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Unicorns all over the place in fantasy tax debate

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Illustration: Eric Lobbecke.

His budget won't promise taxpayers any unicorns, Scott Morrison assured the National Press Club last week. Good thing too, for they are ever harder to find.

Nor is that surprising, as the fabulous creature only appears to the pure of heart. "I've come as a virgin," says Wriothesley in Hilary Mantel's *Bring Up the Bodies*: "They're so rare these days that they send unicorns out looking for them." If its search brought it to Canberra, the heraldic beast would be wasting its time.

But however scant the supply of purity, the nation's capital is not running out of fantasy. And the tax debate has unlocked reserves of creativity one would scarcely have thought existed. Leading the pack is Bill Shorten's claim that "independent modelling" by the McKell Institute shows Labor's changes to negative gearing "will create 25,000 jobs".

Yet that modelling is no more real than the unicorn. Rather, while emphasising that any detailed assessment is "beyond the scope" of its report, all the McKell Institute claims is that a 10 per cent increase in construction activity is "reasonable".

Why it is reasonable, the institute does not say; and it hardly inspires confidence that its estimate of the revenue gain from restricting negative gearing is 10 times that Labor received from the Parliamentary Budget Office, which also accounted for the proposed rise in capital gains tax.

But Shorten faces stiff competition. MP Jim Chalmers, who was previously Wayne Swan's chief of staff, nearly surpassed his leader by claiming the changes are needed to ensure home buyers are not tax disadvantaged compared to investors. Clearly, Chalmers has never read the Henry tax review. Its estimates imply that far from being disadvantaged, homeowners receive an annual per capita tax subsidy two times that to renters and investors combined. Little wonder the review did not recommend repealing negative gearing, since that would merely increase the penalty on the rental market.

As for Chris Bowen, he too did not disappoint, contending that only Australia and New Zealand allow full negative gearing. In reality, forms of negative gearing are common in those continental European countries that have large private rental markets and which tax income on a consolidated basis. Nor are their effective tax rates on investment properties higher than ours; on the contrary, Germany, which is often praised for the efficiency of its housing markets (and is no slouch in the fiscal probity stakes), not only allows full loss deductibility but exempts rental housing from CGT.

Finally, the field saw a late entry from the Australian National University's Ben Phillips on the consequences of Labor's changes for the distribution of income. Now, even first-year economics students learn that just as a tax (on, say, tobacco) may end up being paid not by the firm on which it is levied but by consumers (i.e. smokers), so a subsidy (say, to rental property) may end up benefiting not the subsidised product's suppliers (investors) but those to whom the product is supplied (renters). And without wishing to imitate Ben Stein's economics teacher in *Ferris Bueller's Day Off*, who bores his victims out of their minds by droning on about the theory of taxation, suffice it to say first years also learn the conditions under which the subsidy will flow largely to final consumers: conditions amply met in the case of negative gearing.

Yet all that is plainly a dark continent as far as Phillips is concerned. Without even the slightest caveat, he simply assumes tenants receive none of the tax subsidies whose distributional impacts he purports to model. Pulling out of the hat the tortured remains of the rabbit he snuck into it, he then concludes that the gains go overwhelmingly to the well-off.

It would be tempting to dismiss such absurdities as instances of what Kurt Vonnegut called foma: "harmless untruths, intended to comfort simple souls". But that would underestimate the damage Labor's changes would cause by destabilising property markets, undermining confidence and worsening economy-wide inefficiencies. Nor are those risks solely due to the restrictions on negative gearing; the increase in CGT would be every bit as harmful.

After all, given that we tax what are merely nominal gains, our CGT is already high, as are our taxes on savings generally. For example, an investor who bought Telstra shares when Telstra was first floated and sold them last week would have incurred a tax on inflation-adjusted capital gains of well over 100 per cent. And the fact that we don’t allow full recovery of capital losses, but tax all gains, just pushes those effective rates higher, raising both their economic costs and the costs a further hike would inflict.

Interactions with other taxes would then compound the damage. Take stamp duties: their effect, a recent Treasury working paper emphasises, is to induce property owners to defer sales, so that there is far too little turnover in housing markets; but by increasing the incentive to hang on to assets, the higher CGT would aggravate the distortion, with the result that for each $1 of tax revenue obtained from the sale of investment properties, national income could fall by $1 or more.

Ultimately, however, the harm would not solely be economic. A society that penalises savers is as impoverished morally as it is scarred economically. Less oriented to the future, and with ever shrinking reserves of self-reliance, it could only turn to government when hard times struck.

Little wonder the apologists for such a future have to peddle fairytales to make their aspirations palatable. But there are, as US modernist poet Marianne Moore would say, real toads in Labor’s imaginary gardens.

And once we’re in it, no unicorns to bail us out.