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How should the country adjust to being poorer?

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Appearing last week on the ABC's 7.30, former treasury secretary Ken Henry claimed Australia has a revenue problem, because the ratio of tax revenues to GDP is lower than in 2002, the implication being tax rates should rise. And that was only the highlight of a week-long "taxfest", in which the media was crowded with like-minded pundits proposing ways of lightening taxpayers' wallets.

With consensus breaking out, it seems churlish to allow facts to intrude. But the reality is that while tax receipts are a lower share of GDP than in 2002, their ratio to national income is at precisely its long-run average.

What that implies is that if revenues have not increased as much as previous budgets projected, it is mainly because incomes have not grown as rapidly as those estimates assumed. Simply put, we are not as rich as the forecasts expected, and so we are not paying as much tax.

Nor is it difficult to understand why the gap is so large. When Wayne Swan, in his 2013-14 budget, increased public spending by 4.3 per cent in real terms, triumphantly declaring that "the public finances are strong", he assumed (unrealistically, as this column then suggested) that the terms of trade would stay at stratospheric levels through 2014-15.

As things turned out, they fell by 13 per cent. And with the terms of trade now a third lower than in 2011, the ABS measure of "real net national disposable income per capita" has dropped 4.5 per cent.

The budgetary consequences are straightforward. Labor not only overestimated growth but systematically overstated the tax revenues that growth would generate. As incomes have fallen, their projections have turned to custard, with revenues running some 8 per cent below Labor's four-year forecasts.

So the real question in policy terms is not whether revenues are higher or lower than some benchmark; it is how we should adjust to being poorer.

Now, to those of us who are ordinary mortals, the argument that because our incomes are down, tax rates should rise, will seem positively bizarre, since higher taxes will reduce our disposable incomes even further and cause even greater pain.

But that is merely because we accept the notion that if there is durably less to spend, we should spend less. We therefore naively believe that with a smaller pie to share around, public expenditure ought to be reconsidered and, where possible, scaled back.

But the capacious minds who dominate the great tax debate aren't constrained by common sense. In this Sargasso Sea of economic policy — an immense, turgidly revolving whirlpool in which the hulks of old ideas moulder, encrusted with verdigris, refusing to sink — logic is turned on its head, and a shrinking capacity to pay becomes a justification for pushing up tax rates.

The resulting competition to devise ways of achieving that goal has been intense — so much so it seems invidious to declare a winner.

But with three corkers in as many days, it would be unfair not to give the Grattan Institute's John Daley a guernsey, noting that Saul Eslake echoed many of his contentions.

Daley began his dash by arguing the GST should be raised, using some of the revenue to reduce income tax rates, particularly for low and middle-income earners, thus increasing the incentives to work.

But he then went on to argue that those same income-earners should be "over-compensated" for the higher GST rate, presumably by increasing benefits. However, those benefits are means-tested, so the more they earn the less they would get, entirely defeating Daley's objective. And since the over-compensation must be paid for, effective tax rates at the top of the income distribution would also have to rise, compounding the distortion.

After that promising start, Daley couldn't be stopped.

Warming to the tax hike theme, he argued now was not the time to reduce company tax rates; rather, on his logic, they too should be greatly increased. Why? Because "global interest rates are at their lowest for at least 5000 years and the world is awash in capital".

But interest rates are not low because investment is in such abundant supply as to make company tax rates virtually irrelevant; on the contrary, they are low because the willingness to bear investment risk has plummeted, forcing the price of safe assets (notably government bonds) to unparalleled heights and interest rates to unparalleled lows.

Under those circumstances, with investors more nervous than ever, our international tax competitiveness, instead of being inconsequential, is critical.

Finally, Daley told us, "reducing super tax concessions, limiting negative gearing and winding back the capital gains tax discount" would be "the least bad tax increases". But how, one wonders, does he know? After all, economists have a standard way of measuring the efficiency cost of a tax: they compare the income loss it causes taxpayers to the income gain accruing to government.

However, Daley hasn't published any such estimates: indeed, he hasn't even disclosed the effective tax rates his proposals imply. Yet conventional analyses suggest their efficiency costs would be high, with Robert Lucas, the 1995 Nobel laureate in economics, arguing that if one thing distinguishes modern economics from that of the 1960s, it is understanding that "neither capital gains nor any of the income from capital should be taxed at all".

That may be overstating matters; but before Daley books his own ticket to Stockholm, he might want to substantiate his claims.

Or perhaps not. Perhaps in this debate, as at the fabled 2020 Summit, each person is entitled to his own facts, so long as he shares the common, left-leaning, opinion. And yes, as at the 2020 Summit, that opinion may be lightweight; its costs, however, are sure to be anything but.