Editorial —

“LETTING AUSTRALIA DOWN”

Let us hope that the media does not mirror the ideas, values and attitudes of the Australian people. It it does, we have come to a sorry pass indeed.

The performance of the media (we are speaking, of the media in general — there were exceptions) during CHOGM was disreputable, indeed contemptible. CHOGM was by far the greatest international conference yet held in this country, attended by the heads of government of 41 nations representing one-quarter of the world’s peoples. But this singular and impressive fact entirely failed to evoke any enthusiastic response, any faint glimmer of national pride, in the cynical, insular, self-centred minds of many of those who write or speak for the media.

Long before the Conference had commenced, the media set out to downgrade the whole exercise. CHOGM, we were told, was a sheer waste of time and money. More than that, the necessary security arrangements would gravely inconvenience the citizens of the host city. Traffic would be disrupted: the noise of the helicopters overhead was something that the “delicate” constitutions of the people of Melbourne should not be called upon to endure. The expenditure on the conference chambers represented a profligate use of the taxpayers’ money. In any event, CHOGM, it was asserted, would achieve nothing. At best, it would prove to be just another “talk-fest” or “gab-fest”, to use those slick, ugly in-words much beloved by the representatives of the media. At worst, it would expose irreconcilable differences between the nations concerned, thus serving to demonstrate the futility of the modern Commonwealth.
One gained the impression that nothing could have pleased the media more than that CHOGM should have turned out to be a spectacular failure — preferably with dramatic walkouts by the heads of some of the attending nations. When it became clear, after the first few days, that CHOGM was going far better than even the optimists had anticipated, that a pronounced spirit of co-operation, even of friendship, between the heads of government was emerging, and that viewpoints on practically all the big contentious issues were revealing a remarkable unanimity, the media made a noticeable change of course. It began to have a bit both ways. Editorials appeared in two or three of the daily newspapers suggesting that CHOGM should be taken seriously, in other words that it was not such a waste of time and money after all. Indeed, the editorials went even further: they saw fit to concede that in its Prime Minister, Australia had unearthed a statesman of international stature. But these sentiments contrasted incongruously with the vicious vendetta which media columnists and reporters continued to pursue against Mr. Fraser, a vendetta which began in November, 1975, and which has persisted almost without cease ever since.

At this point, the media plumbed the depths of contemptible behaviour. Frustrated, even angered, by Mr. Fraser’s obvious success as Chairman, press, radio and T.V. commentators, turned to suggesting that a palace revolution was in the offing which would very likely depose him in the weeks following CHOGM. Not satisfied with that, they began to circulate false rumours about the Prime Minister’s health: that Mr. Fraser was desperately ill and could be compelled to relinquish his office within a matter of weeks. (The gallant Margaret Thatcher was overheard saying to Mr. Fraser, “Don’t worry, you will outlive them all”). It must have been intensely galling to all these Fraser-haters that, despite the immense burden he was carrying as Chairman of CHOGM, the Prime Minister’s appearance improved the further the conference went. And it must have been equally as galling for the media critics to have to observe the obvious respect in which he was held by the heads of government of the other Commonwealth countries. (One wonders what would have been the reaction of the media had Mr. Whitlam been in Mr. Fraser’s shoes.)

But the small-minded people of the media were not finished yet. As CHOGM entered its final phase there came the unanimous statement of
purpose called "The Melbourne Declaration". Seizing on the New Zealand Prime Minister's — the odd man out — description of this document as a series of pious platitudes, the media made a last-ditch attempt to denigrate the Conference as a talking shop of no practical value. It chose largely to ignore the important communique which concluded CHOGM and which contained specific proposals to give effect to the principles stated in "The Melbourne Declaration".

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Two observations, at least, may be made on this whole sorry story.

Thoughtful, responsible Australians have been deeply concerned for some time about the standards and values of the media. Its performance during CHOGM served to confirm that this concern was totally justified. On a number of occasions, experienced representatives of the overseas press expressed their astonishment at the attitudes of the Australian media and its attempts to belittle the most important international gathering yet held in this country.

The truth is that for a long time now too many representatives of the media — political columnists, radio and T.V. reporters and interviewers — have been concerned not to promote the welfare of their country, not to contribute to a balanced public understanding of great issues, not to make a responsible, constructive contribution to Australia’s problems, but to stir up the maximum amount of trouble of which they are capable, to indulge in continuous carping, often childish criticism of pretty well everyone and everything, to pursue their petty private vendettas, and to propaggate their own half-baked political, economic and social ideas. In CHOGM they reached an all-time low of immature, irresponsible and vicious reporting and comment. Most decent Australians are thoroughly fed up with them.

