The Super Guarantee: Keating's Great Big Tax on Everything

A submission by **Prosper Australia**[*] to the

Inquiry into the Mineral Resource Rent Tax Bill 2011 and related bills

(Senate Standing Committee on Economics)

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Abstract

We submit that:

A federally mandated, employer-funded superannuation contribution of 9% of wages/salaries is equivalent to a federally *funded* contribution paid for by a **9% federal payroll tax**—equivalent in every respect, except that the former arrangement is **off-budget** so that its scale, inefficiency and regressiveness can be kept out of the news. This hypocrisy should end: compulsory superannuation, like any other tax-transfer program, should be *on*-budget so that its targeting and funding are exposed to public criticism.

The revenue from taxes on super-normal profits, being volatile, is unsuitable for funding recurrent expenditure but eminently suitable for diversion into superannuation.

The present combination of compulsory super contributions and the GST is patently worse than an NZ-style "all-in" consumption tax raising the same revenue. If the latter is too terrible to contemplate, the former should be considered more so.

The revenue from a broad-based land-value tax, being reliable (the more so because it promotes and stabilizes economic growth), is capable of funding recurrent expenditure. In political terms it is especially suitable for hypothecation for the age pension, because the desire to avoid churning leads to a tax exemption for the principal residences of persons of pensionable age.

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1 If it were visible, it would be risible

A 9% federal payroll tax for general revenue would not pass the laugh test, let alone the electoral test. Neither would a federally funded superannuation contribution set at 9% of the individual wage or salary, with the result that the workers with the highest incomes get the biggest handouts. But put the two together and take most of the combination off-budget, and you get Australia's newest sacred cow: the Superannuation Guarantee (**SG**).

If the system were brought on-budget and thereby exposed to the light (and heat!) of budget debates, the voters might demand that government-funded super contributions be means-tested or at least capped, that contributions be made for persons whose working lives are interrupted (e.g. by motherhood or less fortunate events), and that the necessary revenue be raised by something other than a tax on jobs.

Fund managers would not oppose such reform, because they would continue to receive contributions, and because they would understand (even if most voters didn't) that if contributions were funded by something more efficient than a payroll tax, the ensuing economic growth would lead to higher contributions, hence more funds under management.

One of the few things that might be said in favour of the present *de facto* payroll tax is that the revenue from payroll taxes is reasonably steady.[1] But that virtue is wasted when the revenue is hypothecated for super contributions made over a 40-year working life, during which any fluctuations in the contribution stream can be expected to average out. Almost any alternative source of revenue would be an improvement.

2 Null hypothecation

As the new Resource Rent Tax is on-budget while the Superannuation Guarantee is off-budget, the attempt to link the two was always going to be a flimsy fabrication. It became even flimsier as the Resource Super Profits Tax was first replaced by the Minerals Resource Rent Tax and then further watered down, with the result that both employers and the Commonwealth are out of pocket:

- For employers, the cut in company tax will not pay for the increased superannuation contributions;
- For the Commonwealth, the revenue from the MRRT will not pay for the cut in the company tax rate, let alone the higher deductions for higher super contributions.

If the SG had been on-budget, the Government could have simply added the RSPT to the list of taxes whose revenue was reserved for super contributions. That would have put the hypothecation beyond dispute—and made it much harder for the mining companies to portray the tax as an attack on people's superannuation portfolios.

The salient disadvantage of profit-based RRTs, and indeed of super-normal-profit taxes in general, is that the revenue stream is volatile. But that hardly matters if the revenue is hypothecated for long-term savings, because there is ample time for fluctuations in contributions to average out. Resource-rent/"super-profit" taxes are therefore peculiarly suitable for funding superannuation contributions.

