

FRIDAY 29 MAY 2015

RE: THINK TAX DISCUSSION PAPER MARCH 2015....ECINYA'S SUBMISSION

From Ecinya Consultants Pty Limited
Level 16/ 20 Hunter Street Sydney 2000
Managing Director: George Sutton B.Ec, ACA, FFin
Phone: 0417 066 207/ 02 8023 4033

ECINYA

ECINYA is an acronym for 'Exercise Caution IN Your Affairs' . For the past 13 years Ecinya has operated as a licensed Investment Adviser. George Sutton is the Managing Director. George has been a former lecturer at The Securities Institute, a corporate Finance Executive with two major investment banks, a rated analyst with BZW and then Managing Director of James Capel Australia, now HSBC Securities. His major interests are politics, economics, the stock market and golf, each of which require study, technique, discipline, patience, and a sense of humour.

PREAMBLE

This contribution to the debate about ideas surrounding the omnipresent tax debate is meant to be substantially holistic but within that narrative provide some basic and relatively simple recommendations. Tax is the biggest thing that governments do and despite the sustained muddled headed approach it has all worked out in the end and we have sound economies in many parts of the world, including Australia, despite the alleged incompetence of political and government imbroglios. Our recommendations of themselves will NOT fill the budget gap, but they could provide a beginning that could then benefit from the increased tax revenue streams that come from a return to trend economic growth in nominal terms.

Willie Sutton the famous American bank robber was once asked "Why do you rob banks?" His reply was "Because that's where the money is". Governments are much like Willie, when they see a boom they like to tax it, milk it to a point where the cow dies of malnutrition. Mr Swan attempted this with his mining and carbon taxes. The current parliament is looking at superannuation with a gleam in its eye, and the larger state governments are rejoicing in a housing boom underwritten by global central bankers attempting to overcome a lethargic global economy and wilful spending by governments seeking re-election on a regular basis.

To talk about economics requires more and more, that one write about politics. (Paul Krugman "The Great Unravelling" 2003.)

Opportunities, challenges and problems can be described as secular, structural or cyclical. Today secular embraces demographics, structural the role that government plays in clogging the economic system, cyclical the current iron ore and coal prices.

Governments have a history of applying band-aids to policy solutions that over time fall off the wound exposing it to obvious infection, sometimes of a terminal nature. In the end the Treasury of last resort is the taxpayer. Generally speaking if any solution does not make good common sense, it hardly ever makes good economic sense. We can have a good news taxing solution but it does require more than glib sound- bytes to sell it. The reality of modern free enterprise economies is that all taxes impact on the prices of assets, goods and services. The other fundamental of importance is, of course, employment.

The document (Re: Think etc) we are asked to respond to is excellent in parts, superficial and questionable in others and embraces self-serving language in abundance. Easily observable is the emphasis on international comparisons of dubious significance and merit (e.g. Norway?), plus a pre-occupation with the concept of 'fairness'. Obviously, Treasury were not the final authors as a consistently high level of reality and maturity seems to not be in evidence. How much bang you get for your taxation buck is different in different countries (idle desalination plants, forgotten?); how is taxable income calculated in different countries; what is the attitude to taxation, is it different than say Greece; some countries have historical and natural advantages that others do not; government waste varies from country to country; GDP is rubbery in many respects, for example there is no adjustment for increases in leverage, especially government leverage; proximity to markets; per capita statistics overlooked; inflation is measured imperfectly; market size etc

Ecinya fully recognises that our policy recommendations require appropriate modelling which we are not in a position to do, but Treasury under proper instruction have the skills and personnel to get it right IF they consult with the right people operating in the real world outside of Canberra.

Note: We have not commented on negative gearing or dividend imputation which on balance we believe should NOT be changed or modified at this point in time and circumstance. We have some reservations about dividend imputation but believe the cure being proposed by some is worse than the alleged problem. Adoption of the major Ecinya recommendation 8 on capital gains(subject to modelling) should assist in alleviating housing shortages which have been filled by private investors for many years.

