TAXATION AND THE ECONOMY

SINCE the end of the war the burden of taxation has been one of the most hotly-contested questions of economic policy. The Commonwealth Government has been continuously and bitterly criticised for maintaining in peace a level of taxation which, it is claimed, is destroying enterprise, curbing production and undermining the health and virility of the Australian economy.

The Government has now attempted a reasoned defence of its policy in a document entitled "Taxation and the Economy," which comprises one of a series of papers presented to Parliament by the Federal Treasurer when introducing the Commonwealth Budget for the current financial year.

"Taxation and the Economy" is in some ways a curiously unscientific and unsatisfactory document. For instance, it states that: "Propaganda about taxation is probably doing more harm than taxation itself." There is a measure of truth in this; some of the attacks made on the Government's taxation policy have been over-coloured and have neglected to pay proper regard to the true facts. But, ignoring the terms of its own reproof, the Government, in attempting to defend itself from these attacks, sometimes stoops to a level which is itself little above that of the propagandist. The public is entitled to expect something better in a Government economic paper.

THE STATE OF THE NATION

The paper rashly asserts that the soundness of the Government's policy is proved by the present state of the economy:—

"Clearly that policy has not checked—

(a) employment, which is everywhere at a maximum;

(b) production, which is increasing in practically all fields; and

(c) enterprise, which has never been more active."

It is true that taxation has not checked employment. But the level of employment has, under present conditions, nothing whatever to do with the level of taxation. It is due entirely to the intense demand—both at home and abroad—brought about by the necessity of replacing the destruction and losses caused by the war. Practically everything that Australia can produce is in strong demand. Taxation has not made much impression on this demand. Why should it? A large part of demand, the overseas sector, is not affected by taxation in Australia. Also, the proceeds of taxation are for the most part spent, and its effect therefore is not to alter greatly total spending, but merely to change the source of demand from private individuals to governments or from the higher incomes to the lower.

TAXATION AND PRODUCTION

The other two claims are however highly questionable. If all were well with production, why is there such a clamour from all quarters for increased production? Why has the Government itself recently entered in consultations with the trade unions on the need for greater output? Why have economists of the standing of Professor Copland criticised the failure of production to respond to the high level of demand, and contrasted the post-war production position in Australia very unfavourably with that in the United States and Canada—countries, incidentally, in which taxation is very much lighter than in Australia?

A careful examination of statistical information leaves no doubt that Australia's record in production since the end of the war has been anything but inspiring. Many other factors besides taxation have contributed to this, but that the weight of taxation has been at least partly responsible should be beyond argument. There seems to be arising in certain quarters a strange new theory that the level of taxation can be raised to almost any heights without seriously affecting the amount of work a man is prepared to do, or the responsibilities and risks he is prepared to undertake. Nevertheless, these theorists would find it extremely difficult to argue that heavy taxation has had no effect—to take one field of production in which the response has been noticeably poor—on the number of sheep the sheep-farmer is prepared to run, the number of acres the wheatgrower is disposed to sow, or the number of cows

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the dairy farmer is willing to milk. It is time we returned to a little basic commonsense in this matter. Even so extreme and unrepentant a socialist as Dr. Hugh Dalton* in a standard text on taxation states: ". . . it is probably impossible to impose heavy taxation in a modern community without thereby causing some check to production." And it is probably safe to say that Dr. Dalton's conception of what constituted "heavy taxation"—his book was first published in 1922—fell far below the lofty heights which taxation has now reached in Britain and Australia.

EFFECT ON PERSONAL INCOMES

"Taxation and the Economy" deals first with the relief from taxation that has been granted the individual since the end of the war. It claims that the heavy reductions which have been made in rates of taxation, combined with the fact of rising incomes, mean that the net money incomes left to most people have greatly increased. This is not to be disputed. But it is noticeable that the annual income ranges selected to illustrate this point go no higher than £600. These incomes cover about 80 per cent. to 90 per cent. of all taxable income-earners. But what of the other 10 per cent. to 20 per cent.? Are they of no account? Or, on the contrary, does this class comprise most of those people who provide the enterprise and managerial leadership, carry the heaviest responsibilities, take the greatest risks, and provide most of the educational, professional and expert skill?

There is no question that reductions in taxation on the lower incomes since the end of the war have been considerable. But there has been no comparable relief for the upper incomes whose burden of taxation still makes the pre-war load seem a feather-weight. The upper 10 per cent. of income-earners earn one-quarter of total taxable income, but pay over half of the total income tax on persons. In 1938-9 personal taxation amounted to 4 per cent. of the total national income. In 1944-5, the war-time peak year of taxation, it reached 13 per cent. of the national income. In 1947-8 it was about 11 per

* Former Chancellor of the Exchequer in the British Government.

cent., or nearly treble the pre-war percentage.* The reductions in personal taxation since the war-time peak year, considered as a proportion of the total income of the community, have therefore not been nearly so generous as the Government paper contrives to convey. The concessions granted have been very largely to the advantage of the lower incomes, while those people on the higher and middle incomes have been virtually "left out in the cold."