The second observation arising out of CHOGM is that in Mr. Fraser, Australia has a leader of undoubted quality. The I.P.A. has on occasions strongly disagreed with some of the domestic policies of Mr. Fraser’s Government, but this has not blinded us to the fact that, taking into account the difficulties it has had to face, its overall achievements, while less than many hoped, have not been unimpressive. That this is so is quite largely attributable to Mr. Fraser himself.

It is hard to think of Australian political leaders who have been able to make a pronounced impact outside their own country.
Lord Casey would certainly be one. Mr. Fraser is now another. This should be cause for some pride on the part of the Australian people. That it is probably not is largely due to the unceasing vendetta pursued against the Prime Minister by the media and the picture it has painted of him.
TAX REFORM: WHERE DO WE GO FROM HERE?

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In the furore earlier this year about the “flat rate tax” proposal floated by the National Country Party, useful as this was in bringing some of the complexities of tax reform to public attention, the fundamental case for reform which was cogently stated by the Asprey Committee as long ago as 1974 was almost lost sight of. The case is worth restating and reconsidering in the light of the issues brought out by that debate and by more recent developments.

The Case for Reform

The fundamental case is that progressive income tax, once widely viewed in western countries as the fairest and most efficient policy instrument for raising government revenue, has become a farce and a menace.

One reason of long standing has been the ever-growing burden laid upon the tax by the expansion of the public sector in the welfare state. As the proportion of national income claimed by government has risen from 5-10 per cent in the nineteenth century to 25-40 per cent today, the apparent need to adapt the tax burden ever more finely to the differential “capacity to pay” of taxpayers in different circumstances has grown with it, while at the same time governments have found it convenient to use income tax exemptions and rebates to subsidise favoured groups or to promote other policy objectives. The result of this process has been an enormous increase in the complexity of the system, and hence in scope for evasion and avoidance and in the difficulty of enforcement.

The problem had become serious even before inflation got out of hand during the 1970s. Two-digit inflation has greatly magnified it. By continuously shifting taxpayers on any given level of real income into ever higher tax brackets, it has turned progressive income tax into a built-in revenue escalator, cumulatively adding to the burden and inequity of the system and giving governments a powerful vested interest in inflation.

The inequity of the system is chiefly as between wage and salary earners, on one side, and all other taxpayers, the self-employed and recipients of property incomes, on the other. While the former, under pay-as-you-earn (PAYE), have
only limited scope for illegal evasion or legal avoidance, income tax for the latter has, as Professor Russell Mathews has put it, become virtually a voluntary tax. At the lower end of the income scale, there is widespread illegal evasion of tax through cash transactions which escape the tax net — a recent guess puts the size of the "cash economy" in Australia at $11 billion or 10 per cent of GDP.\(^1\) At the upper end, there is pervasive legal avoidance of tax. A large and lucrative industry of tax lawyers and consultants advises clients on ways legally to minimise their tax liability. As one of them has explained — probably bragging a little — "international tax planning has become a sophisticated and well-developed art. Individual schemes can be devised for taxpayers which ensure that no Australian tax becomes legally payable. Alternatively, if they feel morally bound to pay some tax, the same techniques can be modified so that each taxpayer becomes his own assessor".\(^2\)

A quantitative indication of the resultant discrimination in tax treatment of wage/salary and other incomes is provided by Figure 1 which shows the much slower growth of tax received from the self-employed (provisional taxpayers) than from wage and salary earners (PAYE taxpayers) despite the rise in the proportion of all taxpayers in the former category.\(^3\)

The paradoxical consequence is that what was once thought to be the fairest tax, both in the sense of vertical equity (taxing people on different incomes according to their capacity to pay) and of horizontal equity (imposing the same tax liability on people in like circumstances), has become grossly inequitable in both senses. Actual tax paid outside PAYE now bears little relation to the nominally progressive rate structure, and the disparity increases with every attempt to improve the equity of the system in either sense.