RECOMMENDATIONS and COMMENTARY

<p>Recommendation 1: Australia should move to a 5 year Federal parliamentary term with a minimum term of 4 years.</p>
--

Commentary: Taxation moneys well spent create vast and worthwhile community infrastructure and social assets, and taxation is central to good government. However, the frequency of elections means that nothing works as well as it should for as long as it could. Australia is an extremely talented and lucky country with abundant human and natural resources. Our potential will never be fully realised if we seek to change direction dramatically every three years because political expediency and striving for points of difference over-take common sense policy continuity. The economic and political cycles have become destructively disengaged at a time when economics and politics are more engaged than ever. Policies take time to work in a globalised world of shifting

trade and political alliances and often need to be fine-tuned over several parliamentary terms. Good policy badly executed results in poor outcomes. Bad policy well executed or badly executed results in even poorer outcomes.

Recommendation 2: Impose a Federal 5% GST on everything including food and education collected concurrently with States GST.

Commentary: To facilitate abolition of some obsolete taxes and reduction in other taxes and to bypass states where consensus on any sensible reform appears remote or unlikely to be achieved in a satisfactory time-frame. Our back of the envelope calculations suggest that \$50 billion would be raised in this way which would, naturally, be offset by some pension changes and low-end welfare transfer payments. Once again appropriate modelling is required.

Recommendation 3: Reduce personal tax scales and possibly company tax to facilitate abolition of taxes such as payroll tax and numerous other taxes identified in the Henry Report (weight 5 kilograms).

Commentary: We fully realise that payroll tax is a state tax but direct grants can replace revenue foregone. We have a 1991 paper available on payroll tax if required. Fringe benefits tax seems counter-productive. Our best guess is that a top marginal rate of 30% seems sensible with an interim scale rate of 20% and a re-visit of the tax-free threshold.

Recommendation 4: Tax benefits for Superannuation Funds should be dependent on maintaining an appropriate ratio of 'approved assets'.

Commentary: This is a partial throw-back to the old 30/20 rule and would enable the budget to be repaired as approved infrastructure funds as an example would supplement government expenditures. Suggestion is start at 5% and move to 10% over the following 5 years. Take note that the Federal budget is not a profit and loss account it is simply a cash flow statement.

Recommendation 5: Create an Electoral Bank to make election funding more accountable, transparent, effective and efficient, and consonant with the concept of democracy.

Commentary: An imperfect Ecinya paper on the subject is attached. Without the 'big end of town' there would probably be no town at all, without trade unions we all might still be working in sweat shops for \$2 each day. It is clear though that each of these constituents have a disproportionate say in how the country is governed, though their contributions are vital and necessary. If any lobby wants a direct say then they must disclose it rather than do it undercover of a political party to accrue post-election benefits.

Recommendation 6: Remove the word 'fairness' from the debate.

Commentary: Language is important in selling policy frameworks and 'fairness' is a rubbery concept in policy-making and execution. (Extract from "The Road to Serfdom" by F.A. Hayek attached). Additionally, Don Watson in his 2003 book "Death Sentence: The Decay of Public Language" had this to say: It is something else, however, when journalists ignore abuses of the public language by people of influence and power, and reproduce without comment words that are intended to deceive and manipulate. When this happens journalism ceases to be journalism and becomes a kind of propaganda; or a reflection of what Simone Weil called 'the superb indifference that the powerful have for the weak'.

Recommendation 7: Senate electoral reform, a major structural problem.

Commentary: Clearly the system is broken. Perhaps apart from the preference result, a 10% primary vote should apply, or 'first past the post', or optional preferential voting.

Recommendation 8: Treat capital gains as ordinary income on a sliding scale.

Commentary: Velocity is important in a dynamic economy. Too many assets are locked up because of capital gains tax. An asset held for under 3 years could be fully taxable and then a sliding proportion of the gain is taxable over the next 7 years with tax-free status achieved at say year 10. This should help to relieve the housing shortages in some markets.

Recommendation 9: Replace the paid parental leave scheme with a rebate or tax deduction for the remaining earner.

