

**Apsley Pastoral**

*“Rising above the mosh pit”*

Submission to the White Paper Tax Review, from **Apsley Pastoral Co**



Written by **Graham Harman**, Director and Public Officer

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***Preface***

*The call has gone out for contributions to a Tax Review White Paper process, and Australia has risen up and cried out like a mosh pit.*

*The* ***good*** *news is that everyone, Treasury and the Treasurer included, seems passionately to want some* ***particular*** *tax ruled out! Or – in! And no-one is shy about - saying so! The* ***bad*** *news is, that it’s Mandy Rice-Davies central. When told in court during the Profumo affair that the 3rd Viscount Astor had denied ever having me her, it was Mandy Rice-Davies who famously retorted – “Well he would say that, wouldn’t he?” And it’s been the same identical experience with the Tax Review. All I’ve heard so far is real estate agents demanding the retention of negative gearing, women demanding the repeal of the tampon tax, mothers demanding tax breaks for mothers, farmers demanding tax breaks for farmers, banana growers demanding a banana levy, and so on and on and on.*

*This submission will be one of the few submissions, if not the only submission, from someone who could not imaginably care less what the recommendations of the Green and White Papers end up being.* ***My*** *gripe, is that the 200 page Tax White paper Discussion paper which has been offered up to the tax-paying public for comment, is an organisational shemozzle. So - this submission suggests ways to improve the methodology. I don’t want to see a particular tax outcome! You don’t address foundational questions like, what is the nation’s desired tax take and what is the basis for that? And you don’t coherently ask or answer absolutely essential questions like, “what is the tax system trying to achieve?”*

*“If you fail to plan, you plan to fail”*

*Secondly, I have a keen interest in communication. If you had been clear about “framing” issues, you could have saved a rainforest by now.*

*A third key theme of this submission is the need to treat the Tax Review holistically. Nobody is. Even the uncritical application of CGE models by Treasury, drips with Ricardian vice.*

*Minimum standards of basic due process were in my view completely absent from the Tax Discussion White Paper. I would like to see a dramatic lift in the quality of the subsequent papers. C’mon, Australia, you can do better than this. Thank you!*



Graham Harman

***Acronyms***

ACOSS Australian Council of Social Services

AWE Average Weekly Earnings

BEPS Base Erosion and Profit Shifting

CGE Computable General Equilibrium; AGE – Applied General Equilibrium

CGT Capital Gains Tax

GDP Gross Domestic Product

GST Goods and Services Tax

IPART “Independent” Pricing and Regulatory Tribunal

MRDA Mandy Rice-Davies Applies



NDIS National Disability Insurance Scheme

NIB Newcastle Industrial Benefits (a private health insurer)

NFP Not-for-profit

PAYE “Pay-as-you-earn”; PAYG - “Pay-as-you-go”

PCA Principal Components Analysis

SGL Superannuation Guarantee Levy

WET Wine Equalization Tax

***Executive Summary – “10 Steps to Success”***

**Here are my suggested 10 steps to success, in conducting a Tax Review. This is my suggestion about how, as a taxpayer, I would like to see you approach the Green and White Papers:**

**Step 1. Think about and document and communicate the effects of the review process itself, before you initiate the review process.** You need to state, at least conceptually, the costs and benefits of “old” versus “new” taxes, respectively, including estimates of relative efficacy and efficiency, and of the costs of change. And you need to sketch out up front what the “fear and uncertainty” cost of the process itself is – for example, will the existence of the review cause people to sell franked shares, hold off buying land etc? On the plus side, to what extent will perceptions of buy-in, improve taxpayer compliance? Or will perceptions that the process is a whitewash, reduce buy-in?

**Step 2. Think about the causes of the call for a tax change process.** For example, the mind-boggling and unacceptable complexity of taxes such as the Medicare and GST taxes are in my view merely symptoms of political dysfunctionality, vacillation and horse-trading. Complexity has not arisen because Treasury does not know how to design a tax. There’s no point fixing complexity, only to see your work undone in future. One reason that you are muddled and failing, is that you are erroneously treating symptoms not causes.

**Step 3. Think about the nature of the problem you have, and specify what the optimal size of Government is and why.** Put that question to bed, ***before*** discussing ***particular*** taxes. The press have been having a high time recently juxtaposing footage of Government, when in Opposition, claiming that “*fiscal problems are a spending problem, not a revenue problem*” – and then, barefaced in Government, as iron and coal prices plummet, stating that “*fiscal problems are a revenue problem, not a spending problem*”. It’s great 6 o’clock theatre. (My own blink reaction is that you have neither a revenue problem ***nor*** an expenditure problem. You have a ***distribution*** problem. The national welfare bill is $132 billion, and if you divide that by Average Weekly Earnings of $1,100 and annualise, and if you allow for an average household size of 2.6 people, then you already have enough welfare dollars each year to pay AWE to the households of ***6 million*** disadvantaged Australians. Tax problem? ***What*** tax problem? Personally, I would have thought that that was heaps.) Whatever. My key point is, that I don’t ***care*** what the answer is. ***I care that you ask the question***, and substantiate and articulate your answer, and record and communicate that answer, and get at least the buy-in, of those Australians who have a different answer.

**Step 4. Spell out the duality of tax with expenditure; and the efficacy, and the limits to efficacy, of related Separation Theorems.** I am so angry about this. You simply cannot run a credible tax review, without ***doing*** that. If you go into Wikipedia and type, “Principles of Taxation”, you are reading about this issue within ***30 seconds***. But – I read the 200 page Tax Discussion Paper ***all day***, and there was ***nothing*** about this. One reason that you are muddled and failing is that, whilst spruiking the necessity of holistic analysis, you are attacking the problem piecemeal.

**Step 5. Clarify the Objectives of the Tax System, and the Optimal Size of the tax take.** OK –so here’s a feature – ***one*** of the features – of the Tax Discussion paper, that completely and totally horrified me. The tax system, is a tool. So – first things first – ask, what is the ***purpose*** of that tool? And - you ***do*** answer that question – on Page iii. But then you give a ***different*** answer on page 1. And different again on page 2. And different again on page 7. ***There are 37 totally different answers to that question, in your paper!*** I like – counted them! At 5 page intervals! It’s like, you’re makin’ up the question, as you go along! That is no way, to do it!

And – you need to think about the ***orthogonality***, or lack of orthogonality, of those objectives, even at this early stage. And you need to count targets and instruments, in a Jan Tinbergen sense. And you need to communicate that. What’s ***your*** tally, of instruments and targets? One reason that you are muddled and failing, is that you are trying to do too much simultaneously, just with one tax system.

**Step 6. Define your terms and examine your language.**  For example, your definition of a “Tax” is not in my view fit for purpose, in light of the stated purpose of the review. Your definition of “Tax” on page 16 (in a ***footnote*** for Heaven’s sakes) is so narrow, and so uncognisant of BEPS, that you have cruelled your chances of success, before you have even started! Then there’s the word “***lower***” – it’s one third of your whole prescription for the Nation’s tax system – but you don’t ***define*** “lower”! Lower than ***what***? How ***much*** lower? Then – there’s “income” and “capital gain”. There is deep community unease about investors in real estate claiming an income loss, and then not having to offset that claim against subsequent capital gains. And one reason that that debate is muddled and senseless, is that you neglected to define “income” and “capital gain” up front, and to provide a principles-based statement, about how and why, if at all, they are different. Then again, there’s the intense debate about “**Negative Gearing**”. That debate, should be illegal. As your own paper points out (on Page 64) – there is not even ***any such thing*** as “negative gearing”. If people believe that General Deductibility is wrong, then they should have the right to argue their case. But – if that is what they mean – then ***those*** are the words they should be forced to use. A prerequisite for a coherent “national conversation” is that people use words that mean stuff. And the incessant appellation of the leitmotif “***concessionary***” to the phrase “***Capital Gains Tax***” is another linguistic travesty. You can countenance reasoned and substantiated arguments for a higher CGT rate by all means. But ***don’t*** allow people to describe this highly distortionary and arbitrary tax on inflation, which is significantly ***more punitive*** than the “non-concessionary” regime which applied from 1983 to 1999, as “concessionary”. It’s just - ***wrong***.

**Step 7. Say something about essential key concepts like framing and consistency and churn and path-dependency.** The needed-to-play term “***Framing***” does not appear anywhere in your document, I did a search. ***You continually need to state, the reference point you are starting from***. “Tax prescriptions”, are in fact often no more than outworkings of totally arbitrary starting points. It’s pointless. So - the Tax “debate”, if that is not too strong a word, is infested by statements such as the following: *“The ACOSS report said that over half of the benefit of "negative gearing" deductions goes to the top 10 per cent of personal taxpayers, earning more than $100,000 a year.”* Well – hel-loo! And similarly, if you earn a salary of $100,000 a year, the cost to you, of taking a day’s vacation, is $400. But the cost is nothing, if you are homeless and unemployed. So – it would be just as sensible to say that the Government should ***subsidise*** this unfairly high cost of vacations facing rich people. And it would be just as sensible, to say that “*over half of the benefit of ‘extraction and transport’ deductions goes to the top 10% of mining companies, capitalised at billions of dollars*”. These are stupidities. But – in the absence of clear prior statements about ***Framing***, they will endlessly proliferate.

Then there’s ***consistency***. Someone senior – although, like, I get it, that it’s the senior people that are the problem, not the solution – but, someone needs to be riding shotgun on ***consistency*** in this Review. You correctly point out, on Page 14, that it is a desideratum. But then – just about everything about this tax review, is totally inconsistent. E.g. - how come people can get away with running a national chain of consumer-goods stores, which they configure as a franchise network, and get out of paying any payroll tax on, which gives ***them*** an unfair advantage over non-franchises AND then whinge that GST-free online shopping has an unfair advantage over ***them***? That guy ***invented*** the unlevel playing field.

And then there’s ***Churn***. For many people, it’s ***the*** biggest issue in tax. And – I did a word search on that, too – and you do not even ***mention*** it. Figure 2.11 on Page 29 shows that the a very significant 20% of middle Australia is getting 20% of their money vaporised by Canberra. That is a lot of hamburger.

And then there’s **path dependency**. You don’t mention that, either. It’s really important. I provide specific examples of this in my submission but basically, you are attacking a problem which on your own representation is an holistic one, in a bolt-on fashion. Outcomes are hugely sub-optimal in consequence.

**Step 8. Document and Consider the Motivational and Psychological aspects of the Tax System.**

You need to say a lot more than you have, about getting ***tax-payer buy-in***. They key question to ask is not, for example, “*whether mobile factors of production can easily move elsewhere and damage Australia’s growth prospects and erode the tax base*”. The key question to ask is, “*why do mobile factors of production not want to pay tax?*” Everything is mobile and price elastic, in the long run. The ***only*** tax that I cannot legally avoid is a Poll Tax and – even though Poll Taxes are gold-standard from a tax design viewpoint – I am guessing that they are not on the agenda. You need to anticipate the likely second and third round responses to your alienating of some taxpayers by going hard on soft targets like, say, home-owners and to appeasing other taxpayers by going soft on hard targets like, say, multi-nationals.

You also need to consider the fact that under current arrangements, ***the incidence of the cost of tax system complexity, does not fall on the tax designers***. If you make something “free”, demand inevitably skyrockets. You need to introduce price signals that charge the designers for tax system complexity. In this submission, I offer some practical suggestions for that.

**Step 9. You need to say something about the Ricardian Vice.** Those CGE Models are pretty dodgy, in my view, and their “conclusions” are no more than artefacts, of the structure of the models. And to take another example, from the current debate - the Laffer Curve disappears, if you take Norway out of the chart. And so on. That doesn’t mean don’t use models. But it does mean, be honest and communicative about their biases.

**Step 10. Tie it all together and say something holistic!** For Heaven’s sakes! This is supposed to be the whole entire point of the Review!

