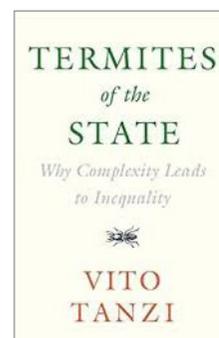


- 6 Page 47 of Joe Hockey, *2015 Intergenerational Report—Australia in 2055*.
- 7 Significant income at the top doesn't relate to labour supply, but is still affected by tax rates such as capital gains. Tax at high income levels also affects decisions to innovate and migrate, for example Enrico Moretti and Daniel Wilson, 'The Effect of State Taxes on the Geographical Location of Top Earners: Evidence from Star Scientists', NBER Working Paper No. 21120 (April 2015). All these impacts are included in estimates using taxable income as the comparator.
- 8 See Michael Potter, 'Capital in the Twenty-First Century: A Critique of Thomas Piketty's Political Economy', *Agenda* 21:1 (Canberra: Australian National University Press, 2014).
- 9 See Treasury briefing released under Freedom of Information: <https://treasury.gov.au/foi/2180/> and page 30 of Productivity Commission, *Shifting the Dial: 5 Year Productivity Review—Inquiry Report* (24 October 2017).
- 10 For example Oguzhan Akgun, Boris Cournède and Jean-Marc Fournier, 'The Effects of the Tax Mix on Inequality and Growth', OECD Working Paper 1447 (2017); Page 48 of International Monetary Fund, 'IMF Fiscal Monitor: Acting, Now Acting Together' (April 2016); Box B.5 of OECD, 'Tax and Economic Growth' (2010); Lars Feld and Jost Heckemeyer, 'FDI and Taxation: A Meta-Study', *Journal of Economic Surveys* 25:2 (21 February 2011), 233–272; and Simeon Djankov, Tim Ganser, Caralee McLiesh, Rita Ramalho and Andrei Shleifer, 'The Effect of Corporate Taxes on Investment and Entrepreneurship', *American Economic Journal: Macroeconomics*, 2:3 (July 2010), 31–64.
- 11 The IMF states the corporate effective tax rate in Australia is in the upper third of the rates for developed countries: see page 21 of IMF, *Australia: 2017 Article IV Consultation—Staff Report*, IMF Country Report No. 18/44 (20 February 2018); the domestic ownership argument completely ignores where the *marginal* (or new) dollar of investment comes from, and ignores investment into new businesses; and a correlation of two variables (GDP and tax rates) is uninformative about the direction of causation, and is likely to be very biased due to the absence of controls. Some studies showing company tax adversely affects GDP are listed on page 15 of Michael Potter, *Fix It or Fail: Why We Must Cut Company Tax Now*, CIS Research Report 20 (Sydney: The Centre for Independent Studies, October 2016).

Termites of the State: Why Complexity Leads to Inequality

By Vito Tanzi
Cambridge University
Press, 2018, 447 pages,
£22.99 (hardcover)
ISBN: 9781198420938



Reviewed by Robert Carling

This is a book about state (meaning government) intervention in democratically governed, market-based economies from one of the world's foremost scholars and practitioners in public finance. He has made it more topical by paying a lot of attention to inequality. To those who might be put off by yet another tome on that subject, I would say don't be—because it's much more than that, and in any case offers valuable new insights into the role of the state in relation to income distribution.

Vito Tanzi's writings appeal to a wide range of readers, being just technical enough for academics but not too technical for the general reader. *Termites* is no exception. There is not a single table or graph, let alone algebra or equations—just 400 pages of text that are generally easy to digest, if somewhat marred by repetition that should have been edited out.

Whether it is Trump's protectionism or Turnbull's bank executive accountability regime, state intervention with a populist twist has gained momentum in the past ten years. Tanzi puts this into context by tracing the history of philosophical and economic thought in Britain, Europe and the US as it relates to government intervention since the *laissez faire* era of the late 1800s. This is a valuable narrative in its own right, though I can't help feeling that what Tanzi describes as the 'market fundamentalism' (p.35 *passim*) of the 1980s and 1990s is part caricature. It is clear from Tanzi's historical narrative that he is acutely aware of the flaws and limitations of state intervention in practice, as well as its power to do good. He is also well aware of the potential disincentive effects and other flaws in high taxation and welfare. He thinks many governments spend more than they need to, and is

no fan of crude Keynesian stabilisation policies or of bloated public debt. As you would expect of an economist who spent 27 years with the International Monetary Fund, he is a strong believer in fiscal discipline.

These issues get an airing in *Termites*, but its emphasis is different. Tanzi explains his unhappiness with the current state of market economies by building the following thesis. Faith in markets became excessive in the 1980s and 1990s and led to deregulation and growing inequality. Economies and markets have become more complex and require more government intervention but of a different kind, which has largely failed to materialise. The rich and powerful have prospered from complexity and are able to manipulate government intervention to their advantage. Crony capitalism prevails. Tax policy changes since the early 1980s have further increased inequality. Government regulatory intervention also has distributional consequences, which have systematically favoured the rich and powerful.

The ‘termites’ referred to in the title infest markets as well as the state. In the latter, they ‘corrupt, or distort, the legitimate economic role that governments try to play’ (pp.119-20), while also distorting the legitimate workings of markets.

Compared with Tanzi’s past writings, there is less emphasis in this book on the tax and spend dimensions of state intervention. But he does express sympathy for the idea of a universal basic income (without calling it that), which I find curious as it would greatly increase the size of government beyond what Tanzi considers adequate. He also thinks it is time to consider lifting taxation on very high incomes while avoiding significant damage to incentives (though it isn’t clear how that could be done).

