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The Tax Wilderness

How to Restore the Rule of Law

Geoffrey de Q. Walker

Perspectives on Tax Reform (1)

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Foreword

The total tax take in Australia is very high. This year, Tax Freedom Day—the point in the year where we finally generate enough money to cover the government's annual spending so that we can start to earn money for ourselves—falls on 21 April. This means all of us on average are working nearly four months of every year just to keep the government going.[1]

Some advocates of even higher government spending suggest that, compared with other developed economies, Australia is still a 'low tax' country, and that workers and companies could comfortably pay more.[2] They are wrong. The total proportion of GDP that goes to the different levels of government is slightly below the OECD average, but this is only because we raise less than they do in indirect taxes such as the GST. When it comes to taxing incomes, Australia is up there with the continental Europeans and is way ahead of most of its neighbours in the Asia-Pacific region.

The Economist recently reported how much a production worker with two children earning an average manual wage loses in tax and social security contributions (net of allowances received) in different OECD countries.[3] In Australia, this worker forfeits 15 percent of gross earnings—more than in France, Italy, Japan, the United States, the United Kingdom, Spain, Austria, Switzerland, Portugal or Ireland. Higher earners do even worse—our top rate of income tax (47% plus Medicare levy and surcharge) is only a bit higher than in other OECD countries, but it cuts in at a much lower income threshold (A$62,000 here, compared with A$83,000 in France, A$84,000 in the United Kingdom, A$98,000 in Germany, A$115,000 in Canada and A$549,000 in the United States).[4] But it is the so-called 'battlers' on very low incomes who come off worst of all, for as they increase their earnings, high rates of income tax combine with the loss of means-tested benefits to deprive them of 60, 70 or even 80 cents of every extra dollar they earn.

Concern about the effects of effective marginal tax rates like these generally focuses on the economic issue of incentives. There comes a point when the prospect of giving up half or more of any additional earnings leads people to decide that it is simply not worthwhile making the extra effort. Taxation then starts to produce gross inefficiencies, for people stop working as much or as hard as they used to, and governments find their tax levies are not producing the revenue they have come to expect. Governments are drawn into a vicious spiral, jacking up tax rates to try to compensate for the falling revenues that their high tax demands have created.

In *The Tax Wilderness*, the first in a series of CIS monographs on tax reform in Australia, Geoffrey Walker discusses these perverse disincentive effects and the mess that governments get themselves into in responding to them, but he also points to another set of issues less often considered in discussions of tax policy, namely, the legal consequences of ever-increasing taxation. Walker's analysis demonstrates, that high taxes can not only undermine a nation's wealth, but also erode the fundamental principles of the rule of law.

The rule of law requires that rules and sanctions be clearly specified in advance (so people know how they are supposed to behave and what will happen if they do not), and that all rules apply equally to everybody. Walker shows that, as taxation has rolled forward, so the rules governing tax liabilities have become so tangled and complex that nobody can be sure any longer what the rules say or how they will apply in any given case. We live, he says, in 'an anomic state in which the law has lost its intelligibility, certainty and predictability'. The inevitable result is that the Australian Tax Office (ATO) has come to enjoy huge discretionary powers. The ATO no longer simply implements a known set of rules, but rather is in the business of developing and amending the rules case by case. 'The tax system', says Walker, 'can hardly be called "law" at all but rather direct bureaucratic rule.'

The combined effect of ever-rising taxes and the increasingly arbitrary interpretation of tax rules has eroded the moral basis of taxation. Walker recognises that nobody ever enjoys paying taxes but he points out that in the 1950s and 1960s, relatively low taxation and a comparatively simple set of tax rules meant that most people paid what was due without too much complaint

or ill will. Today, however, the ATO (and behind it, the government) finds itself locked into a destructive relationship of repression and resistance with ordinary taxpayers. Where people can avoid tax (for example, by exploiting loopholes, or by gravitating to the informal economy), they increasingly do so; where they cannot (the PAYG taxpayers who have tax deducted by their employers before they ever get to see the money), people become resentful at the unfairness of it all.

If we are to extricate ourselves from what Walker calls this 'downward spiral of dysfunctionality', we need to restore the goodwill of the public by getting tax levels back to something which most people would see as reasonable. Walker recommends three specific policy changes: a rise in the zero-rate tax-free thresholds (so that nobody pays tax until they have at least earned their own subsistence); a cut in the top rate to no more than 30 percent (to restore work incentives); and a return to the indexation of tax brackets (to stop governments profiting from their own failure to control inflation through so-called 'bracket creep').

To the extent that tax cuts like these result in a shortfall of revenues, Walker suggests much of the difference could be made up by radical reform in the welfare system (the biggest and fastest-growing sector of public expenditure).[5] His key message, however, is that revenues will not fall to anything like the extent that defenders of big government fear, because popular resistance will decline as people come to see the tax system as fair and reasonable. The truth of this insight has been demonstrated many times since the famous 1981 Reagan tax cuts (which produced a $9 billion increase in revenues when a $1 billion shortfall had been forecast). Walker cites the recent example of Russia, where the move to a 13 percent flat rate tax in 2001 increased revenues from 9 to 16 percent of GDP, as well as the cut in the Australian company tax rate from 39 to 30 percent (where again, revenues went up rather than down).

The importance of Geoffrey Walker's paper is that it shows the price we are paying as a nation for government's failure to keep its tax demands within reasonable bounds. It is bad enough that escalating taxation is undermining enterprise, penalising initiative and destroying the will to work. When we add to this the corrosive effects it is having on the fundamental principles of the rule of law, and on the moral relationship between the state and its citizens, the case for fundamental reform becomes even more compelling.

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Endnotes

1. J. Buckingham (ed.), *State of the Nation,* Fourth Edition (Sydney: The Centre for Independent Studies, forthcoming).
2. The latest example is Michael Keating, 'The Case For Increased Taxation', *Policy Paper* No.1 (Canberra: Academy of the Social Sciences, 2004).
3. *The Economist* (1 March 2003), 94. The report was based on OECD, *Taxing Wages* (Paris: OECD, 2002).
4. KPMG report cited in *The Daily Telegraph* (5 February 2003).
5. For more detailed analysis of potential savings from welfare reform, see P. Saunders, *Welfare Isn't Working* (Sydney: The Centre for Independent Studies, forthcoming).

Executive Summary

The crucial role of sound institutions of government in creating the conditions for growth and prosperity is well understood today. Of those institutions the rule of law is the most vital.

In the federal tax field, however, the rule of law has all but collapsed under pressure of the sheer volume of often unintelligible legislation and the grant of wide discretions to the Australian Taxation Office (ATO) and the courts. The ATO, with its power to vary the incidence of tax and issue binding rulings, is increasingly becoming the final deciding authority. Legal advice leaves taxpayers unmoved as ATO rulings become the only source of certainty for those seeking to plan their future activities.

The separation of powers has also virtually broken down: the executive government exercises legislative and quasi-judicial powers, the judiciary exercises policy-making powers, rights effectively turn on opinions about a citizen's purposes and in a variety of ways the law is changed at the point of application.

A symptom-oriented attack on these specific problems would not heal our institutions of government and would only ensure that the problems of evasion, avoidance and pathological administration would reappear in some other form. A lasting solution must take account of the insights of public choice research and of the effects that the rampant inflation of the 1970s and 1980s has had on tax scales and the dynamics of revenue collection. As these effects have never been squarely faced, the worldwide tax revolt of the 1980s largely passed Australia by.

The modest tax cuts of recent years have been too small to rectify the pattern of perverse incentives bequeathed by uncorrected bracket creep. Effective reform, for example, should include raising the tax-free threshhold to $14,000 and substantially overhauling the rate structure, perhaps adopting the 30 percent top rate recommended by the IMF. Experience overseas and in Australia shows that substantial tax cuts, because of their impact on incentives and growth, need not cause revenue shortfalls.

Controlling public sector expansion is a key issue in the tax debate, and recent research shows great scope for slimming the welfare budget, which currently represents 29 percent of government outlays, federal, state and local. Since the 1960s, real national wealth at all levels of income has doubled, yet governments' welfare spending has increased fivefold. One subject for reform is the definition of poverty itself, which currently focuses on inequality rather than need. Other important reforms include the restoration of tax indexation, the lack of which is the main cause of our present misfortunes.

Survey results show majority support for both tax and welfare reform, and the beginnings of a public debate can now be seen. Australia faces a rare opportunity to boost general prosperity, end the brain drain and restore the rule of law.

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INTRODUCTION

TAXATION, INSTITUTIONS AND GROWTH

The importance for national prosperity of sound institutions of government, and especially of the rule of law, is well understood today. *The Australian Law Journal* notes that 'Institutional economics has established a high correlation between economic growth and the rule of law'.[1] Research indicates that most of the international variation in income per capita—perhaps as much as 85 percent—can be explained by the institutions and policies countries adopt.[2]

Equally well appreciated is the quasi-constitutional nature of tax law. It is the primary link between a nation's citizens and their government, a window into the nation's views about justice and civic society.[3] The Nobel laureate James Buchanan points out that part of its quasi-constitutional character comes from the fact that it remains in force, with minor variations, over a sequence of budgetary periods[4] as well as electoral cycles. But it goes beyond that. Revenue law and policy played a central role in the evolution of Western constitutional democracy, not least because it triggered the three great constitutional revolutions—the English, the American and the French. Australia's only popular uprising, the 1854 Eureka rebellion, is generally regarded as a tax revolt. The United States experience with the income tax levied to finance the war of independence—which Jefferson attacked on the ground that it required the government to wage a war against the people to collect it—led the constitutional framers to deny Congress the power to impose an income tax, a power it did not receive until the 16th Amendment was passed in 1913.[5]

Joseph Schumpeter once said that a people's spirit is written in its fiscal history, 'stripped of all phrases'. In like vein, the historian Charles Adams views the whole history of organised society as a series of events in which government increases its tax burden beyond what taxpayers are willing to stand. That then leads to taxpayer revolt, violence and drastic changes in the structure of society.[6] On that view, the state of a nation's tax system is a good pointer to its social and political future.