You need to determine the ***size of the tax take - holistically***. This is a dual problem with the size of Government and of expenditure, so you ***have*** to address those two simultaneously. And – your answer does not need to please everyone, but it does need to be ***principles based***. Saying “this is what they do in a peer group of bankrupt countries in Europe” – which is the whole of Chapter 2 in your Discussion Paper - or “this was the tax percentage of GDP in John Howard’s day” does not, in my view, qualify as “principles based”. Maybe the message of BEPS is ***not*** that you need to load an increasing proportion of tax onto the bunnies who can’t create Irish Sandwiches, for a given target tax take. The size of the tax take, is a variable. Maybe society’s revealed preference (i.e. revealed by BEPS) is, that society wants smaller Government. That may not be the only interpretation to consider, but it is, one of them. You need to profile match expenditure and receipts - ***holistically***. You can’t “Re:think” the tax system – in the sense of deciding what proportion of the revenue raising should be each of, for example, general revenue and user pays revenue, and how progressive the scales should be – independently of matching that to what you are spending the money on – i.e. freeloadable public goods like defence, versus public goods with identifiable users that you can charge for like tollways and bridges, versus transfer payments. ***Then*** – make the big picture allocations, holistically, ***before*** drilling down into the detail.

A tax review is something you have to ***organise***.



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I proceed by commenting on the White Paper in page order. My feedback is numbered with the Chapter number I am referring to before the decimal and the comment number after the decimal.

***Comment numbers are bold black italic, page reference first, comment number second.***

***Topic headers are in dull red italic.***

**Summary points** are highlighted in yellow – and these are also collected together as *Appendix I* if you need a summary.

*Quotes from the Tax Discussion paper are in blue italic.*

**Recommendations that I would like to see either embodied in, or put forward in, the Green Paper are in green.  
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***Foreword i.1***

***Objectives of the tax system***

There are a number of ways you could start a Tax Review, but let’s start by asking: What is the ***purpose*** of Tax? If you’re doing a review, ***you need to know where you’re going with it and why***, and you need a clear sense of ***purpose***. *“If you don’t know where you’re going, any road will take you there”.*

The good news is, that you state a purpose of tax on Page 1. An objective of an improved tax system is *to promote economic growth*. The bad news is, that that is, on your own representation, a totally incomplete answer to the question. Your real answer has 37 components, and is scattered throughout your report piecemeal at 5 page intervals, like the Space Shuttle Columbia strewn across the Nevada desert. There are also two really important purposes of tax, that you do not refer to at all.

**Recommendation: In the Green paper, you should state all of the objectives of tax, together, coherently, on one page, somewhere in the first few pages.**

Page iv is blank! You could fit a list of objectives of tax in there!

Here’s an example, in your own words:

**The Objectives of Australia’s Tax System are:**

**#1. Page iii.** *to deliver lower taxes*

**#2. Page iii.** *to deliver simpler taxes*

**#3. Page iii.** *to deliver fairer taxes*

**#4. Page 1.** *to promote economic growth*

**#5. Page 2.** *to raise the revenue required to fund public services*

**#6. Page 2.** *to not impose unnecessary costs on the economy* (via decision distortion and deadweight compliance costs – **Page 24; Page 112**)

**#7. Page 7.** *to support improvements in productivity*

**#8. Page 7.** *to encourage workforce participation*

**#9. Page 8.** *“Tax reform offers an opportunity to improve opportunities”.* So – ***seriously*** guys and gals. How much is someone getting ***paid***, to write this stuff. National tax reform – is ***important***!

**#10. Page 14.** *to finance the social safety net that supports our society’s most vulnerable*

**#11. Page 14.** *equity*

**#12. Page 14.** *efficiency*

**#13. Page 14.**to be characterised by *certainty and stability*

**#14. Page 14.** *sustainability*

**#15. Page 14.** *consistency*

**#16. Page 16.**to collect commercial recompense for Government supplied *goods and services* and to collect *royalties*

**#17. Page 38.**to implement compulsory public *insurance scheme*s, such as the *NDIS* and *Medicare*

**#18. Page 99.**to *encourage innovation* – for example, via *R&D tax incentives*

**#19. Page 113.** *to address compliance costs falling disproportionately on small business*

**#20. Page 99.** *to correct a bias towards risk aversion*

**#21. Page 99.**to correct for the fact that *earnings from capital are treated more generously than labour*

**#22. Page 100.** *to correct disadvantages of being small*

**#23. Page 100.** *to support job creation*

**#24. Page 115.** *to provide small business owners with access to funds for their retirement*

**#25. Page 116.** *to compensate for the impact of natural events that are difficult to predict such as drought, fire, flood or disease*

**#26. Page 119.** *to encourage start-up businesses*

**#27. Page 121.** *to support the NFP sector* and, Page 124 *to ensure that the overall level of activity in the NFP sector is closer to optimal* (So - definition of “optimal level”?? ***Pleeeaase ….***)

**#28. Page 124.** *to improve societal outcomes*

**#29. Page 125.** *to repair the Budget via temporary levies*

**#30. Page 131.** *to replace narrow-based taxes*

**#31. Page 133.** *to not put private providers* (i.e., in competition with Government providers) *at a competitive disadvantage*

**#32. Page 151.** *macroeconomic stabilisation* (D’oh! ***Automatic stabilisers and fiscal policy*!** At last! Page 151!)

**

**#33. Page 157.** *achieving desired behavioural changes*

**#34. Page 159.** *supporting wine produces and independent beer producers*

**#35. Page 162.**to assist with a grieving process. *“Like the WET, the Luxury Car Tax was introduced as part of the GST tax reform package”*

**#36. Page 163.**to *address market failure* including, Page 165, *“corrective taxes”*

**#37. Page 164.** *to protect domestic industries*

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So – that is what, on your own representation, you are trying to achieve with tax and with **Re:think**.

***Foreword i.2***

So – my immediate comment, having clarified the objectives of tax ,is – that **you need demarcation on what Objectives are targetted by Tax, and which aren’t.** Why is it a good idea that pursuing all these objectives, is the job of the ***tax system***? Why ***these*** objectives?

For example, here’s another way of doing it. You could simultaneously hit your Simplicity and Efficiency objectives (which would be collinear and commensurate objectives in this example, so you only need one instrument to hit both) by raising all of your taxes via a Poll Tax, and you could assign the Fairness objective to the expenditure side of the ledger via the Welfare System. And you could have as much Lowerness as you wanted – or, indeed, Higherness – by adjusting the instrument of the Tax ***Rate*** – which is dual to the Tax side and to the Expenditure side, and which provides an additional degree of freedom.

As always, I don’t care what the answer is. But if you are serious about having a Re:think, then **your Green Paper needs to explain and substantiate which objectives of the tax system are being targetted by which instruments, and why, and in particular which of your 37 objectives are being targetted by each of:**

* **Compositional decisions on the Revenue side of the Budget;**
* **Compositional decisions on the Expenditure side of the Budget;**
* **Compositional decisions about each of the Revenue and the Expenditure sides of the Budget; and**
* **Decisions about the size of Government Revenue.**

***Foreword i.3***

If you could express yourselves in terms of **tilt, level and kink** (which I define in a moment) it would really help. You show the results of these things, in Chart 2.11 and Table 3.1. But **you need a principles based discussion**.

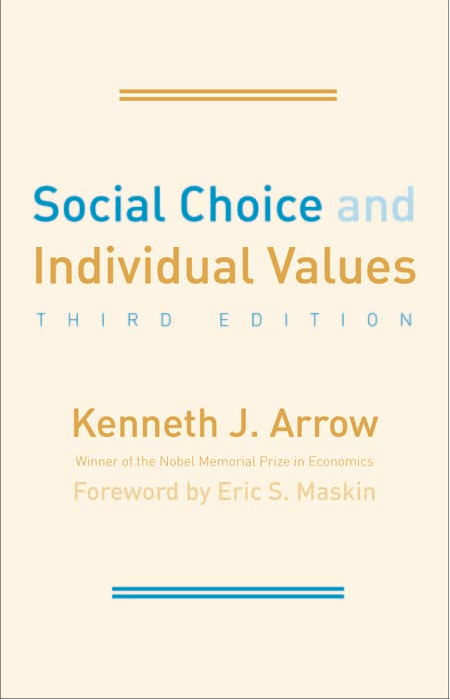
**Ground Zero:** First up though, you need to be clear about **Framing**. Let’s frame the structure, by stating that **the role of the Public Sector (“Government”) is to provide “Public Goods”**. That’s kinda tautological, but in a good way – it’s definitionally true. So – as a society you need to agree on , and to list all the Public Goods that you want – Army, Navy, Air Force, Law and Order, biosecurity etc – and divide the cost of that by the number of people you have, and levy a Poll Tax.

**Tilt.** Next step is, you may want to Tilt that. You could decide that some people should pay more than others (please state your basis for that), and abolish the Poll Tax, and impose, say, a “flat” percentage tax that raises the same total amount of money. Some people will, at this stage, think it is ***fair*** that people with no income pay no tax and some people will think at this stage that it is ***unfair*** that people with no income are free-loading on Public Goods like national Defence and Law and Order, but are not contributing. You need to have that debate and spell it all out. There is a degree of social engineering and of redistribution, in doing that. You may want to do that. But – you need to write down and communicate – ***why?***

**Level.** Next step, is to determine the ***Level*** of Government activity. You may decide that the Government is the best provider of a whole bunch of stuff – postal service, medical insurance, education, childcare, whatever. This increasingly destroys consumer choice – they are forced to pay taxes for these non-public goods, and them are forced to consume them. You can do that! But – given the deadweight costs - you need a pretty good reason, *why.* Please state the reason.

(Incidentally - I wish to object very strongly to the whole of Chapter 2, which - moronically, and astoundingly – attempts to work out the appropriate size of the Government tax take, as a percentage of GDP, by looking at what a whole bunch of cup-cake Northern Hemisphere countries do. That is such a totally awful way to address that question. It is truly awful because:

* The Welfare State has bankrupted those other countries in your comparison cohort set. That is the whole point of the Financial Crisis. ***That*** fiscal mix, does ***not work***. Why would you model yourselves on a failed system?
* Secondly, it just kicks the can down the road with respect to the true foundational reasons. Why did ***they*** choose that proportion of GDP? ***Where is their principles based Social Contract?*** Guess what – they don’t have one.
* Thirdly – the only thing that is relevant to working out the appropriate size of the ***Australian*** tax take, as a percentage of GDP, is a preferences based analysis of ***Australians***. That’s what a tax system, ***is***. You have not done that. Your whole entire paper, has zero cred. in consequence.



***Read* the *book*!** Ken Arrow won the Nobel Prize for this stuff! Your Re:think paper in contrast would not win a high school economics competition.

Then – there’s **kink.** Taxes do not have to be flat percentage taxes of, say, income, where you pay less and less tax until you hit zero income. You could make the tax rate tip negative below, say, $10,000 income per annum. There can be a kink – a safety net. There’s a whole lot of totally pointless and annoying confusion about whether things like Superannuation are a ***safety net or a right***. If you provided principles-based discussions of Tilt, Level and Kink – the correct structure of the Superannuation system, for example, or Medicare, would then just fall out, from those agreed principles.

***Foreword i.4***

Hate to point this out, given that one of my key points is that you have too many objectives, but **there are at least three important objectives of tax that you forgot to mention** in your list of 37 objectives.

***Objective 38 – Revenue protection function***

It’s often said that, say, the top 20 taxes raise 93% of all revenue, and that the remaining 7% of revenue is raised by a further 5,729 taxes. Whatever. So – you might think, at first blush – complexity is such a huge problem in the tax system! We should, like, abolish the 5,729 taxes that are so low impact, and divide the tax rate on the top 20 taxes by 0.93, and you have a revenue-neutral solution to complexity! You have reduced the number of taxes by, like, whatever [(5,729 minus 20) divided by 5,729], percent, is!

BUT – you need to check, that removing those taxes, does not elicit big changes in behaviour, that would totally undermine the Top 20! Maybe many of those ostensibly tiny taxes, are serving a really big purpose!

**In your Green Paper, you should identify which taxes, whilst apparently trivial in terms of money raised, are playing crucial roles in supporting the integrity of the tax system as a whole; and which, are merely adding to complexity for minimal revenue impact.**

***Objective 39 – Libertarian paternalism***

Notions of Libertarian Paternalism are absolutely central to vast swathes of the Australian taxation system, and I am amazed that you did not explicitly mention it in your Discussion Paper. It is often used as a justification for the Government seeing it as its business to make people save for their retirements, for example. That is, like, two trillion dollars! It is testimony to the ineptness of your paper, that you have a $2 trillion slush fund, which is likely based on Libertarian Paternalism, and you do not mention Libertarian Paternalism.