\(\text{FIGURE 1: Personal Income Tax}\)

Source: Budget Paper No.1, Statement No. 6, August 1981.
Critics of progressive income tax have pointed out that, apart from its inequity, it also has adverse effects on the efficiency of the economy, and have highlighted the adverse effects of high marginal rates of tax on the incentives to work and save. Economists tend to be sceptical about the more extreme versions of this “supply-side” argument. Most people have little control over their own hours of work, and for anyone who works for a target income or saves for a target amount income tax could have positive rather than negative effects on the inducement to work or save. While conceding therefore that high marginal rates of personal income tax may discourage overtime by wage earners and extra hours of work by professional people, economists would not regard this as a major problem. The really serious effects of personal income tax on the efficiency of the economy are almost certainly not those on the incentive to work and save but those on the inducement to evade and avoid. As we all know from everyday observation, hardly a business transaction, large or small, takes place nowadays without careful attention to ways in which tax liability can be minimised. Not only does this process absorb much of the time and energy of highly skilled people, both tax consultants and businessmen, but it results in massive distortion of resource allocation. For the way things are done is governed only partly by considerations of economic efficiency and largely by considerations of tax evasion or avoidance.

The case against progressive income tax in conditions of chronic rapid inflation on account of its inequity and adverse effects on efficiency is further strengthened by an aspect of the system which increases both the urgency and the difficulty of reform. This is its operation as a revenue escalator. The faster the rate of inflation, the larger the government’s revenue from income tax — even in the absence of any growth in the real income of the country and its taxpayers — and thus the growth in its own expenditure which the government can afford. Progressive income tax in these circumstances becomes an independent mechanism, apart from all the pressures from sections of the community, for increases in government expenditure and in the size of the public sector and the bureaucracy. For this very reason, inevitably, governments display marked reluctance to surrender their hold on such a magic wand. Reform of income tax demands a considerable measure of self-denial from governments; the prospects for reform therefore depend the more crucially on public pressure.

What, then, can be done?

**Tax Indexation**

In principle, tax indexation provides a simple means of eliminating the worst effects of inflation on the operation of personal income tax. By tax indexation is meant a commitment by government automatically and periodically, say once a year, to offset the effects of inflation in shifting taxpayers into higher tax brackets
by appropriate adjustment of the income brackets to which particular rates of tax apply, coupled with corresponding adjustment of thresholds, concessional deductions, etc. Tax indexation does not necessarily involve a commitment to reduce, or not to increase, income tax revenue. What it does mean is honest government, in that any increases in income tax revenue, have to be secured explicitly by higher rates of tax (after indexation) rather than by the surreptitious inflation tax. Tax indexation has for some time been practised by one or two European countries, such as Austria. It was one of Mr. Fraser’s campaign promises and was in fact embarked upon by his Government, but was soon whittled down to partial indexation and then none at all.

Mr. Fraser has since then candidly explained the politics of tax indexation: “I think one of the problems of full tax indexation is that I don’t believe people understood it. I am not at all sure I wouldn’t prefer to have the freedom to give optional tax cuts, as and when we could at times, so that people would remember it”. In other words, automatic tax indexation gains little if any of the political kudos of well timed and publicised “optional” tax cuts. This is hardly a good enough argument for giving away the eminently desirable principle of tax indexation. Perhaps Mr. Fraser could try harder to get more political mileage out of a display of virtue and out of the benefits to taxpayers of the automatic annual cuts. But it will clearly be an uphill fight to get governments of any political complexion to restore and stick to full tax indexation, and in any case tax indexation is only a partial remedy.

Eliminating Tax Avoidance

Opposition spokesmen, and others on the Labour side of politics, have tended to dismiss the case against progressive income tax on the ground that the simple remedy is “clamping down on tax avoidance”.

Apart from being politically rather disingenuous — virtually nothing was done by the Whitlam Government to tackle the problem, while considerable efforts to close loopholes have been made by the Fraser Government — the notion that tax avoidance can be greatly reduced is simply unrealistic. It is important to appreciate that what is at issue is not illegal tax evasion, i.e. failure to meet legal tax liability through failure to make returns or to disclose all taxable income. Such illegal tax evasion is difficult enough to suppress, but it is the smaller part of the problem. The major part is tax avoidance, i.e. arrangements of the taxpayer’s affairs designed to minimise his legal tax liability. Tax avoidance is not illegal and, in its very nature, cannot be made illegal. Courts have declared it the right of a taxpayer to ensure that he pays no more tax than he is legally required to do. Mr. Justice Mason, of the Australian High Court, has said that “the taxpayer who wishes to reduce his liability to
tax...is as much entitled to legal advice as any other member of the community....Tax avoidance is not an offence....and it is difficult to conceive how it could be made an offence.\(^5\)

