the IPA review

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AN INCENTIVE BUDGET

THERE is widespread agreement on the need for what is called an "incentive budget". An "incentive budget" implies a general easing of the burden of taxation or, at the very least, a redistribution of the burden so that it weighs less oppressively on enterprise and on the savings necessary to finance enterprise. The obstacle in the way of such a budget is the massive scale of government expenditure which has so far defied all attempts to curb it. On the contrary, like Topsy, it grows and grows and continues to consume an ever larger part of the national income.

Many of those who urge drastic cuts in government expenditure do so in obstinate disregard of present-day political realities. The public pressure on goverments for more and more cash hand-outs and for a constantly widening scope of government services of all kinds has, in recent years, been well-nigh irresistible, and it has been one which no political party could afford to ignore except at the cost of tens of thousands of votes at the polls.

But, while the large-scale slashing of expenditure envisaged by these people is beyond the realm of political reality, there is ample scope for worthwhile economies which, in sum, would prove to be not insignificant. If the use of the axe is out of question, the pruning knife is still a practicable instrument of trade.

Moreover, the realisation seems to be dawning at last that all these government benefits have to be paid for, and that there are practical limits to which you can expect the other fellow to foot the bill. Far from providing steadier jobs and better living standards, excessive government spending, because of the heavy taxes necessary to finance it, saps the spirit of adventure and achievement on which employment and economic progress largely depend. Hence the public pressure for increased government services is now accompanied by the opposite pressure for lower taxes.

The present Commonwealth government is caught unhappily between these conflicting forces. The path of economic wisdom is fairly plain. It calls for the restoration of enterprise and the encouragement of initiative through the modification and adjustment of tax scales. We have reached the point where it would be wise for the government to sacrifice, if necessary, politics for economics, to risk courting a small degree of political unpopularity—which may, in the event, fail to materialise—in order to satisfy the demands of a realistic and progressive economic policy.

Great Increase in Expenditure Since 1947-8.

In 1938/9 Australia spent about £218 million, or about 28% of the national income, on government services—federal, state, semi-governmental and municipal. During the war government expenditure rose to a peak of £750 million in 1942/3, thereafter hovering around £700 million—about 60% of the national income. With the tapering off of defence expenditure to the low figure of £23 million in 1947/8, government outlays were brought back to £505 million representing 29% of the national income—about the same as before the war. But, from this point on, government expenditure has risen by leaps and bounds because of soaring administrative costs, the growth of social services, public works programmes of unprecedented magnitude, and the mounting threat of "the cold war".

The comparative trend is shown in the following table:—

	Total Government Expenditure*	Percentage of National Income
1947/8	£505 m.	28.8%
1948/9	576	29.7
1949/50	700	30.5
1950/51	966	31.0
1951/52	1,139	35.2
1952/3 est. ..	1,210	35.0

In six years government expenditure in money terms has more than doubled. Allowing for price changes, real expenditure has increased by about 40%.

What are the prospects of cutting down this immense outlay by governments? This question can be conveniently discussed under four main heads of government expenditure—administration, social services, defence and public works.

Administration.

Administration costs consist in the main of the costs of government departments, such as the Federal or State Treasuries which are not run as business undertakings like the Railways or Post Office. The increase in the administrative cost of governments is largely a reflection of the greatly extended range of activities now carried on by the Commonwealth Government. Most of the increase in staff employed by all governments—from 42,000 before the war to 108,000 in 1947 to 127,000 in June, 1952—took place in Commonwealth Government departments. The number of public servants coming under the jurisdiction of the Commonwealth Public Service Board, excluding postal officials, has risen from about 12,000 in 1939 to 78,000 in 1952. New departments

* Includes expenditure by Federal, State and Municipal Governments and expenditure by semi-governmental organisations.

ve been created—such as Immigra-
n (3,500 employees), Social Services
,000), Civil Aviation (5,000), Labour
d National Service (2,000), National
evelopment (500), Works (16,000)—to
al with new post-war responsibili-
s. Existing departments, such as
patriation, Taxation, External Af-
irs and the Prime Minister's Depart-
ent, have also been greatly enlarged to
pe with growing functions.