Commentary: A direct payment through the tax system might be required for single parents. The Liberal Party admonished Labor for lack of cost benefit analysis yet we cannot remember seeing any such analysis on this subject from either party.

Recommendation 11: Produce a White paper review on the cost of government in Australia.

Commentary: A lot of taxpayers do not believe they are getting value for money. Parliamentary salaries seem somewhat low and the fringe benefit offsets seem somewhat high. The last two Federal budgets might have been better received if a prominent policy was a 5% reduction in parliamentary costs and a couple of ministers had not been caught 'double-dipping'.

Recommendation 12: Change industrial laws to facilitate manufacturing especially import replacement.

Commentary: A nation of importers will create more jobs abroad than at home. It is impossible to be pro-jobs and anti-business. Australia is excessively focused on exports. We should have an import replacement policy as well. In fact we have gone backwards and even reversed many of the Keating work-place reforms. Small business, for purposes of the wrongful dismissal laws needs to be re-defined to something like at least 50 to 100 workers. The employment safety nets seem excessive – base pay+ compulsory superannuation+ workers compensation insurance+ payroll tax+ long service leave+ overtime in a 24/7 world+ parental leave+ legal compliance costs for rightful dismissal. Youth unemployment is a major problem for Australian and global governments, and we wonder why youth lives without hope and turn to drugs rather than seeking the material and psychological sustenance that an enjoyable occupation provides.

Recommendation 13: Welfare and retirement reform to be looked at together. No person to be entitled to an age pension unless they or their family unit have had a tax file number for say 30 years.

Commentary: Australia is a wonderful country where a lot of people of working age and capacity don't feel the need to work for their living. Obviously the genuinely disadvantaged must be helped.

Recommendation 14: Amalgamate some local councils.

Commentary: To reduce inefficiency and corruption as council rates and charges are a tax, and costly delays are a tax on progress.

Recommendation 15: Improve government accounting standards.

Commentary: Obfuscation is rampant and many documents appear to be designed not to be read. Volume overtakes quality and clarity.

Recommendation 16: Require banks to pay adequate interest rates on all deposits over a certain sum e.g. \$2000. Examine credit card rates.

Commentary: Because the banks are large taxpayers and large providers of franked credits they have become an arm of government. The interest rate might be a fixed or flexible percentage of the RBA funds rate. Banks have too much free money from people who can ill afford to lend interest free. Lower bank profits will reduce dividends and hence imputation refunds.

.....

COROLLARY AND CONTEXT TO THE ABOVE

In 2005 Ian Macfarlane, Governor of the Reserve Bank said –

The principal contribution that monetary policy can make to economic well-being is to maintain low and stable inflation. I think it is true to say that if you wished to forecast the path of the Australian economy, and you were able to have fore-knowledge of only one economic variable, the one you would choose would be the path of the world economy. That is not to say that we have no influence over our own destiny – we can make the situation better or worse than it would otherwise be – but we cannot escape the influence of the world business cycle and the other factors that feed off it.

Australia is about 1.5% of world GDP and about 0.03% of the world's population. This results in a high per capita GDP putting us within the top 10 countries.

It is relatively easy to say that there are four systems of government – capitalism, socialism, communism, and totalitarianism. Ecinya is of the belief that what we need for Australia is BALANCED FREE ENTERPRISE and we have been banging this drum for a very long time. Today, in developed economies we have governments in all of its various forms (federal, state, municipal) running at somewhere between 20 and 30% of the economy, squeezing the private sector. The capitalism vs socialism debate is not worth having for neither exists in abundance in the developed world, nor even in most parts of the emerging world.

Balanced free enterprise means that there is a valid and useful role for government including the provision of social and commercial infrastructure that provide appropriate community solutions. The genuinely disadvantaged have to be helped. Government is essentially an agency function where taxpayer's money comes back to them via constructive government initiatives in education, health, infrastructure, security, law and order etc. Our editor's recollection of the best years of government in Australia have been the Menzies era, the Hawke-Keating-Walsh years and the Howard-Costello years. The worst years have been Whitlam, Fraser, and then the disastrous Rudd-Gillard-Greens era.

