The truth about our taxes: Some are good, some are bad, and both parties have it wrong

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Ian McAuley busts four prevailing myths about taxation in Australia.

If Australia is to have a serious consideration of tax reform, all parties should avoid getting locked into hard "positions", and be ready to re-examine their own beliefs on taxation.

Unfortunately Treasurer Scott Morrison, in saying that any changes in the tax mix won't increase the overall tax take, has already dug himself into a position. And Opposition Leader Bill Shorten has promised to oppose any increase in the GST.

A hundred years after the "war to end all wars" we might hope that our politicians have learned something about the futility of positional standoffs. There is nothing agile or innovative about trench warfare.

As one who has studied and taught taxation policy I don't want to join the chorus of advocates for specific tax changes (it's too early for that) but I do want to open up the debate by looking at four myths about taxation – including Morrison's view that taxes must not rise and Shorten's view that any rise in GST is necessarily regressive.

Myth #1: Tax must not rise

The first myth is that we must not let public expenditure, and therefore taxation, rise above its present level. In fact, much of the chatter from the government has been about reducing public expenditure as a means to close the fiscal deficit.

As Ben Eltham points out, however, "the dominant fact of fiscal policy in Australia is that the government requires more revenue".

Australia already has a very small public sector – as a proportion of GDP much smaller than in most prosperous OECD countries and by some measures the smallest of all such countries (even smaller than America's).

We have under-invested in education and infrastructure, and are using expensive and inequitable mechanisms, such as toll roads and private health insurance, to provide services that can be far more efficiently funded by the public sector. As Miriam Lyons and I show in our work [Governomics: can we afford small government?](), politicians' obsession with "small government" is impeding our economic progress.

We point out that among developed countries there is no relationship between the size of government and economic growth or economic competitiveness. There are countries such as Japan and Ireland with small government and poor economic growth, and countries such as Sweden and the Netherlands with large public sectors and strong economic growth.

What counts is not the "size" of the public sector, but its performance. Contrary to neoliberal prejudice, there is no reason why the public sector cannot be a leader in innovation and efficiency – even though successive Australian governments seem to have gone out of their way to hobble it, in order to give the private sector a head start.

Myth #2: Taxes discourage effort

The second myth is that taxes invariably distort economic resource allocation. That is, they discourage firms and individuals from contributing to their fullest.

Some badly-designed taxes do indeed misdirect effort, and we seem to have plenty of such taxes – a capital gains tax system that encourages short-term speculation while discouraging (through a lack of indexation) long-term investment; fringe benefit tax provisions that encourage firms and individuals to spend more on cars than is necessary for business purposes; tax breaks that direct personal saving into residential real-estate (thus reducing housing affordability) rather than into productive enterprises; and superannuation tax breaks that subsidise the accumulation of personal fortunes to finance an indulgent lifestyle among the well-off elderly.

But the idea that high personal and corporate income taxes discourage enterprise needs deconstruction. Tax cuts for the well-off can actually decrease their motivation to work, because the beneficiaries find they can finance their desired lifestyle with less effort. And the claim that, at 30 per cent, Australia has high company taxes, conveniently ignores the effect of dividend imputation, which brings the effective tax rate for domestic investors down to very low levels.

And there are some taxes, better called "user charges", that can correct distortions in private markets. The clearest example is a carbon tax, which brings to account the cost of contribution to global warming.

Myth #3: We hate all taxes

The third myth is that all taxes are unpopular. Politicians and lobbyists are wont to talk about the "burden" of taxation – one of Morrison's favourite terms. It's strange, however, that we should think of paying for our public goods as a "burden", when the same better-off Australians who pay the lion's share of income taxes, and who benefit from public goods, don't talk about the "burden" of paying for clothes or eating out.

In fact, research does not reveal a general aversion to taxes. If people see a link between taxes and benefits, they can be quite supportive of taxes. That's why taxes such as the NDIS levy (and many other specifically-identified taxes) are generally well-received. If, however, people believe that their taxes are going to allow politicians to dispense benefits to undeserving interest groups they naturally clam up.

Myth #4: No regressive taxes

The fourth myth is that some taxes should be off-limits because they are regressive. The GST is the strongest case in point.

In general, all consumption taxes are indeed regressive and are much more regressive than income taxes – the case is well-established. But it's important to look at the whole pattern of taxation and public expenditure.

A rise in GST would be regressive, but if it can be channelled as extra revenue to state governments (rather than financing personal or corporate income tax cuts), the resulting benefits can be quite progressive, because state governments spend about half of their revenue on schools and hospitals, which form an important part of the social wage. (Those with a stomach for a little mathematics can see a 2013 conference paper I presented.)

If our consideration of taxes is to make progress towards a serious policy debate, with everything on the table as the Prime Minister claims to want, the government and opposition both need to come out of their trenches and start talking about principles and the way we might fund the public goods and welfare transfers necessary for our continued prosperity.