PART ONE

THE FEDERAL TAX SYSTEM: THE DECLINE OF LAW'S EMPIRE

The Australian tax system displays a range of symptoms suggesting a virtual collapse of the rule of law. Those symptoms include the flourishing cash economy which, as Mark Latham points out, at an estimated 15 percent of GDP is one of the developed world's largest and equivalent to New Zealand's entire economy.[7] An underground economy of that magnitude requires the involvement not only of many businesses, but also of millions of consumers, who apparently believe that the greater spending power they can achieve through cash discounts is worth more than the duty to comply with a law they obviously consider unworthy of respect.

Australia's flourishing cash economy is estimated at 15 percent of GDP, equivalent to New Zealand's entire economy.

Another symptom is the growing irrelevance of the law and its institutions. Tax advisers display increasing signs of disorientation in trying to cope with a body of law that the Federal Court's Justice Hill, then a leading tax barrister, in 1987 described as 'unintelligible'.[8] Normal legal advice is problematic because otherwise lawful arrangements can be overriden through the semi-subjective appraisals of purpose creeping into the application of Part IVA of the Income Tax Assessment Act 1936 (Cth). The High Court now seldom grants leave to appeal in federal tax cases, as if it had given up hope of keeping the tax system subject to legal principle and normal adjudication methods, despite revenue law's constitutional importance.

The present state of the rule of law in the federal tax arena stems from a number of immediate causes. These causes can also be viewed as symptoms because, as general systems theory tells us, effects have a tendency to feed back into the causation process.[9]

Symptoms and Causes

1.Tax Legislation: Volume and Uncertainty

The sheer quantity and ever-changing content of tax legislation is undermining its ability to command general obedience. That is partly because of the practical difficulty of knowing what the law is and what it means. Before the High Court in the *First Uniform Tax Case*[10] needlessly gave the Commonwealth a monopoly (at first *de jure,* later *de facto*) of income taxation, the relevant federal legislation occupied 81 pages in the statute book. Now it has exploded to 8,500 pages, or 13,500 pages if one includes fringe benefits, capital gains and superannuation provisions. It has been estimated that if tax legislation were to keep growing at the present rate, it would cover 830 billion pages by the end of the century and would take 3 million years to read.

The sheer mass and continual amendment of this legislation, coupled with the hazardous interplay of lengthy and widely scattered definitions and deeming provisions, make predictable interpretation and reliable advice next to impossible. The ATO's assessors themselves can understand only a small part of it. Even in 1987, Justice Hill, having described much of the legislation as 'unintelligible', went on to say that '[m]any provisions in the legislation are not applied for the simple reason that no one is able to comprehend them'.[11] While the rule of law does not require that all laws be applied all the time,[12] beyond a certain point non-application creates a risk that normally unused provisions will be enforced for discriminatory or arbitrary purposes. That kind of uncertainty is inimical to productive investment and growth.

Behind the vast volume of actual legislation looms an equally massive bulk of ATO public determinations, public rulings, bulletins, interpretative decisions, policy papers, circulars, administrative guidelines and practice statements. Some of these are expressed to be binding on ATO officers, and in general staff (no doubt prudently) rely on these sources rather than on the legislation, thereby giving them in practice something close to the force of law. In perhaps 90 percent of cases these materials are consistent with the enacted law, but in the remainder the ATO is effectively making its own rules. In generating this mountain of administrative norms the ATO may be doing little more than trying to make an unworkable law work. But the net result is to add to the system's unfathomable obscurity.

The sheer quantity and ever-changing content of tax legislation is undermining its ability to command general obedience.

Uncertainty in the law is a major factor in undermining the rule of law, and tax is riddled with it. That stems in part from the legislation's sheer volume and detail,[13] for which the Treasury is usually blamed, and in part from such inherently indeterminate provisions as the general anti-avoidance rule ('GAAR') in Part IVA.[14] Even the most punctilious compliance with all applicable specific provisions is liable to be second-guessed, and perhaps nullified, by the ATO or the courts under Part IVA. Purposive interpretation is thwarted when no clear principle underlies the law, as when the legislature uses tax incentives to promote objectives other than revenue raising.[15]

As Lord Oliver has pointed out, where there are legal rules in an area without a clear moral imperative, the rules must be clear.[16] On the question of tax law's moral content Justice Learned Hand was blunter: '[N]obody owes any public duty to pay more than the law demands. Taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.'[17] Whatever moral force the legislation may have is undermined when its complexity and ambiguity make outcomes depend, not on working out the right answer, but on inside knowledge, administrative concessions or luck.[18]

The attitude of many taxpayers (other than the wretched conscripts of the PAYE army) is increasingly to treat the law and the courts as irrelevant. Legal advice leaves them unmoved. All they really want is an ATO ruling that will protect them from penalties or prosecution. Many just surrender and let the government have its way. 'A common comment by corporates now,' observes KPMG's Michael Evans, 'is, "I know I'm not getting it right but if the Tax Office wants to come out and go through everything and tell me where I've underpaid, I'll pay it because that is cheaper than putting a process in place to comply with it."'[19] We have come a long way—from John Hampden and 'the rights of Englishmen'[20] to Part IVA and hopeless resignation.

Taxpayers and their advisers are unanimous in pleading for tax law to be made shorter and clearer. Unfortunately, if other factors are held constant, it may be hard to have both. A tax act that is shorter and simpler may not be clearer or more certain—the legislation's stupefying detail is, after all, an attempt at certainty.[21] On the other hand, the revenue lobby (comprising the ATO, the Treasury and their allies in politics, academia, the media and the welfare industry) are less perturbed. They realise that the law's very uncertainty and incomprehensibility advances their agenda, because it enables the tax authorities to offer taxpayers the predictability they need for long-term planning and adjustment in exchange for somewhat heavier assessments. As Geoffrey Brennan and James Buchanan point out, 'If government can succeed in keeping taxpayers off balance in their planning, additional revenue potential may be available for exploitation.'[22]In other words, the government can run a kind of protection racket, offering immunity in exchange for larger tax payments than the law, properly construed, might require.

Others, however, see a very different kind of advantage in the complexity of tax legislation: '[T]ax complexity has a positive role to play in our national evolution. It is history's way of telling us that we have the wrong system for raising funds for public purposes—and compelling us to find another.'[23]

2. Statutory Discretions: Wagging the Dog?

A further symptom of the law's growing irrelevance in the tax field is the swelling number of wide statutory discretions granted to the commissioner.

Such discretions are not new. An early example from 1964 was s 99A of the Income Tax Assessment Act (ITAA), which left it to the commissioner to decide in certain circumstances whether a person should be required to pay tax on trust income at a higher or a lower rate. Over time such provisions have multiplied: in 1973 came s 80DA (prior year losses), in 1981 s 102AE(6) (non arm's-length transactions), and in 1984 the discretionary penalty remission provisions in s 222. By 1982 the trend was arousing concern, with Chief Justice Street of New South Wales pointing out the unequal bargaining positions of citizen and bureaucrat in litigation, with its tendency to enhance the power of the bureaucracy and make it more authoritarian in its dealings with the public.[24]

Judicial review serves the rule of law when courts apply known rules and principles, not when their decisions may turn on their opinion.

The ultimate grant of discretionary power is, of course, Part IVA, enacted in 1981 and to which the rest of the Act is subject. Australia has placed more reliance on the GAAR than any other Western democracy,[25] and Part IVA's supporters argue that it may strengthen the rule of law by increasing compliance with tax legislation.[26] The problem, however, is that it seeks to encourage compliance by means that compromise the rule of law, for example by depending on discretion and opinion.[27]

Part IVA enables the ATO to alter the scope of the tax law, to impose what amounts to a tax by analogy where none was imposed by the statute. It can declare after the event how much tax is to be paid without saying it in advance.[28] There is also a problem in ensuring that in reaching these decisions the ATO applies only relevant criteria,[29] not least in view of the commissioner's policy of targeting taxpayers he considers to be 'aggressive' in their tax planning. Quite apart from that, Professor Jeffrey Waincymer argues, this approach 'offends against the separation of powers doctrine and the requirement that laws be made by parliament not bureaucrats'.[30]

The ATO's exercise of its discretions may be reviewable by a court but, quite apart from the difficulty of persuading a court to overrule a discretionary ATO decision when the burden of proof is reversed as in Part IVA appeals, vesting a wide discretion in a court is no great improvement on vesting it in an executive official. Professor Waincymer has warned that in Part IVA 'too many key policy questions have been left for judges to answer'.[31]

Judicial review serves the rule of law when courts apply known rules and principles, not when their decisions may turn on their opinion about someone's purposes [32] or on policy questions, and when the result may be to disapply explicit statutory provisions. Sir Harry Gibbs considers that Part IVA's discretionary power to override other provisions of the Act

'amount[s] to an abandonment of the rule of law'.[33] Neither Britain nor the United States has a GAAR, and practitioners from those countries aver that the rule of law has survived relatively well in their tax systems.

