From the Executive Director

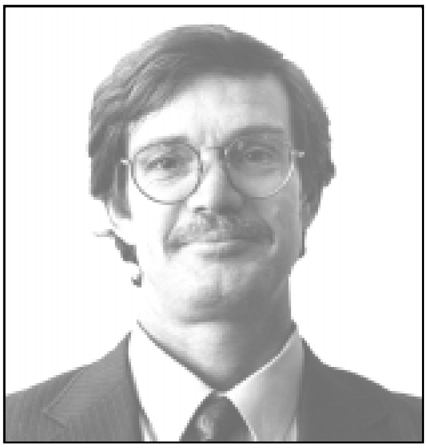
MIKE NAHAN

Missing Direction

WHAT has been most notable in the recent tax debate and election campaign is what has *not* been talked about—Australia's chronic savings problems.

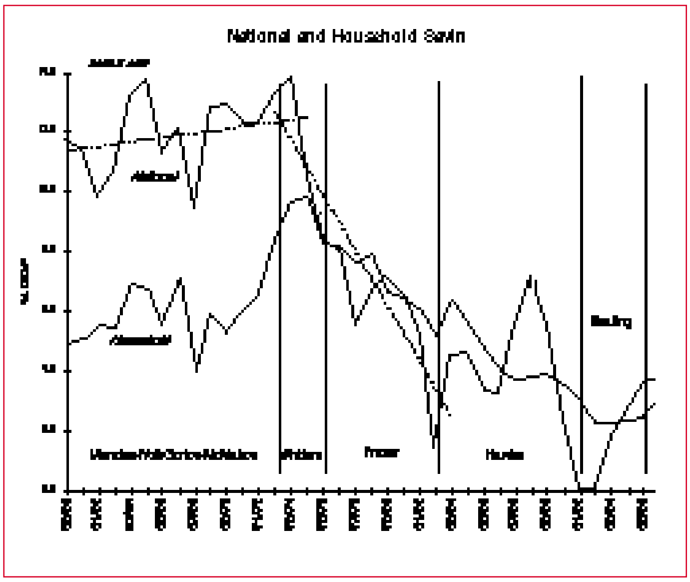
In their rival tax packages, politicians have competed to return promised future budget surpluses resulting from some modest budgetary repair by the Howard Government. The two main parties have certainly differentiated their products. Howard offers a more fundamental reform with the GST both replacing the antiquated sales tax and allowing greater scope for deeper income tax cuts. Beazley has taken a much more traditional vote-buying route.

Neither major party wants to appear to be favouring the rich by lowering the top tax rate of 47%. But that top rate is increasingly out of step with other countries—New Zealand has moved its top rate down to 33%. Our own high top rate establishes a capital gains tax that curbs the incentive to innovate and build up assets. Both major parties fail to give tax relief to people who want to build up their assets. Both packages overlook prosperity's engine—savings and investment. And Treasurer Costello's previous tinkering with superannuation has worsened disincentives to save.



The best and fairest tax systems impose a flat rate on everyone. Throughout most of Christendom's history, the Church levied such a tax (the tithe). Ironically, many invoking the Church's name in the tax debate seem to want the opposite approach.

But a flat tax is not yet on the agenda, so the next best approach is a system that taxes spending and not income. In this regard, the shift in the Coalition's tax package away from reliance on income tax gives it an edge over Labor's package. But government revenue remains income-tax based, so savers face a double tax—they pay on the original earnings and pay again on the income or capital gain which that saving generates.



As Michael Warby and I outline in the IPA's latest Backgrounder, *From Workfare State to Transfer State: Where We Were and Why We've Changed*, since the Whitlam Government there has been a shift away from government (and private) saving and government investment towards expenditure on government transfers—health, education and welfare (in the three years of the Whitlam Government they shot up from 12 per cent of GDP to 17 per cent and are now 21 per cent of GDP). Both governments and households have been substituting current expenditure for saving. Our tax system discourages saving: increasing transfer payments reduce the incentive for households to save, and lower income growth makes it harder to save. Meanwhile, our governments have cut their own saving and investment to fund the escalating costs of government transfers.

Australia's savings languish near the bottom of the international league. Our total savings are only 18 per cent of GDP, net savings (after depreciation of capital) are about 5 per cent of GDP, with households contributing just 3 per cent. These low savings levels mean that we rely on foreign savings to fund between a fifth and a third of our investment.

The silence in the national tax debate about Australia's chronic problems of domestic capital generation—that is, saving—show how excessively dominant alleged equity issues have become. It is nonsense to complain about mounting foreign ownership and foreign debt—the inevitable consequence of importing capital to keep our investment levels up in the face of falling Australian saving—if we will not tackle saving issues seriously.

A society can only expect to operate successfully in the long term if it juggles the full range of issues successfully. Despite what is often claimed to the contrary, Australian policy debate has shown a continual tendency to pay too much attention to equity issues—conceived in a particularly narrow way—and too little attention to efficiency ones. Yet much of Australia's surprisingly resilient response to current global economic problems comes precisely from the attention to efficiency issues in the economic reforms of the last 15 years. There is nothing equitable about recession or low economic growth.

That the 1998 election campaign has not seriously discussed saving says much for our national myopia and provides little basis for confidence in our ability to tackle important issues intelligently. IPA