Incidentally – can you help? It was Sunstein (in his 2013 paper) and Thaler and Sunstein (in their 2003 paper) who made a case for “libertarianism paternalism” with reference to Government intervention. They argued that framing choices can have a powerful, positive impact on outcomes, while preserving the basic freedom to choose. One example that they give is that the order in which food is presented in a cafeteria may influence which items are chosen by customers. Hence, the cafeteria manager may preserve the ability of customers to choose, while making it more likely that they select a healthier diet. Such analysis speaks directly to the relation between member choice and default funds in the superannuation system. The nomination of the default fund and its investment strategy is very important, especially for disengaged members who are unlikely to ‘choose to choose’. Under the superannuation guarantee, the system is the ***opposite*** of Thaler and Sunstein. On reflection – Thaler and Sunstein have described the café example, ***the wrong way round***. The Cafe, is ***paternal libertarianism*** - i.e., the substance is libertarian, but the gimmick is paternal. So – paternal should be the adjective. In the superannuation example, the heart of it is a 9% tax. That is ***paternalism***, no question. But then, at the margin, you get some choice. Libertarian is the ***adjective***, in the superannuation case. So – Australia’s super system is libertarian paternalism and you should spell that out. But – you should prevent Thaler and Sunstein perverting the language like that, in the public debate. You should ask them – hey, you’re a National Government, ***tell*** them – to republish their paper the right way round, if they want their ideas to circulate in Australia.

***Objective 40 – Endorsing Tax Evasion***

Treasury seem to be saying, in a lot of the commentary floating around, that multi-national companies can easily avoid tax, so as a nation we should recognise that, by cutting their tax rate. If one of the objectives of the taxation system is to endorse tax evasion – or avoidance, or whichever one it is - well, cool. You should explicitly say so.

***Foreword i.5***

***Definitions - Foundational***

My next comment would be, that **Tax is a tool, not a set of agent Preferences.** You cannot achieve targets such as “Fairness”, in my view, simply by Re:thinking the Tax System. There are 23 million Australians in Australia, and nearly all of them care passionately about “Fairness”, and pretty much no two of them agree about what “Fairness”, is. So – you need clear instructions from the principals – the people, and the politicians – about the ***definition*** of “Fairness”. Document that, ***before you start***. And you need them to provide you with lots of other definitions as well. Here’s another example from your paper. Objective #27 of the Tax System, from the above list, is *to ensure that the overall level of activity in the NFP sector is closer to optimal.* Cool. You can push back, you know! So – you need a clear documented statement, from the principals in this project, as to ***what*** the *optimal overall level of activity in the NFP sector*, like, ***is***. And when you find out what it is, and why – write it down! Share it with us!

Page 156 is blank! You could fit it in there!

And – same for all the other Objectives!

What does “lower” mean?

What does “efficiency” mean?

On the plus side of the ledger, you do include a mooted definition of “Complexity”, which looks pretty good! – although, it would be nice if you could provide even a scoping-shot numerical estimate, and not just general principles, great though the principles are..

And you do include a clear definition of “tax”, albeit in a footnote, and scammed from the OECD. But that looks like a poor definition, as I discuss below in Foreword 1. You note that the Tax System was “formed in the 1950s” but immediately then adopt an unreconstructed 1950s definition of what a tax is.

***Foreword i.6***

***Collinearity and Orthogonality***

The next thing that totally jumps out at you about the Objectives of this Re:think, when you gather all the Objectives together on one page as I am recommending, is that ***very few of them are either Collinear or Orthogonal***. Or, indeed, ***commensurate***. That’s a big problem, that you need to talk about!

Page 4 is blank! You could fit that discussion in there!

(If the Objectives were ***Collinear***, that would not be a problem because, subject to differential scaling factors, you could have more Targets than Instruments, and kill two birds with one stone, and that’s great.

And if the Objectives were ***Orthogonal***, well, that’s more Instrument consumptive, because you need an independent Tax Instrument for each independent Tax Target – as pointed out by the late, great Dutch economist, Jan Tinbergen. But still – that is OK! You can divide and conquer your Objectives, and deal with them one at a time! Mark your man!



Tax targets in the blue shirts. Tax instruments in the red shirts.)

So – so much for an ideal world.

But that is, like, so totally ***not*** what you have. What do we do about the ***cross-correlation*** between objectives? Can you write about that in your Green Paper? For example, once you’ve set the revenue raising rate on, say, alcohol, based on, say, 1. the price-elasticity of alcohol, you’ve also willy-nilly set 2. the medical cost recoupment 3. the behaviour discouragement 4. the wine-producer support and 5. the pre-GST level regret alleviation, levels of the tax.

So - why did you do all that, in ***that order***? (i.e., that’s just an example). But – in general? Why not set, say, the optimal wine-producer support rate first, and let the amount of revenue raised just flow from that? Or – whatever? As a taxpayer, that is not clear to me. The answer ***crucially depends***, on what order you pursue the objectives in.

To address this central issue, I was expecting to read a whole lot about trade-off functions in your Discussion Paper – but, you did ***not*** talk about those. Here’s an example of why you need to articulate **national trade-off functions**.

First up, quoting from the Sydney Morning Herald, March 30, 2015[[1]](#footnote-1) – ACOSS ***get it*** that taxing food and basic necessities makes things ***simpler*** and more ***efficient*** (reduces dead-weight destruction of consumer and producer surpluses and the average destruction of gains from trade per dollar of tax revenue across the GST as a whole), but they also believe that that is ***unfair***, and they further believe that fairness should be ***addressed on the Revenue side*** of the Budget and not the Expenditure side. And they have reasons for all of that. It’s a coherent and substantiated argument. And – ***pursuant to an unstated but implicit trade-off function*** – they conclude that the fairness benefits outweigh the complexity and dead-weight gains-from-trade losses. (And – pursuant to a claim that there are missing markets for compensation, they would further likely argue that the current arrangements are “Pareto optimal given constraints”). Cool.

Second up though, I would personally agree with all of the ***componentry*** of that but, if I had to have a GST, I would unhesitatingly invoke Frank P Ramsey’s 1927 Economic Journal article[[2]](#footnote-2), and tax food and basic necessities. But – and this is my key point – that is not a disagreement about the ***facts***. It’s not even a disagreement about the desirability of simplicity and of efficiency and of fairness. In large part, it’s about ***differences in trade-off functions and in preferences***.

So- c’mon team – please state your proposed plan to ***resolve*** those differences.

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The way this Tax Review has been going so far, it’s the Mosh Pit stuff. Everybody just, like, yells out in favour of this tax, or of that tax. Surprise! You ain’t gettin’ nowhere.



**The Green Paper should state which of the 37 Objectives of the Tax System are non-orthogonal, and spell out proposed societal trade-off functions for national approval.**

Not everyone will agree on the exact formulation of those trade-off functions, of course. That’s what living in a society ***means*** – compromise! But if you state trade-off functions (a) that would offer some hope of arriving at a coherent conclusion, and I’m not sure that any other approach, does; and (b) you owe it to the dissidents to clearly explain ***why*** they lost the debate, about any ***particular*** tax.

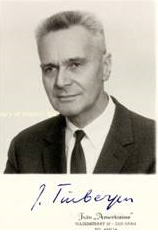
(The above example is slightly more complicated than being just about trade-off functions, of course. The two sides in that debate (me, and ACOSS) would also disagree about the ***definition*** of “fairness”, and about whether this example ***satisfied*** that definition. That’s a framing issue, further discussed below. And there’s also a ***trust issue*** going on – the reason ACOSS believe that it is impossible to move to a full Pareto optimal position, is that they believe the Government will offer compensation for the disadvantaged in exchange for increased GST scope (rate or coverage) and then, having taken the increased GST part of the deal, will reneg on the compensation part. ACOSS is correct, politicians are renegers to the core, so it’s a well-founded reservation. But ***trust*** is so foundational to the effective functioning of the Tax System (and, indeed, to the functioning of the Australian Commonwealth’s entire Social Contract) that I’ll cover ***trust*** in a later comment).

***Foreword i.7***

***Targets and Instruments; Existence Statement***

OK, so when – and only when – you have thought about the extent to which your 37 objectives are collinear, you can make a general arm-wave comment about the existence or non-existence of a tax system that could, in principle, address all those objectives. (My blink reaction is, that you are trying to achieve too much. You are trying to treat the Tax System as a Policy Instrument magic pudding, and you are failing because it can’t be expected to do all that or at least, it cannot be expected to do all that, simultaneously).

So - are all of these objectives even ***achievable***, using the Tax System? Is someone in Treasury or the Government or wherever keeping count of the number of “Targets” and of “Instruments”, and checking that they are in balance as prescribed by Tinbergen? There is no indication, in your paper, that you are.



**Please explicitly state in your Green Paper whether a solution exists, given the tax instruments at your disposal and the objectives you state in the paper.**

Just so we know.

**Please state in your Green Paper how many total objectives the tax system has, and how many total instruments you have, and - rough order of magnitude - how collinear they are. And please state how many independent objectives the tax system has, and how many independent instruments you have.**

Page 128 is blank! You could fit it in there!

You can map from total to independent by using Principal Components Analysis (PCA).

(Equivalently, you could specify the ***order*** in which you are going to address the objectives, and orthogonalize as you go. At the national level, however, I do not believe that it is possible to communicate that to 23 million Australians. *“We are now targeting the health-cost recoupment subcomponent of the tax on alcohol consumption that is uncorrelated to Ramsey pricing, WET and industry subsidization”*. That is a technically clean solution, but, that is just, like, ***soooo*** not a standard English usage of the term “health-cost recoupment”).

***Foreword i.8***

***The duality of Revenue and Expenditure – Compositional Matching***

Duality is so important, in designing a tax system! And you don’t use it!

Page vi is blank! You could fit it in there!

The irony is, that in recent years, the duality of the tax system has inappropriately intruded itself into, and splattered itself unintelligibly throughout, the personal tax return forms. Every year at tax time now, I get a call from my auntie in Dubbo, asking me what my taxable income is, so that she can fill in her own tax return, and work out whether she qualifies for the pensioner discounted postage stamps or has to pay the full rack rate. My income should be so none of her damn business! It happens, because the tax system has recently been inextricably integrated with the welfare system, and the means test on welfare is at the family unit level. It’s a reasonable link in principle. But you are doing it inappropriately. You should be thinking about the duality of tax and expenditure during tax design (but, by and large, in the Tax Discussion White Paper, you don’t); and you should not be bothering taxpayers with that in their tax returns or co-mingling individuals returns (but – clobberingly – you do).

And also – so, rock me gently – defining your terms is so important! And your definition of tax is ***wrong***! That is so bad! Here’s your definition of tax, it’s a footnote on Page 16 that is a reference to the OECD: “***a tax is a compulsory and unrequited transfer to government***”. Given the problems you face, that is not a very helpful definition of tax!

And - this is supposed to be a “Re:think”! In the same way that you need a top-down holistic table showing what the purposes of tax are, so, too, you need a top-down holistic table showing ***what the taxes are disbursed on***. This is because:

* Firstly, you can’t achieve one of your three key stated objectives of this review, viz, lower taxes, without a commensurate lowering of expenditure. (***Any*** idiot could deliver an effective prescription for “lower, simpler, fairer taxes”! How hard can it be? You just delete all current taxes! No-one pays any tax, at all! ***That*** is lower, simpler, and fairer! But – like – dur! That is not much help!)
* But secondly, a big motivator for this tax review, is **BEPS**. And – it’s the “compulsory and unrequited transfer to Government” ***component*** of total Government receipts, that is at the epicentre of that base erosion and of profit elusiveness.

So – my point is – that it can be difficult to get global information technology and flat-pack furniture companies to even admit to making any profit in Australia, let alone getting them to pay a credible amount of Australian tax. That’s because, if they’re being asked to make ***compulsory and unrequited transfers*** well, why would they care? They are going to spend 20 bucks on a thesaurus, and they are going to look up synonyms for the word, “compulsory”.