Every legislative attempt to close a loophole for tax avoidance is liable to open three more, a challenge to ingenious citizens and their legal advisers to find new ones. Something can perhaps be done by dragnet clauses which confer far-reaching discretion on taxation commissioners, of the kind recently inserted into the Act by Parliament at Mr. Howard’s initiative. But excessive administrative discretion is in itself undesirable and liable to invite action by the courts to circumscribe it. No doubt the new legislation will do something for a while to inhibit the “blatant, artificial and contrived arrangements”\(^6\) at which, according to the Treasurer, it is aimed, and the new directive to the courts to interpret legislation with regard to the intentions of the legislature (rather than on the narrow construction favoured by the recently retired Chief Justice) may also be helpful. But, as Mr. Howard made clear, the legislation is not intended to “cast unnecessary inhibitions on normal transactions by which taxpayers legitimately take advantage of opportunities available for the arrangement of their affairs”.\(^7\) In the nature of the problem, one must be sceptical whether these worthy efforts can have more than a marginal and temporary effect.

The root of the problem is the complexity of a system of income tax which becomes more complex with every laudable attempt to refine horizontal equity in the definition of income and in adjustment of tax liability to differences of need and capacity to pay, as well as not so laudable uses of income tax by governments for extraneous policy purposes, such as subsidies for mining or fertiliser use or life insurance or home ownership. For opposition spokesmen, and others with a tender social conscience, to uphold progressive income tax as the ideal instrument for taxing citizens according to their ability to pay if only tax avoidance is prevented is to cry for the moon, to hide the reality of an increasingly inequitable and inefficient tax system behind the facade of a nominally progressive rate structure.

**The Flat Rate Tax**

The proposal for a 20 per cent flat rate income tax was first put forward by a member of the economic committee of the N.S.W. Liberal Party, Mr. R. Tanner, but was then taken up with enthusiasm by the National Country Party and given a run for its money during the by-election campaigns of last February.

In principle, the idea of a flat rate (i.e. proportionate) income tax is a logical response to the problems of progressive income tax which we have outlined. It would in the simplest possible way obviate the need for tax indexation since marginal and average rates of tax would be equal, so that there would no longer be any shifting of taxpayers into higher tax rates.
brackets with inflation or any built-in escalation of tax revenue. Any moderate rate of tax, whether 20 or 25 per cent, would also reduce, though hardly eliminate, the disincentive effects of high marginal rates and the inducement to evade and avoid. It has been suggested, for example, that a 20 per cent marginal rate of income tax, unlike a 60 per cent rate, would be less than the cost of many tax avoidance schemes. If the proposal is interpreted literally, in the sense that all incomes would be taxed at the flat rate, without exemptions, concessional deductions or rebates, it would also drastically simplify the tax system, and thus correspondingly reduce opportunities for avoidance, as well as greatly cutting the cost of collection and compliance.

The benefits of simplification of even so drastic a version of the flat rate scheme should not be exaggerated. Even if all exemptions, concessional deductions and rebates were abolished, this would still leave a major set of definitional issues which no income tax can avoid and which are the source of much of the complexity of the present system. This is the gamut of complications associated with the definition of income, including allowable costs of earning (net) income, the treatment of imputed income (such as imputed rent from owner-occupied houses), fringe benefits, capital gains, etc. It is important to recognise that even a flat rate income tax would be saddled with all these troubles associated with any tax on income. But it would undoubtedly be a lot simpler than the present system.

An across-the-board flat rate tax on all incomes, however, is clearly impossible. All those whose incomes are so low that they now fall below the threshold (at present $4,041) or are taxed at lower average rates than 20 per cent — at present rates anyone on an income below $270 a week or $14,000 a year — would come to be taxed more heavily. This would be so widely regarded as inequitable as to be politically impracticable. (Mr Tanner’s original proposal is reported to have included a provision for cash rebates of some kind for people on low incomes, a provision which would already have implied some departure from the simple flat rate.) In other words, the best that the proponents of the scheme could really hope for would be a 20 per cent maximum marginal rate, leaving rates on lower income substantially unchanged. Such a reform runs into two major objections.

