TAXATION AND INCENTIVES

THIS financial year, total tax receipts are expected to rise to £957 million compared with £718 million for last year—an increase of £239 million or 33%. As a percentage of national income, taxation may rise from 25% to around 30%. Part of this increase has been forced upon the Government by growing defence commitments; part is the outcome of the Government's decision to use the tax weapon as an anti-inflationary device to reduce spending power and to encourage resources to move into essential forms of production at present in short supply.

Under present circumstances a high level of taxation is inescapable. But there must come a point where mounting taxation becomes such a serious threat to initiative and enterprise, such a serious detraction from incentive to raise output, that it brings about lowered production and reduces the rate of industrial expansion. So far from being a corrective for inflation, heavy taxation then tends to become a force making for further inflation. It aggravates the disease it is intended to cure.

Where is that point, and have present rates of taxation already gone beyond it? It is not easy to give a definitive answer to this question. But what is certain is that taxation in most modern communities is now absorbing such a large share of the national income that governments and peoples should be acutely alive to the danger that it represents. To tax a community beyond the point where it is prepared to give its best in work and enterprise is the path to industrial stagnation. Producers generally are discouraged from increasing their efforts and from taking the risks of fresh enterprises when the major part of any additional return they may expect to obtain will be absorbed in taxation.

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Heavy direct taxation on incomes is especially dangerous in a young economy such as Australia in which the primary emphasis must be on rapid development and the encouragement of every shred of enterprise and adventure the country can command. The post-war history of Australian primary industry seems to provide unassailable evidence of the disincentive of high taxes once producers get it into their heads that they are only "working for the Government."

Besides its serious effects on production and industrial development, heavy direct taxation may add to inflation and distort the economy in other ways. Firstly, companies and other businesses and farmers are encouraged to boost costs and expense accounts in order to reduce their taxable incomes and conversely they are discouraged from striving to cut down these expenses. Employers are not so enthusiastic about cutting costs and achieving economies when they know that a large part of the anticipated gains will be taken by the Treasury. Second, activities are steered away from constructive enterprises into channels in which the burden of taxation may be escaped, even by such legitimate means as capital gains. Third, high taxation may compel taxpayers to draw on liquid reserves and investments or to increase their bank overdrafts. Potentially frozen funds are thus transferred to governments who spend the proceeds. Fourth, producers are encouraged to spend a greater proportion of their incomes rather than to reinvest it in their farms or businesses to improve their profitability.

COMPARATIVE TAXATION LEVELS HERE AND OVERSEAS

There is evidence to suggest that Australia has erred in leaning too heavily on direct personal taxation rather than indirect taxation as a source of revenue. The following table shows the proportion of national income absorbed in direct and indirect taxation in Australia, United Kingdom, United States and Canada in 1939 and 1950.

	Australia		U.K.		Canada		U.S.A.	
	1938/9	1950/51	1938	1950	1939	1950	1939	1950
	% of National Income.							
Direct Taxes on Persons	4.2	11.7	7.9	11.7	2.6	5.2	3.3	8.6
Indirect Taxes	11.9	10.7	15.5	22.5	17.6	16.3	13.0	10.0

Sources:—National Income Estimates Australia and United Kingdom. Canadian Hansard. U.S. Survey of Current Business.

NOTES—

1. Direct taxes on persons include income tax and inheritance and gift taxes, death duties, etc.
2. Indirect taxes have been taken to include customs, excise and sales taxes and all state and local government rates and taxes other than on income, etc. They include payroll taxes in Australia and employer-employee contributions to National Insurance Funds, etc.— 4% of National Income in United Kingdom, 2% in Canada and 3% in U.S.A. The portion contributed by employees is, of course, in the nature of a direct tax, but has been included in indirect taxes as it would be difficult to segregate and as it would make only a small difference to the figures.

Australia shares with United Kingdom the distinction of very high levels of direct taxation but, with the exception of U.S.A., imposes the lowest level of indirect taxation. Unlike Canada and United Kingdom, which in 1950 levied indirect taxes respectively 16.3% and 22.5% of national income, indirect taxes in Australia in 1950/51 amounted to only 10.7%. As they bear relation to expenditure and not income, the payment of indirect taxes is much less painful to the taxpayer than payment of direct taxes. The significance of direct taxes is brought home to everyone in diminished pay envelopes and lower earnings.