In contrast, if you broaden the scope of your review to include ***voluntary*** and ***requited*** transfers to Government, and if you treat the ***proportion*** of that, in the total receipts mix, as a variable/***policy tool*** – suddenly, you’re cooking with gas! You can invoke a Turnpike Theorem! Not in the usual, metaphorical sense in which economists typically invoke Turnpike Theorems in the course of optimisation problems, but in the literal sense! You can toll-gate stuff! And – even better – if you pause for a nano-second and think about the definition of “unrequited”, you will immediately realise that the OECD has screwed up that part of the definition too. Taxes paid into consolidated revenue are not only requited (you get the benefit of a whole Government and social order out of it), but, crucially, the resultant services are ***far more gateable than you appear to give them credit for***.

OK – so – you need to draw an “EAT Diagram” (it stands, not only for what the ATO does to your paycheque, but also for “Expenditure Aware Taxation”). In that diagram, you need to background and deemphasise the actual particular sources and uses of Government cashflows, and foreground and highlight the extent to which they are each of:

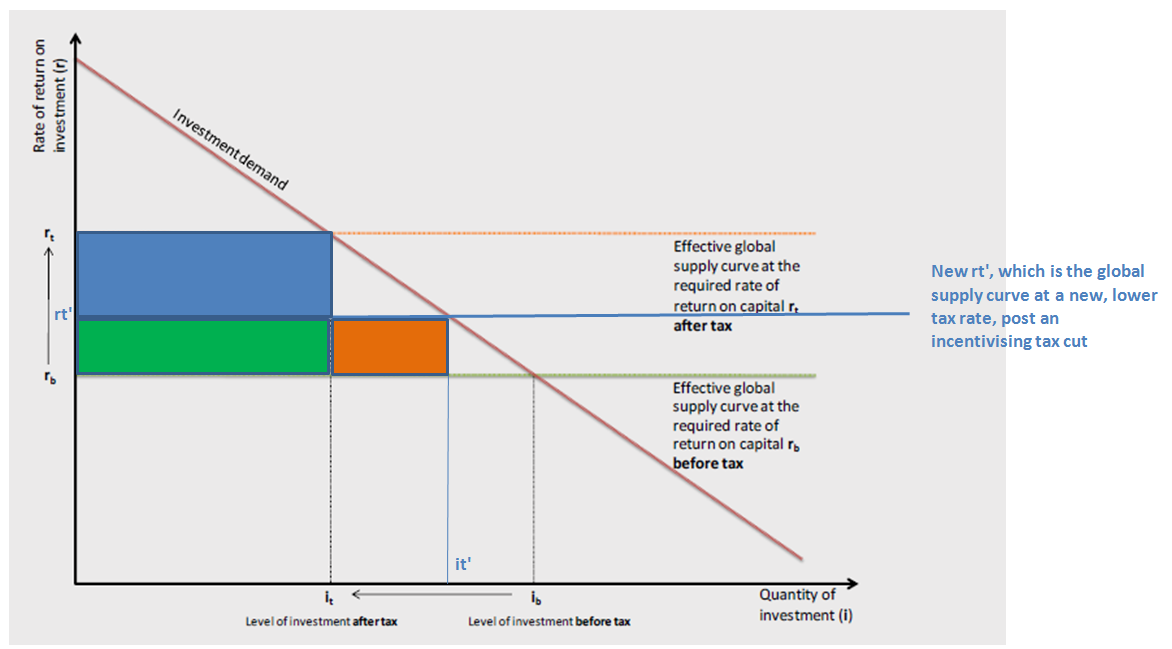
* Unrequited, unmatched and ungatable (e.g. “border protection; biosecurity”)
* Unrequited and unmatched, but gatable (e.g., “law and order”)
* Requited and unmatched and gatable (e.g. “Medicare Levy”, state school education)
* Requited and matched and gatable (e.g. “bridge tolls”)
* Cashflows arising from public enterprise trading, (e.g., Australia Post)

So – my first point is, that the existence of the BEPS problem implies that ***you should be changing the tax mix away from unrequited and ungatable sources of revenue, and towards a user-pays model.*** Flat-pack furniture has to get to the showroom somehow! If they won’t declare a profit and pay tax like everybody else, well, cut both company tax which they weren’t paying anyway, and cut PAYE tax to make that fair on the wage-slaves, and jack up taxes on roads all over Australia, and especially on the block surrounding the showroom! Cop that! you buccaneers.

And my second crucial point is, that a central tenet of the Western legal framework, is that law and order is gatable. You can charge for it, and you can withdraw that. I cannot believe that you are being so pusillanimous about multi-nationals that want to operate in Australia but who do not want to pay tax in Australia! I cannot believe that you are giving any heed to the wheedling voices of the “lower corporate tax” brigade, with their craven advice to give up the fight at the first hurdle, and to endorse non-taxpaying proclivities by lowering the tax rate to recognise that behaviour. You are the *<<deleted>>* ***Government***! You can declare ***caput lupinem*** on these pirates! They chose to incorporate, and to take on the rights and responsibilities of a body-corporate, and if they are not up for the responsibilities, like, paying tax, well, you can easily declare them outlaws to the Commonwealth and pro rata decrease their rights. See how they like it, when people start stealing their intellectual property in Australia, and burning down their flat-pack warehouses, and you tell them, tough, you did not pay for law and order, you do not get the protection of law and order.

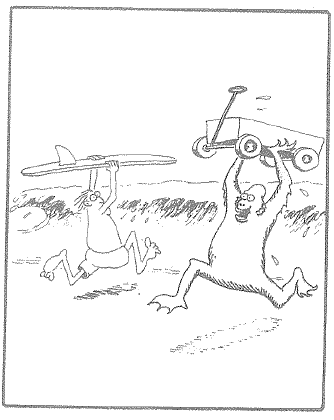
This is kindergarten stuff! Remember that Russian folktale about the Little red Hen? Here’s how Wikipedia tells it: *“In the tale, the little red hen finds a grain of wheat and asks for help from the other farmyard animals (most adaptations feature a pig, a cat, and a frog) to plant it, but none of them volunteer. At each later stage (harvest, threshing, milling the wheat into flour, and baking the flour into bread), the hen again asks for help from the other animals, but again she gets no assistance. Finally, the hen has completed her task and asks who will help her eat the bread. This time, all the previous non-participants eagerly volunteer. She declines their help stating that no one aided her in the preparation work. Thus, the hen eats it with her chicks leaving none for anyone else.”*

Incidentally – I really object to the chart on page 79. It is not obvious to me why the orange rectangle is bigger than the blue triangle – which appears to be the Gruens' key point.



And even if it were bigger – if you part fund it by crimping Dividend Imputation, well, as fast as foreign capital supposedly comes into Australia from overseas well, Australian capital is likely to pour overseas from Australia.

It’s like, the guy with the waggon …

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***Foreword i.9***

***The duality of Revenue and Expenditure – Sizing the Tax Take, and justifying “lower”***

**Your key mantra and #1 Objective for taxes, is that tax should be “lower” (p. iii).** That is mathematically equivalent to saying, that your key mantra and #1 Objective for taxes, is that ***Government expenditure and public services and/or handouts should be “lower”***, and that it turn is mathematically equivalent to saying, that your key mantra and #1 Objective for taxes, is that ***a whole bunch of Australians will have to give up a lot of stuff that they currently perceive themselves as getting*** ***for “free”*** either (a) back from their own taxes, (b) from other Australians or (c) from some reified “Government”. The belief in “free Government” is an unshakeable national religion, and you have to make a comment that factors that in.

Page 180 is blank! You could fit it in there!

My key point is, that ***if you attempt to market “lower taxes” and, equivalently,” lower expenditure” as you currently are marketing them – i.e., via some glossy blue-white-and-black artwork, and some racey copy-writing and simplistic three-word slogans – well you will get the exact same outcome you elicited with the 2014 Federal Budget***.

Outrageplosion.



So – there are four things you have to work with, viz:

1. A declamatory / ideological / emotivist case for lower taxes;
2. A rational, explicable, substantiated case for lower taxes;
3. A declamatory / ideological / emotivist case for higher taxes;
4. A rational, explicable, substantiated case for higher taxes.

And so – and this is still my key point, continued – ***there are three very large (albeit quite distinct) sections of Australian society who will totally NOT accept “lower”, on the basis of the glossy declamatory / ideological / emotivist shiny black-white-and-blue rant which you are so far proffering***.

Firstly, members of the **Right-of-Centre Party**, who really do want lower taxes and smaller Government, totally ***hate*** what you are doing, because they see the abject failure to provide a coherent narrative as eliciting a countervailing outrageplosion and delivering Government straight back into the hands of the Left-of-Centre Party in two short years time. Ask at any branch. ***They’re as angry as all hell***.

Secondly, members of the **Left-of-Centre Party** totally ***hate*** what you are doing because they completely disagree with the stated objective and they want higher taxes and more Government. Ask at any branch. ***They’re as angry as all hell too!***

Thirdly, there are many ***regular people*** (like myself), who could not imaginably care less whether taxes are lower or higher or the same, but who totally ***hate*** what you are doing, because they perceive politicians, Leijonhjelm aside, to be chaotic thinkers; because they unshakably consider “declamatory / ideological / emotivist” to be pejorative descriptors; because they believe that designing a nationally-agreed prescription for the $400 billion national tax budget should require more than the sort of blue-white-and-black three word slogan that you would expect to find on a Fantail wrapper; because they are not prepared to assign any credibility to a Tax Discussion White Paper that omits all the needed-to-play stuff in this submission, such as discussion of micro-foundations, churn, path-dependency, Ramsey-pricing, orthogonality and so on. ***These regular people, are as angry as all hell, too.***

These three groups, separately, and even more so in total, are so important that the tax review process cannot proceed without getting, if not agreement, at least buy-in from these people. I get it, that politicians may not know much about tax. But, I would have kinda hoped, that ***being politic*** was a core competency. Just yelling “lower” with increasing stridency will not bring people around! You need to provide some kinda ***convincing rational substantiation*** for “lower” taxes, including a rational convincing substantiation for the duals to that – lower public expenditure, and cuts to what people are now “getting” from the “Government”. Page 180 is blank! You could fit it in there!

(Now – you may well be thinking – the Tax Discussion White Paper spends a big chunk of Chapter 2, discussing this very issue. But when you think about it, it does not actually ***say*** anything.

The good news is, that working out what the optimal size of Government should be, from first principles, and evidencing your view, cannot be rocket surgery. Here are a couple of suggestions to illustrate the types of argument that I regard as a *sin qua non* of getting the nation on board for lower taxes. They do not have to be these exact arguments. But – like – if you don’t have ***any*** basis for pursuing lower – or, for that matter, higher – taxes, you are going to be, like, ***loathed***.

Principles-based sizing of the tax take #1 – Inflection points in the demand curve for public goods.

Despite not having a strong prior on the size of Government, I only have to eyeball the public expenditure profile, and to think about it for 2 minutes, to deduce that the Government is about twice as big as it should be. And the reason is, that about half the things the Government does and spends money on, are the genuine concerns of a Commonwealth and are inherently public in nature. It’s a tad arbitrary, sure, but I’m thinking of border protection, roads and bridges – i.e., the archetypical ***trinoda necessitas*** of bridge-bote (repairing bridges and roads), burgh-bote (building and maintaining fortifications), and fyrd-bote, (serving in the militia, known as the fyrd) -handed down to us from Anglo-Saxon times; and things like law and order; compulsory vaccination against community threats like polio and whooping cough; preventing over-fishing; and maybe, at the local level, things like collecting the garbage in urban areas, and sweeping the streets. OK, so here’s my economic-principles-based rationale that the Government ***should*** do these things – here is why, ***these*** things:

**“Characteristic List 1”:**

* They are basic;
* They are common to just about everyone’s set of preferences; a high degree of homogeneity of preferences can be identified;
* They are public goods (i.e. everyone can use them, they are valuable, and they are exposed to free-rider risk –in a good way);
* They are natural monopolies – it doesn’t work, if only 80% of people vaccinate against polio or support the legal code;
* They are characterised by steep, inelastic demand curves. You totally need civil order, and to not catch polio, and not to have plague-ridden streets, and to not get invaded by Vanuatu, and so forth.

