THE UNIVERSITY OF MELBOURNE

Occasional Address

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"An Old Tax is a Good Tax"

An adage or aphorism in the tax literature is "an old tax is a good tax". The wisdom in the statement is that there are significant costs in changing or even modifying a tax system and a government, in changing or modifying taxes, needs to be sure that the 'deadweight costs' such as new administrative and compliance complexities of introducing the change are outweighed by the benefit to society of such a change. They often are not!

It is a rare election campaign where taxes are not an issue. The recent Federal election was no exception nor has the return of the government saved us from the likelihood of further changes to the tax system beyond the tax relief promised.

Governments, indeed economists, lawyers and accountants are always looking for the 'optimal' tax system when, in fact, the typical taxpayer knows quite well the optimal tax is the one the other person is paying! One view of the 'optimal tax' is that it is one which does not cause resources to be allocated in any different way than a no tax system. The only such tax that I know that approaches this goal is a Poll Tax – a tax per head of voting population. These have long be discarded, not only because of their unpopularity, but often the very purpose of a tax is affect resource distribution e.g. a tax on pollution.

I would like to briefly explore the basis to most taxes and, in the context of the times, why a change in the tax system, as distinct to changing a tax rate, is often unnecessary and moreover, costly.

Any tax has to be on something of substance such as what is consumed (a consumption tax) or something that is saved (an investment or asset tax). Indeed, an Income tax is a tax on both savings and consumption. Although, if you spend all of your income then the Income tax becomes a consumption tax. Therefore those that argue we should focus on income tax rather than a consumption tax because the latter will have a greater effect of the poor only applies to the extent that there is a tax free threshold on most income taxes. We could of course duplicate that apparent benefit from most income taxes by providing a consumption voucher to those deemed poor. So this need not be an argument against a consumption tax.
A further argument often used against consumption taxes is they are not 'progressive' as most income taxes are where the greater the income the greater proportion of tax that is paid. However, this implies that a consumption tax can only be levied as a point of sales tax e.g. our Goods & Services Tax. A consumption tax can be levied on income when all savings or investments are tax deductible and so a progressive consumption tax can be achieved by progressively taxing income with savings as a deduction.

There are those who would argue we should have greater emphasis on consumption taxes because this would favour investment and production over consumption which is true enough. However, what is the purpose of production if it isn't for consumption? So the relative merits of investment or savings taxes over consumption taxes is really a personal thing, your personal time rate of discount which in a free society we would expect at the margin be the market's discount or interest rate which is effected and affected by government policy.

To argue that capital gains taxes must be set at the same rate as income taxes for fair or optimal tax collection is to ignore the nature of our tax system which effectively applies both investment and consumption taxes. Allowing a discount for capital gains is to give greater emphasis on consumption tax which can have just a much merit as an increase in a tax on investment – the type of tax affects resource distribution and it depends on the objective of the system which should be given greater emphasis, this was not addressed during the recent election.

Similarly, there have been calls for a reduction in company taxation on the grounds that Australian company taxes are amongst the highest in the world. This ignores that fact that Australia has an Imputation company tax system, so that the actual Australian company tax rate as distinct from the statutory rate of 30% is actually nearer 20%. This is amongst the lower world company tax rates which average about 26% when weighted by GDP or around 24% for OECD countries.

Those that argue for a reduction in Australian company tax rates are really arguing that Australia needs to attract foreign capital and as foreigners do not generally benefit from the imputation system the tax rate is too high for them. The domestic demand and the supply for foreign capital will be a function of its price. Taxes certainly influence price but at the end of the day the price of foreign capital is the exchange rate, if Australia needs (demand) more foreign capital than is currently supplied it will have to pay a higher price that is the exchange rate will drop and conversely if there is a surge in supply of foreign capital. We do not need to adjust the tax system!

The examples I have given here is that the tax adage that "an old tax is a good tax'' and what that entails should be remembered by policy makers before they reach for the "tax weapon" to address an perceived social problem.

Doctor of Commerce *honoris causa* citation

Chancellor,

Emeritus Professor Robert Officer has given years of distinguished service to the Australian community. He is an outstanding example of positive action that flows from a deep academic understanding.

Professor Officer began his professional journey as an agricultural science student at the University of Melbourne.

Graduating with a PhD from the University of Chicago in 1971, where his doctoral thesis was supervised by Professor Eugene Fama who was later a Nobel Laureate in economics, Professor Officer was at the forefront of the then rapidly developing application of economic principles to financial markets and decisions.

Returning to Australia soon after graduation, he was one of an elite group who brought the systematic study of Finance into mainstream teaching and research in Australia's universities.

Professor Officer is very well known to, and highly regarded by, the Australian business community. On two occasions he was appointed by newly elected governments to conduct a wide-ranging policy review, and other contributions have included ten years as a director of the Victorian Transport Accident Commission, ten years as a director of the Victorian Funds Management Corporation and three years as chairman of the Victorian WorkCover Authority.

One of Professor Officer's most notable and lasting contributions has been to the reform of Australia's taxation system. His analysis and advocacy of the imputation system of dividend taxation played an important role in its adoption in Australia in the late 1980s. This system has affected the decision-making of untold thousands of Australian companies, and millions of shareholders.

Professor Officer's contributions extend also to the not-for-profit sector where a number of Foundations and associations have benefited from his expertise. Chancellor, I present to you, Professor Robert Officer for admission to the degree of Doctor of Commerce (honoris causa).