If the existing company tax, the existing Petroleum Resource Rent Tax and the new MRRT were replaced by a unified corporate tax including an "Allowance for Corporate Equity", that too would be eminently suitable for hypothecation for superannuation contributions. We proposed such a tax (albeit

[1] See the graph in G. R. Putland, "Unreliability of stamp duty & income tax", *LVRG Blog*, Sep. 17, 2011; www.t.co/z9769cAx.

without the same hypothecation) in October 2010, in a submission to the Senate Select Committee on Scrutiny of New Taxes.[2] We were therefore pleased to learn that a Treasury committee is now working on a similar proposal.[3]

3 The Super Guarantee *already* depends on the tax power

The legislation supporting the SG is designed on the understanding that s.51(xxiii) of the Constitution, whereby the Federal Parliament has power to make laws with respect to "old-age pensions", refers to pensions *provided by the Commonwealth*—not provided by private entities. To the extent that the legislation directly compels employers to make super contributions into private accounts for their employees, it relies on other powers, notably including the corporations power, the territories power, and the referral power. But these other powers are not sufficient to cover all employers.

So the Keating government, in order to provide universal coverage by *private* superannuation funds, used the *taxation power* to enact the Superannuation Guarantee Charge (**SGC**). Any employer who fails to make the standard SG contributions is required to pay the shortfall in the form of the SGC, plus interest and administration fees. The Commonwealth then pays the SGC and interest into the worker's superannuation account. These transactions are *on*-budget. As a further penalty, the SGC, unlike the standard SG contributions, is not tax-deductible. Thus the SGC—which is a tax—is the penalty regime enforcing the SG.

As recently as 28 September 2011, in *Roy Morgan Research Pty Ltd v Commissioner of Taxation*, the High Court ruled that the SGC is a valid exercise of the taxation power. In so doing, it confirmed that s.81 of the Constitution, which requires all Commonwealth revenue to form a single Consolidated Revenue Fund, does not prevent hypothecation of particular taxes for particular purposes.[4]

Thus, for the purpose of implementing the SGC, the Commonwealth needs the administrative machinery of a federally funded super contribution (with choice of fund!) paid for by a federal payroll tax, *plus* the machinery to establish which employers and employees are inside the federal tax/transfer system, and which are outside by reason of compliance with the SG regime. In addition, every employer needs the machinery to comply with the SG regime and, in the event of a mistake, the SGC regime.

This needless multiplication of compliance costs, most of which fall on small employers, with consequent fragmentation of a worker's superannuation among multiple accounts incurring multiple fees, all for the sake of keeping most of the system off-budget in order to maintain a false pretense of small government, is reprehensible in the extreme. If the Commonwealth was going to use the tax-transfer powers to enforce a payment from *A* to *B*, the honest and efficient way to do it was to levy a tax on *A* and pay a transfer to *B*.

4 Keating's Great Big Tax on Everything is worse than Howard's

In 2009-10, Australian workers earned a total of $553 billion in wages and salaries.[5] The SG collected about 9% of that, i.e. $49.7 billion ("about", because compulsory super contributions are not payable

[2] Prosper Australia, "Replacing Mining Royalties and Company Tax", submitted to the *Inquiry into the National Mining Tax*, Oct. 20, 2010; www.is.gd/prosper_mrrt.

[3] Peter Martin, "Swan tax shake-up targets super rich", *The Age*, Dec. 6, 2011; www.is.gd/martin_spt.

[4] That much should be obvious; if all else fails, the Appropriation Bill can specify the amount to be appropriated from consolidated revenue for the said purposes in terms of the revenue contributed to consolidated revenue by the said taxes.

[5] ABS 5204.0, Table 6.

on overtime but are payable on some non-wage/salary income). The revenue side of the SG was equivalent to a payroll tax, whose impact was partly shifted downstream in the form of higher prices of goods and services (with no exemptions for necessities of life!) and partly shifted upstream in the form of fewer jobs and lower pay.

By way of comparison, the GST collected only $46.5 billion in the same year.[6] Its impact was shifted partly downstream in higher prices of goods and services, and partly upstream in lower production and lower *producer* prices net of tax.