SOCIAL JUSTICE AND INCENTIVES

The fact that the paper is able to claim that a man with a wife and two children earning £11/10/- now pays less tax than in 1938-9 suggests the immense extent to which the burden of taxation has been shifted from the backs of the lower incomes on to those of the middle and higher incomes. This can only mean that a very large part of the vast increase which has taken place in personal taxation since before the war is now being borne by the middle and upper incomes. This represents the most striking and, in its implications, the most far-reaching and profound difference between the pre-war and post-war economy. It can be supported neither on the grounds of social justice, nor of an economic policy calculated to achieve maximum productivity and to advance standards of living.

WHAT A SMALL CUT IN GOVERNMENT EXPENDITURE WOULD MEAN IN TAX RELIEF

"Taxation and the Economy" suggests that it is impossible to achieve any substantial measure of tax relief by cuts in government expenditure, the great part of which is inescapable and cannot be reduced. It states: "Critics never face up to the problem of meeting these post-war expenditures. They talk of cutting expenditure, but only in cheese-paring ways, the effect of which upon taxation is negligible."

This is quite misleading. It is not generally realised, and apparently not by the authors of this paper, that a compara-

* See Table I on page 182.

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tively small cut in government expenditure would enable quite material relief to be given to incomes above £600. For instance, if government expenditure, which is at present running at the rate of about £500 million a year, were reduced by £10 million, this would allow an average cut in taxation of about 30/- a week on incomes between £600 and £1,000, or of something like £1 a week on all incomes over £600. A reduction of £20 million in government expenditure would double the amount of relief—an average of £3 a week for incomes between £600 and £1,000, £2 for all incomes over £600. Cuts of this magnitude are not to be sneezed at. They would certainly be very welcome to the hard-pressed middle income-earners.*

A recasting of the method of financing social security on a straightout contributory basis would also help to relieve these people of their present excessive and unfair burden as well as to strengthen the motive-power of personal incentive.

DEVELOPMENT AND ENTERPRISE

A most unsatisfactory and unconvincing section of the Government paper deals with the effects of taxation on company profits. Figures of undistributed profits are advanced to prove that taxation has resulted in no shortage of investible funds for purposes of capital development, and of total net company profits to prove that taxation has not discouraged enterprise.

It is perfectly true that there has been a substantial increase in the total of undistributed profits and of total net company income—the former has moved from £45 million in 1938-9 to £64 million in 1947-8; the latter from £75 million in 1938-9 to £108 million in 1947-8. But that is only to be expected at a time of inflation of money values and when the amount of money held by the public has nearly trebled. The paper, however, omits to mention that the costs of new build-

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* These calculations are made from figures published in the Quarterly Summary of Australian Statistics, March, 1948, and in the 27th Report of the Commonwealth Commissioner of Taxation. The calculations are not, of course, put forward as definite proposals, but only as an indication of the magnitude of the relief from taxation possible through comparatively small cuts in government expenditure.

ings and equipment have much more than doubled since 1938-9, and therefore that the figure of £64 million, representing profits set aside by companies, is worth less to those companies than £45 millions of profits set aside in 1938-9.

At the annual meeting of Australian Paper Manufacturers Ltd. last September, the Chairman of Directors stated that it would cost the company £10 million at today's prices to replace fixed assets valued at less than £3 million in the balance sheet. This is typical of most well-established companies. So far, therefore, from there being ample funds in the hands of companies for investment purposes, the real value of these funds has declined sharply by comparison with 1938-9.

Moreover, the number of companies and the capital invested in companies are today very much greater than before the war. The number of companies assessed for taxable income increased from 13,201 in 1938-9 to 16,082 in 1944-5. All companies in existence today would probably number around 17,000, about one-third of which are public companies. Thus, despite an increase of 30 per cent. in the number of companies, the real value of profits set aside by companies is in total less than in 1938-9.

A further important point is that in 1938-9 economic conditions were, if anything, below normal—unemployment was about 10 per cent.—whereas in 1947-8 economic activity was at a high level with most sections enjoying record money incomes. In the interests of economic stability companies should therefore now be in a position to put aside unusually large amounts of money to reserves in order to meet the inevitable recession from abnormal boom conditions. But taxation at present levels is obviously preventing this.

MONEY PROFITS IN MANUFACTURING LESS—
DESPITE THE BOOM

Finally, much of the increase that has taken place in the money value of undistributed profits is accounted for by pastoral and mining companies enjoying record money incomes from peak overseas prices, and by wholesale and retail organisations earning the greatest money turnovers in their history. On the other hand, many basic manufacturing industries are making lower profits than before the war and, in order to maintain dividend rates, are cutting into much-needed reserves.

The profit position of various industries is set out in Table II.* This Table tells a very different story to the figures of company profits in the Government paper which show an overall increase from 7.6 per cent. on shareholders' funds in 1939 to 8 per cent. in 1947. Actually this improvement is largely accounted for by a remarkable increase in the profits of mining and pastoral companies (these have risen from 6 per cent. to 13.5 per cent.). Profits in manufacturing have actually fallen from 8.5 per cent. to 7.9 per cent. Due largely to the effects of heavy company taxation, the proportion of the total national income taken by company profits has fallen. Dividends which comprised 3.7 per cent. of the national income in 1938-9 fell to 2.7 per cent. in 1947-8; undistributed profits fell from 5.5 per cent. to 3.9 per cent.