So – enter the Government! They are forcing people to buy things that ***people*** not only want anyway, but ***all*** people want anyway, and would pay heaps more than they are paying, for, if they had to, and can purchase way more efficiently, as a national community, than they could as individuals.

Cool. That accounts for about half of what the Government does, in Australia.

But my local council (I am in NSW, where rates are regulated by IPART) has recently successfully applied to IPART to levy rates in excess of the rate cap, to pay for a whole load of ***extra*** “needs”. Here are some examples:

* $3.2 million of other ratepayers’ money spent on “exercise paths” at a local park;
* An “indoor aquatic centre”;
* A “mountain bike facility with a skills zone, pump track, freestyle mounds and 1.7 km network of trails”;
* A “cultural centre in the middle of a wildflower garden”;
* An “upgrade to the Library catalogue so that you can access it from your iPhone”;
* An upgrade to the rolling green lawns of a local Golf Course for wealthy middle-aged golfing businessmen;
* A BBQ lunch for a “national tree day”.

And there are a million examples of similar extravagant furbelows at the Federal Level – starting with the subsidies for Australia’s Olympic team, which fail every single principles–based rationale for spending public money, that you could imaginably imagine. Spending $12 billion of Australian taxpayers’ money trying to take out the Hindu Cush is another example. No invading army, in the whole history of invading armies, has ever taken out the Hindu Cush in, like, history.



OK, so here’s my economic-principles-based rationale that the Government should ***not*** do these things – here is ***why***, ***not*** these things:

**“Characteristic List 2”:**

* They are sophisticated luxuries;
* They are not common across different people’s sets of preferences; a high degree of heterogeneity of preferences can be identified;
* They are public goods (i.e. everyone can use them, they are valuable, and they are exposed to free-rider risk – only now, in a bad way);
* They are not natural monopolies – for example, a free equivalent alternative to spending $3.2 million of ratepayers money on “exercise paths” at a local park, is for people to stop driving their kids 5 blocks to school in their Landcruisers, and to get exercise by using the pre-existing footpaths, and walking their kids to school;
* They are characterised by flat, elastic demand curves. Indoor aquatic centres (don’t forget Australia has free beaches, just up the road, and we have a free river, just down the road), cultural centres in wildflower gardens, upgrades to golf courses? These things are price elastic.

So – where does that get us, in providing a principles-based argument for or against “lower” taxes?

In my view, both the goods characterised by Characteristic List 1 ***and*** the goods characterised by Characteristic List 2 are ***public goods***. They are public, and they are goods. OK. **BUT** – there is a huge kink in the demand curve, as you move from List 1 to List 2. There is a reasonable expectation that the heterogeneity of consumer preferences increases as dollar values increase, which means that **the deadweight cost of compulsion rises exponentially** the further the Councils breach the rate caps and, more generally, the more Australia moves from smaller Government to bigger Government.  Virtually everyone wants the garbage collected and the streets swept with the first dollars they spend. A tiny selfish minority want to spend $3.2 million of other ratepayers’ money on “exercise paths” at a local park in preference to simply going out and exercising in the fresh air which you would have thought that anyone could have done for free. **Beyond the cap, very many more people are being forced to buy what they don’t want, than are within the rate cap.** Secondly, over and above any heterogeneity considerations, consumer demand curves are going to be way flatter as dollar values rise. The demand curves for garbage collection and swept streets are steep. The demand curves for $700,000 environmentally sustainable storm-water harvesting systems are very flat, as are the demand curves for some of the extinguished alternative private uses that the rates in excess of the rate cap would have been used for if IPART had not condoned the breaches. **So the deadweight losses are very large – large consumer surpluses are getting vaporised** under the auspices of IPART and big Government.

So – now we have a clear view! Taxes, ***should be lower***! And – we can now explain – ***why***!

But – like – you need to ***explain*** that to people like ACOSS and Ross Gittins and the Left-of-Centre Party and the Environmental Party – all of whom want bigger Government and higher taxes, but only on a “mosh pit” basis. You need to articulate that explanation! Page 188 is blank! You could fit it in there! I would be happy for the bleeding hearts to win the argument for higher taxes and bigger Government. But – like – ***you need to force them to articulate why there is not a major kink in the demand curve for public goods, at about half the size of the tax take, that we have right now.*** It’s not gettin’ us anywhere, that the higher taxes brigade just shout ever louder, and it’s not gettin’ us anywhere, that the lower taxes brigade just shout ever louder. You need to ***organise*** stuff! I get it, that the Government may not know much about tax. But, I would have kinda hoped, that ***governance*** was a core competency.

**Please state in your Green Paper your dollar estimate of the cost of compulsion in the tax system.**

That cost will be more than just the size of the consumer and producers surplus triangles foregone, of course. It will be the whole shebang – the entire price times quantity rectangle of people being forced to buy stuff from “Charcteristic List 2”, above, that they just, like, totally did not ***want***. (Some things, in fact, will be viewed as “bads”, not “goods”). You can easily estimate that number, and you should state that number. Given the knife-edge nature of the debates over a lot of this stuff, and in the light of my foregoing discussion about where the dividing line between Characteristic list 1 and Characteristic List 2 would plausibly fall, my guess is that the, in Senator Leijonhjelm’s words, deadweight loss “Cost of Compulsion”, is around 50% of 50%[[3]](#footnote-3) of the tax take, i.e., **$100 billion per annum**. If your estimate is different, that is cool, you’re the guys with all the machinery to run the calcs. But just, like, please ***state*** that number, and your methodology and assumptions. **It is a super-important number.**

So much for an example of some ***economic*** principles supporting “lower”. Here’s a ***political*** example of a principles-based argument for lower. As always, I don’t care what the answer is, and I don’t care what the principles-based basis is or what the argument is. But, like, there needs to ***be*** a nationally agreed basis, and a spelled out rational argument. I am still mad about the three word slogan approach to managing $400 billion, and I’m still mindful of the 2014 Budget debacle which ensued when the Government did ***not*** articulate a rational basis for what it was doing.

**Principles-based sizing of the tax take #2 – The Democratic Manifesto**

The entire foundational social contract manifesto on which Australia’s whole post-Aboriginal Western democratic liberal society is based, is Locke and Mill. If you are having a foundational Re:think of the tax system, then **you need to re-ground on that stuff for essential guidance**. That’s John Locke’s ***Second Treatise on Civil Government***, which lays out the blueprint for majority popular rule (“democracy”)and it’s John Stuart Mill’s ***On Liberty***, which lays out the blueprint for preventing democracy degenerating into a tyranny of the majority over the minority. These agreed blueprints for the particular form of the social contract, which is used in Australia’s society – i.e., Locke and Mill - have a whole ***lot*** to say, about the appropriate size of Government, in general, and, to the current question, about “lower”, in particular.

OK – so – here is a totally crucial quote from Mill’s ***On Liberty***:

“*There is, in fact, no recognised principle by which the propriety or impropriety of government interference is customarily tested. People decide according to their personal preferences. Some, whenever they see any good to be done, or evil to be remedied, would willingly instigate the government to undertake the business; while others prefer to bear almost any amount of social evil, rather than add one to the departments of human interests amenable to governmental control. And men range themselves on one or the other side in any particular case, according to this general direction of their sentiments; or according to the degree of interest which they feel in the particular thing which it is proposed that the government should do, or according to the belief they entertain that the government would, or would not, do it in the manner they prefer; but very rarely on account of any opinion to which they consistently adhere, as to what things are fit to be done by a government*”

Bingo! The creators of our Western liberal democracy, totally knew all about the chaotic mosh-pit response you wood inevitably elicit, if you stood up in 2015 and called out – “Yoo-hoo Australia!! Tax Review time! Anyone have any views??”

But – that is why Mill is so famous. It was Mill who provided the principles-based answer which – until I started witnessing all this tax review mosh-pit malarkey – I had thought that as a Commonwealth we had all already ***agreed*** on. Here it is (same reference – “***On Liberty***”):

*“The object of this Essay is to assert one very simple principle, as entitled to govern absolutely the dealings of society with the individual in the way of compulsion and control, whether the means used be physical force in the form of legal penalties, or the moral coercion of public opinion. That principle is, that the sole end for which mankind are warranted, individually or collectively, in interfering with the liberty of action of any of their number, is self-protection. That the only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others. His own good, either physical or moral, is not a sufficient warrant. He cannot rightfully be compelled to do or forbear because it will be better for him to do so, because it will make him happier, because, in the opinions of others, to do so would be wise, or even right. These are good reasons for remonstrating with him, or reasoning with him, or persuading him, or entreating him, but not for compelling him, or visiting him with any evil in case he do otherwise. To justify that, the conduct from which it is desired to deter him, must be calculated to produce evil to some one else. The only part of the conduct of any one, for which he is amenable to society, is that which concerns others. In the part which merely concerns himself, his independence is, of right, absolute. Over himself, over his own body and mind, the individual is sovereign.”*

Great! This is totally relevant to two current situations in Australian parliament.

First up – here’s a recent quote from a NSW Federal Senator, Sen. David Leijonhjelm (LDP, NSW):

“*One of the strangest insults regularly leveled at me is that, as a classical liberal, I am ideologically driven. Who knew that having a consistent, principled belief system — and representing a large chunk of the population in the process — would be viewed as grounds for fault? …. And because classical liberalism is an important part of the Western political tradition – it's what led Gough Whitlam to oppose conscription, Malcolm Fraser to oppose apartheid and Bob Hawke to support uranium mining and microeconomic reform – I thought at least other politicians and members of the Canberra press gallery would be aware that classical liberals don't exist just to make Labor see sense on economics and Liberals see sense on civil liberties. I anticipated having to explain my political views to the electorate. I see that as part of my job and I take it seriously. And I expected people – from both left and right – to disagree with me. But I did not expect to be criticised for being consistent.*

*My hassles are mostly a result of the fact that few of my colleagues and even fewer in the media have any experience of a parliamentarian who publicly subscribes to a consistent philosophical position. As I keep explaining, and many struggle to understand: if it's not harming anyone else, it's not the government's business, whether they approve or not. … Just because you don't like the idea of two women getting married or the bloke down the street having a well-stocked gun cabinet doesn't mean you should seize the levers of power and stop either or both from happening.”*

For the purposes of defining what “lower” means, in a tax review context, the point here is that, in the same way that there is a sharp kink in the demand curve for public goods, so too is there a disconnect in the jurisprudential basis for tax.

And – so knock me over with a cornstalk and call me Banjo Patterson – the jurisprudential disconnect occurs at about the same size of Government as the economic kink, that is, ***the tax take should be in the order of $200 billion, not $400 billion***.

(Another way to think about this politico-foundational kink, is to be very clear about the distinction between ***legal***, and ***compulsory***. Australia’s current, agreed Social Contract (i.e. Locke + Mill) states that it should be ***legal*** for the CEO of ACOSS to give her own money to people who, in her opinion, are needy and deserving recipients, provided that she has the consent of the recipients. It further states that it should be legal for her to give her own money to consenting adults, even if her opinion is wrong and it turns out that those adults are neither needy nor deserving. That is totally up to her. Australia is putatively a part of the Free World, and she should not ***need*** a reason to hand out her spondulics. Cool. But the burden of proof totally ***reverses*** when you shift from “legal” to “compulsory”. She’s entitled to her opinion, sure. ***But so is everybody else***. She may have a passionately held view that beggars should be given taxpayers money to help them out, but so what? She does not have the right to make her preference set, ***compulsory*** for everybody else. If everyone is going to insist that the things that they want get subsidised by everyone else, and to insist that the things that they don’t want get taxed or banned, well, **there is no general equilibrium solution that satisfies that societal preference set**).

There are two other alternatives, when you write tout Tax Green Paper, to a principles-based approach based on Locke and Mill – for a total of three possibilities.

**Please explicitly state in your Green Paper whether your Tax Recommendations regarding the appropriate size of the tax take are:**

1. **Based on Western liberal democratic political principles as articulated by Locke and Mill;**
2. **Principles-based, but those principles being other than Locke and Mill, and if so, please articulate what those alternative principles are; or**
3. **Chaotically and emotively arrived at, on the basis of whoever happened to have the numbers this week and who shouted the loudest.**

I’m not complaining. I’m just sayin’ - people are not telepathic. It would be very helpful for ***you to state***, and for ***taxpayers to know***, which of these three (additive, exhaustive, and mutually-exclusive) approaches you have adopted.