Another site of discretionary power is to be found in the commissioner's powers of settlement and compromise, which are described in the ATO's *Code of Settlement Practice* and in its *Receivables Policy*. Resting on the general provisions of s 8 of the ITAA 1936 and s 3A of the Taxation Administration Act 1953, these powers give effect to the 'good management rule', an accepted principle in revenue law that recognises the need to make efficient and sensible use of the ATO's resources. Particularly in relation to advance pricing agreements, the exercise of these powers carries the risk that the ATO may make arrangements with a taxpayer that operate outside the law, a possibility that became reality in the United Kingdom in the *Fayed* case.[34] In Australia, the settlement and compromise powers have so far worked reasonably well, but their existence adds to the growing irrelevance of the law.

The grant of wide discretions on this scale has two main consequences for the rule of law. First, it conflicts with both the principle of legal certainty and the principle of equality before the law. It becomes harder for citizens to plan ahead if they have no sure way of ascertaining what their future tax liability will be (subject to the rulings system, of which more in a moment), while the discretions are so wide that there is no assurance that similar cases will be treated in a similar way. Secondly, broad discretions threaten the constitutional principle that no tax should ever be laid that has not been specifically authorised by parliament. That principle was established by John Hampden in his resistance to paying ship-money in 1637 and later reasserted, in different ways, in both the French and American revolutions. In Edmund Burke's words, 'Would twenty shillings have ruined Mr Hampden's fortune? No! But the payment of half twenty shillings, on the principle it was demanded, would have made him a slave.'[35] Thus A.L. Goodhart, writing in 1958, thought it self-evident that '[i]t would be a gross violation of a basic constitutional principle if Parliament were to give any Minister discretion in a matter relating to taxation'.[36]

Only the largest corporations and wealthiest taxpayers can now afford to challenge an ATO decision in court or otherwise seek judicial review.

3. The Rise of the ATO as Deciding Authority

A third symptom is the growing ascendancy of the Australian Taxation Office as the final authority, combining aspects of the executive, judicial and even legislative roles. Only the largest corporations and wealthiest taxpayers can now afford to challenge an ATO decision in court or otherwise seek judicial review. For most citizens today, the best source of 'legal' certainty is an ATO ruling. The ATO knows this and encourages the attitude behind it by offering safe harbour to the taxpayer tempest-tossed on a sea of dubiety.

Under the system of self-assessment, itself made necessary by the inability of tax assessors to keep up with the flood of amendments and case-law, some form of binding ruling procedure was essential if any reliable predictions of tax liability were to be possible. Hence the introduction in 1992 of the present public and private rulings regime,[37] embodying dispensing powers of such scope as to make a James II sob with envy.

Useful though it is in present conditions, the rulings system has adverse consequences. One is that it weakens the separation of powers. A central tenet of that doctrine is that it must not be possible to change the law at the point of application. That ensures that the judicial function determines the citizen's rights by reference to previously enunciated legal rules and principles rather than by personal opinions or extraneous policy considerations.

The system of binding rulings puts the ATO in the position of effectively giving final determinations, thereby intruding into the judicial function and making the ATO judge in its own cause. At the same time it overlaps into the legislative role,[38] as in the system of internal directives described above, or when we see the ATO laying down what look very much like statutory rules, as in the case of limited recourse loans in *Firth*.[39] During the Boucher era the commissioner occasionally went so far as to announce that the ATO was proposing to 'amend the law' in some way.

Some tax commentators deprecate the role of the separation of powers in the revenue context and would prefer the roles of the three branches to be seen as a mere 'specialisation of functions', with the courts and the legislature 'simply play[ing] different roles in the policy-making process'.[40] 'The role of judges in tax cases should be to decide what result would reflect the most sensible tax policy'.[41] But there can never be that kind of collaboration or overlap between the three branches of government. The rule of law needs a degree of tension between them in order to ensure impartial enforcement and independent adjudication.

If those separation lines become blurred, as they have following the expansion of the ATO's role, other consequences will start to appear. Under such a system, Professor Waincymer points out, 'There is also no guarantee that the administrator will be impartial, fair or would appropriately balance the interests of taxpayers against the interests of revenue collection'.[42] On the contrary, there is good reason to fear that constant government pressure on the ATO to maximise collections will have the opposite effect. One sees this in emerging double standards, as when the ATO applies Part IVA when it considers an arrangement to be outside the 'spirit' of the legislation (as the ATO interprets that 'spirit'), but when the GAAR produces an unintended liability, commitment to the spirit of the law is discarded in favour of strictly literal interpretation. Again, while a concessional ruling is welcome to the parties, it can cause resentment in others who are not similarly favoured. Both these developments create a feeling that equality before the law is being compromised and strengthen perceptions of unfairness.

Renumerating tax officers according to the amount of revenue they collect recalls the 18th century tax-farming abuses that helped trigger the French Revolution.

The advent of staff performance bonuses is unlikely to improve matters.[43] The practice of remunerating tax officers according to the amount of revenue they collect recalls the 18th century tax-farming abuses that helped to trigger the French Revolution. It may tend to weaken the principle of even-handed enforcement which, like equality before the law, is an important element of the rule of law.[44]

Heavy reliance on bureaucratic rulings has given rise to corruption in some Third World countries. Allegations of bribery in a pending criminal case involving ATO approval of certain mass-marketed avoidance schemes suggest that the Third World phenomenon may have landed on our shores, an alarming development given the historical rarity of blatant bribery in Australian state and federal government.

The Constitutional Wilderness

The erosion over recent decades of vital constitutional and juristic principles has brought us to an anomic state in which the law has lost its intelligibility, certainty and predictability, where the executive government exercises legislative and quasi-judicial powers, the judiciary exercises policy-making powers, where rights effectively turn on opinions about a citizen's purposes, where the principles of impartial enforcement and equality before the law are undermined and where, in a variety of ways, the law is changed at the point of application. The notion that the courts should give effect to government policy, which was banished by *Entick v Carrington*[45] in 1765, is starting to return in areas such as GAAR, with the encouragement of some commentators.[46] The nation's highest court seems to have all but abandoned the federal tax field as doctrinally unrewarding[47] and scholarly writers have concluded that it is no longer possible to write a treatise identifying authoritative principles in Australia's federal tax law.[48]

The result is that the tax system can now scarcely be called 'law' at all but rather direct bureaucratic rule. While the law does retain vestiges of its role—judicial review would still prevent totally arbitrary treatment, such as a higher rate for blue-eyed taxpayers—for most citizens the judicial system and the traditional analysis of legal rights in the tax arena[49] are irrelevant. Some commentators take a relaxed view of that trend. Professor Graeme Cooper, for example, speculates 'whether the rule of law is still important in the tax context. For example, the rule of law might be a value that should be given absolute primacy in cases where the curtailment of personal freedoms, or the expropriation of property without some attempt at lawful justification is threatened. But might it be appropriate to modify or circumscribe its application in a tax context . . . ?.'[50]

That would be a perilous step. The constitutional importance of tax law as a template for the relationship between government and citizen is widely recognised. Even Justice Lionel Murphy warned that vesting tax officials with more and more discretion 'may well lead to tax laws capable, if unchecked, of great oppression'.[51] Further, governments may use tax laws as the vehicle for the wider erosion of civil liberties. The Hawke government exploited an alleged 'crisis' of tax avoidance as a pretext for introducting compulsory ID cards, that recurring dream of elitists and authoritarians everywhere.[52] When the necessary implementing regulations were blocked by the Senate, the government dropped the idea and little more was heard of the tax avoidance 'crisis'.

PART TWO
THE DYNAMICS OF DEADLOCK: ENFORCEMENT VERSUS RESISTANCE

The Commonwealth's approach to avoidance and the underground economy has been to attack selected symptoms. The PAYG system and the GST have set off in pursuit of part of the cash services sector. Discretionary powers and Part IVA lie in wait for those who do not cleave to the spirit of the law, and Australia has placed more reliance on GAAR than any other Western democracy, to the detriment of more fundamental tax reform.[53] But for all that the front-line has not moved far. Research into the psychology of taxation reveals that increasing the authorities' enforcement zeal may be counterproductive if it fails simultaneously to deal with underlying causes. More effective policing may in fact cause more effective resistance by worsening attitudes,[54] and heavier penalties will only multiply the number of appeals.

Just as the symptoms approach to avoidance and evasion has produced disappointing gains and unintended consequences, merely targeting the specific anti-rule of law phenomena described above will not be enough to heal our institutions of government. Cutting back discretions, confining the ATO and the courts to their constitutional provinces and ending Part IVA's flirtation with imputed subjective purpose[55] will not reinstate the rule of law. The Taxpayer's Charter and the Inspector-General of Taxation will do little more than prevent or put out spot fires without mitigating the underlying problem. Simultaneously making the legislation substantially simpler, shorter and clearer—goals favoured on all sides—may be an unattainable objective.

More effective policing may in fact cause more effective resistance by worsening attitudes, and heavier penalties will will only multiply the number of appeals.

The symptom-oriented approach will only ensure that the problems of evasion, avoidance and pathological administration will reappear in some other form, such as emigration, leisure substitution and the storming of remaining shelters, such as negative gearing or the financing of ghastly motion pictures. That will follow inevitably if reform disregards the basic dynamic of federal taxation in Australia today. That dynamic is the irreconcilable confrontation between the two opposing forces of (1) enforcement and (2) resistance.

1. Enforcement: Formerly, economists and political scientists interpreted the revenue-raising process through the 'benevolent despot' model, under which the institutions of power were assumed to act in the 'public interest'. Government was seen as raising revenue to the extent needed to pay for a suitable list of public goods. If citizens conscientiously paid their tax and a surplus resulted, government would reward them with a tax cut.

