**Reflections on last week's 'tax forum'**

*(Article by Saul Eslake, Director of the Productivity Growth Program at the Grattan Institute, published in the Melbourne* Age*, and in the online edition of the* Sydney Morning Herald*, on Wednesday 12th October 2011)*

Unlike the authors of the editorial in Saturday's *Age*, I didn't consider the two days I spent at the 'Tax Forum' in Canberra last week a waste of my time. I never expected it to produce substantial 'outcomes'.

The history of tax reform in Australia over the past twenty five years tells us two things. First, major tax reforms are almost impossible to achieve without a substantial measure of bi-partisan support. Paul Keating was able to achieve some significant taxation reforms in the late 1980s – albeit not as much as he would have liked – in part because John Howard as Opposition Leader didn't oppose them. John Howard himself turned the 1998 election into a referendum on tax reform and almost lost it. Second, tax reform is impossible to achieve – especially in the absence of bi-partisan support – without being able to draw upon a big fat budget surplus in order to compensate the politically significant 'losers' – of whom there will inevitably be some out of any tax reform worthy of the name. Right now, there's neither bi-partisan political support for tax reform (or for anything else); and the budget is still in deficit, with only thin surpluses in prospect (on current official forecasts) for 2012-13 and beyond.

But the history of tax reform also tells us that events like the one held in Parliament House last week can serve as starting points for far-reaching tax reforms when circumstances subsequently become more propitious. As it happens, I also attended the 'tax summit' hosted in 1996 by the Australian Chamber of Commerce and Industry and the Australian Council of Social Service. They were seen as 'unlikely bedfellows' for such an exercise; and as I recall the Howard Government was even less enthusiastic about it than the Gillard Government was about last week's event. Yet that summit was, like last week's event, notable for the knowledgeable and open-minded way in which discussion occurred. And, with the benefit of hindsight, it was the starting point of a process which ultimately led to both the business income tax reforms of 1999 and the indirect tax reforms of 2000.

To be sure, last week's event began with business organizations and the trade unions 'marking out territory', a little like male dogs peeing on electricity poles. But the remainder of the two days was characterized by a willingness to listen to other people's points of view, to seek areas of common ground, and to recognize gestures of goodwill when they were offered.

The only exceptions to that were the occasional display of mean-spiritedness on the part of trade union leaders unwilling to recognize that some business leaders were actually willing to support tax reforms that might result in themselves paying more tax; and a rather churlish demand from the Western Australian Treasurer for a larger share of the GST revenues so that he could spend it on infrastructure in mining regions, despite the fact that Western Australia's per capita income is now 45% above the national average, that the WA Government actually expects mining companies to provide most of the infrastructure in the Pilbara and other resource-rich regions rather than doing so itself, and that its 'Royalties for Regions' policy actually transfers money raised in the Pilbara to the WA Nationals' heartland in the southern wheatbelt.

Former Treasury Secretary Ken Henry made two important points in his address on the second day of the Forum which should inform thinking about the future course of tax reform. The first was that the appropriate vehicles for achieving equity or fairness objectives were the personal income tax and transfer (pensions and benefits) system. The second was that we should judge the fairness of the taxation system by the results of the system as a whole (combined with that of the transfers system), rather than by the fairness of each of the specific taxes which comprise it.

In other words, in striving to achieve a tax system which raises sufficient revenue to pay for the services which we expect our governments to provide, in as simple a manner as possible, with the least distorting effects on economic activity and the decisions that individuals and business make about saving and investment, we should not be too troubled if some individual taxes appear to be 'unfair' provided that, after taking account of the impact of all the other parts of the tax and transfer system, the overall result is seen to be 'fair'.

This is highly relevant to both sides of the tax debate. The Government, trade unions and most community organizations are implacably opposed to any broadening of the base or increase in the rate of the GST because they believe that it would impose a relatively greater burden on low-income earners. In fact, this isn't necessarily true. The Henry Review produced analysis showing that the most affluent 20% of households spend six times as much on GST-free food as the poorest 20%, and that more than one-third of the $6 billion of revenue foregone as a result of the exemption of food from the GST benefits households in the top 20% of the income distribution. And while it's true that poorer households spend a larger proportion of their income on medical and health care than richer households, the reverse is the case for education and financial services, which are also exempt from the GST.

But it would be possible to compensate, or indeed over-compensate, lower-income households for the effects on them of any increase in the rate or broadening of the base of the GST, as the Howard Government did when it introduced the GST in 2000 and as the Gillard Government proposes to do with the carbon tax (which would otherwise adversely impact low-income households who spend almost twice as high a proportion of their incomes on household energy than high-income ones).

Broadening the base, and/or increasing the rate, of the GST is the most obvious and least distorting way of financing the inevitably greater demands that State Governments will face for higher health care spending as the population ages. The only alternatives available to State Governments, under our Constitution, would be further increases in taxes like stamp duties or payroll tax. And if broadening the base and/or increasing the rate of the GST can be accompanied by changes elsewhere in the tax and transfer systems which leave low-income households no worse off, there are no reasonable grounds for objecting to it.

On the other side, business organizations and high income earners should be more willing than most of them thus far have been to accept that the personal income tax system has a legitimate role in offsetting changes in other areas of the tax system, and more broadly in the way in which the economy operates, in order to ensure greater 'fairness' in the distribution of income and wealth, which has become less equal over the past decade, in part as a result of policy changes which have been made in response to pressure from business and high-income earners.

Higher top marginal tax rates, or lower thresholds at which the top rate becomes payable, are *not* the best way to achieve greater fairness in the tax system, or in the distribution of income and wealth. A much more effective way, one which would also reduce the complexity of the tax system and the extent to which it distorted investment and saving decisions, would be to eliminate or at least curtail some of the various forms of tax preferences which disproportionately benefit higher income earners – such as 'negative gearing', the concessional treatment of superannuation, the use of trusts to distribute income to members of a household with lower marginal rates than the primary earner, and the concessional tax rate applicable to capital gains.  But all of these have substantial and politically influential constituencies who would make life very difficult for any political party which sought to take them on.

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