Taxes, Health and Federalism

Mike Nahan

The Howard Government's victory in the Senate, which comes into effect in July 2005, has led to a renewed push for reform. And not before time, for there are clear signs that the gains from past reforms are beginning to wane—productivity growth is slowing, capacity constraint is beginning to bite, the cost of regulation is growing, the efficiency of government is declining and the savings rate is almost zero.

Taxation should be near the top of the list—especially for Liberals—but it isn't. Why and how is this so?

Liberals, by theory and constituency, should have a strong predilection for lower taxes, an aversion to tax complexity, and should value personal choice and responsibility over enforced collectivism.

It is well known, moreover, that the Australian tax system remains seriously flawed. The top marginal income tax rates are high and kick in at a relatively low level. The interaction between the tax and welfare systems produces effective tax rates of often over 80 per cent for low-income earners, locking many thousands of people out of work and in to welfare. The Tax Act has become a destructive monster of 7,000 pages with tax compliance estimated to be consuming over $8 billion per year.

The leading members of the Howard Government know this. After all, they spent the better part of six years making the arguments for creating and defending A New Tax System (ANTS). Although ANTS did make some major improvements, it was seriously warped during its passage through the old Senate. Moreover, it did not address everything—such as the high tax rates.

Why, then, are the leading erstwhile proponents of tax reform in the Howard Government—Prime Minister John Howard, Treasurer Peter Costello and the Finance Minister Nick Minchin—resisting another wave of tax reform?

How do we return to our liberal traditions and lower taxes?

Howard and Costello are willing to cut taxes, but only as a residual. As Mr Costello said:

> We are going to fund health, education, tsunami relief, the war on terror, we are going to fund our troops in the field and we are going to balance our budgets, and when we have done all of that we are going to keep taxes as low as is consistent with that.

Tax cuts will come after spending and subject to a balanced budget.

A cynic might argue that the Howard team, having mastered the art of buying votes with judicious dollops of taxpayer largesse, is loath to limit its capacity to do so in the future by cutting taxes now.

There is another perspective, and this is that there is concern within the Howard team that people currently prefer higher spending, particularly for health, to tax cuts.

The polls on tax cuts versus spending are notoriously malleable and most often used as a tool to spruik bigger government. As stated by V.O. Key in *The Responsible Electorate: Rationality in Presidential Voting 1936-60,* 'the voice of the people is but an echo', shaped by the 'clarity of alternatives presented to it and the character of the information available to it'. If the information and options put forward are distorted and incomplete, so too will public opinion.

Some patterns can be gleaned from the available survey data.

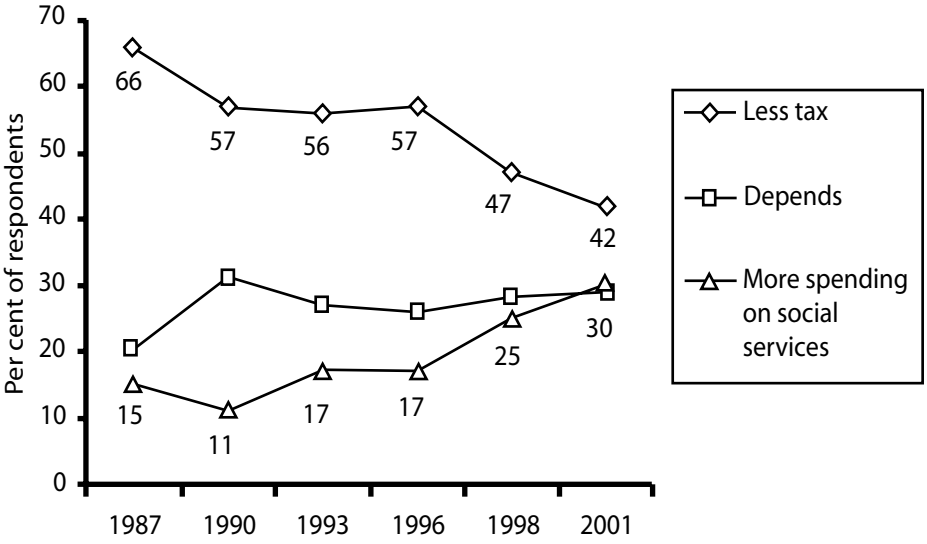
First, more people still prefer tax cuts than more government spending in general (see Figure 1). Second, the popularity of tax cuts as opposed to higher spending has declined over the last decade-and-a-half. Third, when the choice is narrowed down to tax cuts versus additional health spending, the pendulum of popularity swings strongly in favour of the latter. Fourth, increasing spending on areas other than health is much less popular, particularly if it is for unemployment benefits and social welfare.