That perspective was associated with the public finance theories of such economists as Francis Edgeworth and Arthur Cecil Pigou. It was first questioned by the Norwegian scholar Knut Wicksell, who complained that it 'seem[ed] to have retained the assumptions of its infancy, in the 17th and 18th centuries, when absolute power ruled almost all Europe'. It was also criticised as being 'unmotivated', and thus unconvincing: it offered no reason why governments or rulers would be motivated to use their power to advance the public interest rather than their own.[56]

A model that would explain public finance in the context of a modern mass democracy was thus needed. It was supplied by public choice theory, essentially the application of economics

to political science,[57] which posits that politicians and bureaucrats act from the same motives of self-interest as everyone else. 'The State is not the agency that nobly and conveniently steps in to correct the supposed deficiencies of the free market,' writes Professor Gary Anderson, 'but a giant rent-seeking machine that provides coercive wealth transfers to the highest bidder (albeit in a fairly efficient market)'.[58]

Public choice economics has replaced the benevolent despot theory with the model of government as a Leviathan that spends up to the limit of its revenue-raising capacity. This view, magisterially enunciated by Professor Geoffrey Brennan of Australian National University and the Nobel laureate James Buchanan,[59] offers a much better explanation of contemporary reality and has annihilated the old benevolent despot view, at least among economists.[60]

The public choice perspective also points out that normal electoral processes are insufficient to restrain self-seeking governments and bureaucracies. The authors note that the tax revolt in the United States began in 1979 with Proposition 13, a California citizen initiated referendum (CIR) measure. It emerged from outside the normal parliamentary processes and interparty competition, in the face of opposition from most of the political and media establishment.[61]

Substantial reform can also be pushed through by semi-revolutionary figures such as Margaret Thatcher or New Zealand's Roger Douglas, but where both CIR and influential firebrands are lacking, as in Australia, Leviathan can block any significant lessening of his revenue-raising power. On the contrary, any changes he makes tend to increase it.

2. Resistance: There will always be some people who will break even the fairest tax laws. Those Sydney barristers who omitted ever to lodge a return did so even in the 1960s, when they would have paid a marginal rate of only 25 percent. But today's trench warfare between non-compliance and government arbitrariness is a comparatively recent phenomenon that dates only from the 1970s.[62] The 1950s and 1960s, one perplexed commentator observes, were marked by an 'almost sheep-like taxpayer compliance' that mysteriously broke down in the next decade.[63] Apart from illustrating the academic tendency to portray the Australian people as somewhat less than human, this account overlooks the crucial development that transformed taxpayer attitudes. That was the ravaging inflation unleashed by Frank Crean's 1973 and 1974 federal budgets which distorted the established tax scales out of recognition and vastly increased the burden of government on the people. That may have been the intention,[64] though the government of the day tried to make it look like an accident. Those distorted scales remain substantially uncorrected to this day.

Today's trench warfare between non-compliance and government arbitrariness is a comparatively recent phenomenon which dates only from the 1970s.

Until the massive bracket creep (or gallop) of the 1970s, most people complied with the tax laws, partly because they considered them reasonably fair, and partly because non-compliance did not pay—the relatively minor savings obtainable did not warrant the costs and risks involved. Thus, taxpayer compliance was rewarded with reasonable tax laws; or, more accurately, reasonable tax laws were rewarded with taxpayer compliance.

It is common ground that unfairness in a tax system threatens compliance. Australians see the present federal tax system as unfair for two reasons:

(i) The rich are able to avoid tax in ways unavailable to earners whose tax is deducted from their wages, and;
(ii) Income tax rates are too high.

During the 1980s in Australia, the revenue lobby succeeded in diverting the political-media debate almost exclusively onto reason (i). Reason (ii) is the one that directly affects and influences most people, but it was almost never mentioned. That is still the case today.

The result was that the great tax revolt of the 1980s passed Australia by. While in Britain, the United States and New Zealand income tax rates fell sharply, in Australia the abolition of the 60 percent rate was more than outweighed by the abolition of tax indexation[65] and the introduction of a raft of new taxes and restrictions, including capital gains tax (CGT), fringe benefits tax, heavy taxation of retirement benefits, the tax file number and later the goods and

services tax. The income tax cuts that accompanied the introduction of GST have also been swallowed by bracket creep, for Australia, unlike Britain, still has no tax indexation.

For Australians the only significant relief during the tax revolt era came at the State level, with the virtual abolition of death duties. That came about because the political establishment could not control Queensland's Bjelke-Petersen government, which was the first to do away with that unpopular impost. Interstate competition did the rest,[66] for unlike the Commonwealth, individual States lack monopoly power and cannot prevent people from voting with their feet. The establishment struck back, however, reintroducing death duties by stealth via CGT; and this time, the revenue flowed to Canberra rather than to the then hard-pressed States.

The result was that Australia ended the century with its tax take at an all-time high and the nation has moved significantly higher in the international tax burden league table. In 2000-02 alone, Australian taxes on wages rose by 1.2 percent, while 19 OECD countries registered decreases in tax burdens, 15 of them reducing their top rate.[67] At present Germany is in the process of cutting its top rate from 48 to 42 percent, and France has announced a general 3 percent income tax cut. Most Australian families carry a heavier income and social security tax burden than average Britons, Americans and even the French. The OECD reports that a production worker's family in Australia loses 14.8 percent of gross earnings in income tax (after allowing for cash handouts), as against 14.5 in France, 11.5 in the USA, 11.1 in Britain, 9.0 in Austria and 8.5 in Switzerland.[68] The revenue lobby's promise that the new taxes and enforcement measures would lead to substantial rate cuts has been broken—another piece of evidence against the 'benevolent despot' theory and in favour of the government as Leviathan model.

The people have never voted for income taxes at the present rates and would have defeated any government that proposed them. The current situation is the result of bracket creep and failure to reform, and its results have been a decline in taxpayer morality: people do not regard working in the cash economy as cheating because they believe they are paying too much.[69] Government must increasingly rely on withholding or reporting at source.[70] While the cash economy has been called the tax avoidance of the masses, even the masses have been venturing into sophisticated forms of tax avoidance, with construction workers, Melbourne tram drivers and Sydney bicycle couriers being notionally employed by their own service companies and people of moderate means negatively gearing a second property.

Under our unreformed system, perverse incentives abound. At the lower levels, the growing tax burden is driving onto the welfare rolls people who could support themselves if taxes were lower.[71] The low tax-free threshhold of $6,000 gives them every incentive to stay on welfare, as they face effective marginal rates of up to 70 percent if they resume work and thereupon lose welfare payments. At the higher levels, a tax-driven brain drain is developing. Professor Wolfgang Kasper warns: 'young, mobile Australians know from a growing number of emigrated colleagues that, in most Asian countries, income taxes are much lower. This explains why Australia suffers from skill shortages and why occasional recruitment drives by short-staffed organisations so often fail.'[72] Robert Gottliebsen agrees: 'Many [expatriates] intend to return but discover the 48 percent tax rate cutting in at ridiculously low levels means they can't afford to move home until they've made their fortune offshore. It's then too late . . . [T]here is global competition for skilled migration, so if we wanted to increase total migration, we would have to lower our skills criteria'.[73] Australia's diaspora now numbers over one million, a high proportion for a young country of 20 million which is in other respects regarded as a good place to live.

The recent unprecedented housing bubble was fuelled by the tax treatment of negative gearing. The resulting price inflation has propelled ordinary family homes into the luxury land tax.

The disincentives are multiplied by large-scale distortions. The recent unprecedented housing bubble, for example, was fuelled by the tax treatment of negative gearing.[74] The resulting price inflation has propelled many ordinary family homes into the luxury land tax that most States levy on expensive real estate.[75] 'Parliaments and public commentators have lost sight of the fact that, beyond a certain point, government spending and taxation hamper

economic growth', Professor Kasper points out. 'No country has ever achieved per-capita income growth of 4 percent on a sustained basis once general government spending exceeds 40 percent of the national product. Australia is now edging close to this mark . . .'[76] Others note that Ireland did not become the 'Celtic tiger' until it slashed its spending to GDP ratio, which in 1985 stood at 51 percent, but by 2000 was down to 29 percent.[77]

In a famous exchange of views in the 1940s, Lord Keynes agreed with the eminent Australian economist Colin Clark that if government spending and taxation exceeded 25 percent of GDP it would become counterproductive.[78] Ironically, Australia's underground economy, estimated at 15 percent of GDP, seems to bring Australia's spending and tax to GDP ratio back to the 25 percent level, via what law and economics doctrine calls 'a corrective transaction'. But it does so in a haphazard and lawless way.

The rule of law is thus being steadily undermined by increasing resistance by the population, which is met by ever-increasing arbitrariness by the authorities. The two sides are deadlocked in a downward spiral of dysfunctionality. The only possible outcomes are a collapse into total authoritarianism or a thorough reappraisal and reform of the tax system. Reform is obviously preferable.

PART THREE
THE POTENTIAL FOR REAL REFORM

Reversing Negative Incentives: Lowering Tax Scales

To have any significant impact on the present morass of disincentives, distortions and non-cooperation, effective reform must include substantial reductions in the personal income tax burden. The modest cuts delivered so far are too small to affect incentives. A good place to start would be the tax-free threshhold (TFT) or zero rate step. At present, liability to income tax begins at an income of $6,000 per annum. That is less than half the annual dole of $12,370 (including rent assistance for a single person) or just over a quarter of the federal minimum wage of $22,400. In 1980 the TFT was $4,441, which in today's dollars would be $14,000, and in 1960 a family on average weekly earnings paid no income tax at all.[79] The same was true in 1943, when the government was funding a full share of the greatest war in history. For comparison, the French TFT today is 15,000 euros ($25,000).

Modestly renumerated people such as school teachers and nurses are joining Kerry Packer in the top tax bracket.

