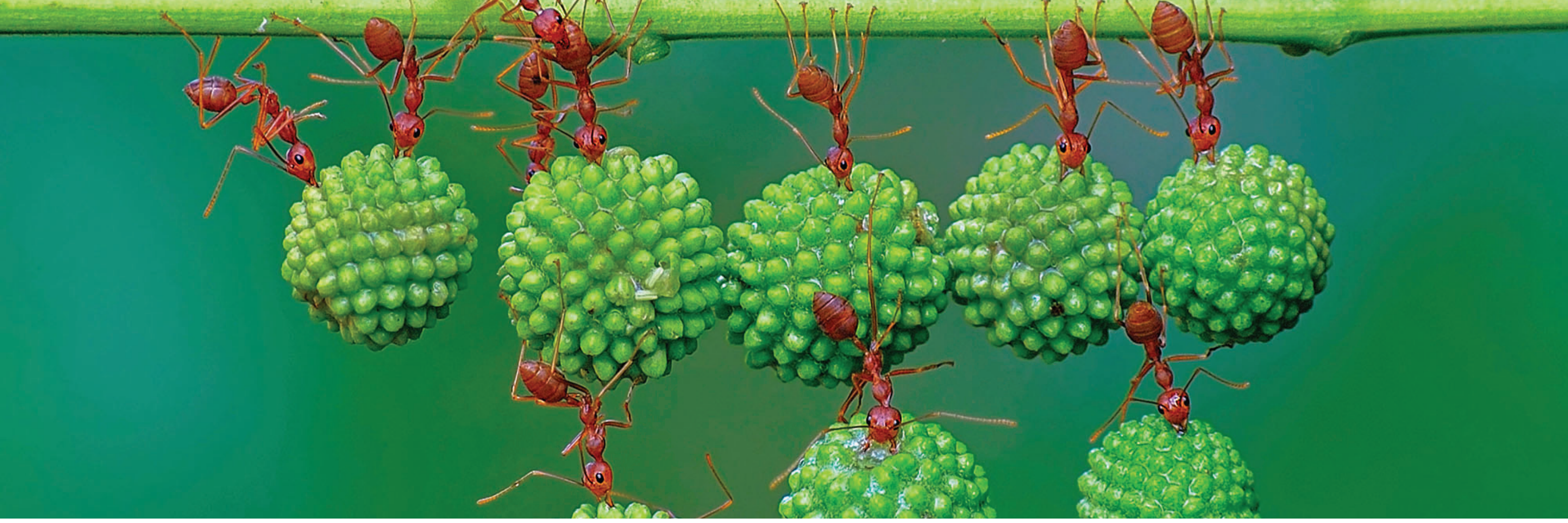

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# The case against tax increases in Australia: The growing burden

Michael Potter

Australian taxpayers will be hit with a tax increase over the next five years of 12.7% per person in real terms. The extra tax burden, above the 40 year average, is expected to be $29.6 billion, or $1,228 per person (see table 1), in five years.

This is the estimated tax increase based on policies in the 2016 budget, assuming there are no further changes. Any additional tax increases, including proposals to wind back the CGT discount or negative gearing, will exacerbate the problem. Tax levels will grow at a faster rate than in the budget, and the total burden will be even further above its historical average.

This report details the case against these forecast tax increases as well as any additional tax hikes.

**Growth in the tax burden, and spending levels, by the numbers**

The federal government imposes a tax burden of 22.1% of GDP in the current financial year (2015–16). This is just above the 40 year average of 22.0% of GDP (Figure 1). Based on analysis in this paper, the burden is set to increase over the five years to 2020–21 by 12.7% per person (adjusting for inflation). The tax to GDP ratio is set to increase by 7.8% over this timeframe and reach 23.8% of GDP.