Relative to national income, direct taxation on persons in Australia has increased from 4.2% in 1938/9 to 11.7% in 1950/51. This has been brought about largely by steep increases in taxation rates on middle and upper income earners. The following table sets out the amount retained of each £ of income at various income levels in 1938/39 and 1951/52.

Relative amounts of income retained by taxpayers in Australia.

Annual Income £	1938/39 Amount Retained out of each £ of income	1951/2 Amount Retained out of each £ of income
200	19/4	19/7
400	18/9	18/9
600	18/4	18/2
800	18/–	17/6
1,000	17/9	17/–
1,500	17/4	15/11
2,000	16/11	14/10
2,500	16/5	13/11
5,000	14/5	[illegible]
10,000	12/3	[illegible]

NOTE: These figures relate to personal exertion income only and make no allowance for dependants. The 1938/39 figures cover combined N.S.W. and Commonwealth taxes. Victorian taxpayers would have retained a higher proportion of their incomes, taxpayers in other States possibly less.

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Before the war the burden of income tax was fairly light on most income earners. The great part of the community escaped with taxation payments of less than 2/- in the £. Few paid more than 5/- in the £. In contrast today probably about 100,000 persons pay taxes ranging from 5/2 in the £ at £2,000 up to 12/4 in the £ at £10,000. If account is taken of property income, the rates become even higher.

MARGINAL RATES OF TAXATION AND INCENTIVES

Most taxpayers, when considering whether or not they should work more overtime or expand their output, take into account *marginal rates* of taxation rather than *average* rates. Marginal rates of taxation are the amounts which go in taxation out of each *additional* £ earned. Examples of marginal tax rates at various income levels are as follows:—

Income £	Tax on an extra £ of Income
700	4/5
800	4/9
1,000	5/10
1,400	7/4
2,000	9/6
2,800	11/-
5,000	14/8
10,000	16/6

Once taxpayers reach an income which they consider adequate for their main needs, they increasingly ask whether or not it is worth while making an extra effort when they retain a much smaller proportion of each additional £ of earnings. Thus, in answer to the query why man-hour output in certain fields of mining is inadequate, the men answer: "Why should we bust ourselves? It is true we make more money, but as every pound we make puts us into a higher taxation grade, what we net out of the extra exertion is relatively so small there is no point in busting ourselves."

The wheat-grower is asked why he won't grow more wheat and the dairy farmer why he won't produce more butter-fat, and they retort in similar vein: "We are not going to take the risk of cropping more wheat or running more cows when the Government will take more than we get out of the extra return." Administrators and executives in like manner tend to shun the mental strain of higher responsibilities. "Why should we aspire to the Managing Director's post? At £2,000 a year the Government gets 9/6 in the £ out of bonus additions to our salary. If we do reach £5,000 a year our bonuses will be worth only 5/4 in the £ after paying taxes."

Present rates of tax are so heavy as to discourage the adventurous, striving, ambitious individual from attempting big enterprises. This type of rare person has been the inspiration of economic progress in the past and it is certain that no society—in the foreseeable future—will be progressive unless he is retained. The man prepared to risk the long, hard, hazardous ascent to the heights must not be deterred from so doing by failure to place glittering prizes at the summit. The nation must reward its great men greatly if it is not to deny itself the fruits of exceptional skill and enterprise.

PRIMARY PRODUCTION AND TAXATION

Resentment at existing levels of taxation probably reaches its most acute form among primary producers, the majority of whom earned comparatively small incomes before the war. Few paid more than 1/- or 2/- in the £ in income tax. With the enormous increase in average farm incomes, from £140 in 1938/39 to £2,520 in 1950/51, many farmers and graziers have now moved into the high tax brackets.

Based on Victorian data, the spread of incomes (employers and self-employed) in primary production in Australia, before the war, was roughly as follows:—

Annual Income	Nos.	%
Under £501	305,000	96.5
501-1,000	8,500	2.7
Over 1,000	2,500	.8
	316,000	100.0

Source: Taxation Report—Victoria, 1940, Commonwealth Year Book.

