

Political Economy of Tax Reform

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Why Tax Reform?

- A more productive economy by reducing tax distortions
- Greater simplicity to reduce costs
- Redistribution to meet society equity objectives
- More, or less, revenue

My focus: reduce tax distortions for a **more productive economy**, constrained by **similar aggregate revenue and broad equity** as now.

Framing the Tax Debate

- To satisfy multiple objectives, requires reform packages
- Focus should be on the medium and longer term
 - major tax reform infrequent and long lasting
 - equity assessed for final incidence, and consider life cycle
- Generally require involvement of the three levels of government

Taxation Distortions to Decisions

- A \$ of tax revenue involves **both**
 - a \$ transfer from private to government, **plus**
 - a productivity loss of induced changes to private sector decisions (for many taxes 30 to 80 cents)
- Some examples of distorted decisions:
 - Labour income tax distorts work vs leisure, and market vs home production
 - Hybrid capital income tax on different saving (S) and investment (I) options distorts composition of S and I
 - Current GST distorts choice of food vs clothing, water vs electricity
 - Payroll tax small business exemption changes choice of firm size

General Reform Packages to Increase National Productivity

1. Broader base (by removing exemptions and deductions) and lower rate
2. Change the tax mix from more distorting to less distorting tax bases
3. Better design of special taxes to correct for market failures

In the context of similar to current: aggregate revenue; and distribution across broad income and demographic groups.

1. Broader Base and Lower Rate: some examples

- Labour income tax: tax super contributions and fringe benefits the same as wages (a \$ is a \$)
- Capital income tax: set similar rate for different forms of income for
 - Residents
 - Non-residents
- GST: NZ type base
- Land tax: remove exemptions
- Payroll tax: remove exemptions

Comprehensive Labour Income Base and Lower Rates

- Reform package
 - Comprehensive base. Remove tax expenditures for employer super contributions and for fringe benefits. A \$ of labour cost equals a \$ of employee remuneration, regardless of form. Follow payroll base.
 - Lower income tax rate for revenue neutral
- Efficiency gains
 - Remove distortions to mix of remuneration
 - Lower tax rate reduces distortions to work vs leisure, S and I,
- Equity. Balance broader base with lower rate
 - Most little affected
 - Losers (winners) are those with > (<) average super and FB; arguably greater horizontal equity

2. Tax Mix Change Packages

- Idea: shift tax mix from high distorting taxes (where decisions sensitive to price changes) to lower distorting taxes
- Some examples
 - Larger GST to replace income tax and stamp duties
 - Larger land tax to replace conveyance duty
 - Larger land tax to replace some stamp duties and/or income tax
 - Larger payroll tax to replace some income tax

Land Tax to Replace Conveyance Duty

- Idea: replace conveyance duty and current narrow base state land tax with a comprehensive flat rate tax on local government rate base. ACT example
- Efficiency gains
 - Replace most distorting tax with least distorting tax. Save 60-80 cents/\$ of revenue switch
 - Removes disincentives to change ownership when circumstances change
- Equity effects
 - Similar average tax burden on property, and very small asset price effect
 - Winners are frequent movers, losers are infrequent movers. Interesting horizontal equity

3. Rationalise Market Failure

Correction Taxes: some examples

- Replace current fuel excise and state taxes on motor vehicles with a
 - vehicle user fee for road damage,
 - congestion fee by location and time, and
 - pollution external cost
- Replace maze of taxes on alcohol with a flat rate per volume of alcohol
- To meet greenhouse gas emission 2030 target, use a broad based price on emissions- tax or ETS. Could recycle some of revenue windfall for equity.

Final Thoughts

- Tax reform in the current fiscal state will be a big investment
- Necessary to
 - Explain the problems with the current system
 - And why reform proposals will be better in terms of
 - Productivity gains as a key to sustaining rising living standards
 - Net revenue and equity effects
 - Effectively debate false arguments of lobby groups