GDP BEING DRIVEN BY TOO MUCH 'G'

It seems perfectly clear to us that Gross Domestic Product (GDP) is being driven by too much "G"..... an excess of Government which is 'crowding out' the private sector. Small business resides in the middle class where most of the employment is created so that when you crowd out the private sector you crowd out the aspirational middle class. The result is simple – less velocity in the economy, less income growth, less economic growth, less employment growth.

The simple equation for GDP is -

- $GDP = C + I + G + \text{Net Exports}$

GDP is the total market value of all final goods and services produced in a country in a given year, equal to total consumer (C), total investment (I) and government spending (G), plus the value of exports less the value of imports (Net Exports). GDP is adjusted for inflation using one of several inflation measures. In America it is the Implicit Price Deflator.

Over short periods the GDP numbers can be a bit rubbery, but in the longer-term they are reliable enough and when supported by other anecdotal and hard evidence, we can generally say the GDP is rising or falling at a near-enough-to-accurate rate. GDP growth is important because it is the source of company profits and company profits play a part in stock-market advances and hence national wealth. Healthy growth in GDP usually means healthy profit growth, but if GDP is expected to fall then expectations take over and the forward estimates for profits and GDP influence share market outcomes. Perceptions of sustainable periods of economic growth lead to higher share prices. Such perceptions are called 'confidence'.

Looking at world economic growth numbers from the IMF we see that world economic growth in the period 1992 to 2001 averaged 3.2%, and in the 8 years from 2002 averaged 3.6% but inclusive of a global recession of 0.6% in 2009. The peak years for growth over the last decade were 2006 and 2007 when GDP growth averaged 5.25%. In broad terms a 1% fall in GDP is akin to taking out of world growth about US\$700 billion, about 75% of the entire Australian economy in purchasing power parity terms.

Another way of looking at it is, if the world economy grows at 3% per annum then it doubles about every 24 years, and at 4% per annum it doubles about every 18 years, a sizable difference.

Australia is a Federation of States and numbers are not available to us on a basis that consolidates the states and the Commonwealth, but numbers were given in a Ken Henry speech of 30 November 2009 that indicate that Government has become too large in Australia relative to the sum total of GDP. Because Government is funded by taxation, it is not being over-simplistic to state the following

-

- more taxation = more government
- more government = less consumption due to less disposable income
- less consumption = less production
- less production + more imports = lower GDP growth

WHAT DOES THIS MEAN?

One of the great difficulties in the standard GDP formulation is that governments can increase their expenditures not only via increased taxation, but by increasing their debt. However, a couple of things result from this approach. Firstly, you have to pay interest on the debt and secondly at some future time you have to repay the debt. Ultimately, greater borrowings means that you have to have more income to repay debt and principal and/ or sell trophy assets (e.g Arnotts Biscuits, Speedo, Petersville Foods, and, almost, GrainCorp).

For government the only source of income is taxation as all of their other services generally lose money. Higher taxation causes big businesses to want to pay less tax (by moving their tax base offshore, by transfer payments, by exploiting double tax agreements), or to reduce their costs of production. The easiest way for BIG companies to reduce their costs of production is to produce in lower cost countries. This means lower growth at home, less jobs, and over time can impact on the ability of a country to repay its debts in a timely manner. Then a debt downgrade results and a vicious circle begins. These processes take a long time to evolve and sometimes having evolved, take a long time to become a recognisable problem such as in Greece, Spain, Iceland, Italy, Portugal, Ireland, England, America etc.

However, there is no universal qualitative measure of GDP. For instance if the C...Consumption.. is debt funded/ leveraged then the quality is potentially diminished. If the G... Government... is debt funded/ leveraged then the quality is even more diminished because the empirical evidence is that governments misallocate resources (waste) on a regular and recurring basis. One wonders whether GDP should be adjusted each year by subtracting the net increase in private and/ or public debt from the equation.

