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## **NON-AGENDA**

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With the view of causing an increase to take place in the mass of national wealth, or with a view to increase of the means either of subsistence or enjoyment, without some special reason, the general rule is, that nothing ought to be done or attempted by government. The motto, or watchword of government, on these occasions, ought to be — Be quiet. . . Whatever measures, therefore, cannot be justified as exceptions to that rule, may be considered as *non-agenda* on the part of government.

— *Jeremy Bentham* (c.1801)

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### **How to Tax Food and Make the Tax System More Progressive at the Same Time**

**Matt Bengé**

**A**USTRALIA'S Commonwealth government is claiming that it has a mandate to introduce the reforms it put to the voters at the October 1998 election. These reforms include a 10 per cent goods and services tax (GST) on a wide range of goods and services, including food. However, the Australian Democrats, whose members are close to holding the balance of power in the Senate, claim an opposing mandate. They promised to make the government's tax package 'fairer'. In particular, they have vowed to oppose a GST on food.

If the Democrats succeed in having food zero-rated, this will create two sets of problems for the government. First, approximately A\$5 billion of tax revenue will be lost. The government would then have to accept a higher budget deficit, cut government spending more vigorously, abandon some of the promised income-tax cuts, or implement some combination of these three options.

Second, zero rating of food would inevitably make the GST more complex. Small business groups have argued that they should be compensated for additional complexity if food is zero-rated. It would also result in many absurdities. There seems no good reason to zero-rate restaurant meals. But if restaurant meals are taxed, what about takeaway food? If takeaway food is taxed, what about hot chickens or cold prepared foods in supermarkets? In Britain, hot pies and cold pies are taxed at different rates. If some food is zero-rated, there will inevitably be some arbitrary borderlines.

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Perhaps more importantly, if food is left out, this may lead to a domino effect with other industries claiming special treatment. The gains from lobbying by powerful special interests are likely to be substantial. Policies can be overturned in either the House of Representatives or the Senate, giving lobbyists a double chance of success. And lobbyists may be particularly influential at present because the balance of power in the Senate is determined by a handful of votes cast by minor parties and independents.

This note does not make any judgment on whether the government's package already provides adequate compensation for the poor; commentators may reasonably differ over this issue. It merely points out that, relative to the situation where food is zero-rated, it is possible at no additional cost to tax revenue to introduce a more progressive reform in which food is taxed.

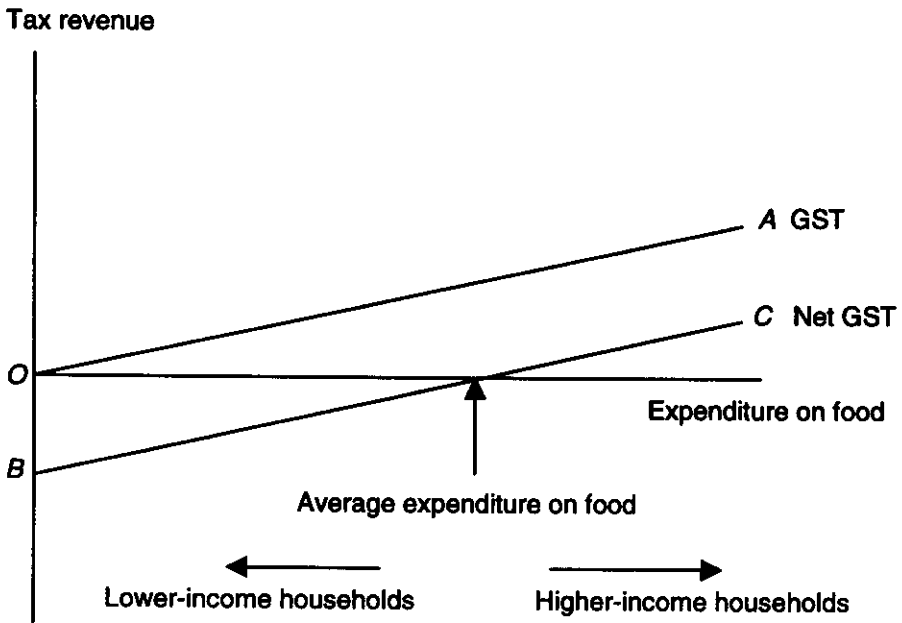
The proposal put forward might do little to relieve the government's revenue problem. Accordingly, the government might oppose it because it believes it has a mandate to implement the tax reform proposals that it put to the electorate. However, it is far from clear that the government will succeed in getting its legislation through the parliament. The proposal does at least overcome the other problems of zero-rating food and it does so in a way which makes the tax system *more* progressive than would be the case if food were zero-rated.

