive.

We (both Labor and Liberal) used to think that the answer to opening gaps between different tax rates was to harmonise the system by cutting top rates. But now the thinking is that if we have some uncompetitive tax rates we should harmonise the system by making them all uncompetitive. It can work inside the country, maybe, but it can't work if our neighbours and trading partners don't go down the same road. I don't think Singapore or Hong Kong are going to increase their tax rates to help prevent Australian business relocating to their shores!

The government does have a tax problem. It is that there has been no adjustment to the tax thresholds for five years. Inflation is taking every Australian into higher average tax rates. The forward estimates for this budget will go out to 2019. Without adjustment that will show nine years of bracket creep.

This ever-increasing burden of tax requires no new action and no legislation. It happens in the absence of action. To get action, the government needs to restart the conversation about getting taxes down, not up.

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