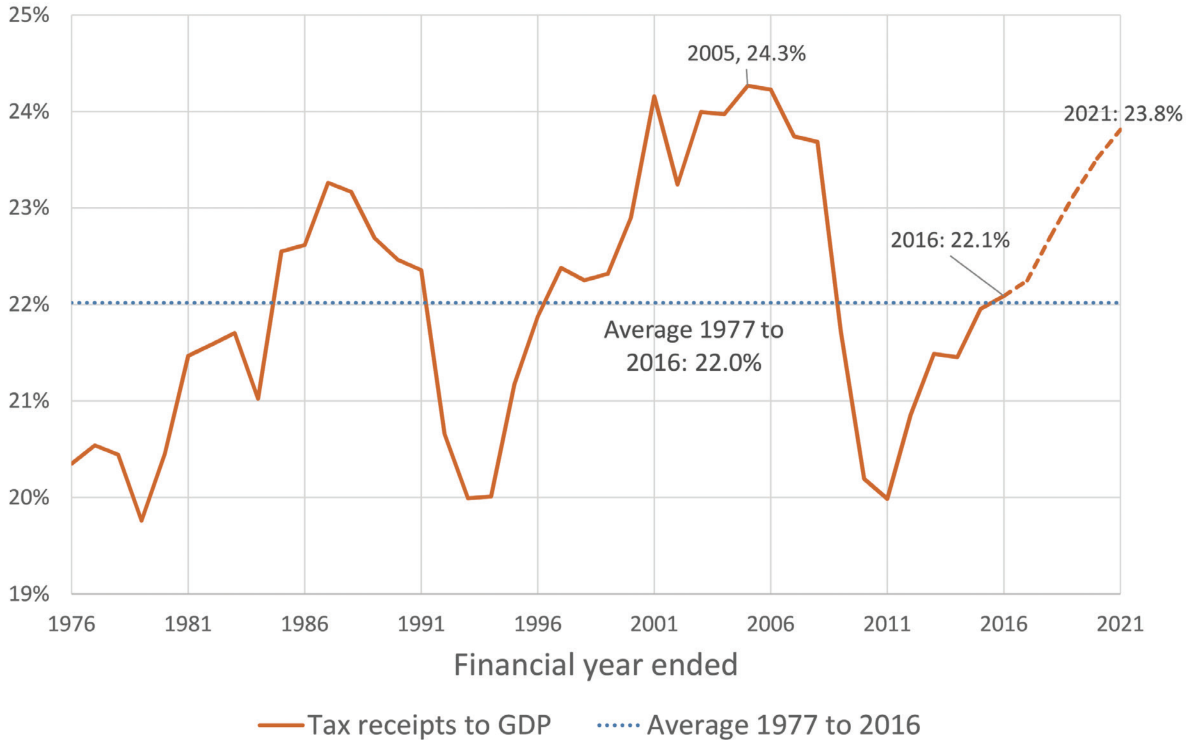
Spending levels are currently 25.8% of GDP, which is well above the historical average of 24.9%. Spending levels are expected to fall somewhat, but this assumes the passage of numerous measures through Parliament that have either been blocked or have yet to be presented.

The tax burden imposed by federal, state and local governments combined is currently 28.2% of GDP, well above the 40 year average of 27.5%, and is set to grow to 29.1% in three years.

## Historical comparisons

The federal government tax burden since 1975–76 is in Figure 1 below, showing the forecast tax increase to near-record levels if nothing is done.

**Figure 1: Federal government tax to GDP ratio**




This forecast tax hike is mainly caused by bracket creep, which is the failure to adjust personal tax thresholds for inflation or wages growth. The tax burden is set to approach levels from the middle of the mining boom. But this is clearly inappropriate, because investment, wages and the overall economy are much weaker today compared with the boom period.

The tax burden imposed by all Australian governments follows a similar pattern: it is currently above the historical average and set to go well above.

The gap between current and forecast tax levels and their historical averages is shown in Table 1 below.