First, it would be argued that it would be wrong to relieve the burden of income tax on the upper income groups, “the rich”, while leaving that on the lower income groups, “the poor”, unchanged. This objection which in the public debate was voiced even by Liberal Party spokesmen — Dr Ian Story, the chairman of the Party’s economic committee, referred to the flat rate tax proposal as “the millionaires’ relief scheme” — is much less convincing than it appears at first sight. The really rich are those with business and property incomes and for
them, in Professor Mathews’s phrase, income tax has very largely become a voluntary tax. Those whom a reduction of higher marginal rates to 20 per cent would most benefit are those middle income (higher wage and salary) earners whom inflation has in the past decade pushed into the higher tax brackets. Conversely, those on the lowest incomes, especially those below the threshold, are not in the main “the poor”, in the sense of full-time workers earning low wages, but students, housewives and other part-time earners who, in most cases, contribute to a much larger family income. Nevertheless, introduction of a flat rate tax in the form of a ceiling marginal rate of 20 or so per cent would undoubtedly give the greatest benefit to people on high salaries and might, on this ground, be thought inequitable.

A second, and in practice more conclusive, objection is that it would involve a substantial loss of revenue to the government. A figure of $7,000 million has been mentioned for the NCP version of the proposal.\(^8\) It is this fact which has unavoidably linked all proposals for reduction of personal income tax — whether in the form of a flat rate tax or a mere scaling down of marginal rates (in a Liberal Party scheme from the present 32, 46 and 60, to 24, 40 and 50) or any more general recommendation for less reliance on personal income tax such as that of the Asprey Committee — with proposals for increased indirect taxation. What is proposed, in one form or another, is a shift in the proportion of total tax revenue from direct (especially personal income) to indirect tax, or rather a reversal of the opposite shift which, as Figure 2 graphically illustrates, has been brought about in the past two decades, chiefly by inflation.

Figure 2, incidentally, draws attention to a singular irony, the fact that the oil levy, although designed to take from the established Australian oil producers the large windfall that would have accrued to them with the adoption of import-parity pricing, in other words an excess profits tax on companies, is treated as an indirect tax and this, in 1979, restored the ratio of indirect tax to income tax to where it had been in 1970. But this is a temporary factor. The contribution of the oil levy will in any case decline with the relative share of “old oil” to which it applies. If, as now seems likely, nominal world oil prices remain constant for some years to come, the contribution of the oil levy to revenue will dwindle rapidly. The need for additional revenue from some source, higher direct or indirect taxes, to fill this gaping hole will present itself even sooner and more urgently than was expected only a few months ago.

FIGURE 2 Ratio of Indirect to Income Tax Revenue OVERLEAF
Higher Indirect Taxes

The Asprey Committee, and others since, have favoured a Value Added Tax (VAT) because of its wide coverage, including services as well as goods (and therefore its relative 'neutrality' in terms of effects on resource allocation). British experience of great administrative difficulty, not least to thousands of firms involved in its collection, has brought VAT into disrepute, though the fact that the tax had apparently worked well in the continental EEC countries suggests that some of the difficulties encountered in Britain might be avoided. Alternatives are a retail turnover tax (the main tax in the USSR and all other communist countries) which is also believed to require a large administrative apparatus or an extension of the present wholesale sales tax to a much wider range of goods and (some) services, the least logically tidy but probably the simplest and most practicable solution.

There is very little doubt that, were we able to start from scratch, the case for giving a broad-based tax on consumption much greater weight, relative to personal income tax, would be overwhelming. Unfortunately, we cannot, and the difficulties of lifting ourselves from the present mess are very great.
After pondering various indirect tax alternatives for a year and more, the Fraser Government in March of this year rejected them all, chiefly on the ground that additional indirect taxation sufficient to offset worthwhile reduction in personal income tax would add greatly to inflation. To quote the lengthy statement in which the Treasurer, Mr Howard, justified the Government's decision to abandon this approach to tax reform, at least in the form in which it had been under consideration, "each additional $500 million raised through indirect taxes results in direct and indirect additions to the CPI (consumer price index) of almost 1 per cent. There are additional flow-on consequences for the CPI through the wages system which are hard to quantify". He added the pregnant comment that "there was the disturbing possibility that the Arbitration Commission could not be persuaded to discount effectively for the price effects of a shift towards greater reliance on indirect taxation".