Because the GST has a consumption/destination base while a payroll tax has a production/origin base, the GST is less damaging to Australia's international competitiveness. The GST is also less regressive in that its upstream effect is not concentrated on labour.

It might be alleged that the regressiveness of the GST is further reduced because certain necessities of life are GST-free. But the benefit of those concessions has been, at best, greatly exaggerated. More than a third of the benefit of GST-free food goes to the top 20% of households in the income distribution.[7] Moreover, the GST-free list is not limited to necessities of life; for example, it also includes the fees of elite private schools. Most of the concessions increase compliance costs which are passed on in prices borne by low-income households.

If Australia's GST were as broad-based as New Zealand's, the rate required to yield the same revenue as at present would be 5.5%,[8] and compliance costs—which are regressive—would be generally lower because there would be no need to distinguish between taxable and non-taxable supplies. If, in addition, the GST were implemented as a retail tax, compliance costs would fall further—to zero in the case of non-retail businesses.

The above figures imply that if the rate of the broad-based retail tax were raised to about 11.5%, it would replace both the SG and the GST, with no additional compliance costs for employers. No employers would incur compliance costs in relation to their employees' compulsory superannuation. Only retailers would incur compliance costs related to the consumption tax. There would be no *de facto* federal payroll tax reducing the earning opportunities of workers.

If an all-in retail tax at 11.5% is judged to be politically unacceptable, the same judgment should apply *a fortiori* to the present combination of the GST and the SG, which is less internationally competitive and more regressive and has higher compliance costs.

If compulsory superannuation contributions were funded by an all-in retail tax, then, instead of gradually raising the present SG rate by 3 percentage points, one could achieve about the same increase in contributions by raising the retail tax rate by 2 percentage points. That would bring the retail tax rate to about 13.5%. By way of comparison, New Zealand recently increased its all-in GST rate from 12.5% to 15%—in one step.

If an all-in retail tax at 13.5% is judged to be politically unacceptable, the same judgment should apply *a fortiori* to the raising the SG rate from 9% to 12% on top of the existing GST.

5 If retiring on property investments is such a good idea...

The saving vehicle preferred by most Australians—or rather by most of those who have any remaining capacity to save, after the taxes that presently pay for the age pension have clipped their income, and after the payroll tax masquerading as the SG has reduced their earning opportunities and raised their cost of living—is investment in residential property.

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[6] ABS 5506.0, Table 1.

[7] Henry et al., *Australia's Future Tax System: Final Report* (Dec. 2009), section D2-1; www.is.gd/henry_d2_1.

[8] Estimated from Chart D2-1 in Henry et al., *loc. cit.*

The average individual Australian property investor is negatively geared. Incredibly, the "average" is for *all* individual investors, including those who have paid off most or all of their mortgages; those who have just entered the market are *more* negatively geared than the average.

This investment strategy does not make sense for the investors (to say nothing of the rest of the population) unless property appreciates. And the appreciating component of property is *land*; buildings depreciate due to wear and tear, technical obsolescence, and locational obsolescence. The appreciation of land is due, not to any effort of its owner, but to the increasing capacity of the surrounding community to pay rent for its use, or interest on its purchase price.

It follows that retirees supported by property investments are in fact supported by tenants and first-time buyers; they are no more "self-funded" than pensioners supported by taxpayers. One might therefore ask: *In what sense is a retiree supported by property investments any less burdensome to the community than a retiree supported by taxpayers?* The answer is that the former is merely the recipient of a price that exists naturally in the economy, while the latter depends on taxes that distort the economy.

Of course that answer fails to acknowledge that tax concessions for property investors require higher taxes on everyone else, with consequent distortions. But to the extent that the answer is valid, *the same advantage can be had by funding the age pension out of a tax on land values*.