Back in October 1985 **Peter Drucker** had this to say -

I think, there has been an irrevocable shift in the last ten years. No matter who is in government, he would no longer believe in big government and would preach cutting expenses and would end up doing nothing about it. This is because we, the American people, are at that interesting point where we are all in favor of cutting the deficit – at somebody's else's expense. It's a very typical stage in alcoholism, you know, where you know you have to stop – tomorrow.

It is now apparent that Mr Drucker was an incorrigible optimist because the rhetoric that has come from the Blair, Bush, Obama, Hollande, Rudd-Gillard-Greens governments is not anything about small government at all. The universal mantra is "Markets have failed. When markets fail, governments have to "step in". This is despite the fact that it was government inefficiency, poor policy formulations, and lack of oversight that caused the markets to fail in the first place. The failure of national governments over the past two or three decades to follow simple economic rules is now reflected in the structural and systemic problems that now need to be overcome. Quantitative Easing (QE) seems more like a band-aid than a lasting solution. Most probably, the hole is so deep that only a unified plan will shift the role of government back to the centre. Qianlong in his Qing Dynasty proclamation of 1645 is speaking from the grave.

The Way of Heaven is profound and mysterious and the way of mankind is difficult. Only if we make a profound and unified plan to follow the doctrines of the centre, can we rule the country well.

This SECTION relates to Recommendation 5.

Crony capitalism : Capitalism's cancer. Crony socialism : Socialism's endemic malady

PROLOGUE

America is a profound example of human progress for some and a source of disappointment for others. America is regarded by its fevered supports as a beacon of light driven by capitalism. For most of the past 20 years or so there has not been all that much 'capitalism' in America. Indeed, we find that to debate 'capitalism' and 'socialism' is altogether a frivolous and ill-directed argument in itself. We believe that the developed economies are best described as 'free enterprise' and this can be either 'unbalanced' or 'balanced'. In America, Australia and Britain the cumulative imbalances have led to 'unbalanced' being the dominant conclusion..

'Unbalanced' behaviours precedes disequilibrium (the imbalances become structural) which leads to political, economic, and social volatility.

In our view an ELECTORAL BANK along the lines suggested in our Insight essay of 11 August 2009 would do much to make free enterprise more balanced, more productive and the voters and their beneficiaries more prosperous. Electoral funding reform would, in our view, assist politicians to begin to regain their electoral integrity and result in better economic management outcomes.

THE ESSAY first published 11 August 2009

'Crony': A friend or companion

Collins Dictionary

It is a mixture of money and politics that Australians have become accustomed to over the last decade. But this culture of paying for access has become increasingly problematic in recent weeks as lobbying scandals make headlines nationwide.....

Dick Warburton, a former Reserve Bank director and prominent company director, has had enough. He is scathing about the fund-raising culture that has developed in Australia. The former chairman of David Jones and Caltex says "it has become a racket".....

Warburton, as an elder statesman pulling back from corporate life, can be frank. For most others it would be a poor business decision to speak out against a system that both major parties rely on to fill their election coffers.....

"Access can now be purchased, patronage is dispensed, mates and supporters are appointed and retired politicians exploit their connections to obtain 'success fees' for deals between business and government," Fitzgerald told an audience in Brisbane last month.

Australian Financial Review 8/8/2009 "Democracy For Sale."

With Labor governments mired in cronyism as established fact all up and down the eastern seaboard, the emerging irony is this: it may yet be the Liberal Party that emerges to save what reputation for decency these shabby outfits have left.

The man most likely to restore Labor's moral compass at both the state and federal level is Michael Ronaldson. Ronaldson is well known in Victoria, but less so outside that state. He was Malcolm Turnbull's numbers man against Brendan Nelson. He remains part of the Opposition Leader's inner coterie. Which means he'll be a busy man this week.

He's survived cancer and still smokes. That makes him a mug when it comes to his health and I've told him so. But he's no political mug. A direct talker in the Australian tradition, he's known almost universally on both sides of politics as "Ronno". He's determined; when cancer felled him he was forced to retire from his seat of Ballarat. That was in 2001. He came back to Canberra via the Senate in 2005.