It must be reluctantly conceded that the
ospect of any spectacular reductions in
e size of these staffs is remote. The
ting strength of public servants alone
sufficient to make any Government tread
rily in the matter of drastic economies
the public service.

cial Services.

This is the most intractable part of
vernment expenditure. In fact the cost
social services is far more likely to in-
ease than diminish.

This year the cost of social services
ll amount to over 10% of the national
come, compared with 7% in 1938/9 and
in 1947/8. The ageing of the popula-
n and extensions to health and medical
hemes will in the near future involve
rther additions to cash benefits, while
need for better educational and health
cilities and other civic requirements
y add to the cost of social services in
d.

fence.

Defence is budgeted to absorb £200
llion in the current year. Before the
r just over 1/- in every £ of govern-
nt revenue was devoted to defence. In
47/8 defence outlay fell below 1/- in
£, but this year it will probably take
er 3/-. The biggest items consist of
v defence equipment, such as ships and
craft, which accounted for nearly half
total defence bill for 1951/2. Service
—permanent forces, national service
inees and citizen military forces—costs
nearly £50 million. The Korean War to date has cost £13¾ million—an average of £6 million per annum—and the total outlay on the Rocket Range since its inception has been £24 million.

If Australia is to shoulder its fair share of responsibility for the defence of the free world, any substantial reduction in defence expenditure cannot be entered into lightly. Moreover, the critic of heavy defence expenditure must still face up to the fact that in 1951 Britain spent 13.4% of national income on defence, while U.S.A. (17.0%) and Canada (10%) are all bearing defence commitments in excess of the Australian outlay (5.1%).

Public Works.

Apart from defence, public works account for most of the substantial increase in expenditure since 1947/8. Public works took 7.8% of the national income before the war, and 5.6% in 1947/8. Now they are absorbing over 10%. Australia's public works programme in the post-war years has been lamentably planned and managed. The general design was overambitious and too many projects were attempted at once, setting up an absurd competition for technicians, labour and materials which has added greatly to costs, and led to extravagant squandering of public monies. The lack of coordination is largely the product of State and Federal political rivalries. Individual items showing the greatest rises in expenditure compared with pre-war are power schemes, civil aviation, the railways and public buildings. On the other hand, expenditure on roads and harbours has not kept pace with national income. Expenditure on water schemes does not seem excessive compared with pre-war.

Although the International Bank has commented adversely on the planning of public works in Australia, and the matter was again raised at the recent Sterling Area Conference, the cynic may be pardoned for wondering whether the States will abandon their "parish pump" politics for a logical national programme of priorities.

TO sum up, reductions in government expenditure of the really spectacular variety are outside the realm of practicability. The public demand for social services and benefits seems to be insatiable. A careful watch should be maintained on the costs of proposed health schemes; such palpably vote-catching measures as marriage loans should be resisted; but no drastic policy changes can be anticipated in the field of social services. The trend will in all probability be toward expansion rather than restriction. Even were the planning functions of the Commonwealth Government reduced, and some of the newer government departments scrapped, the economies achieved—while important in themselves—would be Lilliputian when measured against the giant proportions of the total government budget.

Any great curtailment of defence expenditure cannot be expected while international tension continues. Public works, it is true, offer real scope for the economies to be achieved through better planning and management. But governments have come to regard large-scale expenditures on public works as essential to full employment, and there are also the new aspirations for national development which command almost universal support.

