Remarks to CTSI third international conference

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I think the ATO has to be congratulated for the joint initiative with CTSI which is actually searching out evidence on which to base policy. I wish more areas of government would do the same – a strikingly large amount of policy in Canberra is based on preconceptions and theoretical presumptions rather than empirical research.

Let me start by briefly mentioning some items of interest from my current research. I am working on a comparative study of governance and institutions in Australia, Singapore, Canada and New Zealand. I use institutions in the same sense as John Rawls in his Theory of Justice: that is,

“By major institutions I understand the political constitution and principal economic and social arrangements. Thus the legal protection of freedom of thought and liberty of conscience, competitive markets, private property in the means of production, and the monogamous family are examples of major social institutions.”

The institutions that have been the main subject of my study have been accountability of elected officials and the bureaucracy; the media; academe; and the civil service itself. The institution of taxation has not been the major focus, but it has crept in unavoidably during the many discussions I have had in these countries about fiscal policy making. The methodology I have adopted has consisted primarily of discussions with the most senior fiscal policy makers in the countries studied, supplemented with interviews with external observers to “triangulate” the responses received from within executive government. In the time available I cannot outline the research findings as a whole, but can share a few brief anecdotes.

Singapore is an interesting case – they have a strong tradition of savings, and the government has been committed to maintaining budget surpluses. These surpluses have been invested over time, to the extent that now some 12% of total Singapore revenue is income from investments. It is also to my mind a myth that Singapore is a low tax country – we have to take into account that the Central Provident Fund in that country is a compulsory contributory safety net which takes the place of most of the
social welfare spending in other countries, and in many ways has to be regarded as equivalent to taxation: it is compulsory, enforced by government, and unlike Australian superannuation arrangements, also managed by government. It is about as close as possible to being a hypothecated tax – with the purpose being to provide for the contributor’s retirement welfare needs – as one can get without calling it a tax.

An item from Canada which will be of interest to our ATO colleagues here is that many Canadians admire our record in implementing our GST – I had a discussion there with Professor Paul Boothe from the university of Alberta who is doing a comparative study across countries of GST implementation and he suggested strongly that we had done it much better.

One of the significant developments internationally is that after a strong period of convergence in fiscal practices, encouraged and fostered by multilateral institutions, we now see signs of divergence in practice among the developed economies. In my view this is for two reasons.

First, public sector practice goes through cycles of convergence and divergence as practices evolve separately and are either adopted, flourish and disperse or die out, and then new practices arise and go through the same cycle. I call this, after Gould, a punctuated equilibrium in public sector evolution.

Second, we have seen a long and extended period of economic growth in all of the countries I have been examining – this has brought novel challenges, such as what to do with unwanted government surpluses. We saw tax cuts, albeit modest, in the last Australian budget. Canada has resorted not only to tax cuts but to the creation of Foundations independent from government (at least in theory) into which billions of dollars of funds are channelled.

The first half of the twentieth century saw the rise of fiscal policy as a major lever for governments, influenced of course by Keynesian economics. The second half saw the rise of monetary policy and the dominance of central banks. I think we may now see a return to fiscal policy as a major lever – for the obvious reason that there is little scope for central banks to lower interest rates below zero. In this context, the role of taxation will be critical, and it is more important now than ever that we develop a better base of evidence on which to support taxation.

I’d like to take up two themes – trust and defeating the fiscal termites.
Trust

I was struck by Val Braithwaite’s remarks yesterday on the links between hope, trust and compliance. In this context we ought to be worried that Australian confidence in government is low by international standards. I have seen some recent work, which I hope the author may publish soon, which seems to suggest our confidence in the public service in Australia is lower than even the USA. If confirmed, I would find this an interesting result given that as a consumer of a number of public services while in the USA I observe that Australia is streets ahead – try going through US customs, visiting a post office or a motor registry and doing the comparisons.

What does this tell us? One possible hypothesis is that the objective quality of government services is a less important factor in confidence in the public service than is the strength of democratic institutions in the country concerned. At this conference we have seen some evidence in relation to the Swiss cantons, presented by Lars Feld, which may lend support to this hypothesis. That is, in those cantons with a stronger democratic impulse in the form of citizen-initiated referendum procedures, tax morale may be stronger. It would be interesting to tease out this relationship further.

Another question I would pose, given I agree strongly with Michael Henzel that both the rational and responsible models of taxpaying are important, is whether Australia is well served by the post war agreement with the States. The end result of the agreement is that there is a disjunction between the States as service providers and the Commonwealth as the levier of taxation – thus the responsible citizen sees less evidence that their taxes are going in to, say, schools, hospitals, roads and other amenities given these are overwhelmingly State rather than Commonwealth responsibilities. Although this has been discussed from an intergovernmental perspective (see debates on “vertical fiscal imbalance”) there has not been as much attention paid to its possible effects on taxpayer compliance and trust.

But both rational actor political theory and institutional theories of path dependence suggest that once a community decides on a particular set of

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1 Based on a survey of a variety of public opinion surveys. These are difficult to compare across
constitutional arrangements that past decision constrains our choices about future arrangements. So it is a dilemma we are left with.

Possible solutions include a greater transparency in the reporting on taxation arrangements, including reporting on the Goods and Services Tax GST. Currently the Commonwealth maintains the GST is a State tax and the States that it is Commonwealth – opening up a gap in reporting.

For example, the annual tax expenditures report does not include exemptions from the GST on the grounds that this is a State matter – which means this particular tax expenditure is missed altogether.

Detailed and disaggregated reporting on all of the revenues raised and their application, in a form the public can understand, could make the links between taxation and spending more obvious for the “responsible citizen” class of taxpayer. Such an effort would require commitment on the part of both the Commonwealth and States, but is technically feasible.

Fiscal termites

Erosion of the tax base is a constant problem for democratic societies. Governments have sought to reduce the apparent tax take, in response to public criticism, and deliver tax expenditures to special interest groups, but at the same time have sought to maintain spending programs.

The result of these conflicting pressures is that one strong trend has been the growth in other sorts of taxes to replace traditional income and corporate taxes– in Australia examples (among many) include levies to pay for dairy adjustment, various sorts of user charges which hover around the borderline between a tax and a charge, and additions to the tax system such as the medicare levy and the guns buyback levy.

Clearly dollars are fungible and so these last two are not hypothecated taxes in the true sense. In Australia hypothecation requires setting up of a special account into which funds are directed and which pay for a specified activity. Nevertheless in the public eye these taxes are intended to pay for specific activities, so perhaps a less technical term (such as “earmarked” taxes?) would be more descriptive.

I think it remains an open question whether such earmarked taxes encourage greater compliance. Some such as the Medicare or guns levies can be relatively popular and accepted. That might not always be the case. There was talk of a levy to pay for the Iraq war – given the public
controversy over whether Australia should have been involved, it is possible that such a levy could have become one of the most avoided taxes in Australia’s history. Had I still been in government I would have been advising against a war levy for this reason, seeing its potential to undermine confidence in the tax system as a whole. Are hypothecated or earmarked taxes going to be more attractive to governments in future? I think there are signs pointing in this direction, but desirably a better research base should underpin any changes to policy.