Taxing investment

John Hyde

Some economic facts are inescapable. One such fact is that, if we are to reduce our foreign debt, then we must finance more of our investments ourselves, instead of borrowing from foreigners. To do this, we must increase savings. Incidentally, so long as we continue to live high and not save, it is rather silly to complain about Japanese and other foreign ownership of 'Australian' assets.

We may be an inherently feckless people. Certainly padres and school teachers no longer teach us the virtues of thrift, and we have developed the bad habit of describing wealthy people as 'lucky'. There are, however, other reasons why we don't save as much as we might: the government does things for us and to us that make saving unattractive.

In the first place, those people who live their lives without saving are promised a government pension and Medicare. If our grandparents had not saved, they would have faced risks we do not face. What is more, these government pensions are not paid from government savings but from taxes raised at the time the pension is paid. The government has a huge liabilty but no sinking fund invested in income-earning activities. Given the extremely bad record of all governments when managing investments, that may be just as well---WA Inc and the VEDC really are but the extreme examples of government bungling.

Not content with subsidising people who don't save, the government also taxes twice those who do so---the second time at a confiscatory rate. Tax evasion aside, the incomes from which savings must be made are taxed before anything is saved. Then the earnings of the subsequent investments are taxed as well. What is more, there is no adjustment for inflation such as we have with the capital gains tax.

Consider someone taxed 33% on his last (marginal) dollar who has a fixed-interest deposit of $1000 earning 15% when inflation is 8%. His interest is $150. $50 of this goes in tax. That leaves him with $1100. But $1080 are needed this year to buy what a $1000 could have purchased a year ago. In real terms, the investment has earned only $20 (which is less than the cost of most rounds of drinks). The government has encouraged him to spend his $1000 on a good party.

No wonder savings are inadequate.

I doubt that the government is about to abolish the aged persons' pension or abolish Medicare. But it could reduce the penalties the tax system inflicts upon people who save. In short, it could do what New Zealand has already done: substitute a broad-based consumption tax for much of the income tax we now pay. In Australia's case this would have the added advantage of subsuming our rather messy wholesale sales tax. This was Mr Keating's preferred option (so called, Option C) at the time of Mr Hawke's self-indulgent Tax Summit.

There were four objections raised to Option C---none of them persuade me. They were:

1. That change is itself costly both for taxpayers and administrators. This is true but it is a price well worth paying substantially to reduce income tax.

2. That the change from income tax to consumption tax is regressive. This could be true but Mr Keating designed benefits for the poor that would have more than offset any regressive consequences.

3. That the tax is inflationary. This argument confuses a once-off price rise with inflation. It is sufficient to observe that New Zealand's inflation is now about half our own.

4. That it is foolish to let the government get its hands on more money. This objection is also ill-founded. Governments are unlikely to find a softer option than progressive income tax. Such has been the effect of inflation upon the income tax scales that our government has been able increase per-capita, real, government expenditure, produce a budget surplus and give us a so-called tax cut---all at the same time.

If Labor is serious about reducing the foreign debt and buying back the Gold Coast etc, then Mr Keating should dig Option C, or something like it, out of his bottom draw---now.

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