

Australia's Tax System: Some principles for reform

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Thanks to the Committee for the opportunity to provide this submission. I am Associate Professor of Economy and Society in and Macquarie School of Social Sciences and co-director of the Australian Basic Income Lab. My research focuses on social policy and public finance. This submission reflects my own views.

My recent research (Spies-Butcher 2023) has focused on policy lessons from Australia's experience of economic and social policy reform since the 1980s. I focus on the kinds of reforms that proved successful and the political circumstances that led to their implementation, as well as policy areas where policy challenges appear entrenched. While my focus is primarily on social policy (e.g. Medicare, family benefits, childcare, housing, pensions and education), in each case these changes were achieved alongside, or frustrated by, broader fiscal considerations and tax debates.

Here I highlight three lessons from this research that may be of interest to the Committee.

1. Australia's tradition of 'compensation politics'.

Significant tax reforms have often involved packages that change multiple tax, and often spending, initiatives simultaneously. For example, the Tax Summit of the 1980s saw changes to expand the tax base through new Capital Gains and Fringe Benefits taxes alongside reductions in headline tax rates. The introduction of the Goods and Services Tax not only reorganised indirect taxation, but also expanded social payments, as did the introduction of Carbon Pricing in the 2010s (also see Wilson et al 2013).

Compensation politics reflects two important principles. First, while welfare economics is built upon the Pareto Criteria – that a change is beneficial where it produces at least some winners and no losers – in practice policy change is generally judged according to less stringent criteria. If a policy change results in higher overall incomes, then in principle the Pareto Criteria can be satisfied through side measures that compensate losers from the proceeds gained by winners. Australia's policy experience suggests combining reforms to ensure overall equity – especially that low-income and economically precarious households are always net winners – improves the chances of policy success.

Second, these policy experiences highlight an important equivalence between tax measures, tax concessions and social benefit programs. Each of these policy types applies government regulation to directly influence economic incentives, the distribution of income and the fiscal balance. As such, most policies of each type could be restructured as one of the other types with broadly the same policy effects, with tax concessions understood as both negative taxes and tax expenditures, and social benefits understood as both social expenditures and negative taxes.

Where tax changes improve efficiency and incentives, but create some low-income or precarious losers, increased social spending can ensure equity and political acceptability. This conclusion goes particularly to questions of taxing those whose incomes are less than the cost of living – many of whom receive public benefits. For example, tax changes to more consistently tax wealth and income from capital have the potential to improve productivity, expand the fiscal base and improve equity, but because

asset ownership is tightly coupled with our retirement income system (via housing and superannuation), such changes can produce some low-income or precarious losers. Measures that directly compensate (or even over compensate) these losers can aid political acceptability and overall generational equity.

2. Taking Incentives seriously.

Australia's compensation politics is partly the result of its existing policy structures. The widespread use of tax exemptions for social purposes and the flat-rate structure of social benefits reinforces the equivalence of tax, tax concession and social benefit systems, and the political acceptability of integrating their reform. However, the same policy structures combined with strong norms around fiscal discipline often hamper a focus on incentives and productivity. I highlight two challenges in particular.

First, targeting of social benefits creates high effective marginal tax rates as benefits are withdrawn for those on moderate incomes. Generally, the goals of targeting would be better achieved through the tax system than the welfare system, where benefit withdrawal rates act as a less visible form of taxation. The lack of visibility has also led to changes to indexation that reinforce these problems while having the largest negative income effects on middle-income households. As households and work patterns have become more diverse, so tight targeting and the combination of household and individual means-testing has reinforced these incentive and equity problems. **Combining tax reform with more universal and individualised benefit payments can increase the incentive and productivity benefits of reform alongside equity benefits.**

Second, benefit conditionality seriously hampers attempts to systematically integrate benefit and tax systems. Conditionality of payments based on activities, rather than income or the category of recipient (e.g. age, parental status), undermine targeting based on equity, increase administrative costs and complicate incentives. Recent experience during the pandemic, where the increase in JobSeeker recipients remained high after employment rebounded, suggests conditionality also discourages many potential recipients who meet the criteria of need, but avoid the stigma of receiving support. These effects undermine the ability to effectively use compensation politics, and suggest **welfare conditionality acts as a structural barrier to economic reform.**

3. Fiscal policy beyond taxation.

Recent fiscal policy innovations have highlighted alternatives to taxation in raising revenue. The Housing Australia Future Fund and elements of the Future Made in Australia policy both use equity to claim fiscal revenues. Likewise, some inclusionary zoning models and public-private finance models in infrastructure involve fiscal claims via ownership rather than tax receipts. The transfer of new housing stock to social housing providers, or construction of public infrastructure in conjunction with planning changes are both examples.

Each of these examples involves equity claims over the proceeds of new private sector investments without exerting control over business management. The terms of the Future Fund explicitly rule out a controlling or influential stake. There are specific advantages to

such models when applied to new investments that financially benefit from government decisions, such as mining licences or rezoning. The same principles may apply in cases where uniform taxation is difficult because of transfer pricing or existing tax concessions. **It may be administratively simpler and more politically acceptable to achieve the fiscal and distributive goals of taxation via forms of public equity, especially in the resource and infrastructure sectors.**

References

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