**Table 1: Gap between forecast tax burden and historical average**

| Year | Commonwealth government | | All Australian governments | |
|---|---|---|---|---|
| | Total $bn | $ per person | Total $bn | $ per person |
| 2015–16 | 1.2 | 49 | 11.1 | 461 |
| 2016–17 | 3.8 | 159 | 8.8 | 364 |
| 2017–18 | 11.4 | 471 | 18.3 | 758 |
| 2018–19 | 18.5 | 765 | 25.3 | 1,047 |
| 2019–20 | 24.7 | 1,023 | NA | NA |
| 2020–21 | 29.6 | 1,228 | NA | NA |

### *The budget deficit*

Today's large budget deficit is imposing substantial costs on future taxpayers. An alternative measure of the tax burden includes the deficit, which is a form of deferred taxation, as well as the current tax burden. This measure is well above its historical average.

Tax increases to reduce the budget deficit just shift the tax burden from future taxpayers to current taxpayers. As a result, these tax hikes have major problems.

Instead, the historical evidence indicates that deficit reduction should occur through restricting growth in government spending:

- Spending is currently well above its historical average of 24.9%.
- During previous periods when the budget was close to balance, the federal tax burden was at or around current levels, and much lower than forecast tax levels. In these years, spending was much lower.
- In years when economic growth was around current levels (and unemployment around current levels) the federal tax burden was lower than today's level, and much lower than forecast levels. In these years, spending was also lower.
- Similar, or even stronger, results are produced from analysis of the combined tax burden of all Australian governments.

### *Historical times of high tax burden*

In the past 40 years, the federal tax burden was substantially above the average for only two periods: 2000 to 2007 and 1986 to 1988 (see Figure 1). In both of these periods, the government provided substantial tax cuts. In contrast, today the tax burden is heading well above average, and government policy decisions to date have done almost nothing to offset this tax increase. Cuts to some taxes have been largely offset by other tax increases, and proposed company tax cuts will have little effect on this upward march in the tax burden.

### *Historical tax reforms*

Any explicit tax hikes will be in stark contrast to successful tax reforms, which have not increased the tax burden. Major policies to increase the tax burden have been abandoned or repealed, including the mining tax, the carbon tax, recent proposals to increase the GST, and (older) proposals to impose CGT on assets bought before 1985.

### *Historical tax cuts – were they excessive?*

Historical tax cuts did not cause the current deficit or a revenue shortfall, because tax levels today are above their historical levels, regardless of previous tax cuts. Tax cuts during the mining boom prevented the all-time high in the tax burden, reached in 2004–05, from being even higher. A higher tax burden might have just encouraged an increase in the size of government, with no improvement in the budget.

### *Should taxes be higher because of tax avoidance?*

Some commentators have argued that tax avoidance nullifies the case for tax cuts. However, it is perverse to argue that the total tax burden should continue to increase because of tax avoidance. The higher taxes impose the greatest cost on people and businesses that don't avoid tax, and have no impact whatsoever on the most successful tax avoiders who pay no tax at all. There is no justification for taxes to be higher on businesses paying the full rate of tax because other unrelated companies are avoiding tax. In addition, higher tax levels are likely to exacerbate tax avoidance.

### *Does the state of the economy, or revenue write-downs, mean taxes should be higher?*

The current budget situation is almost entirely due to government policy, not the state of the economy, as shown in official estimates of the structural budget balance. The recovery from the GFC and the end of the mining boom are having only a tiny impact on the budget.

This implies that both spending and revenue levels are largely due to government decisions. High spending levels can't be blamed on the economy, and tax revenue is not weak because of the end of the mining boom, despite so-called revenue writedowns.