What do these trends mean?

First, that the efforts at State and Federal level to drive efficiency and greater transparency in government spending put in place during the 1990s have had the effect of engendering greater support for government spending. That is, voters think government is now more efficient, effective and transparent; which of course they are—in some areas. What has not been noticed by the public is the distinct decline in efficient, effective and transparent government spending at *all* levels over the last six years. This needs to be remedied to make space for tax cuts.

Second, tax reform, particularly the GST along with cuts to tax rates and tax thresholds, has reduced the desire for additional tax cuts. Put another way, tax reform has given gov-

Figure 1: 'If the government had a choice between reducing taxes or spending more on social services, which do you think it should do?'



Source: Grant. R (2004) Less Tax or more social spending: twenty years of opinion polling, Parliamentary Library, Research paper No. 13 2003-04.

ernment the ability to pluck the goose with less hissing. This is particularly the case for the States. They have been given a huge growth tax raised by the Commonwealth—the GST—at a time of a huge consumption binge. This has generated unprecedented revenue flows, particularly for the laggard States and Territories of South Australia, Tasmania and the Northern Territory. To the State electorates, this largesse appears as money for jam.

Third, people have a hierarchy of spending priorities, with health at the top and unemployment at the bottom, and their views on tax cuts depend on which area of spending they expect to be affected. If people think, as the proponents of bigger government are wont to portray, that a dollar less in tax is a dollar less for public hospitals, they are, on average, against such a trade-off. On the other hand, if the tax cuts come from a lower priority area, they are not—for example, the $24 million subsidy for the Tasmania-to-Sydney Ferry (aka the chunder bucket), or the $780 million cost overrun of the 'very fast' but slow trains slowly being rolled out in regional Victoria, or the $1.2 billion Perth–Mandurah light rail system (which, on current expectations, will be a ghost train for 75 per cent of its run).

Fourth, people have become fearful about the funding of health. Stories about increasing waiting lists, ambulance bypassing, declining bulk billing rates and cuts to pharmaceutical subsidies, coupled with the rising costs of technology and advanced services, have given rise to fears of having to go it alone without the support of government. In addition, as the population ages, health becomes a more important issue and the desire for government to take on individuals' health risks increases. For example, the average expected health cost from all sources per year for a 65-year-old is just over $12,000, while the expected annual health costs for a 35-year-old is around $900. These translate into 55 per cent and 2 per cent respectively of average wages. One can see why the old are prone to concerns about the level of health spending for them.

Of course, from a classical liberal perspective, the views of the median voter should not matter, particularly when, in reality, a very small proportion of tax revenue is spent on classical public goods such as defence, police, public health, and pollution abatement and control. People should have the right to reap the benefits of their own labour and saving.

We have, however, travelled far from our liberal traditions and too many people have become dependent upon the government taking from others on their behalf. The question is: how do we return to our liberal traditions and lower taxes?

First, unfunded tax cuts that drive budgets into the red are not the answer. Debt is nothing less than taxes postponed. Costello is right on this.

Second, we must renew the drive for efficiency, effectiveness and transparency in government spending. Costello is also correct in arguing that the focus needs be on the States and Territories—they are responsible for service delivery and infrastructure where the major gains are to be made. But the Commonwealth is also more than an appropriate target. The drive for efficiency in spending in Canberra has waned in recent years as the propensity for pork-barrelling has grown. For example, in the last federal election, Coalition politicians issued how-to-vote cards which contained a colour-coded map of the district with every grant/project given over the last term and every new one promised during the next term. The Gallop Government followed the Howard Government's lead during the recent WA State Election.

Third, over time, we must develop a health system that is based on individual choice and responsibility rather than socialism.

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