* * * *

SINCE the political obstacles in the way of dramatic cuts in government expenditure appear almost insurmountable, the conclusion must be that an "incentive budget" will have to concentrate mainly on revising tax policies and on redistributing the tax burden. The guiding consideration must be to reduce the burden of taxation at the points where it presses most severely on enterprise and savings- the two vital lubricants of the econom mechanism at present in short suppl The chief offenders in this regard are t excessive rates of personal income t and company tax. **But, if relief is to afforded at these points, the impossibili of wholesale reductions in indirect tax tion must be frankly confronted.** Tho who argue most vociferously about t need for slashing indirect taxes wou quickly lower their voices if they we told that the consequences of this wou be an increase in their personal tax. is difficult to see how we can have bot If income tax—both personal and co pany—is to be reduced on any worthwhi scale, then the revenue from indirect tax must be at least maintained, and probab increased. Since indirect taxes have comparatively small influence on the w to work and on enterprise, the conclusi is inescapable that, in general, an "i centive budget" should concentrate main on reducing the burden of income ta There is also the important considerati that indirect taxes today comprise only slightly higher proportion of to national income than before the war, a that other countries, notably Cana (with an unrivalled record in postw development) place much greater relia on this form of taxation than Australi

Taxation of Companies.

Company taxes, as a percentage of t national income, rose from 2% in 1938 to 4% in 1947/8. They are now at ab 5%. Of each £ of profit, companies m now pay over to the Government ab 9/- compared with less than 4/- bef the war. When departmental disallo ances of deductions are taken into accou the impost is in many cases over 10/- the £ of real as distinct from taxa profit. In turn, shareholders must p taxes on their dividends ranging fr about 5/- in the £ for the typical inco earner with a modest portfolio of shar o over 15/- in the £ for the large investor with income from other sources which puts him in the heavy tax range. Before the war dividends were not doubly taxed*.

The argument against taxes of these proportions is that they reduce the incentive to industrial expansion, and what is equally important they starve industry of the financial resources which will enable it to expand. In particular they bear heavily on the young company with prospects of rapid growth, but in which the element of risk is greater. There is less profit to plough back into the business, whilst the investor, subject to heavy tax on his earnings, is likely to invest his diminished savings with greater caution in well-established enterprises. The economic argument against heavy company taxation has always been strong; today, when there is an acute scarcity of savings, it becomes stronger than ever.

Inadequate depreciation allowances are also a sore point with companies, and indeed any business today. Existing allowances for depreciation have become unreal in view of current costs of replacing buildings, plant and equipment. More liberal depreciation provisions and a reduction in taxes on profits would do much to rejuvenate the risk capital market, for companies and their shareholders are by far the largest source of savings for new investment.

Individual Income Taxes.

Personal income taxes have increased from 3.3% of the national income in 1938/9 to about 11% for the current financial year. Most of this very steep rise has fallen on the middle and upper income earners. **In the latest year for which figures are available, the top 15% of taxpayers provided about three-quarters of the total revenue from income tax collections.**

Both the present Federal Government and its predecessor have emphasised that the burden of tax on the ordinary wage-earner with a family compares more than favourably with other English-speaking countries. A wage earner on £15 per week (approximate average weekly wage of male factory worker) with a wife and child pays less than £1 per week tax or about 1/- in the £. On the other hand, taxes on each extra £ of income earned by the higher income earners range from 8/6 at £2,000 to 15/- at £10,000. This may be effective in the matter of winning votes, but it imposes a deadening burden on enterprise.

Carried beyond a certain point, steeply progressive taxation defeats its own ends by reducing the total pool of wealth available to improve the lot of the under-dog and the low income earner. By weakening incentives high taxation cuts into pioneering investment that makes more jobs—and makes them more productive. The wage-earner has much to gain from lower taxes on those who open up new avenues of employment. If the taxes paid by most farmers are so high that they prefer to sit on the front porch rather than to grow more wheat or wool or employ migrants to develop their holdings, then the community is clearly worse off as a result of its high tax policy. Powerful motives are needed to encourage men to change from a secure position to one with chances of brilliant success or total failure, or to induce an investor to risk his savings in the development of new products, processes or services. Very high marginal taxes reduce the force of these motives.