The current $6,000 threshold is of course modified by various offsets, but they are of little consequence. The Low Income Tax Offset, for example is worth a maximum of $150 at an income level of $20,701 and tapers off to zero at $24,449. Like all other offsets, it does not apply at all if it would result in a tax refund. The maximum Family Tax Benefit for two children (Part A) raises the threshold only to $6,400, while even for six children, Parts A and B combined increase it to no more than $13,900, or less than the real TFT level in 1980, a derisory concession given the cost of raising and educating six children. Being means-tested, it operates as a disincentive to work, whereas a higher TFT would not.

Although raising the TFT would benefit all taxpayers, not just the lowest earners, it would be hard for the Senate opposition to block it, as public opinion clearly favours such a change. An AC Nielsen/Centre for Independent Studies survey of 5,721 Australian residents in March 2003 found that 43 percent favoured a threshhold equal to the basic welfare level ($12,370), while 35 percent preferred the federal minimum wage level ($22,400). Only 13 percent were satisfied with the present position.

Next, the rate structure must be overhauled. It must be hard for citizens to feel any respect for a system under which, as now, a worker on close to the average weekly wage pays a marginal rate of 42 percent. And with the next step starting at $62,500, an absurdly low figure by world standards, such modestly remunerated people as schoolteachers and nurses are joining Kerry Packer in the top bracket, which now catches one taxpayer in five.

To reverse the brain drain, promote growth and restore the ethic of compliance, the top

marginal rate should be cut to 30 percent and should commence at a much higher level than the present $62,500. Corresponding adjustments to the other rates would be needed. A top rate of 30 percent would match the company tax rate and would permit substantial administrative simplification.[80] It would make the nation competitive in the race for internationally mobile capital and skilled labour, as a 2002 IMF assessment of the Australian economy argued.[81] It would also help to reduce Australia's high tax enforcement and collection costs.

The need for internationally competitive company tax is now generally accepted.[82] It is time to face reality on personal tax as well. There is no point in comparing Australia with the tax hells of the Old Europe, as the revenue lobby does. Australia's tax rates may not look heavy by that standard, but Europe's high taxes have led to seemingly insuperable stagnation[83] and some governments there are now introducing significant reforms. In any case, our immediate competitors are not in Europe but in the Asia-Pacific region where tax burdens are much lighter.

Because of their effect on incentives, large tax cuts need not lead to the commonly predicted revenue shortfalls. The Reagan administration's 1981 reduction of the top rate from 70 to 50 percent was denounced by academics and the media as an outrageous handout to the rich. The Internal Revenue Service predicted a $1 billion drop in collections from high earners in 1982. The reverse happened. Money poured out of avoidance schemes into taxable forms of activity. Non-withheld tax receipts, mostly payments by the affluent, rose from $76 billion in 1981 to $85 billion in 1982 and continued to rise in 1983. Instead of a $1 billion drop in tax receipts there was a $9 billion rise. In the midst of an economic downturn, a 28 percent cut in the top tax bracket had brought an 11 percent increase in revenues from the rich.[84] The further reduction of the top rate in 1986 from 50 percent to 28 percent (plus social security levy), paid for by reducing deductions, was likewise successful.[85] Similar results were reported from rate reductions in Japan, Hong Kong, Singapore, Austria and Britain, while rate increases brought disappointing gains or unexpected losses.[86]

A spectacular recent example is Russia, which in 2001 abandoned its 'progressive' rates and adopted a 13 percent flat tax on personal income. The lower rate, limited deductions and simpler system have produced vastly more revenue, with a 50 percent real increase in the first two years and overall economic growth of 10 percent. Over three years, income tax collections as a percentage of GDP have increased from 9 percent to 16 percent. Small business has a choice of either paying a 6 percent flat tax on their revenues or a 15 percent flat tax on their profits. Russia now has a budget surplus and the best tax laws in Europe.[87] China is reportedly considering copying the Russian model.

The federal parliament's slashing of the company tax rate from 39 percent to 30 percent has been followed by a sharp increase in revenue from that source.

The most recent illustration can be seen here in Australia, where the federal parliament's slashing of the company tax rate from 39 percent to 30 percent has been followed by a sharp increase in revenue from that source.[88] Indeed, higher company tax receipts were largely responsible for the $7 billion budget surplus announced in September 2003. While economic growth was a major reason for the higher company tax collections, it is also likely that part of that growth itself stemmed from the incentive effects of the rate cuts.

At present even the modest reforms linked to the introduction of GST have been largely blocked. The opposition in the Senate has rejected the lifting of the top rate threshhold to $75,000. A diluted version of the superannuation surcharge reform was allowed through only because it was cynically understood that the minor tax cut involved would soon be negated by bracket creep.[89] It is perverse that Vladimir Putin, a former head of the KGB, has given Russia a liberal, incentive-building revenue law while Australia still suffers under a tax regime based on class warfare ideology.

Some politicians and columnists incorrectly claim that Australians actually want to pay higher taxes so as to expand the welfare state.[90] The Australian Council of Social Service (ACOSS) supports high marginal rates. Some believe that this position, which seems to have little to do with the activities of the bodies ACOSS represents, is based on the belief that high marginal rates increase the incentive to give money to charity, a doubtful assumption.[91] The advocates of higher taxes usually argue that the additional revenue could be raised by 'soaking

the rich'. The scope for that is limited, however, as the top 30 percent of earners is already paying 68 percent of the tax,[92] and capital is highly mobile today.

The public plainly favours lower taxes over higher spending by a ratio of three to one,[93] as even some commentators who favour higher taxes, such as Fred Argy and Peter Saunders (of the Social Policy Research Centre), are forced to admit.[94] Further, in a public opinion poll at the time of the 2001 federal election, twice as many people expressed an unprompted desire to reduce taxes than wanted to tackle inequality, and when respondents were asked what the federal government could do that would most benefit them and their families, tax changes—not redistribution—dominated people's answers.[95]

These findings are especially striking when one considers that in recent years there had been virtually no public debate on the possibility of substantial federal tax cuts. It is in the personal interests of politicians to expand government rather than cut taxes because government spending programmes are targeted, while the benefits of tax cuts are smaller and more widely dispersed.[96] Substantial tax cuts are thus not in the platform of any major political party. Many people must have abandoned hope of any significant easing of the fiscal burden as a realistic possibility. Consequently, the underlying potential voter support for serious tax reform could be much stronger than those findings indicate.

The public plainly favours lower taxes over higher spending by a ratio of three to one, as even those who favour higher taxes are forced to admit.

There are two developments that may strengthen this public support still further. One would be if housing and other asset values were to deflate significantly. In that event popular opinion could quickly become highly critical of high-taxing governments.[97] As a slump in asset values would be painful for many people, one would not wish to see it occur, let alone make it more likely. But if it happens it will concentrate the public mind.

The other development would be a growing public realisation that there is much more scope for reducing the fiscal burden of government than has previously been thought. This is already happening, in the following way.

Controlling Welfare Spending

As Michael Brooks and John Head point out, controlling public sector growth is a key issue in the tax debate.[98] The largest single head of public spending is social welfare, which accounts for 29 percent of government outlays, federal, state and local. Federal welfare payments alone swallow 10 percent of GDP.[99]

Since the 1960s the real national wealth, at all levels of income, has doubled. Yet during that period government spending on welfare benefits and services has increased five-fold in real terms, and reliance on welfare support as the sole or principal source of income has increased from 3 percent to 14 percent, or one in every seven working-age adults. The welfare state now employs almost one-fifth of the Australian labour force.[100] Probably almost all Australians are willing to pay tax to maintain a welfare safety net, if only out of far-sighted self-interest—financial misfortune could strike almost anyone. But public support for welfare policies should not be confused with support for enforced equality of outcomes. In the 2001 survey, only 2 percent of respondents listed greater egalitarianism as a preferred government policy, an unsurprising result when 95 percent of full-time earned incomes already fall below double average weekly earnings.[101] The Australian ideal of equality and the 'fair go' has more to do with the idea of equal *rights* (equality before the law) and equal *status* (no-one is more worthy than anyone else) than with support for equality of incomes or wealth.[102] It certainly does not mean that those who choose not to work are entitled to live off the earnings of those who do.[103] As Peter Saunders and Kayoko Tsumori put it in a significant recent work, 'Willingness to help those who are thought to be in need does not indicate enthusiasm for a general programme of income redistribution.'[104]

Since the 1970s, however, the welfare industry has manoeuvered the public into acquiescing in a colossal expansion of the social welfare budget by building a massive structure of unexamined claims on a foundation of dubious premises and fallacious arguments. The main source of misconceptions and false logic has been the welfare industry's definition of 'poverty' itself.

Most Australians (over three-quarters in fact)[105] define 'poverty' as a lifestyle below subsistence level, an inability to acquire the basics of food, clothing and shelter. That state is what is known as 'absolute poverty'. Australians will strongly support any domestic programme that is presented as being needed to remove 'poverty' in that sense, especially *child* poverty.[106] But as it is agreed on all sides that absolute poverty scarcely exists in Australia, the welfare lobby since the 1970s has instead focussed on poverty defined in a *relative* way, that is, inequality rather than poverty.

[Equality] does not mean that those who choose not to work are entitled to live off the earnings of those who do.

The conditions now exist for a fundamental reappraisal of the welfare system. Recent scholarly re-evaluation of the concept of poverty and other issues shows great potential and support for slimming the public sector and reducing the tax burden.[107] But any reform proposals face determined opposition from vested interests, especially the welfare industry. That group is also in denial about the spectacular success of the Clinton administration's 1996 legislation aimed at reducing the number of lone parents living on welfare, which cut numbers on the welfare rolls by 58 percent in the first three years,[108] while the critics' predictions of a humanitarian disaster were falsified.[109] The 1996 US legislation stands as one of the few examples of a social reform that has actually achieved its objectives.

