Tax reform must not be jettisoned

*By Andrew Bragg

Our inefficient, 1950s tax system is a drag on our competiveness in the Asian century. Structurally changing the tax system must dominate reform discussion over the next twelve months.

The tax system should encourage Australian business to create growth and jobs and it must provide sustainability of spending programs such as the National Disability Insurance Scheme (NDIS).

The recent Intergenerational Report (IGR) makes the strongest case for tax reform ahead of the Tax White Paper due next week. The 2015 IGR lays down the gauntlet to the business community to heavily engage in the national debate on tax reform.

With the increasing debate on intergenerational equity in the current budget settings, this is a perfectly named government report to till the ground for reform.

The IGR presents a snapshot of our future, which without tax reform looks bleak.

Lee Kuan Yew's death this week should remind us that we are always at risk of fulfilling the 1980s style prophesies on "Banana Republics" and "White Trash of Asia".

The 2015 IGR results are, in essence, telling us what we already know − the tax base will heavily erode and the costs associated with ageing will escalate.

The number of working aged for every person aged 65 and over has fallen from 7.3% in 1975 to 4.5% today. The ratio will be just 2.7% by 2055. This is the key starting point.

The smaller proportion of working Australians greatly diminishes our tax base which is already heavily reliant upon personal income taxes – well above the OECD average.

As former Treasury head Martin Parkinson said in his farewell address late last year: "In contrast to the focus of our public debate, comparator countries are lowering personal and corporate income taxes, and shifting the tax mix in favour of more efficient tax bases, in order to better compete globally. The consequence for Australia of maintaining a 1950s tax mix in the 21st century should be self-evident."

This inconvenient truth is rarely part of our public debate on national competitiveness.

We are also heavily reliant upon corporate taxation.

This problem was identified in the IGR where it was stated: "Australia's reliance on corporate income taxes is amongst the highest in the developed world and significantly higher than key regional competitors."

Translation −our company tax rate of 30 per cent compares poorly to the Asian average of 21 per cent, many of whom are our major trading partners. This means it is harder to attract investment which creates growth and jobs.

Our 1950s tax system with a heavy reliance on personal and company income taxes is not competitive now and will only get worse without reform. Having three free trade agreements with North Asian economies will only go so far in helping Australian exporters. Competitive tax regimes are needed to complement the new market access which has recently been gained.

We cannot keep on spending when we have a structural deficit and a tax system that is not fit for this century. As the new Treasury Secretary John Fraser said in his recent address to the Committee for the Economic Development of Australia:

“The reality is that Australia has spent its way to a structural budget problem. Government payments are growing faster than government revenues and without action, this trend will continue.”

Without change, we will drift into permanent budget deficits of up to 122 per cent of GDP by 2055.

Recent high cost programs such as the generous assets test for the part pension and the NDIS are all nice to have when the tax base is assured.

It is also important that policies designed to address the ageing population are carefully designed. For instance, the superannuation system must be tightly calibrated with the social security system so that the benefit to the taxpayer of the tax treatment of superannuation is maximised. Super must reduce age pension costs and it can do more.

Any new expenditure heightens the underlying structural issues and highlights again that the tax system is broken and budget settings are unsustainable.

Ultimately, the Tax White Paper will provide a process we badly need to ventilate the issues of changing demography, competitiveness and sustainability of spending.

While long-term, structural reform will only be possible if the public supports change, the business community must also highlight how the tax system retards Australian growth and jobs.

The IGR is our best shot at tax reform.

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