There is no way of telling at what rate of marginal tax (i.e., the tax on each extra

* Pre-war, dividends were exempt from State income tax and for Federal tax a rebate (at the shareholders' rate of tax on property incomes, or at the company rate, whichever was the less) was allowed to shareholders in respect of dividends distributed by companies.

£ of income) the danger point is reached, but a practical commonsense assumption might place it at around 10/- in the £. Under the present rates of tax, this point is reached at about an income of £2,800. At £10,000 the marginal tax becomes 15/-. The latest income year for which statistics are available, 1949/50, reveals that 34,000 people earned over £3,000 per annum and paid £70 million in taxes. This figure today might be well over £100 million. If the rate of marginal tax were limited to 10/-, the tonic effect on farm production and business enterprise would far outweigh any direct embarrassment that might be caused to the national finances. Actually, in the long run, the increase in incomes might yield a large part of the tax forgone, even at the lower rates levied.

At the time of the introduction of the last Federal Budget, revenue from personal income tax and company tax was estimated at £550 million. It seems now that actual collections will be somewhat higher. **An "incentive budget" that means anything would have to contemplate a reduction in revenue from these sources of, say, £100 million.** This figure is, of course, no more than a rough guess, but it can be taken in order to indicate with some definity the broad proportions of the problem. Possibly well over half this loss in revenue would be incurred by smoothing out the income tax scale so that the marginal rate of tax of 10/- was reached at £10,000 instead of at £2,800 as at present. The remainder would arise from reductions in public company tax to an average of, say, 7/- in the £, an equivalent cut in taxes on private companies, and a liberalised system of depreciation allowances.

* * * *

How would a fall in revenue from income and company taxes of the order of £100 million be made up?

In the first place any economies in gov ernment expenditure should be applied t reduce the need for Treasury Bill financ which, in the current year, will be un comfortably high. **This would mean th extra revenue from other sources woul have to be found to compensate for th lost by reason of income and company ta concessions.**

The reduction of income taxe would leave members of the public an industrial companies with addition funds and it is reasonable to expect th some of this money will find its way int the government bond market. This, com bined with the prospect of improving eco nomic conditions and greater financi liquidity, should mean a much stronge market for loan monies than in th current year. There is no doubt that on of the main reasons for the weakness o the market over the past twelve month has been the heavy exactions on th public imposed by income taxes.

WHAT other sources of addition funds can be tapped?

An increase in revenue from custom duty will undoubtedly follow the easin of import restrictions, recently announced The great part of the balance would hav to be found in the field of sales tax. A present less than one-third of sales ar subject to sales tax. An important addi tion to revenue would be obtained by re ducing the number of exempt items an imposing a nominal rate of, say, 5%. This admittedly, would be politically unpopula and would have certain undesirable fea tures. But if there is to be any worth while cuts in the income tax field — an any "incentive budget" demands that cut be made and that they be worthwhile — there seems no escape from obtainin more revenue from indirect taxation.

The U.S. Committee for Economi Development, a group of progressivel minded American business men pos sessing direct links with the new Eisen hower administration, in a report on Tax and Expenditure Policy prepared last year for the guidance of the American Government, recommended a wider spread of sales tax as less inflationary and less injurious to production than any other alternative.

Of course, no doubt most of us would like to see all taxes reduced—direct and indirect. **But we are faced with the dilemma that if decisive reductions are to be made in income taxes, then revenue from indirect taxation will have to be maintained—possibly even increased.** Token concessions over the field would achieve no effective economic purpose and would please no one.

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TABLE I.—COMBINED EXPENDITURES OF AUSTRALIAN GOVERNMENTS 1938/9 TO 1952/3.