So - anyhow – these are just ***examples*** of principles-based underpinnings – although I would need to be convinced, that the examples I provide, are not correct.

***Foreword iii.10***

***Paradigm Instability – lower/higher***

One essential feature of the tax review that you did not state, that you need to state up front, is the **time horizon**. **Over how long a time period are any changes expected to persist in the future?** There is a mismatch in my view between Objective #1, viz, “Taxes should be lower”, on page (iii), on the one hand, and the political cycle, on the other.

In the period allotted for commentary on the Tax Discussion White Paper, the mosh pit has gone into overdrive on ***both sides*** of the “lower” question (i.e., “lower” ***and*** “higher”. The “higher” camp typically couch their arguments as requests to curb “tax expenditures”, although usually without any explicit analysis either of the implicit framing assumptions, or of the optimal size of the tax take). My concern is, that if a Right-of-Centre Government shoe-horns in a program of lower taxes for the next 30 years, in the absence of a coherent narrative that the electorate has bought into, and in the absence of tri-lateral buy-in from the Left-of-Centre Party and the Environment Party, well, in 3 short years time we will have ***another*** tax review and a program for ***higher*** taxes for the next 30 years. It is a nutcake way to do things.

**Please explicitly state in your Green Paper the time horizon over which you expect “lower” to pertain.**



***Foreword iii.11***

***Intertemporal Framing Instability and the Ratchet Effect***

One of the key points of this submission, is that intertemporal framing instability, in conjunction with an associated ratchet effect, is a major driver of ruinous complexity in the tax system and hence a major impediment to one of your three key stated objectives, “Simpler”.

**You need to explicitly state the extent to which you believe intertemporal framing instability is a threat to your goal of simplicity, and state how you propose to address it.**

Here is my statement of what it is, and three alternative suggestions for fixing it.

**Framing instability – what is it?**

There are two basic ways of framing fiscal issues – ***by exception, i.e., a “safety-net” model***, and ***by inclusion, i.e., a “universalist” model***. And the collective stance of Australia’s Commonwealth, on that question, is ***unstable***. That’s a very big problem!

Despite the long-term nature of policies such as Superannuation, in particular, Australia has a “turn-and-turn about” political system – left-wing for a few years, then right wing for a few years, *ad infinitum*.  They take turns. And in superannuation tax policy – but also in health (and health taxes and funding), education (and education taxes and funding), and welfare (and welfare taxes and funding), whatever – the Left of Centre Party and the Right of Centre Party have radically *different framing perspectives[[4]](#footnote-4)*. **The Right of Centre Party “believe”** (if that is not too strong a word) **in policy by exception.** In general, saving for people’s retirement (and paying for their medical and education and childcare bills etc) is just, like, so totally none of the Government’s business! *Trinoda necessitas!* But, sure, if some small subset of the population, through no fault of their own, is an ***exception***, and is in dire need well, you have a safety-net, paid for by taxing those able to help. Cool. **Labor, in contrast, “believe”** (if that is not too strong a word) **in policy by inclusion.** Universal super, a universal Medicare system, and universal State education, and so on, entirely paid for by the better-off, and enjoyed equally by both the better-off and the worse-off. (The logic goes, if I understand it aright, that only by forcing everyone, including people that don’t need Government help, into, say, the Government Super, or Health, or Education systems, will there be a society-wide incentive to ensure that those systems are of an acceptable standard for the indigent (i.e. given that everyone, including both the indigent and the non-indigent, are all forced to use those systems, themselves). I think it’s built on a lack of trust, that the safety net, under a safety net model, will be any good. Whatever).

These two diametrically different ideologies can easily result in exactly the same ostensible policy of course – for example, for a while there, students paid half the cost of a university education directly, personally, and the “taxpayers” paid the other half. The Right of Centre Party (OK, this is a bit of a caricature of what actually happened, but you get the idea) described this as “FEE-HELP” – their presupposition being that the ***students*** should pay it all via fees, but the Government was paying half and so – that was a “***HELP***” from the Government! But when the Left-of-Centre Party presided over the self-same system, they described it as “HECS” – a “Higher Education Contribution Scheme”. *Their* presupposition was, that the ***taxpayer*** should pay it all, but the students were paying half and so – that was a “***Contribution***” from the students!

Now – I get it that the long-suffering electorate are caught in an endless, pointless, Sisyphean arm-wrestle between putative Left and putative Right. Move over, Albert Camus. Every 5 years, the Left Party get in, and build a universal system and then, 5 years later, the Right Party get in, and dismantle it, and then Left Party get back in, and rebuild and then …. you get the idea. It keeps them amused, and it keeps them out of trouble.

And - it should be a simple build up – tear down, build up – tear down ***oscillation***. How hard can it be?

But it ain’t. There’s a strong tendency within the system to ***ratchet*** and to ***garble***.

This is very clear in healthcare for example. Up until 1983, there were public and private hospitals, and there was private health insurance. “Safety net”, by exception. Then it went universal (“inclusion”), and everyone got Medicare care, and those who earned higher incomes paid multiple times as much into the system, as those who, for whatever reason, earned lower incomes. And now (surprise!) it turns out that if you extend the system (health, super, whatever) from “safety net” to “universal”, it runs out of money. Then the Fairies-at-the-Bottom-of-the-Garden Party grab the balance of power, and insist on a reversal of the exemption to the rebate on the surcharge beyond the means-test – but only on Mondays and Wednesdays, only in NSW and WA, and with a carve-out for Wagga Wagga. And we are starting to get increasingly insistent nutcake comments from the then health minister such as:  *"We will take care of those that can't take care of themselves. But at the same time people on incomes like mine, or a reporter on $300,000 or $400,000 a year - should we expect to go to the doctor for free? That's a reasonable question to ask.”* And the same loopy deal from Maurice Newman, who was on the review board: *''It doesn't seem to me to be just that . . . if I go to the doctor, that my consultation should be free. I should of course make some sort of contribution to that,"* said Mr Newman, a former chairman of the ABC and the Australian Securities Exchange. And similar credulity-straining comments from the Federal Treasurer, with reference to his poverty-stricken electorate of North Sydney, and its purported egregious reliance on bulk-billing.  These three public figures, of course, are ***already*** paying a squillion into Medicare – it’s whatever 1.5% times what they earn or at least, what they get paid, is. They are ***already*** making “some kind of contribution”. Free? ***Dur!***

Now, if they’ve changed their mind, and want to change back from “universal” to “safety net” well cool – but the no-longer covered people now need to be able to ***drop out*** of paying any Medicare levy at all, because that levy was introduced in the first place, as a *quid quo pro* for the ***inclusion of all the payers***, in a ***universal*** system. It’s fair that higher earners should pay 10 times as much as lower earners, for ***identical*** “free” service. But it’s ***not*** fair, that they should pay 10 times as much as lower earners, for ***no*** “free” service. You are an idiot, if you think that it is “*of course*” true that that is fair. It should be a swinging pendulum. But – they are trying to pervert it, apparently with some success, to a ratchet! It’s a monstrous, chaotic hybrid of the inclusive and exceptive approaches to policy, and it comes with the pricetag of ruinous complexity costs.

So what about super? Well – health, education, super – it’s all the same dynamic. You totally need to decide, guys and gals, whether it’s safety net, **OR** universal. Policy by exception **OR** policy by inclusion. You created a *universal* SG system, forced everyone into it and now, you are complaining that the “*tax expense of the SG is greater than the cost of – the pension, or, <<insert mega-budget item of your choice>>*” and “*we need to go to a safety net model*”.

**Bar-room brawl**



The end result of all this is, that it’s me that’s the stakeholder, it’s me that has to fill in the Quarterly Activity Statements, it’s me that has to spend 40 minutes in my NIB branch trying to find out what one standard box in my standard personal tax return relating to my bog-standard health-insurance policy might imaginably mean, and here’s me, cowering behind the bar, aghast, as the furniture of the Tax Act is hurled vehemently back and forth between the hard-line right “safety-netters” of the centre-right-party, and the hard-line left “universalists”, of the centre-left party.

You smash up all the windows with this petty wrangling over inclusive vs safety-net, and then you complain about Complexity!



So much for the statement of the problem. I next offer Bar-Room Brawl Solution 1, Bar-Room Brawl Solution 2, and Bar-Room Brawl Solution 3. Solution 1 is the easiest to implement, Solution 2 is the most technically elegant, and Solution 3 is probably the best mix of pragmatic and worthwhile and effective.

**Bar-Room Brawl Solution 1: Keep doing what you’re doing.**

This appears to be the most likely outcome. It would be helpful if you could explicitly state:

* That you are proceeding on the basis of both the safety-net framework ***and*** the universalist framework simultaneously; and
* Whether or not you regard those two frameworks as ***mutually-exclusive*** and if not, why not.

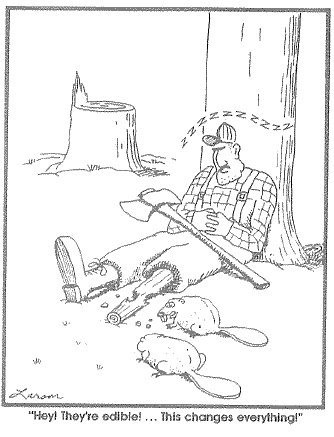
It would also help if you could lift the standard of the debate by requiring commentators to make an initial statement, prior to making tax comments, explicitly describing the framing assumptions in their statements, and linking those assumptions to their own manifestos. So – to illustrate - pick a comment at random – here’s one to hand from Kristina Kenneally:

“Morrison is right to attempt reform of the aged pension. 70% of people of retirement age receive a pension, meaning ***it has ceased to be a safety net and is simply a reward for getting old***. By 2017/18 the cost of the aged pension is expected to rise to over $50bn. Given our declining revenues, we can ill afford to keep handing out taxpayer money to those who can otherwise support themselves in their retirement years.”

That is an unacceptable, chick-logic contribution to the tax debate from a former NSW Labor Premier. Jesus, Mary and Joseph! You cannot simply don your “Hel-***looo***!” expression and state, with an air of pained and incredulous disapproval, that the objective of the system is to be a ***safety-net***.



If the Labor Party is abjuring the ***universalist*** model of the tax system that they have been foisting on Australia since the early 1970s, and are now embracing a ***safety-net*** model, well, this changes ***everything***!



But – who knew? They need to ***say so*** - ***explicitly***.

My key point here is, that Treasury could assist, by asking clarifying questions.

**Bar-Room Brawl Solution 2: Cross-sectional demarcation.**

This solution requires both major political parties to agree that, over the next 20 years, they will each spend about half the time in “power”. Under this solution, they both still go halvies. But instead of trying to run, say, both Health and Education on the basis of intertemporal framework instability, as heretofore, they take one each. Australia runs a fully-committed universalist Healthcare system for 20 years – ***everyone*** is eligible, and ***no*** beneficiaries are stigmatised as being “rich Australians, from whom it is reasonable to expect payment at the time of a visit to the doctor”. And Australia runs a safety-net Education system for 20 years. University fees are fully deregulated, it’s all privately funded and user pays, and there’s some kinda publically funded (out of general revenue) scholarship system for the poor and disadvantaged. The three big advantages are:

* You are not incessantly changing and mangling the rules. “Simpler” taxes, can be achieved;
* People don’t feel constantly cheated by the fact that the process they bought into, be that buy-in reluctant or enthusiastic, is about to be taken away from them; and
* The heat is on, in a “controlled experiment” sense. If universalist healthcare does not work, well, the universalists cannot blame the safety-netters for screwing it up, and they – the universalists – have a really big incentive, to ***make*** it work. And if safety-net education does not work, well, the safety-netters cannot blame the universalists for screwing it up, and they – the safety-netters – have a really big incentive, to make ***that*** work..

And so - for the first time, there is a non-zero chance that the system actually works. My intuition is, that ***either*** system would work better, than the undead twilight zone vacillation that Australia currently enjoys. At least we would not die, wondering.