THE SOURCE OF RISK CAPITAL

The efficient functioning of the free enterprise system depends upon an adequate flow of risk capital into industry. Even if the claim made in "Taxation and the Economy" that there is no shortage of investible funds were conceded, this fact would still be due to four circumstances, three of which are entirely fortuitous and temporary and for which the Government paper makes no allowance:

First, savings which banked up during the war because of the shortage of consumer goods on which incomes could be spent:

Second, the scarcity of durable consumer goods — such as houses, furniture, motor cars—since the end of the war; this means that many people who intend to purchase these goods, when they are able, are forced meanwhile to find a temporary investment for their savings:

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* See page 183.

Third, the increasing practice of life insurance companies and other institutions to invest in industrial stocks:

Fourth, the very high level of money incomes in general brought about by the post-war inflationary boom conditions.

It will, however, be an entirely different matter when these conditions change. Heavy taxation, that is, taxation of present proportions, would then have a very pronounced effect on funds available for investment in equity stocks and thus for improving the productive equipment of the community. These funds can come only to a small extent from workers in the low income brackets whose savings go mainly into savings bank deposits or Government bonds. The money for risk-taking industrial investment must still be very largely provided by those in the higher incomes and from business reserves.*

It is just plain nonsense to suggest that taxation of the present proportions can be levied indefinitely without having an adverse effect on the volume of funds available for investment, and especially for risk-taking investment.

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* See Table III on page 184.

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STATISTICS APPENDED TO "TAXATION AND THE ECONOMY"

TABLE I

Proportion of National Income Absorbed in Taxation

	DIRECT Personal £m.	Company £m.	Total £m.	INDIRECT £m.	TOTAL TAX £m.	NATIONAL INCOME £m.
1938-9	33	16	49	92	141	814
1944-5	166	60	226	153	379	1274
1945-6	171	56	227	171	398	1284
1946-7	167	54	221	216	437	1359
1947-8	177	70	247	227	474	1635
% National Income						
1938-9	4.0	2.0	6.0	11.3	17.3	
1944-5	13.0	4.7	17.7	12.0	29.7	
1945-6	13.3	4.4	17.7	13.3	31.0	
1946-7	12.3	4.0	16.3	15.9	32.2	
1947-8	10.8	4.3	15.1	13.9	29.0	

Source: Estimates of National Income and Expenditure, 1947-48.

TABLE II
Company Profits

	PROFIT AS A PERCENTAGE OF SHAREHOLDERS' FUNDS	
	1939	1947*
	%	%
Manufacturing—		
Food, drink and tobacco	9.5	8.6
Clothing, boots, etc.	6.9	7.8
Textiles, paper, chemicals, rubber, flour and sugar mills	7.0	7.9
Motor cars, furniture and hardware, musical instruments, etc.	15.4	10.7
Bricks, glass, tiles, cement, timber, etc.	7.6	5.8
Iron and steel and heavy engineering	9.3	6.9
Other metals and machinery	7.7	7.9
Total Manufacturing	8.5	7.9
Mining—		
Coal	3.0	3.7
Silver, lead, zinc, tin, etc.	9.6	16.6
Total Mining and Primary Production	6.0	13.5
Distribution—		
Wholesale		
Softgoods and food	4.3	7.8
Wool, hides and skins, oil, stationery, etc.	6.9	6.9
Machinery, motor parts, furniture, etc.	7.5	11.2
Total Wholesale	5.6	8.7
Retail		
Softgoods, shoes, food, drugs, etc.	8.1	9.2
Motor cars, furniture and musical instruments	6.6	9.3
Total Retail	7.8	9.2
Total Distribution	7.1	9.0
Total Services — Utilities, transport, newspapers, etc.	6.5	5.4
Total Finance — Banks, Trustees, Insurance, etc.	4.7	5.0
Grand Total	6.8	7.3

Source: Commonwealth Bank Statistical Bulletin, June, 1948.

* The figures for 1947 refer to the same companies in 1939. The groups are not necessarily complete.

TABLE III

Proportion of Total Savings Accounted for by Income Groups in U.S.A., 1947

FAMILY INCOME GROUPS* (In order of size of income)	PERCENTAGE OF TOTAL SAVINGS
1. Upper tenth	52
2. Second tenth	14
3. Third and fourth tenths	15
4. Fifth and sixth tenths	11
5. Seventh and eighth tenths	6
6. Remaining two tenths	2
	100

Source: U.S. Federal Reserve Bulletin, August, 1948.

Note.—The above table clearly shows that the bulk of the savings in the U.S.A. in 1947 were made by the higher incomes. 60 per cent. of U.S.A. family units forming the lower income brackets were responsible for only 19 per cent. of total savings in 1947.

* Family Income Group is defined as all persons living in the same dwelling and belonging to the same family who pooled their incomes to meet major expenses.

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