The Australian welfare lobby is strongly opposed to learning from the United States' success, arguing among other things that Australia's unconditional welfare approach helps to prevent crime and foster social cohesion. Yet since 1996 American crime rates have been falling sharply while Australia's have continued to rise. Crime rates in the United States are now lower than Australia's for all crimes except murder, and even for murder the difference, on a true comparison, is small.[110] Social cohesion, as several sociologists have long argued, develops from the bottom up, not from the top down, out of the 'little platoons' of families and neighbourhoods coming together to solve common problems, not from government bureaucracies dispensing largesse from on high.[111] Classic sociological indicators of social malaise (crime, divorce, drug abuse, mental illness and so on) were all much lower before the welfare state expanded.[112] The experience of receiving government aid is widely recognised as alienating, stigmatising and disempowering, while the experience of being forced to pay into the system promotes, not altruism, but suspicion of others and anger at being exploited by 'bludgers'.[113]

CONCLUSION

WHERE TO FROM HERE?

In the realm of federal taxation the rule of law has all but been replaced by a system of direct bureaucratic rule. The separation of powers has broken down and key institutions have been compromised. The legislation has become unmanageable, unintelligible and unpredictable, the executive exercises legislative and quasi-judicial powers, the judiciary exercises policy-making powers and, in a variety of ways, the law is changed at the point of application. Major taxpayers increasingly treat the enacted law as irrelevant and acquiesce in the ATO's assumption of the role of supreme deciding authority. None of this was inevitable: in Britain and the United States the rule of law still largely applies to the tax system.

On current indications the chasm between Australian federal taxation and the rule of law is likely to widen. The Integrated Tax Design concept currently being trialled by the ATO for possible general adoption contemplates that the law should no longer attempt to deal with complex situations. These would instead be directly regulated through administrative rulings. Specific anti-avoidance provisions binding on all taxpayers would be replaced by 'compliance strategies' targeted to the 'risk profile' of various 'users'.[114] It does not take much legal imagination to see where that approach is likely to lead.

It is well understood today that the rule of law and healthy institutions of government are essential for long-term economic growth. Failure to uphold those ideals in the tax arena is producing major disincentives and distortions, including a massive and flourishing underground economy, a brain drain and a tax-driven property bubble that has given Australia the world's

highest housing prices relative to income and is deterring overseas capital inflows.[115]

Perverse incentives pervade the present system, which creates disincentives to work, learn, save, risk, innovate,[116] create wealth, support charity and procreate[117]—in short, most worthwhile human activities. It deters skilled people from moving to Australia and deters skilled Australians from staying here. It handicaps workers who have to compete internationally and rewards the devious and the indolent. There is an old saying, and a true one, that people will work *not* to pay taxes but will not work to pay taxes. 'They no longer do what is useful to others and hence profitable to themselves,' writes Professor Kasper, 'but are instead guided by avoiding government-made obstacles, bending rules, seeking preferments, bribing officials and dissimulating their wealth'.[118] According to the OECD, Australia's tax system is the fourth worst in the developed world for rewarding effort.[119]

In a global economy nations have no choice but to compete for highly mobile capital and skilled labour, and tax law is an important part of that competitive market. 'Tax competition is a healthy and natural economic process that weeds out stupid or inefficient taxes', writes ANU's Dr Terry Dwyer. 'There is nothing wrong or immoral about sovereign countries competing for investment by offering differing legal and economic regulatory systems. That is how human beings learn from each other. That is how the world discovered that communism was not such a good economic system.'[120] The Commonwealth has faced the reality of tax competition in relation to company tax,[121] but not personal scales; it would be hard to find a tax structure more 'stupid or inefficient' than one that taxes a worker on average weekly wages at a marginal rate of 42 percent. As the IMF recently reported, 'Lower personal income tax rates would boost work incentives and foster the development of a higher skilled work force by increasing returns to human capital ... [I]n an increasingly globalized economy, Australia will have to remain competitive to retain the services of its best and brightest people'.[122]

Australia needs to raise the tax-free threshold to $14,000 and cut its maximum rate to the 30 percent level recommended by the IMF.

To be effective, any programme to restore the rule of law in the tax field must therefore start from these propositions:

1. Reviving the rule of law in the tax field requires positive incentives

Tinkering with tax legislation and procedures will not revive the rule of law or restore government institutions to their proper roles. Curtailing discretionary powers, rewriting the legislation or other symptom-oriented solutions that do not tackle the underlying enforcement versus resistance dynamic will only cause the confronting pressures to break out elsewhere in the system. True reform will need to be substantial enough to change the pattern of incentives so that, as in the 1950s and 1960s, most people will voluntarily meet their obligations and enforcement pressure is needed only to deal with the greedy few. The rule of law can operate only where most people are willing to obey the law voluntarily most of the time. That proposition has been promoted for decades by the political-intellectual elite in such contexts as drug law, pornography and abortion; it is time to recognise that it applies at least as well to revenue law.

2. Changing the pattern of incentives will entail substantial tax rate cuts

The personal tax cuts of recent years have been too small to affect the pattern of incentives, which is why they are seen as so 'costly' from the Commonwealth's viewpoint. They make only trivial inroads into the effects of the massive bracket creep caused by the inflation of the 1970s and 1980s. To be internationally competitive, Australia needs, for example, to raise the tax-free threshhold to $14,000 (its 1980 level, in real terms) and cut its maximum rate to the 30 percent level recommended by the IMF.

3. Large rate cuts need not cause revenue loss

Experience shows that such large reductions need not cause a loss of revenue and usually lead to increased collections (as has happened in Australia following the substantial cut in the company tax rate). That observation long antedates the insights of supply-side economics. The

14th century Arab philosopher-statesman Ibn Khaldun stated it in 1377 in his pioneering work of scientific historiography, *The Muqaddimah*. 'At the beginning of the dynasty,' he wrote, 'taxation yields a large revenue from small assessments. At the end of the dynasty, taxation yields a small revenue from large assessments'.[123]

The Australian revenue lobby persists in treating rate cuts as a zero sum process in which a gain to the taxpayer constitutes an equal loss or 'cost' to the government. But revitalisation of the economy, with more income to divide between the big earners and the rest, is the point of the tax reform. It is better achieved via cuts in personal rates than through special tax packages for business, which share some of the weaknesses of other special interest wealth transfers.[124]

Stronger growth, and thus larger tax collections, will result whether tax cuts apply to the top brackets or across the board. The former approach favours high incomes, on the basis that entrepreneurs in that bracket are the ones who will create new jobs. The latter, more politically acceptable approach should benefit all wage earners, moderate wage demands and generally lower business costs.[125]

4. Tax indexation must be restored

A vital part of any reform programme must be the immediate restoration of tax indexation, the lack of which is the main cause of our current misfortunes. Even the present cumulative inflation rate of 3 percent, while low by the standards of recent decades, is high by those of history and, if not compensated for in tax scale adjustments, will over time effect a substantial transfer of resources from the people to the government.[126] Leviathan must not be allowed to profit from his own wrong, silently debasing the currency so as to drive lower-paid workers into higher brackets. This reform also has the advantages of having little immediate impact on budgeting and of being almost impossible for the opposition in the Senate to reject. Research shows that tax indexation, even on its own, measurably reduces non-compliance. [127]

A vital part of any reform programme must be the immediate restoration of tax indexation.

Tax indexation should be a statutory, automatic mechanism similar to that introduced by the Fraser government, rather than a 'manual' process as in the United Kingdom, where threshholds are raised each year in the budget as a matter of practice and convention.

5. Welfare reform should accompany tax reform

At the same time, recent research has uncovered wide scope for reforming the social welfare system, which is the largest single head of public spending. As currently structured it is producing a steady increase in welfare spending that is unsustainable, especially in a country with an ageing population. 'With the astounding rate of growth achieved across all Western countries over the last 60 years', Saunders and Tsumori conclude, 'most of the population is now in a situation where it could cope more-or-less unaided if only taxation levels were not so crippling'.[128]

Surveys show that a large majority of Australians favour tax reform and a welfare system that is based on mutual obligation and caters for genuine need, not one based on fallacious, ideologically-driven definitions and assumptions. The potential is there for substantial improvements in Australia's institutional structure and competitive position if the reform process can be shifted from its present narrow focus on purely technical improvements[129] to a broader, more principled perspective. For as the Thomson ATP tax writer Terry Hayes comments, 'reform never really got started in a meaningful way for the vast majority of taxpayers'.[130]

Now, however, the beginnings of a public debate can be heard.[131] It is explained that tax cuts do not push up interest rates.[132] There is talk of a higher TFT, flat rates and abolishing returns for most workers.[133] The parliamentary Labor party is reportedly considering a top rate of 35 percent as a possible policy option.[134] We are hearing less of the notion that Qantas flight attendants earning $65,000 or Holden night-shift assembly workers on $72,000 are plutocrats who deserve outright fiscal punishment. 'The incentive system is all wrong,' complains Mark Latham. 'The hard workers are being punished while the rorters are being rewarded . . . For the people who do the right thing in our society, the system is crook'.[135] Australia faces a once in a generation opportunity to opt for fairness and growth. It must not be allowed to pass us by.