The Treasurer here touched on a monstrous paradox which, at any rate in Australia, has constituted a crucial feature of the whole problem of tax reform. Why should a shift in government reliance from personal income towards indirect tax be inflationary? It is true that the introduction of a broad-based indirect tax in any form would add several percentage points to the CPI, but if such a change were spread out over a couple of years it would be a once-for-all rise in the CPI, no greater than that caused in recent years by the Medibank levy or the oil price increase and of no very great consequence, in itself, in the fight against inflation. The consequences would be serious only if the rise in the CPI were passed on, through undiscounted wage indexation, resulting in a large twist to the cumulative spiral of inflation.

The disturbing possibility under the system of wage indexation in force until recently has been that the Arbitration Commission was liable to award an increase in money wages to compensate wage and salary earners for the reduction in their real disposable incomes due to higher indirect tax without allowing for the increase in their real disposable incomes through lower income tax. In other words, a shift from direct to indirect tax was liable to have serious inflationary effects because of the convention, built into trade union thinking and Arbitration Commission philosophy, that real wages should be protected against price increases whatever their source, and hence against indirect, but only indirect, tax increases.

Any such principle need merely be spelled out in this way for its absurdity to be apparent. Whatever the merits of wage indexation, it clearly cannot and must not cover increases in the cost of living due to government tax policy. Wage and salary earners cannot be exempted from indirect taxation, any more than from direct taxation, without making government impossible. The principle at stake was
admirably stated by Mr Hayden, as Treasurer in the Whitlam Government, in his 1975 Budget Speech: “It is the Government’s firm view that, for the purposes of wage indexation, increases in prices resulting from tax measures of the sort that I have announced should be discounted. It would be self-defeating if the system of wage indexation were to attempt to insulate the community from tax measures designed to redistribute resources for the benefit of the community.” The same applies to tax measures designed to shift reliance from one to another kind of tax. Unfortunately, the problem has been, as Mr Howard put it, to persuade the Arbitration Commission of the logic of Mr Hayden’s principle, and the Arbitration Commission cannot in such matters run very far ahead of public understanding.

Formal wage indexation has now been abandoned by the Commission, and this may make some difference. But the principle of “cost of living adjustment” long predated formal wage indexation in trade union thinking and is likely to survive its demise as a continuing influence on wage negotiations and awards. It remains true, therefore, that, until Mr Hayden’s principle is understood and accepted, rational tax reform along the lines recommended by the Asprey Committee, and increasingly recognised by economists as necessary, is liable to be regarded by governments as having, in Mr Howard’s words, a price in terms of inflation higher than they are prepared to pay.

In his August 1981 budget, Mr Howard sought an ingenious way around this difficulty. Instead of attempting a major shift at one stroke from personal income tax to a comprehensive consumption tax, such as VAT, he opted for a very modest move towards greater reliance on indirect taxation, by raising rates of sales tax on some of the semi-luxury items on which it has been levied in the past and introducing a nominal rate of 2.5 per cent on a much wider range of goods, no doubt in the hope that this might provide the base for reform in gradual stages, thus minimising both the effects on inflation and the political costs. However, well he attained the first objective, the second certainly eluded him. Spurred on by every petty and not so petty vested interest — from manufacturers of shoelaces to purveyors of bibles and other publishers — the press mounted a campaign of abuse worthy of a better cause. The public was portrayed as emitting “howls of rage”, thousands of firms would go bankrupt, hundreds of thousands of workers would lose their jobs. Senator Mason, basking in the glory of acting leadership of the Australian Democrats, predicted that the 2.5 per cent sales tax would bring down the Fraser Government: “If they don’t get the message that the people don’t want this form of sales tax, then they face the strong prospect of defeat”. Such huffing-and-puffing need not be taken too seriously. But the reaction to the budget underlined the extraordinary
difficulty which confronts even the most modest tax reform in a political environment such as that of Australia. It is a pity, from this point of view, that the Government, from a mixture of macroeconomic and electoral considerations, failed to accompany the sales tax increase by even a token cut in personal income tax.

Some of the rhetoric that accompanied the outburst about the sales tax reflected a socio-political problem which would unquestionably need to be taken care of for a shift from direct to indirect taxation to be practical politics. A significant reduction in personal income tax, say in the form of adoption of a maximum marginal rate of 20 or 25 per cent, compensated by introduction of a broad-based consumption tax in one form or another, would certainly have some regressive effect, i.e. it would shift some of the burden from higher to lower income groups (chiefly among PAYE taxpayers). However cogently it may be argued that, in large part, such a shift would merely reverse the effects of the inflation tax, some gesture to meet this objection would probably be needed for the reform to be politically acceptable.

