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GST should not be a matter of political machismo

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You may well ask why the government ever floated the idea of raising the GST, given that by far the best tax reform would be bringing public expenditure under control.

After all, if long-term spending obligations continue to increase at a rate that exceeds trend growth in national income, changing the clippers the taxman uses to fleece us will do nothing to stem that rise or reduce its economic costs.

But instead of advancing reforms that would put health, education, social security and defence outlays on a fiscally sustainable basis, Malcolm Turnbull and Scott Morrison have allowed the discussion to be hijacked by the tax addicts, who want the Coalition to cop the pain involved in raising revenues for the next Labor government to squander.

Of course, the government insists any changes would be strictly revenue neutral, and it is undeniable that a tax increased over here can always be matched by a tax reduced over there.

But no matter how generous the compensation, persuading voters that “over here” and “over there” will continue to align is not easy, especially when spending is on a steep upward path. Rather, with deficits looming, the punters could be forgiven for thinking that it is only a question of time before their wallets are conscripted to make up the difference. And what could be simpler to reverse than cuts in income taxes and increases in benefits whose real value inflation will inevitably erode?

Little wonder then that increasing the GST is as about as appealing to the electorate as a dose of cyanide-laced Kool-Aid. And little wonder that the prospect of fighting an election on this issue fills Labor’s sullen ranks with venomous glee, as they recall just how close John Howard, a truly outstanding politician, came to defeat.

For sure, a tax switch might still be worth pursuing were the economic gains material. They were when Howard-Costello reforms replaced myriad highly inefficient sales taxes with a single value added tax; but few benefits, if any, are likely to arise from a switch between income tax and the GST.

Take the claim that such a switch would lessen the disincentives to work. Both first principles and decades of empirical analysis suggest the claim is absurd: decisions about whether to work are not affected by the labels placed on individual taxes but by the overall tax wedge — that is, the gap taxes drive between pre-tax income and

what that income allows us to buy. A consumption tax thanks to which \$10 of income buys only \$8 worth of goods deters earning that extra \$10 every bit as much as an income tax that reduces \$10 of pre-tax wages into \$8 to spend.

To say that is not to deny there are other ways in which a tax switch could be beneficial. In particular, while the GST is levied at a flat rate, the income tax is steeply progressive, so that tax rates rise sharply with income. And since the distortion caused by a tax rises more than proportionately with its rate, the vast bulk of the economic harm inflicted by the income tax is because of its highest rates. A tax switch that flattened those rates would therefore be well worthwhile, as the Henry report noted. That is all the more the case as cutting income tax rates while recovering the forgone revenue through an increased GST would broaden the tax base, collecting more tax both from earners below the present tax free threshold and from retirees.

But imposing such a change would require “a strong hand and an outstretched arm” worthy of the divine intervention that allowed the biblical escape from Egypt; and even a moment’s reflection on the politics forces us to come tumbling down from the thunderbolts of Sinai to the insensate debauchery of the Cities of the Plain.

Nor is there much doubt what form that debauchery would take: as the battle over the proposed tax change heated up, giveaways to low income earners would proliferate at higher income earners’ expense. As a result, far from being compressed, effective rates would, in the immortal phrase of British comedians Max and Ivan, end up as stretched as a dwarf in an orgy, aggravating the damage our tax system causes.

It is true that a GST, which only taxes savings when they are consumed, distorts savings decisions less than an income tax, which taxes both the income out of which savings are initially financed and the earnings those savings generate. It is also true that we would be better off were savings taxed much less heavily than they are.

But if that is the government’s goal, there are more direct ways of achieving it. For instance, instead of threatening to further restrict access to superannuation, the government could make super savings effectively tax free up to the level at which they merely replaced the age pension, thus promoting equity and encouraging the self-reliance that is at the heart of Liberal values. And it could commit to a gradual but steady reduction in company tax, while ensuring, to the extent possible, that dividend imputation did not simply claw that reduction back.

None of that will satisfy the pundits for whom raising the GST is a test of political manliness. However, success in democratic politics is not a matter of machismo but of the “slow, powerful drilling through hard boards, with a mixture of passion and a sense of proportion” that Max Weber identified a century ago. With long-term

spending commitments still unchecked, there is plenty of that drilling left to do.