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19 'Push to Simplify Income Tax Rules', *The Australian Financial Review* (3 June, 2003), 1.
20 Edmund Burke, 'Speech on American Taxation', F. Selby (ed.), *Burke's Speeches* (London, 1930), 12-13.
21 Cooper, *Tax Avoidance and the Rule of Law*, 33. Complexity is also in part the result of an attempt at fairness; see Payne, 'Explaining the Persistent Growth in Tax Complexity', 181.
22 Geoffrey Brennan, James M. Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (UK: Cambridge University Press, 1980), 191.
23 Payne, 'Explaining the Persistent Growth in Tax Complexity', 183.
24 L.W. Street , 'Judicial Law-making: Some Reflections', *Sydney Law Review* 9 (1982), 535, 537.
25 Jeffrey Waincymer, 'The Australian Tax Avoidance Experience and Responses: A Critical Review', in Cooper, *Tax Avoidance and the Rule of Law*, 247.
26 Cooper, 'Conflicts, Challenges and Choices: The Rule Of Law and Anti-Avoidance Rules', 49.
27 This is seen in the example of FCT v Spotless Services Ltd (1996) 96 ATC 5201, 5206; Michael D'Ascenzo, 'Part IVA and the common sense of a reasonable person', *Taxation in Australia* 37 (2 Aug 2002), 70, 76.
28 Malcolm Gammie, 'Tax Avoidance and The Rule of Law: A Perspective From the United Kingdom', in Cooper, *Tax Avoidance and the Rule of Law*, 181, 215.
29 Waincymer, 'The Australian Tax Avoidance Experience and Responses', 304.
30 As above.
31 As above, 305.
32 As above, 304. See Vincent v FCT 2002 ATC 4490, 4518-19 (FCA); 2002 ATC 4742, 4761

(FFC).

[33] Sir Harry Gibbs, 'The Need for Taxation Reform', 11th National Convention of the Taxation Institute of Australia (5 May, 1993), 19-20.

[34] Fayed v Commissioners of Inland Revenue (2003) SC 1; Hon LJ Priestley, 'The Commissioner's Powers of Settlement and Compromise', *Revenue Law Journal* 40 (2002).

[35] Edmund Burke, 'Speech on American Taxation', 12-13.

[36] A.L. Goodhart, 'The Rule Of Law and Absolute Sovereignty', *University of Pennsylvania Law Review* 106 (1958), 943, 957.

[37] For example the Income Tax Assessment Act 1936 (Cth), ss. 14ZAAA-AAM, 14ZAA-ZAZC.

[38] Waincymer, 'The Australian Tax Avoidance Experience and Responses', 304.

[39] Federal Commissioner of Taxation v Firth (2002) 50 ATR 1.

[40] Neil Brooks, 'The Responsibility Of Judges in Interpreting Tax Legislation', in Cooper, *Tax Avoidance and the Rule of Law*, 93, 104.

[41] As above, 99.

[42] Waincymer, 'The Australian Tax Avoidance Experience and Responses', 304.

[43] Ross Greenwood, 'Levy Heavies', *The Bulletin* (May 20, 2003), 62.

[44] Walker, *The Rule of Law Rule of Law*, 40-41, 200-02, see n. 9.

[45] (1765) 19 St. Tr. 1030.

[46] Brooks, 'The Responsibility Of Judges in Interpreting Tax Legislation', 99-100.

[47] FCT v Westfield Ltd. (1991) 22 ATR 400; Graeme S. Cooper, 'The Political Economy Of Taxation and the Roles Of the High Court', *Western Australia Law Review* 23 (1993), 101, 115. The position does not appear to have changed significantly since the High Court's Westfield decision.

[48] Hill et al. *Australian Taxation Law.*

[49] Cooper, 'The Political Economy Of Taxation', 101, 115.

[50] Cooper, 'Conflicts, Challenges and Choices', 17.

[51] FCT v Westraders Pty Ltd (1979) 11 ATR 24, 40.

[52] Geoffrey Walker, 'Information as Power: Constitutional Implications of the Identity Numbering and ID Card Proposal', *Queensland Law Society Journal* 16 (June 1986), 153.

[53] Waincymer, 'The Australian Tax Avoidance Experience and Responses', 247-48.

[54] Alan Lewis, *The Psychology of Taxation* (Oxford: Martin Robertson, 1982), 180.

[55] G.T. Pagone, 'The General Anti-Avoidance Provisions in Australian Taxation Law', *Melbourne University Law Review* 27 (2003), 770, 778, commentary on FCT v Consolidated Press Holdings Ltd (2001) 297 CLR 235.

[56] Knut Wicksell, 'A New Principle of Just Taxation', (first published 1896) in R.A. Musgrave, A.T. Peacock (eds.), *Classics in the Theory of Public Finance* (London: Macmillan, 1958), 72, 82; Gary M. Anderson, 'Referendum, Redistribution and Tax Exemption: A Rent Seeking Theory of Direct Democracy', in Racheter and Wagner, *Politics, Taxation and the Rule of Law*, 81, see n.18.

[57] D.C. Mueller, *Public Choice II* (New York: Cambridge University Press, 1991), 1.

[58] Anderson, 'Referendum, Redistribution and Tax Exemption', 82.

[59] Buchanan and Brennan, *The Power to Tax*, see n. 22.

[60] Anderson, 'Referendum, Redistribution and Tax Exemption', 81.

[61] Brennan and Buchanan, *The Power to Tax*, 25; Alvin Rabushka and Pauline Ryan, *The Tax Revolt* (Stanford: Hoover Press, 1982), 21-26.

[62] John G. Head, 'Tax Reform: A Quasi-Constitutional Perspective', in Cooper (ed), *Tax Avoidance and the Rule of Law*, 155, 178-80.

[63] As above.

[64] The inflationary results of the 1973 and 1974 budgets, coupled with a federal government-backed wages explosion at a time of low growth, were well understood even at the time: 'Oh, No—Not the 1973 Budget Again', *Australian Financial Review* (27 August 1974), 2; 'The inflation merry-go-round', *AFR* (27 August 1974), 1; 'Hyperinflation and Low Growth—The Two Threats', *AFR (*6 August 1974), 12. Even Bill Hayden's 1975 budget, touted by the government as reducing the tax burden on lower earners, led to the tax paid by those receiving less than average weekly earnings rising by 18 percent in a single year: R.J. Tanner, D.J. Collins, *Flat Rate Tax?* (Sydney: Tax Institute Research and Education, 1981), 4. Many countries suffered high inflation during that period as a result of the OPEC governments' monopoly pricing of oil. The Whitlam government lacked that excuse, however, because Bass Strait and Barrow Island crude made Australia self-sufficient in high-grade petroleum during the relevant period and government price controls prevented Australian oil producers from raising their prices to world levels: P. Walsh, *Confessions of a Failed Finance Minister* (Sydney: Random House, 1995), 16; J. Nevile, Australian Inflation—Made at Home or Imported?'

in W. Kasper (ed.) *International Money—Experiments and Experience, Papers and Proceedings of the Port Stephens Conference* (Canberra: ANU Department of Economics, RSSS, 1976). In Switzerland, direct citizen control over government budgets via the referendum system kept inflation (and unemployment) in that country below 2 percent despite that country's exposure to the full effects of OPEC price rises. See Walker, *Rule of Law*, 340-41, see n. 9. One must therefore conclude that the Whitlam government knew what it was doing when it opened the inflation floodgates without altering or indexing tax scales. Such a step would have served its goal of expanding the public sector, without the government being seen to raise the necessary revenue by openly increasing taxes.

[65] David R. Morgan, 'Personal Income Tax Indexation', in John G. Head (ed.), *Taxation Issues of the 1980s*, (Sydney: Australian Tax Research Foundation, 1983), 71.

[66] Geoffrey Walker, *Ten Advantages of a Federal Constitution and How to Make the Most of Them*, (Sydney: The Centre for Independent Studies, 2001), 37-39.

[67] Wolfgang Kasper, *Economic Freedom Watch (EFW)* Report No. 4 (Sydney: The Centre for Independent Studies [CIS], 2003),7; Allesandra Fabro, 'OECD Figures Could Herald Local Cuts', *Australian Financial Review* (23 October, 2003), 5.

[68] Wolfgang Kasper, *EFW* Report No. 5 (Sydney: CIS, 2003),5.

[69] 'Experts Warn on Rising Number of Copycat Cheats', *The Sydney Morning Herald* (3 June, 2003), 6. When the people have genuine control over the tax laws, as under Switzerland's citizen-initiated referendum system, taxpayers feel more of a moral obligation to comply with them: Mads Qvortrup, *A Comparative Study of Referendums: Government by the People* (Manchester: Manchester University Press, 2002), 66, 139; Bruno S. Frey and Alois Stutzer, *Happiness and Economics: How the Economy and Institutions Affect Well-Being* (New Jersey, Princeton University Press, 2002), 139.

[70] Head, 'Tax Reform: A Quasi-Constitutional Perspective', 180, see n. 62.

[71] Peter Saunders, Kayoko Tsumori, *Poverty in Australia: Beyond the Rhetoric* (Sydney: CIS, 2002), 84-5.

[72] Kasper, *EFW* Report No.4 (Sydney: CIS, 2003), 8.

[73] Robert Gottliebsen, 'Taxing Issues of Brains and Ageing', *The Australian* (1 September, 2003), 31.

[74] Robert Gottliebsen, 'Risky Cocktail of Terror, Deflation and Dodgy US Dollar', *The Australian* (20 May, 2003), 24.

[75] Wolfgang Kasper, *EFW* Report No. 5 (Sydney: CIS, 2003), 5.

[76] As above, 4.

[77] Kerr, 'New Zealand's Flawed Growth Strategy', 5, 7, see n. 2.

[78] As above, 4.

[79] Kasper, *EFW* Report No. 5, 9.

[80] Peter Jonson, 'The Punitive Australian Tax System', *Policy* (Spring 2002), 9.

[81] As above, the International Monetary Fund recommendation is in *Staff Report for the 2002 Article IV Consultation*, (9 August, 2002), 15.

[82] A federal government paper has set out some policy principles in that regard: 'An Internationally Competitive Tax System for Australia', *Australian Tax Review* 32 (2003), 51.

[83] Kasper, *EFW* Report No. 5, 2.