The main disadvantage of this proposal though, is that the safety-netter politicians and the universalist politicians would never agree to share. They are ***little*** people. They do not have it in them, to share. They would both rather wreck the place, than get a rational answer. 

(That explains why the GST is such an archetypical abortion of a tax, by the way. Option A was to tax everything, and Option B was to tax nothing. But neither Howard nor Lees would accept “second best”. So – we get a GST on tampons but not on sunscreen. We get a GST on glace fruit but not on candied peel. We get a system that could not imaginably be worse, if we had set out to design the worst imaginable system. We get Option Z).

**Bar-Room Brawl Solution 3: Two-dimensional politics.**

There is a really good solution, and it boasts the major advantage that it delivers each of tax-system, economic, social ***and political*** dividends, ***from the get-go***. It’s a vote-winner! Plus, for the sceptical, you can try it incrementally, and only keep going when you see the immediate positive results.

I get it, that your average Member of Parliament needs to be thrown on his back every morning, by his mother, to get his shoes on. But it should still be within the bounds of human endeavour, to get them to count up to two dimensions (as required by this proposal) as opposed to one, as per current practice.

Conservatives have a sense of social conscience, and also the Labor movement resonates with the work ethic in – well – a “labour” sense. If the Conservative party augmented their hard heads with soft hearts – they would be super-electable! And if the Left-of-Centre Party augmented their soft hearts with hard heads – they would be super electable also!

And - either party could unilaterally start this tomorrow!

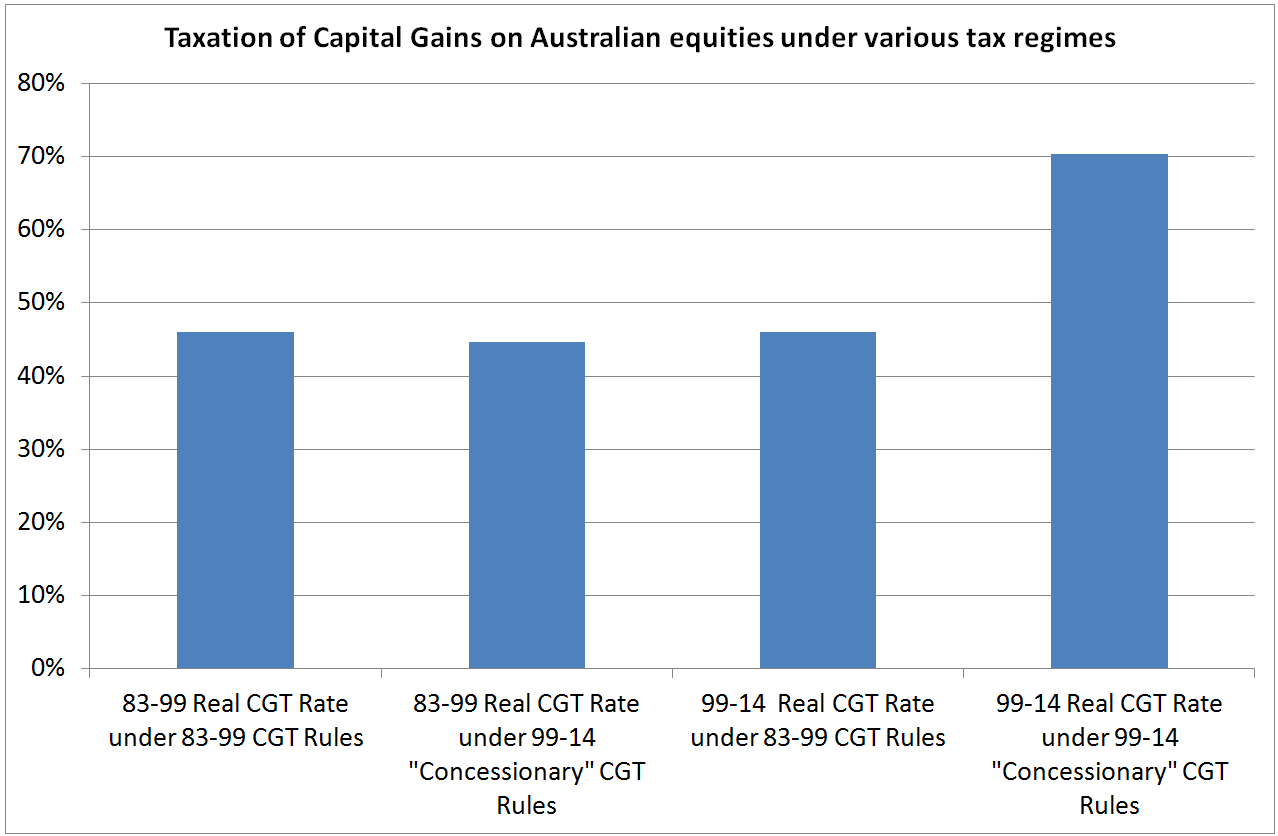
The key insight here is from former Finance Minister Lindsay Tanner, with his immortal line ***– “Why don’t we just try governing well, and see how that goes down with the focus groups?”***

***Foreword iii.12***

***Definitions II – Taxation specific***

**Please define key words like income, capital gains, lower, and “concessionary”, as in “concessionary capital gains tax”.**

Here’s my chart showing that halving the headline rate of CGT, but dropping inflation indexation, is only “concessionary” if the inflation rate is less than half the nominal increase in asset prices. And – that is almost tautologically untrue. Here’s the chart showing that the concessionary CGT rate is punitive:



***Foreword iii.13***

***Taxation pursuant to insurance schemes***

Taxation Objective # 17 relates **to the role of some taxes as constituting contributions pursuant to insurance schemes**. Health Insurance (Medicare) and the NDIS are examples.

The point of my comment about that, is that **the actuarial case for the NDIS Levy is very different to, and immensely stronger than, the actuarial case for the Medicare Levy**. Being catastrophically disabled is very low likelihood, very high impact, and very price ***in***elastic. So – there is very significant scope to create value via an insurance scheme that diversifies that risk. You can also make a reasonable case that such an NDIS insurance scheme should be universal and compulsory and Government sponsored – on the basis that compulsory universality addresses free-rider, adverse selection and moral hazard problems; and because it is consistent with a Rawlsian Veil of Ignorance.

In stark contrast, there is totally ***no*** actuarial case for a Medicare Levy, in any insurance sense. Having aches and pains, breaking a bone, needing spectacles, getting skin cancers lasered off, stitching up a hernia, sprogging a bub – welcome to the human condition! This is the sort of stuff that, statistically speaking, happens to ***every*** Australian, over the course of their life. There is ***no*** case for insurance there! Getting sick is very high likelihood, low impact and – via a host of effects – very price ***elastic***. And, in the case of Medicare, compulsory universality of coverage creates free-rider and moral hazard problems.

(Now - don’t get me wrong. I am passionately ***opposed*** to the NDIS, all things considered. When she laid out the “rationale” for an NDIS, in my opinion then Prime Minister Julia Gillard lied through her teeth. The path-dependency aspect totally sucks. ***From a principles-based insurance and public good perspective, however, the NDIS tax is a corker***).

***Foreword iii.14***

Still on the subject of taxation pursuant to insurance schemes, I wish to register my objection to the Queensland Flood Levy. The reasons for my objection are:

* Welcome to Australia. As Dorothea Mackellar famously expressed it, it’s a land of “droughts and flooding plains”. Taxpayers should ***not*** be paying private people’s private ongoing foreseeable costs.
* It’s a derelictly ad hoc, bolt-on method of deterring a central question for fiscal policy – the size of the tax take. You totally promised an holistic Re:think of the tax system. Makin’ it up as you go along, is not in the finest traditions of holisticness, of CGE, or of Arrow-Debreu.
* It discourages prudent insurance. On your own representation, you are supposed to be discouraging undesirable behaviour and encouraging desirable behaviour.

***Foreword iii.15***

There’s a mismatch between the CGE approach and recurrent claims that tax reform needs to be holistic, on the one hand, and the existence of the GST on the other. I’m happy with the Arrow-Debreu paradigm – prices are determined, not on a “cost-plus, plus GST” basis, but via Walrasian ***tatonnement***. I sell cattle in a Walrasian world for example – the Japanese in the Jap Ox market could not imaginably care less whether Australia has a GST of not! They can buy from, say, Chile! So – if prices are determined by tatonnement (which all your CGE work presupposes) well:

The GST is not even *necessary*, if you **just do the simple math.**

The GST says that I pay **10% of my pre-GST revenues in GST tax, but can claim 10% of my pre-GST costs back as a GST credit.** (And don’t even get me ***started*** on all the paperwork work that is done, and then undone, and then done again, and then undone again, and so on, through *every stage* of the production process).

The Corporate Tax rate of 30%, applied in a GST environment, says that **I pay 30% of (90% of my revenues minus 90% of my costs)** in Corporate Tax.

So well, dur! Do the math!

10% x (Revenues minus Costs) + 30% x (90% x (Revenues minus Costs)

= 10% x (Revenues minus Costs) + 27% x (Revenues minus Costs)

**= 37% x (Revenues minus Costs)!**

**You should just abolish the GST and change the Corporate Tax rate to 37%! It is the same!** And you get rid of a whole layer of tax, and a snowstorm of pink BAS forms

(So – let me tell you how easy I found it – not – to find out whether, if you graze cattle in Australia, and sell them to the local abattoir, and the abattoir exports the carcasses – whether there is a GST. The yellow Sun was rising dewy and fresh, like a golden guinea from the pearly Pacific over Bondi, luck was in the air, and there I was in the offices of an accountant, making a best-endeavours attempt to try to sort out my tax affairs. Is GST applicable? I unguardedly enquired. And - by the time this guy came back with a coherent answer the dusk was falling; the air-chill factor was rising; and the red ball of the Sun was plunging into the cold waters of the Indian Ocean over Exmouth.

***Foreword iii.16***

The GST is biased towards taxing discretionary goods and services and exempting essentials. This is the exact opposite of what standard economic theory prescribes (e.g. Frank P. Ramsey, **The Economic Journal**, Vol. 37 number 145, March 1927). On my estimates, if you levied the GST rationally (i.e. if you taxed essential items and exempted discretionary items, revenue neutral to the current tax take) you would save $1 billion a year in dead-weight losses. Under current arrangements, that is, the consumer is losing $1 billion a year, that the Government does not receive.



**Recommendation: Extend the GST to all goods and services, and compensate the poor and needy. This will both improve the average efficiency of the tax, and reduce complexity.** **Also – “do the math”. You should use your CGE model to obtain a more accurate estimate than my “$1 billion vaporized per annum”, and you should publicise that number.**

***The Psychology of Tax***

Not sure where this goes but – you need a whole ***section*** on the psychology of tax. Writing on the back of tax returns, where your money goes, was a great idea! And a good start! But – there’s sooo much more to do. If people don’t feel they are getting a reasonable deal, and if they feel that politicians keep lying to them, and if they lose trust – well, no amount of tax design will solve your problems. I can give you one hint for free though. You know how every two-bit industry is on the national teat getting industry assistance? And politicians are too lily-livered to take it away? Newsflash. These sharks do not appreciate you. They despise you. So – go read Arthur Hailey’s novel, ***Hotel*** – the bit where Warren Trent, the hotel owner, is talking to the guy who runs the bar in his hotel. The bartender has a sick child, and Mr Trent has been bankrolling the guy’s life, and his family, for years and years. Turns out that that bartender, is robbing the bar, blind …

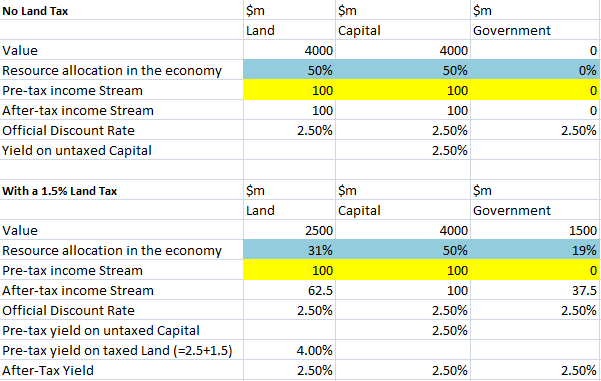
***Complexity***

One key driver of unwanted complexity is the fact that the incidence of the cost of the complexity, does not fall on the tax designers. If you make something “free”, demand inevitably skyrockets.