One possibility would be more systematic imposition of higher rates of indirect (e.g. sales) tax on luxury goods and services, such as luxury housing, cars and other durable consumer goods, foreign travel, restaurants, night clubs, etc. Other new taxes, aimed at taxing property incomes, which have been mooted are capital gains, wealth and resource rent taxes.

The universal experience of countries that have tried to use capital gains taxes is that they are not worth the trouble; adequately designed to be both reasonably equitable and administratively practicable, they bring in little more revenue than they cost to collect. A modest annual tax on wealth or net worth — which might be regarded as an extension of the existing tax on urban real estate in the form of local rates to other forms of private wealth — though also unlikely to raise a great deal of revenue, is much more feasible, judging by the experience of many European countries which have long used it. It is a pity that the mere mention of such a tax brought a political storm upon the heads of ALP politicians. It deserves to be seriously considered. Much the same applies to the idea of a resource rent tax. Though primarily aimed at ensuring that a reasonable share of profits, and especially of exceptionally high profits, flowing to foreign owners of resource development projects in Australia accrue to Australian governments, such a tax would also help make a shift from personal income to indirect taxation politically more palatable.

The problem that has been discussed in this article is how a given amount of total tax revenue can be raised more equitably and efficiently than at present. Nothing has been said about the quite distinct,
though no less urgent and even more intractable, problem of reducing the total burden on taxpayers which is the obverse of the problem of reducing government expenditure. In one sense, this is even more urgent and fundamental, for it is the juggernaut of the ever-growing public sector that has pushed up the burden of taxation and rendered progressive income tax unmanageable. In another sense it is part of the same problem. Attempts to reduce the total tax burden by cuts in government spending founder on the same rock as attempts to reform the tax structure, the unceasing battle over shares among rapacious interest groups (although cuts in government expenditure face the additional hurdle of resistance from organised government employees to any real or imagined threat to their job security). If progress is to be made it cannot confine itself to one approach or the other. Pressure for reform must be maintained on both fronts, enlisting as much public enlightenment and public spirit as it is possible to mobilise. Explanation of the issues, such as this article has attempted, is one weapon in the reformer's armoury.

Conclusions

The six conclusions to which this survey of the issues has led us are the following:

1. There is a overwhelmingly strong case for reducing government reliance on personal income tax because of its inequity, its adverse effects on efficiency and its role as an engine of inflation.

2. It is unrealistic to believe that the problems of personal income tax in its present form can be significantly reduced by legislative or administrative efforts to curtail tax avoidance, although what can be done in this way should no doubt be done.

3. The obvious, and in the long run inescapable, remedy is the approach recommended by the Asprey Committee of reducing personal income tax, preferably by lowering the ceiling marginal rate towards 20 per cent, and, to compensate for the loss of revenue, introducing some kind of broad-based consumption tax, in Australia preferably in the form of wholesale sales tax.

4. A necessary condition for such reform is acceptance by the Arbitration Commission and trade unions of the Hayden principle that wage indexation, formal or informal, must be discounted for changes in the CPI caused by government tax policy.

5. If, to be politically acceptable, such a shift from direct to indirect taxes needs to be accompanied by some additional taxation of higher, and especially property, incomes, a modest net worth tax and a resource rent tax are much to be preferred to a capital gains tax.
6. To be politically acceptable, sales tax increases, income tax reductions and some offsetting taxation of net worth and resource rents must constitute parts of a package introduced gradually over a period of years.

References

3 G. Allen, op.cit. The figure may somewhat overstate the shift which is partly due to the growing proportion of the population who live on the proceeds of lump sum superannuation.
5 Quoted Clyne, op.cit.
7 Ibid.
9 The Australian, 13 March, 1981.
10 The Australian, 28 September, 1981
FREEDOM and TAXES

President’s Address — IPA Annual Meeting, 15th October, 1981

Mr. J. S. Balderstone

I have attended I.P.A. Annual Meetings over the years, but this is the first time as President. My three predecessors — since the I.P.A. was founded 38 years ago — were Sir George Coles, Mr. Eric Lampe and Sir Wilfred Brookes. I expect you will understand the task before me in emulating their leadership. I know that it will be no less difficult than theirs.