	1938/9	1947/8	1948/9	1949/50	1950/1	1951/2	1952/3 (Estimate)
Social Services—	£m.	£m.	£m.	£m.	£m.	£m.	£m.
Cash Benefits	30	87	104	116	143	172	200
Education, Health, etc.	24	68	73	89	105	126	140
	54	155	177	205	248	298	340
Administration	19	50	57	64	75	93	110
Defence	13	23	40	53	98	165	200
Public Works	61	99	136	204	293	375	350
Interest	60	95	96	100	103	108	115
Housing	5	15	22	34	45	62	60
All Other	6	68	48	40	104	38	35
	218	505	576	700	966	1139	1210

TABLE II.—COMBINED RECEIPTS OF AUSTRALIAN GOVERNMENTS 1938/9 TO 1952/3 AS A PERCENTAGE OF NATIONAL INCOME.

	1938/9	1947/8	1948/9	1949/50	1950/1	1951/2	1952/3 (Estimate)
	%	%	%	%	%	%	%
Indirect Taxes	12.0	12.9	12.8	12.3	10.8	13.8	11.7
Direct Taxes							
Income Tax on Companies	2.1	4.0	3.8	3.7	3.2	4.6	4.9
Income Tax on Persons	3.3	9.3	10.3	8.5	11.3	12.2	11.1
Death Duties, etc.	0.9	0.7	0.8	0.7	0.6	0.9	0.8
Total Direct Taxes	6.3	14.0	14.9	12.9	15.1	17.7	16.8
Other Revenue	5.7	2.4	1.7	1.3	1.0	1.2	1.0
Increased Debt.	4.0	— 0.5	0.3	4.0	4.1	2.5	5.5
TOTAL	28.0	28.8	29.7	30.5	31.0	35.2	35.0

Source: National Income Estimates and Commonwealth Statistician.

TABLE III.—COMBINED RECEIPTS OF AUSTRALIAN GOVERNMENTS 1938/9 TO 1952/3.

	1938/9	1947/8	1948/9	1949/50	1950/1	1951/2	1952/3 (Estimate)
Indirect Taxes—	£m.	£m.	£m.	£m.	£m.	£m.	£m.
Customs	31	58	63	78	92	114	62
Excise	16	58	63	66	73	100	104
Sales	9	35	39	42	57	95	88
Payroll	—	17	20	23	29	37	40
Land	3	5	5	5	5	9	4
Entertainments	1	5	5	5	5	6	7
State Stamps and Motor Registrations	10	15	17	21	27	33	40
Local Govt. Rates	14	21	24	25	26	28	30
All Other	9	11	12	17	21	26	30
Total Indirect Taxes	93	225	248	282	335	448	405
Direct Taxes							
Company Income Taxes	16	71	74	85	101	149	168
Personal Income Taxes	26	163	199	195	352	403	385
Death Duties, etc.	7	13	15	17	19	23	27
Total Direct Taxes ..	49	247	288	297	472	575	580
Other Revenue—							
Interest, Business Profits, etc.	44	42	33	30	31	36	35
Increased Debt—							
Loans, Local*	27	71	106	136	142	16	190
Loans, Overseas	3	—10	—14	—30	—16	21	
Treasury Bills	2	—70	—85	—15	2	43	
Total Increased Debt	32	—9	7	91	128	80	190†
TOTAL	218	505	576	700	966	1139	1210

Source: National Income Estimates and other publications by the Commonwealth Statistician.

*Proceeds of loan raisings less purchases of bonds, etc., on the open market and debt redeemed.

†Of this amount the Commonwealth Government has agreed to advance up to £135m. from Central Bank credit and its own resources towards the State Governments' loan works programmes.

APPENDIX

ONCE upon a time, economists used to devote a great deal of attention to the basic principles that should govern a good tax system—the comparative merits of particular taxes, the taxable capacity of a nation, the final incidence (i.e. who really pays the taxes) and so on. We had Sir Josiah Stamp's classic: *"Principles of Taxation"* and studies of such outstanding merit as Hugh Dalton's: *"Public Finance."* It is paradoxical that, today, when taxes have reached unexampled heights, and when the application of sound principles has assumed infinitely greater importance, the problems of taxation receive so little fundamental thought.