**Recommendation. Introduce a price signal, e.g., continue to require private sector companies to administer the collection of the GST, SGL, FBT, PAYG etc, but allow them to charge the Government for that administration on a cost-recovery basis. As an alternative, you could continue to require private sector companies to meet the costs of tax administration, but allow the Business Council, subject to revenue neutrality, to design the taxes. Either way, complexity would magically evaporate.**

***Miscellaneous Questions***

* How come, in Sydney, we can’t have a road toll on Park St (where you don’t want the traffic to go) and we have to have a road toll on the Cross City Tunnel (where we do want the traffic to go). Any rational tax system would tax what you don’t want and subsidise what you do want, and Sydney does the opposite. The story goes, that that would be politically unacceptable – but, that can’t be true either. Because there is a congestion tax on the Sydney Harbour Bridge only 2 short miles north – a.k.a. “time of day tolling”.
* In the context of whether “wealthy retirees should be paying for their own retirement” – have you done any analysis of the simultaneity bias in that? Is it being rich, that allows people to save? Or is it the saving, that makes people rich? Can you state your beliefs on that topic? There are big implications for how you tax people – if it’s the saving that makes people rich, then you do not, in a Walrasian sense, want to discourage that.
* In the context of compulsory superannuation levy - you’re asking me to believe that Janet and John Suburbia are so myopic and stupid and disorganized, that they are incapable of saving for their own retirements and need a paternalistic Government to take 9.5% of their money every week and to warehouse it for them, like kindergarten childers getting some of their pocket money held back and put away for their futures by fussing parents; and also that they (“they”, Janet and John Suburbia) are simultaneously so far-sighted and intelligent and well-versed in governance issues, that they can be trusted to elect the Government? I’m prepared to believe either, but not both. In combination, those two narratives beggar belief.
* There’s a Corruption and Integrity issue with the taxing of aircraft noise. You sold a public asset (the right to pollute the suburban skies), at less than market rates, and without going to tender. It was a total sweetheart deal, between you know who, and you know who else, although the latter party is dead, now. You should have given the residents an opportunity to tender and created some price tension. Coase’s Theorem, applies.
* How come, if I’m a company, I can subtract my costs from my revenues before I pay tax and I pay tax on my Net Profit; but, as a PAYE worker, I have to pay tax on my revenue line, not my profit line. Going to work every day, uses up a lot of my valuable time. I should be able to deduct the cost of that, before I pay personal income tax. There are a whole load of implications of you doing that incorrectly, that keep popping up all over the Tax Discussion White paper. The progressivity of the tax on labour income flies in the face of the marginal cost to the worker. First up, you’re looking for something to do. By hour #60, you’re looking for an excuse to head to the beach, regardless of the tax system. And lying on the beach, is tax free. It is the wrong way round.
* We need truth in labeling, in Tax. For example, you levied a “Budget Repair Levy”, and the Budget steadily deteriorated. If a mechanic took your car, and charged a repair fee, and made your car worse, you would so totally get a refund. Why aren’t you refunding the Budget Repair Levy?
* Isn’t there something dodgy with the concept that a Land Tax is an efficient tax because it does not move? Surely – the Land ***moves*** when you tax it – in the sense that, a significant chunk of its value, ***vaporises i***nto thin air. Here’s the math. Resource allocation is significantly impacted by a land tax – see the blue lines. It is a fallacy, to say that land is immobile.



***NDIS***

And – finally – I really want to object to the NDIS. The Australian Federal Government’s proposal when that was proposed was that given (a) the desirability of a National Disability Insurance Scheme for the disabled and (b) a burgeoning Budget Deficit, the scheme be introduced anyway, and a 0.5% surcharge be added to the Medicare levy to fund it. The then Prime Minister, Julia Gillard commented on this proposal by stating that *"I think it is fair to say to Australians that you will be asked for a little bit more in order to fund something that we all benefit from."* My view is that the Prime Minister’s comments were fraudulent, and that the NDIS scheme is the scam from scamsville.

We’ve seen it a million times. It’s a pea-and-thimble trick. **Step 1**, a Government imposes and levies a quantum of taxes of the community, appropriate and adequate to the funding of the community’s needs and wants. **Step 2**, the Government wastes vast swathes of that revenue on low-priority indulgences, whilst completely neglecting the essentials that we thought we were paying the taxes for in the first place. **Step 3**, the Prime Minister wakes up one sunny morning with a surprised expression on their face, they re-shape that to an expression of deep concern, they invoke some absolutely “must-have” desideratum, which everyone had always assumed was always the core part of your job in the first place, and they then make disingenuous and vacuous statements such as "*I think it is fair to say to Australians that you will be asked for a little bit more in order to fund something that we all benefit from.*" My local Council does it all the time. They spent millions upon millions of rated dollars on upgrading a golf-course for wealthy businesspeople, and on exercise centres, and on aquatic centres, and on high-tech apps for the library, and on a “National Tree Day” and so on. Then they “discovered” that they hadn’t spent any money on the roads, and that the roads were falling apart. It’s third world around here. And – predictably enough – the rhetoric then flows, along the lines of: *“Surely we have a* ***responsibility*** *to future generations to leave the local road network in as good a condition as we inherited it from out forebears? Surely you don’t want to rip off your* ***grandchildren*** *do you? I think it is fair to say to ratepayers that you will be asked for a little bit more in order to fund something that your grandchildren will benefit from."* And then they have the hide to apply to the State Government, successfully, to be allowed to impose an additional “infrastructure levy” to “pay for the roads”.   
  
Julia Gillard was spending, like, $12 billion on “people who have kids” – the Family Benefit Payment? I get it that it is tough having kids. But, unlike being disabled, it is voluntary, and – whilst the teenage years may seem endless – they pass eventually, say by age 32. It is not a life sentence. My view would be that you should take the $12 billion you are currently giving to people whose “lives have been blighted by having kids”, and you give it instead to people whose lives have been impacted by being disabled. It’s called prioritization. That’s what a budget, and a “budget constraint” as described in Economics 101, is – a prioritization of competing needs and wants. The reason it is not “fair”, but ridiculous, to *“ask for a little bit more in order to fund something that we all benefit from”* is that the number of possible proposals “that we could all benefit from”, is an infinite set.

***Appendix I - Summary of Key Points***

You need demarcation on what Objectives are targetted by Tax, and which aren’t.

Notions of Libertarian Paternalism are absolutely central to vast swathes of the Australian taxation system, and I am amazed that you did not explicitly mention it in your Discussion Paper.

Tax is a tool, not a set of agent Preferences.

You need to articulate national trade-off functions.

Duality is so important, in designing a tax system! And you don’t use it!

Your definition of tax is wrong.

You need to draw an “EAT Diagram” (it stands, not only for what the ATO does to your paycheque, but also for “Expenditure Aware Taxation”).

A central tenet of the Western legal framework, is that law and order is gatable.

I really object to the chart on page 79. It is not obvious to me why the orange rectangle is bigger than the blue triangle – which appears to be the Gruens' key point.

Working out what the optimal size of Government should be, from first principles, and evidencing your view, cannot be rocket surgery.

Despite not having a strong prior on the size of Government, I only have to eyeball the public expenditure profile, and to think about it for 2 minutes, to deduce that the Government is about twice as big as it should be.

One of the key points of this submission, is that intertemporal framing instability, in conjunction with an associated ratchet effect, is a major driver of ruinous complexity in the tax system and hence a major impediment to one of your three key stated objectives, “Simpler”.

The actuarial case for the NDIS Levy is very different to, and immensely stronger than, the actuarial case for the Medicare Levy.

There’s a mismatch between the CGE approach and recurrent claims that tax reform needs to be holistic, on the one hand, and the existence of the GST on the other. You should just abolish the GST and change the Corporate Tax rate to 37%! It is the same!

Going to work every day, uses up a lot of my valuable time. I should be able to deduct the cost of that, before I pay personal income tax.

Resource allocation is significantly impacted by a land tax.

***Appendix II - Summary of Recommendations***

**Recommendation: In the Green paper, you should state all of the objectives of tax, together, coherently, on one page, somewhere in the first few pages.**

**Your Green Paper needs to explain and substantiate which objectives of the tax system are being targetted by which instruments, and why, and in particular which of your 37 objectives are being targetted by each of:**

* **Compositional decisions on the Revenue side of the Budget;**
* **Compositional decisions on the Expenditure side of the Budget;**
* **Compositional decisions about each of the Revenue and the Expenditure sides of the Budget; and**
* **Decisions about the size of Government Revenue.**

**In your Green Paper, you should identify which taxes, whilst apparently trivial in terms of money raised, are playing crucial roles in supporting the integrity of the tax system as a whole; and which, are merely adding to complexity for minimal revenue impact.**

**The Green Paper should state which of the 37 Objectives of the Tax System are non-orthogonal, and spell out proposed societal trade-off functions for national approval.**

**Please explicitly state in your Green Paper whether a solution exists, given the tax instruments at your disposal and the objectives you state in the paper.**

**Please state in your Green Paper how many total objectives the tax system has, and how many total instruments you have, and - rough order of magnitude - how collinear they are. And please state how many independent objectives the tax system has, and how many independent instruments you have.**

**Please state in your Green Paper your dollar estimate of the cost of compulsion in the tax system.**

**Please explicitly state in your Green Paper whether your Tax Recommendations regarding the appropriate size of the tax take are:**

**1. Based on Western liberal democratic political principles as articulated by Locke and Mill;**

**2. Principles-based, but those principles being other than Locke and Mill, and if so, please articulate what those alternative principles are; or**

**3. Chaotically and emotively arrived at, on the basis of whoever happened to have the numbers this week and who shouted the loudest.**

**Please explicitly state in your Green Paper the time horizon over which you expect “lower” to pertain.**

**You need to explicitly state the extent to which you believe intertemporal framing instability is a threat to your goal of simplicity, and state how you propose to address it.**

**Please define key words like income, capital gains, lower, and “concessionary”, as in “concessionary capital gains tax”.**

**Recommendation: Extend the GST to all goods and services, and compensate the poor and needy. This will both improve the average efficiency of the tax, and reduce complexity.** **Also – “do the math”. You should use your CGE model to obtain a more accurate estimate than my “$1 billion vaporized per annum”, and you should publicise that number.**

**Recommendation: Introduce a price signal on complexity, e.g., continue to require private sector companies to administer the collection of the GST, SGL, FBT, PAYG etc, but allow them to charge the Government for that administration on a cost-recovery basis. As an alternative, you could continue to require private sector companies to meet the costs of tax administration, but allow the Business Council, subject to revenue neutrality, to design the taxes. Either way, complexity would magically evaporate.**

1. “Cassandra Goldie, chief executive of the Australian Council of Social Service, said she hoped the Abbott government would not use GST reform as a quick-fix way to boost revenue. She agreed GST reform should be up for discussion, but she said it was still a regressive tax and that would hit the poorest the hardest if it was increased. She said supporters of a GST increase will say "that all you need to do is compensate people on the lowest incomes" if it is raised, but they fail to understand "the realities of politics" and what happens over time, saying low income households will rarely be fairly compensated.” [↑](#footnote-ref-1)
2. “A Contribution to the Theory of Taxation”, Frank P. Ramsey, **The Economic Journal**, Vol. 37 number 145, March 1927 [↑](#footnote-ref-2)
3. The first 50% divides the $400 billion Federal Budget into Characteristic List 1 and Characteristic list 2 components. The second 50% recognises the fact that half the people actually want this stuff anyway. Sure, that half may be unhappy that the ***Government*** deployed that money – for example charity and welfare and education and health dollars - rather than allowing the citizens to do it for themselves. Those people have a legitimate grievance. But from an economic perspective these are second order effects. They broadly got what they wanted, so they can just suck it up on the compulsion aspect, for the purposes of this calculation. It’s the Australians who have to spend $100 billion on stuff that they simply ***don’t value at all***, who should be completely and totally pissed off. [↑](#footnote-ref-3)
4. Notwithstanding the proximity of both to the centre, arising from Hotelling’s Theorem regarding central tendency. [↑](#footnote-ref-4)