### **The Proposal**

The basic proposal is to tax food at a 10 per cent rate like other goods but to provide a grant to each household equal to the GST that would be paid on food by an average household. In practice, households may differ in size and other characteristics; but ignore this complication for the moment. Suppose that the average household expenditure on food is \$6,000 a year; with a 10 per cent GST, the average household would pay \$600 in tax on food.<sup>1</sup> If all households were given \$600 a year, households with expenditure below the average would be better off, and those with expenditure above the average would be worse off, than if food were zero-rated. As higher-income households tend to spend more in dollar terms than lower-income households, this would make the tax system more progressive than would zero-rating food.

The proposal is illustrated in the diagram below. In the absence of the grant, GST on food as a function of expenditure on food would be given by the line *OA*. The grant to each household would be *OB* (say, \$600). GST revenue on food net of the grant is shown by the line *BC*. This means that, for poorer households which tend to spend less than the average on food, the grant exceeds GST on food and so net GST collections are negative. For richer households which tend to spend more than the average on food, GST on food would exceed the grant and so net GST is positive.

<sup>1</sup>These are reasonable first approximations. The Household Expenditure Survey for 1993/94 (ABS, 1996) reports average household expenditure on food of \$111 a week.



This form of the proposal would not alleviate the government's revenue difficulties as the revenue raised from taxing food would all be given back as grants to households. There are, however, some other options. The option outlined here leads to a *more* progressive tax system than zero-rating food. If the intention were only to provide as progressive a tax change as would be accomplished by zero-rating food, a smaller level of grants to households might be thought acceptable.

**Household Differences**

This simple discussion has ignored the fact that households differ in important ways, such as size. For example, the cost of feeding an average household of five tends to be higher than that of feeding a couple with no dependants. This is evident from the table below, which presents Household Expenditure Survey data on food expenditure for households of different size. Grants could be adjusted to take account of family size, just as Family Payments are at present.

There would undoubtedly be some administrative costs involved in running the proposed grant system. However, it could operate in a similar way to Family Payments, with grants to households being directly credited to bank accounts. In principle, there would appear to be no substantial difficulty with this approach. The scheme would clearly apply to greater numbers of people than the current Family Payments, but should be simpler to administer because the size of grant would not depend on income.

Clearly, a number of further issues would need to be resolved, such as how grants should vary across households of different size. One possibility would be to

give a grant of some fixed amount per adult and some smaller amount per child. The optimal frequency of payments would also need to be determined.

**Average weekly household expenditure on food and non-alcoholic beverages, 1993/94 (\$)**

	<i>Lowest 20 per cent</i>	<i>Second quintile</i>	<i>Third quintile</i>	<i>Fourth quintile</i>	<i>Highest 20 per cent</i>
2-person household	76.44	85.43	90.89	105.82	132.96
3-person household	97.82	115.55	134.12	138.12	182.39
4-person household	119.62	133.61	152.11	172.02	206.66
5-person household	125.05	147.37	163.93	188.70	232.74

Source: ABS (1996).

### **Concluding Comments**

As noted, the proposal would cost revenue relative to the complete GST including a tax on food. The government might oppose it on these grounds. However, the proposal does at least refute the argument that a GST on food is necessarily unfair or makes the tax system less progressive. Whether or not the tax system becomes less progressive depends on other changes that occur at the same time.

A closely associated point is that even if the Australian Democrats believe they have a mandate to make the tax package fairer, this need not necessarily require them to oppose a GST on food. Indeed, the inclusion of food could be part of a package that makes the tax more progressive.

### **Reference**

Australian Bureau of Statistics (ABS) (1996), *1993-94 Household Expenditure Survey Australia: Household Characteristics*, Canberra (Catalogue No. 6531.0).

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