It is said often, and usually rightly, that "if you tax something, you get less of it." Hence, if you tax paid employment, as the Commonwealth does under the guise of the SG, you get less employment and less pay. But if you impose a holding tax on the value of land, *you cannot get less land or inferior land*, because the supply of land is fixed, while its market value is not created by the party who pays the tax thereon, but is conferred by the effective demand from the surrounding community, as influenced by the tax. Land is bought subject to the tax at a price that allows for the tax. Hence, as long as the "tax" does not of itself prevent the owner from re-selling the land for at least the cost of acquisition, it is not so much a public tax on the owner as a clawback of a private tax that the owner imposes on the rest of the community.[9] Moreover, the holding tax improves the *availability* of the given land supply for productive purposes, because the owners must generate income from the land in order to cover the holding cost—or sell it to someone who will. Land is opened up for construction. Hence employers can more easily afford business accommodation, while employees can more easily afford housing within commuting distance of their jobs out of wages that their employers can afford. Economic activity increases.

Thus a retiree funded by a tax on land values is no more burdensome to the community that one funded by private property investments.

Land-value taxation has the further advantage that its revenue stream is reliable.[10] Indeed, the more it is relied upon, the more reliable it becomes, because it tends to smooth out the bubble-burst-recession cycle. This smoothing happens in two ways. First, through its influence on the returns to property investments, the tax helps to keep property prices (as calculated by rational purchasers) within reach of the financial system.[11] Second, the tax applies negative feedback to the property market: when prices rise, the holding tax rises, encouraging selling and therefore tending to moderate prices; and when prices fall, the holding tax falls, encouraging holding and therefore tending to support prices.

The favourite objection raised by opponents of land-value taxation is that it allegedly strains the cash flow of retirees who own valuable land but have little income. The obvious possibility of deferring the tax until the next sale of that valuable land is either not mentioned, or denounced in terms

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[9] But in this submission we must call it a "tax" because, under the Australian Constitution, the only power whereby the Commonwealth can impose a general holding charge on land is the taxation power.

[10] See note 1.

[11] G. R. Putland, "The financial stability contour map", *LVRG Blog*, Nov. 16, 2011; www.t.co/cmIMiDDd.

that sit uncomfortably with the initial objection. But if the purpose of the tax were to fund the age pension, that objection would be much harder to sustain—the more so because the principal residences of persons of pensionable age would inevitably be exempt from the tax, in order to minimize the need for the pension. If the tax were payable on the land under the homes of those who actually draw the pension, that would be churning; and if it were payable on the land under the homes of other retirees, that would increase the pressure to make those retirees eligible for the pension, leading to more churning.

So, if funding retirements out of land values is such a good policy—and it is—then why not make it official and universal? And why frustrate it by imposing a "superannuation guarantee" in the form of a *de facto* payroll tax that throttles the economic activity on which land values depend?—especially when a substantial fraction of those compulsory superannuation savings are invested in land?! And why endure a transitional period in which taxpayers bear the full burden of the payroll tax but do not yet enjoy the desired reduction in expenditure on the age pension, because sufficient superannuation savings are yet to accumulate?

Unlike payroll taxes, super-normal-profit taxes such as the PRRT resemble land-value taxation in the sense that they are designed to minimize distortions. If compulsory superannuation were financed by super-normal-profit taxes instead of a *de facto* payroll tax, it would not be so self-defeating.

6 Conclusion

An age pension financed by land-value taxation is at least as efficient as any private system of saving for retirement. As long as the pension is entirely funded in this way, there is nothing to be gained by forcing people to save now in order to reduce expenditure on the pension several decades hence; and there is much economic growth to be lost in the mean time when the source of the savings is indistinguishable from a payroll tax in terms of its economic distortions.

If we must nevertheless have compulsory superannuation contributions, they should be brought on-budget. Super-normal-profit taxes such as the PRRT, the proposed MRRT, and any new unified company tax including an "Allowance for Corporate Equity", would then be ideal candidates for funding superannuation; they are less distorting than a payroll tax, and their volatile revenue streams, which render them unsuitable for funding recurrent expenditure, are of little consequence when the revenue is to be saved over a working lifetime rather than spent in the current year.