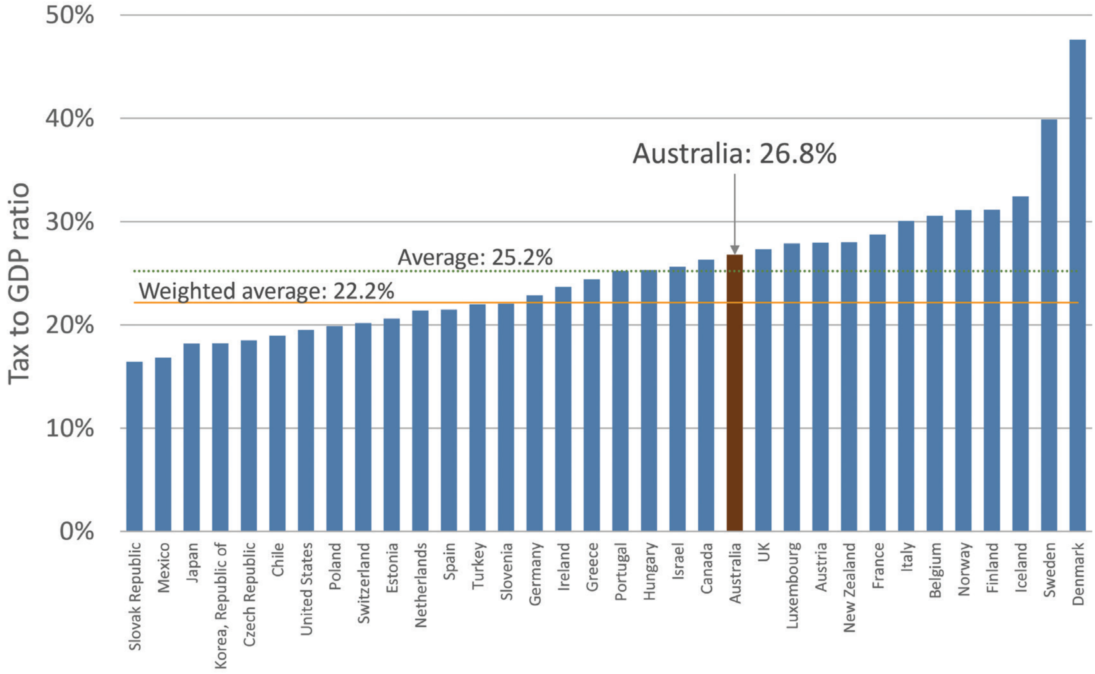
Removing the effect of the economy, tax is likely to be at or above its long run level, while spending would be well above the historical average. Again, this does not support the case for the forecast tax increases, let alone any additional tax hikes.

Taxes should not increase because of revenue writedowns, as these revisions largely reflect forecasting errors. Actual tax levels are more important than whether they were forecast correctly.

## Australia is *not* a low taxing country

Contrary to the view of some commentators, Australia's overall tax levels are above the developed world average according to data from both the World Bank and the IMF. The IMF comparison is shown in Figure 2 below.

**Figure 2: Tax to GDP ratio in OECD, from IMF data**




Data from the OECD does indicate that Australia's tax burden is below the developed world average. This is because the OECD counts social security contributions as taxes while the IMF and World Bank do not. There are good reasons to exclude these contributions from tax comparisons as they don't fully act like taxes.

Australia's revenue from personal and company tax are both well above the developed world average. These are the most inefficient taxes levied by the federal government.

Regardless, developed country comparisons are flawed: they include many poorly performing economies we should not be emulating, and exclude many of our trading partners or countries in our region. Comparisons with the globe show Australia's tax levels are even less competitive.

### *Should Australia's tax burden increase regardless?*

Despite the arguments above, should taxes nevertheless increase? The costs of taking this approach would be particularly large. Studies show higher taxes lead to reduced wages employment, innovation, investment and economic growth, while encouraging tax avoidance.

In particular, Treasury estimates that the forecast increase in personal taxes of 9% over the next four years will cut GDP by 0.55 percentage points, or $376 per person. In addition, tax cuts to limit the forecast increase in the tax burden have large benefits: a company tax cut from 30% to 25% financed by cutting wasteful government spending is estimated by Treasury to increase yearly GDP by $750 per person (1.1%) and national income by $460 per person (0.7%). The yearly benefit to national income is more than 2.6 times the net revenue cost.

These results are consistent with other Australian and international evidence.

Hence, based on detailed historical analysis, international comparisons, and economic studies, there are strong arguments against the tax increases set to be imposed in coming years, let alone additional tax hikes.

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