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Estimated figures for the current financial year 1951/52 are:

Annual Income	Nos.	%
Under £1,001	164,000	54.6
1,001-4,000	100,000(3)	33.1
4,001-6,000	16,500(2)	5.4
Over 6,000	21,000(2)	6.9
	301,500(1)	100.0

Sources:

1. Primary Production Bulletin No. 43.
2. Hansard No. 14, 1951.
3. 30th Report of the Taxation Commissioner. Income grades shown in the Taxation Commissioner's Report have been adjusted upwards in line with latest data in the National Income Estimates and in Hansard.

The primary producers in the very top brackets derived their phenomenal incomes almost entirely from wool growing. But there is still a considerable number with gross incomes around £1,000 per annum who must make decisions whether or not they shall plant more wheat or expand their dairy herds or increase their deliveries of fat lambs and pigs to market. It is here that high levels of taxation tend to build up a psychological antipathy to appeals for greater output of food. Primary producers weren't used to paying heavy taxes in the past and they resent the fact that the community wishes to share in what may now be a fortuitous prosperity. Farmers have got it into their heads that the Government is getting too large a share of their returns and a substantial cut in income tax levels may be all the encouragement they need to expand their acreages or increase their herds and flocks. It is rather significant that the acreage of sown grasses in Victoria has more than doubled since 1938/39, but the output of milk has only risen by 18% and the output of fresh meat has dropped by 6%. Given adequate incentives there is undoubtedly great capacity for an increase in output in these urgently needed products.

A COMPARISON WITH CANADA

Those who still believe that all is well with the Australian economy might study the position in our great sister Dominion, Canada. Like us, Canada has great primary and secondary industries and vast resources still to be exploited.

Since the war Canada has far outstripped Australia in the production of industrial essentials—iron and steel, building materials, housing and farm equipment—and managed to equal or exceed our achievement in the production of consumer goods for which there is a record demand because of high incomes.

It is highly significant that direct personal taxation as a proportion of national income has increased in Canada from 2.6% in 1939 to 5.2% in 1950, whereas in Australia it has increased from 4.2% to 11.7%. Also, as rates of taxation are more progressive in Australia, a much greater burden of taxation has been imposed on the upper tenth of taxpayers than in Canada. Comparative rates of taxation on different income levels are as follows:—

COMPARATIVE RATES OF TAXATION
CANADA AND AUSTRALIA, 1951/52.

	Income Converted to Aust. £.		% of Income Taken in Taxation	
Income Can. $.	At Official Rate of Exchange ($1 = 9/-) £	At Arbitrary Rate of Exchange* ($1 = 5/-) £	Canada	Australia*
2,000	900	500	8	8
3,000	1,350	750	12	12
4,000	1,800	1,000	14	15
6,000	2,700	1,500	17	21
10,000	4,500	2,500	22	30
20,000	9,000	5,000	33	46
40,000	18,000	10,000	43	62
60,000	27,000	15,000	49	69

* For purposes of this comparison, the internal value of the Canadian dollar is assumed to be 5/- Aust. rather than the artifically determined rate of 9/-. In 1937, before depleted dollar reserves necessitated drastic devaluation of sterling and the Aust. £, the Canadian dollar was equivalent to about 5/- Aust. A further indication may be found in the fact that in 1950 average weekly earnings in manufacturing in Canada were $2,280 as compared with £530 in Australia.

In 1949, 88% of Canadian taxpayers earned less than 4,000 dollars a year, contrasted with 94% of Australian taxpayers who earned below £1,000 per annum in 1948/49. This means that the great bulk of taxpayers in Canada and Australia are taxed at almost identical rates, i.e. 8% to 15% of their incomes. But whereas in Canada the taxation scale ranges from 14% at 4,000 dollars to 49% of annual income

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at 60,000 dollars, in Australia the equivalent scales are 15% to 69%. It would seem that Australia has something to learn from Canada in the matter of taxation and incentives. It is surely much better to lighten the individual strain of taxation by imposing a very small burden on a large number of taxpayers, than to take too big a proportion of their incomes from a relatively small number of taxpayers, and thus destroy the incentives to production and expansion which will provide the source of higher real incomes for all in future years.

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