[84] George Gilder, 'The Numbers Tell a Supply-Side Story', *Wall Street Journal* (13 June, 1983). Similarly, California's Proposition 13 (1979), that *bete noire* of revenue lobbies and political elites everywhere, did not lead to the predicted devastation of the state's public services. Instead, it triggered a growth surge that led to California's creating one out of every three new jobs in the entire US in the two years following 13. All the jobs growth was in the private sector. This boom was partly due to the transfer of billions of dollars of additional spending power into private hands, partly to an improvement in business expectations (as future property taxes could rise by no more than 2 percent a year), and partly to a cut in income taxes. After an initial drop, public employment soon returned to its pre-13 level. Property taxes themselves, after being halved by Proposition 13, quickly recovered because of substantial new construction and the sales of existing dwellings (which were revalued at sale to reflect market values): Rabushka and Ryan, *The Tax Revolt*, 95, 98, 203-04, see n.61.

[85] Gustafson, 'The Politics And Practicalities of Checking Tax Avoidance in the United States', 364, see n. 5.

[86] Gilder, 'The Numbers Tell a Supply-Side Story'.

[87] James Glassman, 'Lessons From Russia', *Policy* (Spring 2002), 7; Daniel Mitchell, 'Russia's Flat Tax Works', www.nzbr.org.nz; see generally Daniel Mitchell, *The Flat Tax: Freedom, Fairness, Jobs and Growth* (New York: Regnery Publishing, 1996). The MIT economist Jerry Hausman in 1981 predicted a 6 percent increase in US GDP from a flat tax reform, in Henry Aaron, Joseph Pechman (eds.), *How Taxes Affect Economic Behaviour* (Washington: Brookings Institution, 1981), 27-84. Hall

and Rabushka estimate that the incentive effects of such a plan would translate into a 9 percent GDP rise over 7 years. They view that as a conservative estimate which avoids what they see as the exaggerated claims of some supply-siders: Robert Hall, Alvin Rabushka, *Low Tax, Simple Tax, Flat Tax* (New York: McGraw-Hill, 1983), 18, 57.

[88] Hon. Peter Costello MHR, Federal Treasurer, 'Final Budget Outcome', at press conference (30 September, 2003).

[89] 'Deal on tax Break for Super', *AFR* (8 September, 2003), 3.

[90] Natasha Stott Despoja, 'Best Investment Never Made', *The Australian* (18 June, 2003), 37; Annette Sampson, 'Don't Get Caught Between the New-Greed Aussie and a Dollar', *The Sydney Morning Herald* (3 June, 2003), 1. Such statements misrepresent the results of ACTU and similar opinion surveys, which actually show little support for higher government spending: P. Saunders, 'The Truth About Higher Taxes', *The Age* (20 August, 2003).

[91] Sampson, n. 90 above, notes that Australians give to non-profit organisations at an average rate of $445 per household as compared with US$1,075 ($1,654) for US households. A common attitude in Australia today seems to be that we are already taxed at absurd rates to support the needy (and others), so we are reluctant to pay more voluntarily—except when an unforeseeable disaster strikes.

[92] Kasper, *EFW* Report No. 5, 6.

[93] Saunders and Tsumori, *Poverty in Australia*, 71.

[94] Fred Argy, *Where to From Here? Australian Egalitarianism Under Threat* (Crows Nest: Allen and Unwin, 2003), 122; Saunders and Tsumori, *Poverty in Australia*, 71. There are two researchers named Peter Saunders active in this field, one with The Centre for Independent Studies and one with the Social Policy Research Centre. They hold different views on a number of important issues.

[95] Saunders and Tsumori, *Poverty in Australia*, 71.

[96] Gary Wolfram, 'Taxpayer Rights and The Fiscal Constitution', in Racheter and Wagner, *Politics, Taxation and the Rule of Law*, 66-67, see n.18.

[97] Kasper, *EFW* Report No.4, 8.

[98] Michael Brooks, John Head, 'Tax Avoidance: In Economics, Law and Public Choice', in Cooper, n. 5 above, 53, 89; also Cooper, 'The Political Economy Of Taxation, 103, see n. 47.

[99] ABS, *Government Financial Statistics 2001-02*, Cat. 5512-0 (Canberra: ABS, 2002).

[100] Saunders and Tsumori, *Poverty in Australia*, 4-5, 91.

[101] Saunders and Tsumori, *Poverty in Australia*, 71; Lucy Sullivan, *Taxing the Family: Australia's Forgotten People in the Income Spectrum* (Sydney: CIS, 2001), 75.

[102] Saunders and Tsumori, *Poverty in Australia,* 70.

[103] As above.

[104] As above, 71.

[105] As above, 1.

[106] As above.

[107] See n. 90, 93, 94, 95 and connected text; Saunders and Tsumori, *Poverty in Australia* ; Peter Saunders, *A Self-Reliant Australia: Welfare Policy for the 21st Century* (Sydney: CIS, 2003); Peter Saunders, 'Help *and* Hassle: Do People On Welfare Really Want to Work?', *Policy* (Winter 2003); Peter Saunders and Kayoko Tsumori, 'The Tender Trap: Reducing Long-Term Welfare Dependency by Reforming the Parenting Payment System', *Issue Analysis* No. 36 (Sydney: CIS, 2003).

[108] Saunders and Tsumori, *Poverty in Australia*, 89.

[109] Saunders and Tsumori, 'The Tender Trap', n 107 above, 6.

[110] Saunders and Tsumori, *Poverty in Australia*, 79. The high US murder rate is said to be mainly a function of a particularly high incidence among African-Americans. The National Criminal Victimization Survey reports an overall US murder rate of 5.5 per 100,000 population (Australia's is 2 per 100,000) but notes that blacks are 6 times more likely to be victims and 8 times more likely to be perpetrators. (One should not make hasty assumptions about the reasons for this—the black homicide rate has not normally been as high as it is today). The rate among America's Caucasian-Asian-Hispanic-Native American majority, a more reasonable base for comparison with Australia, is 3 percent: www.ojp.usdoj.gov/bis/cvictgen.htm. On some measures the US majority referred to is claimed to have a lower homicide rate than the United Kingdom: www.commonsenseclub.com/Guns.html. The difference between US and Australian murder rates becomes even smaller if one factors out the large US Hispanic population, which has a much higher murder rate than other non-African-Americans and is a group for which Australia also has no real equivalent. On any measure the US murder rate has been falling since the mid-1990s. For comparison, Brazil's murder rate is 23 per 100,000 and South Africa's is 115: 'Beautiful, Beset Land,' *Forbes* (8 December, 2003), 36.

[111] Saunders, *A Self-Reliant Australia,* 25.

[112] As above, 26.
[113] See n.112.
[114] Michael Dirkis, 'Observations on the Development of Australia's Income Tax Policy and Income Tax Law', *Bulletin for International Fiscal Documentation* 56 (2002), 522, 523, 530.
[115] 'Bubble Trouble Frightens Investors', *The Australian* (19 September, 2003), 20; Gottliebsen, 'Risky Cocktail of Terror', see n. 74.
[116] Wolfgang Kasper, *EFW* Report No. 6 (Sydney: CIS, 2003), 6.
[117] Sullivan, *Taxing the Family*, 15; Barry Maley, *Family and Marriage in Australia* (Sydney: CIS, 2001), 77-97.
[118] Kasper, *EFW* Report No. 6, 7.
[119] OECD, *Taxing Wages, Taxing Families*; at the time of writing the full text of the survey was unavailable, but its effect is summarised in Christine Wallace, 'Marginal Tax Rates in World's Highest', *Weekend Australian* (3-4 January, 2004), 3.
[120] Terry Dwyer, 'The New Fiscal Imperialism', *Policy* (Summer 2002-03), 12, 13, 16.
[121] See n. 82.
[122] IMF, *Staff Report for the 2002 Article IV Consultation*, see n.81.
[123] Quoted in James Ring Adams, *Secrets of the Tax Revolt* (San Diego: Harcourt Brace, 1984), 25. Adams states the supply-side argument on tax reform at 9-12.
[124] As above, 339.
[125] As above, 340.
[126] Historically, except in 16th century Europe, inflation had been a local, temporary phenomenon: Irving S. Friedman, *Inflation: A Worldwide Disaster* (London: Hamish Hamilton, 1980), 17, 102, 88, 139. Persistent, cumulative inflation of one to two percent has been regarded as tolerable (p. 140), but one percent cumulates over 30 years to a rise of 35 percent in prices, and in 50 years, to 65 percent. In an industrial country, even two percent continuous inflation is disruptive.
[127] Wehrner W. Pommerehne, Hannelore Weck-Hannemann, 'Tax Rates, Tax Administration and Income Tax Evasion in Switzerland', *Public Choice* 88:1-2 (1998), 161, 168.
[128] Saunders and Tsumori, *Poverty in Australia*, 85.
[129] Dirkis, 'Observations on the Development of Australia's Income Tax Policy and Income Tax Law', 529, 532, see n. 114.
[130] Terry Hayes, 'Tax Law an Impenetrable Mass', *AFR* (27 November, 2003), 71.
[131] Gregory Hywood, 'Tax Cash Rolls in, But Not Out With Much Efficiency', *The Sydney Morning Herald* (25 September, 2003), 11.
[132] Alan Wood, 'Don't Fritter Away the Fiscal Framework', *The Australian* (21 October, 2003), 11.
[133] David Stevens, 'Unfinished Business at the Margins', *The Australian* (24 February, 2004), 6.
[134] Cherelle Murphy, 'Labor Plays Down Tax Cuts', *AFR* (13 February, 2004), 10.
[135] Latham, 'Those Chains are Stifling Spirit', see n. 7.

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