Just before the close of World War II, the I.P.A., realising that in the post-war period taxation would become a major influence on the health of the economy, carried out a careful study of this problem with the help of tax experts, accountants, and businessmen. This study was published in August, 1945, under the title of *"Taxation in the Post-War Years"*. We believe that many of the conclusions reached as a result of that work are especially relevant to the present high tax conditions, and are worth repetition:—

Pre-War a Mouse!

"We are forced to recognise that the magnitude of taxation in the future will be vastly greater than ever before in our peacetime economic histry. So will its spread. Taxation will extend to every corner of the economic structure; it will influence directly every business decision and enterprise; it will enter into practically every economic calculation as a factor of major importance. From being a comparative mouse in the pre-war economy, it will be, if not a giant after the war—and that is possible—at least something to be reckoned with at every step. The very size of post-war taxation calls for a new approach and a more intensive examination of its relation to the whole economic problem."

There is a crucial limit!

"Taxation above a certain limit must inevitably tend to dry up the source from which it is drawn. The crucial problem of post-war taxation policy in Australia will be to find this limit, and for economic statesmanship to see that it is not exceeded. Nothing could be more disastrous to the economy of the country and the standards of the people than a diminution of the total national production. With taxation at pre-war levels, the effects on production were possibly negligible; but with taxation at the high mark which is probable after the war, the most rigorous attention will need to be paid to economic incentives and to the financial resources left in the hands of industry for expanding and improving the efficiency of its plant and equipment."

A Nation can tax itself out of Prosperity!

"The ultimate source of all taxation and of all state-sponsored services is personal endeavour. High taxation must inevitably tend to weaken this endeavour and therefore to destroy the source of its own creation. It is impossible for a nation to tax itself into prosperity. It is entirely possible for a nation to tax itself out of prosperity. To the wealthy, vigorous, producing country, all things concerned with the material, and indeed spiritual, welfare of its people are possible. To a poor country, struggling under a load of tax exaction too heavy for it to bear, social welfare must remain at a standstill."

Goal is High Production!

"Taxation is itself one of those factors which affect the level of production and the degree of efficiency attained in the use of resources. Even though government commitments may make unavoidable the raising of a definite sum of money by taxation, it is still important to ask how the necessary taxes can best be distributed and levied in the light of the goal of high production."

Stagnation or High Ambition!

"An equalitarian society, that is one in which men are rewarded primarily according to their needs, and not according to their skill and efforts and achievements, will be a stagnant, dormant society with death at the heart. The tremendous industrial and scientific gains of the past century will be dwarfed by those of the next so long as we keep the pathways to the satisfaction of high ambition clear and broad.

Guardian of the Public Interest!

"Whether the business man will decide on a high, or a low, level of activity in his particular enterprise will be determined by a complexity of factors, of which the magnitude and kind of the taxes the business will be called upon to bear are by no means the least important. Here Australian governments have a clear responsibility. In their capacity as guardians of the public interest, they must endeavour to create conditions which will stimulate the business man to the utmost enterprise and efficiency. In the past governments have paid comparatively little attention to the effects of company taxation on business enterprise. They have looked at it more as a convenient means of amassing revenue to meet their own expenditure. This approach will not be good enough for the future—more especially in view of the higher peacetime taxes to which company income will almost certainly be subjected."

Inroads on Resources!

"There is no question that heavy taxation of company income must exercise some restraining influence on business and tend to slow up the rate of economic expansion. This is due less to the loss of incentive because of the smaller prospective profit—although in the case of the riskier forms of investment this is a material factor—than to the inroads made on the financial resources of the business, and thus on its capacity to expand and to keep its plant and equipment up-to-date."

★ ★ ★