Taxes and transfer payments are used by government to reshape market-generated income distribution, but Tanzi rejects the notion that government policy with respect to distribution should be left solely to taxes and transfers. He argues that ‘governments must do their best to promote market conditions that help prevent excessive income concentration’. I find the most novel aspect of the book is its analysis of inequality in the pre-tax/transfer income distribution and the role of

government regulatory interventions in shaping that distribution. He takes head-on the idea that the pre-tax/transfer distribution is a pristine reflection of free market forces and therefore has moral legitimacy. As the market is rigged—and made more so by government intervention—so too is the income distribution it produces. There is plenty of regulation of markets already, but we need a different kind of regulation to ‘make the market function more closely to the way that an efficient market ought to function’ (p.229).

Tanzi goes as far as labelling many high incomes as ‘undeserved’, ‘unearned’, ‘rents’ and due to ‘luck’ rather than effort—and they are therefore fair game for redistributive taxation. Wealthy people generate ‘negative externalities’ (envy and resentment) just by being wealthy! He is scathing about excesses in executive remuneration, particularly in financial institutions.

There is no doubt an element of truth in what Tanzi says about market failures, but can *all* high incomes be characterised in that way, or so many as to justify a fundamental change in tax policy? And while government regulation affects income distribution, it does so in disparate ways and the net effect is not clear. I can think of many regulations that help the downtrodden and hurt the rich and powerful. The book cites impressionistic and anecdotal evidence, but I don’t know if that’s enough to support its strong claims. This discussion is also heavily slanted towards recent US experience, which may limit its relevance to other countries.

Despite venting fury redolent of the Occupy movement, *Termites* is not a call to revolution—it accepts a system of democracy and markets as the best—and with a few exceptions is not even prescriptive. It is very good at setting out the problems and issues, the pros and cons, and alternative courses of action, and gives competing views a fair hearing. But the reader won’t find a specific agenda for action. I ploughed through the book constantly expecting a firm policy recommendation on the next page, but it usually didn’t come. This doesn’t mean the book lacks value—it just stops short in a way that may disappoint some readers.

Tanzi concludes by echoing Keynes’ call in the circumstances of 1925 for ‘new wisdom for a new age’

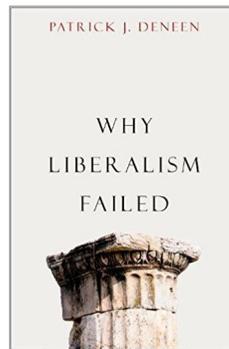
(p.399). As markets are not operating optimally now just as they weren't in 1925, we need a new wisdom of 'well-designed and well-monitored policies [to] bring [markets] closer to the ideal' (p.400). If we fail, populist remedies will multiply and lead to worse outcomes. This is a sobering conclusion. It's just not clear what the 'new wisdom' is.

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Why Liberalism Failed

By Patrick Deneen
New Haven and London,
Yale University Press, 2018,
\$US 30.00, 179 pages
ISBN: 9780300223446



Reviewed by Jeremy Shearmur

Why *Liberalism Failed* is a hard-hitting criticism of liberalism in all its forms, from welfare liberalism to libertarianism, written by a conservative American political scientist. Deneen is explicitly critical of that mixture of classical liberal economics and moral traditionalism which has been popular among many American conservatives. His book has been very well-received, and he has been much feted by conservative organisations and publications.

Deneen weaves a striking story out of several different elements. At its heart is the idea that liberalism favours individual autonomy, and that this is not only a starting point in typical liberal political reflection (for example, in social contract theories), but also that liberals (of all kinds) favour the idea of the state as *creating* autonomous individuals. This happens directly and indirectly by way of destroying traditional institutions and

attachments which previously served to constitute people as moral creatures. Deneen's account makes use of some ideas familiar from American conservatism. He favours Classical and Christian ideas about virtue, and the need for people to be shaped as virtuous. (Here he favours an Aristotelian approach to morality and virtue, but does not deal with the problem that it was on the face of it fatally undermined by the shift away from Aristotelianism in science, which offers a picture of nature that is not teleological.) He is also very keen on Edmund Burke and Alexis de Tocqueville.

Deneen's account of liberalism is strongly influenced by Leo Strauss's controversial view that John Locke should be understood as really a Hobbesian. Indeed, Deneen's view of liberalism is a Hobbesian (or economistic) one, in which people are understood as self-interested, and as not having specific characters shaped by various traditions—or if they have, it is seen as being a key task of the state to enable them to acquire the kind of autonomy needed to question it. On Deneen's view of liberalism, nothing is seen as legitimate unless it is chosen by 'autonomous' individuals. He sees liberals as calling on the state to create people as 'autonomous', but then to regulate them, ever more intensively, to restore a modicum of the order in their lives that older—but now illegitimate—institutions once gave them. Liberalism, on his account, is not opposed to but *requires* statism.

This captures an important point about modern welfare liberalism. But modern classical liberals might find this puzzling, for they are anti-statist. Deneen here offers an argument from Karl Polanyi which suggests that state action is needed to remove various traditional (legal) obstacles to free trade. As an extension of this theme, he cites John Stuart Mill as having argued for state action—and even slavery!—to push people into a market economy. The Mill material is indeed striking, but the wider argument is not as strong as Deneen thinks. First, if there are legal obstacles to the development of a market-based society, it seems a bit rich to claim that someone is a statist for calling on government to change this legislation. Second, Deneen does not appreciate liberalism's arguments about the general benefits of participation in an extended market economy.