And he knows a crooked system when he sees one.

The "crooked system" I refer to is campaign financing. And as it turns out, as shadow special minister of state, it's the system Ronaldson has responsibility for. When Labor's moral warhorse John Faulkner asked for and was given the Special Minister of State portfolio by Kevin Rudd after Labor's 2007 election victory, he was on a mission to clean up political funding in Australia.

Because, like Ronaldson, Faulkner recognises that all those rent seekers in suits, sitting sleekly around the likes of Joe Tripodi in Jordan's Seafood Restaurant outside the ALP conference at Darling Harbour a fortnight ago, are bad news for the democratic process.

Glenn Milne writing in The Australian 10/8/2009

ECINYA TEXT

ECINYA has long believed that Australia had the opportunity to adopt the best of Britain and the best that America has to offer. Though we are fighting the 'good fight' and generally winning, the opportunity to adopt the worst of both of these countries' cultures is alive and well. One of Ecinya's enduring obsessions is that the 3 year Federal parliamentary term leads to poor policy formulation and, too often, poor execution. The daily battle between scarce resources and unlimited wants and needs in context of tight political deadlines all too often leads to poor outcomes. The formal expression of this is 'misallocation of resources.' In a parliament as dysfunctional as our current parliament, with a Prime Minister full of bellicose bluster sprouting economic hog-wash in local and global forums and writing convoluted essays, the problem of misallocation of resources looms as potential policy failure.

Towards a solution

Crony capitalism is one of the factors that has brought the United States of America to its economic knees. We should be consciously aware of the American model.

The recent debate surrounding alco-pops demonstrates the dilemma faced by politicians. We assume the alcohol, pubs, gaming industry are keen supporters of democracy and offending them might be dangerous for many, although we doubt that sports sponsorship leads to binge drinking, except for the highly paid sports stars themselves, and that might be a function of their income rather than advertising sponsorship. The recent revelations of connected and vested interests in Queensland is but another example of a system veering towards the American model.

How about Australia leads the world in electoral reform, and its hand-maiden, electoral funding transparency

Australia creates **The Electoral Bank Fund** it collects donations made by interested parties, corporations and individuals, which are tax deductible, and also the Treasury makes a contribution as well. The funds are invested and earn a return between elections.

Once the election is announced, sitting members receive an allocation of funds on some formula basis, and pre-selected candidates do as well.

Any such candidate can ask for extra funds provided he/ she puts up some adequate security. Moneys spent on winning or losing an election that are not reimbursed become tax deductible.

An independent candidate can also borrow funds on a secured basis and contest the election. They will have a portion of his/her loan dissolved, provided they win a certain number of votes. Perhaps they have to win say 5% of the votes to qualify for dissolution of portion of their loan. If they were to win outright, or to win say 25% of the votes, their loan would be extinguished in its entirety, subject to some defined limits. Bribing voters by cash payments would not constitute 'allowable expenditure'. 'Allowable expenditures' would have to be subject to adequate audit and verification.

Candidates would not be able to use funds provided from any source, be it union, corporate or otherwise.

All fund raising activities would have to be accredited and the funds remitted to the Electoral Bank. Fund raisers could nominate a beneficiary of their efforts, but it would not necessarily be binding upon the Bank Trustees, except in the case of an independent where, subject to source, extra funding might be allocated irrespective of win or loss.

For relatively safe seats funding might be scaled to reflect the realities that a loss is unlikely so that contestable seats are 'over-allocated' funds wise.

Obviously, we at Ecinya, do not have the experience or the information to know how to design the system in its entirety to make it workable BUT this brief essay may contain the germ of an idea that might just work to keep our democracy healthy.

In passing, we note that the major candidates in the last American election spent over \$1 billion: circa \$730 million from Obama, about \$330 million from the McCain camp and about 4 independents spent another \$60 or so million.

In Australia, the last election was our most expensive ever, according to Google, and some \$163 million found its way from the private sector back to the private sector.