Australia, along with the rest of what is known as Western society, is today in as state of unrest, uncertainty and disturbance. Old values have been discarded but not replaced. I would therefore like to try to restate, as much for my own benefit as yours, where we in the I.P.A. stand, where we are going and what we seek to achieve — in short, to take stock and to look to the future. At once some obvious questions arise:—

1. As a nation, are we headed in the right direction?
2. What of the “system” (economic and social), could it be improved? And if so, how are we to go about it?
3. For ordinary Australians, are the portents good? What of individual freedom?

Perhaps I have got the order wrong, because there is one rock upon which the I.P.A. took its stand from the beginning and upon which it must always stand, and that is the supreme importance of individual freedom.

There are of course, various vital freedoms, of speech, religion, assembly and so on; but the one on which the I.P.A. focuses attention is economic freedom of the individual. The Institute has always held that without this freedom, all others are at risk. Perhaps I might first set out four reasons why we attach such importance to freedom in general:—

1. Human dignity and self realisation depend on having the freedom to conduct one’s life as one sees fit.
2. People know their own best interests. They might occasionally make mistakes, but they will learn from them. It is quite ludicrous to think that distant officials can make vital decisions affecting individual well-being.
3. The only way to learn to act responsibly is to take responsibility. Without responsibility men never grow up. As John Stuart Mill put it
“With small men no great thing can be achieved.”

4. If we accept that men gain moral stature by courageously facing difficult decisions and surmounting challenges, then freedom is a prerequisite for morality.

I have said that the Institute's main concern is for the economic freedom of the individual, but if companies are looked at in the somewhat old-fashioned sense of a group of people using their resources towards a common goal, then with some provisos, this concern must apply to them too.

Where lies the main threat to economic freedom? I submit that there is one principal answer to that: Taxation (though many would argue that bureaucratic regulations also bear heavily on individual and companies alike). Of course, if taxpayers were generally in agreement with the extent of taxation and the ways in which it is spent, there might be little dissatisfaction. I am sure that this is not the case. On the contrary, I think most people, in all walks of life, are convinced that a high proportion of public sector spending is unmitigated waste.

No doubt partly for that reason there is already a strong tax revolt, in the form of legal avoidance and outright evasion. Another reason is that taxes are quite simply too high. They are too high to be readily bearable at the individual level, and this is why people are refusing to pay them. They are also too high at the national level, helping to pay for excessive public sector spending. This is now recognised to be the prime cause of the chronic inflation which bedevils economic management. Milton Friedman has suggested that Western economies possibly cannot function properly when the public sector spends more than a third of Gross Domestic Product. Earlier, Colin Clark put the figure at around a quarter. There is probably no rigidly correct figure. The amount of punishment an economy can stand from public sector squandering of its resources probably varies from one country to another and from one time to another for a given country. Without being too definite about it, I suspect that the correct figure for Australia may well be somewhere between those of Colin Clark and Milton Friedman. I also suspect that Britain may have gone well past this vital threshold of economic stability, which may get lower as an economy is allowed to degenerate.

Here lies our problem. For Australia, this vital ratio of public sector spending to Gross Domestic Product rose steadily from somewhat under 30% in the early 1950s to a little over that by the early 1970s. By 1976 it was 38%, which is what it is today. Thus the present Government has been able to do no more than hold the line, in spite of good intentions and, no doubt, good advice. The forces of evil, which would see our economy squander itself to death, are still there — intrusive
greedy bureaucracy, the political handout mentality and so on — and very powerful. The slightest faltering by the Government would be disastrous. We must all try to see that the Government maintains its efforts to reduce its spending.

This is why the Institute of Public Affairs is so important to this country today. It has always been very much an "ideas" organisation, sometimes ahead of its time (as when it advocated two weeks annual leave!), sometimes original (as with its advocacy of the concept of productivity in 1943), always trying to be practical (as in putting forward an economic blueprint after the last election). It has never shrunk from the politically unpalatable, nor will it. We are at present examining a variety of ways in which we can extend our effort in these economically unstable and perilous times. I believe that, now possibly more than ever, the Institute has a vital role to play. I have always tried to be an effective supporter of free enterprise and an opponent of Big Government. I therefore felt honoured to be asked to be the President of an organisation which will, I am confident, be as much of a positive force for good in the future as it has in the past.

**QUESTIONNAIRE**

In this issue you will find a postcard inviting your views on various aspects of the "Review". This is part of a continuing process of revising and up-dating our activities.

In this process, your help in answering the questionnaire and posting it back to the Institute, would be much appreciated.
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In income per head Australia is among the 12 richest countries in the world. 113 countries have a lower income.

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