Resources are scarce; if they are allocated according to patronage the outcomes will be sub-optimal. State governments are struggling for revenues and the Federal government has become significantly interventionist, ostensibly sanctioned by a dead prophet in John Maynard Keynes. It is relatively clear that the Federal government is keen to get to the polls on an exaggerated debate about climate change after winning the second-hand Toyota utility truck debate. Additionally, we are going to soon have a limited debate about the meaning of tax reform as the Henry report arrives before the next election, which will presumably be aimed at replenishing public coffers. Electoral funding and favours asked for and given, seems an important issue for taxpayer scrutiny, for in the end they pay the piper for his tune. The 'tune' is estimated to be something above \$200 billion of public debt. If this debt achieves little because a lot of it goes to cronies, then that would be a monumental waste of resources.

The success of the exceptional Hawke-Keating policy, compulsory superannuation, demands corporate transparency. If we do not have transparency at the top of our political system, it is hard to imagine that it will exist in sufficient quality in the middle and at the bottom. Electoral reform and an extended federal term is long overdue.

their effect on particular ends or particular people cannot be known beforehand. It is in this sense alone that it is at all possible for the legislator to be impartial. To be impartial means to have no answer to certain questions—to the kind of questions which, if we have to decide them, we decide by tossing a coin. In a world where everything was precisely foreseen, the state could hardly do anything and remain impartial. But where the precise effects of government policy on particular people are known, where the government aims directly at such particular effects, it cannot help knowing these effects, and therefore it cannot be impartial. It must, of necessity, take sides, impose its valuations upon people and, instead of assisting them in the advancement of their own ends, choose the ends for them. As soon as the particular effects are foreseen at the time a law is made, it ceases to be a mere instrument to be used by the people and becomes instead an instrument used by the law-giver upon the people and for his ends. The state ceases to be a piece of utilitarian machinery intended to help individuals in the fullest development of their individual personality and becomes a "moral" institution—where "moral" is not used in contrast to immoral, but describes an institution which imposes on its members its views on all moral questions, whether these views be moral or highly immoral. In this sense the Nazi or any other collectivist state is "moral", while the liberal state is not.

Perhaps it will be said that all this raises no serious problem because in the kind of questions which the economic planner would have to decide he need not and should not be guided by his individual prejudices, but could rely on the general conviction of what is fair and reasonable. This contention usually receives support from those who have experience of planning in a particular industry and who find that there is no insuperable difficulty about arriving at a decision which all those immediately interested will accept as fair. The reason why this experience proves nothing is, of course, the selection of the "interests"

concerned when planning is confined to a particular industry. Those most immediately interested in a particular issue are not necessarily the best judges of the interests of society as a whole. To take only the most characteristic case: when capital and labour in an industry agree on some policy of restriction and thus exploit the consumers, there is usually no difficulty about the division of the spoils in proportion to former earnings or on some similar principle. The loss which is divided between thousands or millions is usually either simply disregarded or quite inadequately considered. If we want to test the usefulness of the principle of "fairness" in deciding the kind of issues which arise in economic planning, we must apply it to some question where the gains and the losses are seen equally clearly. In such instances it is readily recognised that no general principle such as fairness can provide an answer. When we have to choose between higher wages for nurses or doctors and more extensive services for the sick, more milk for children and better wages for agricultural workers, or between employment for the unemployed or better wages for those already employed, nothing short of a complete system of values in which every want of every person or group has a definite place is necessary to provide an answer.

In fact, as planning becomes more and more extensive, it becomes regularly necessary to qualify legal provisions increasingly by reference to what is "fair" or "reasonable"; this means that it becomes necessary to leave the decision of the concrete case more and more to the discretion of the judge or authority in question. One could write a history of the decline of the Rule of Law, the disappearance of the Rechtsstaat, in terms of the progressive introduction of these vague formulæ into legislation and jurisdiction, and of the increasing arbitrariness and uncertainty of, and the consequent disrespect for, the law and the judicature, which in these circumstances could not but become an instrument of policy. It is important to point out once more in this connection that this process of the decline of the Rule of Law