

Address to
The Tax Institute SA Convention
Barossa Valley, South Australia
2 May 2014

Bob Day AO
Federal Chairman and Senator-elect
Family First Party Australia

We're all familiar with the dictum, *"In this world nothing is certain but death and taxes,"* but as Will Rogers so rightly observed, *"The only difference between death and taxes is that death doesn't get worse every time parliament sits."*

What I'd like to do this morning is give you a brief overview of some key aspects of the economy; some of the challenges – and opportunities, of the 44th Parliament; my views on the Abbott Government's 1st Budget; and finally what I believe are the essential elements of Tax Reform in Australia.

I remember a time, as I'm sure many here would, when 20 of Australia's Top 100 publicly listed companies had their head offices in Adelaide – Fauldings, Southcorp, Elders, Adelaide Brighton, Normandy Mining, Standard Chartered Finance, News Ltd – it was an impressive list. Today there are 2. From 20 to 2 in just over 20 years.

So what happened? Where did it go wrong for South Australia? And what lessons can the rest of the country take from this?

Leadership. More than at any time since World War 2, Australia needs leaders who understand how the world works, why investment decisions are made, how markets work and how real jobs are created. Whether it's mining, farming, manufacturing, tourism or small business, anything not based on economic reality is doomed to failure.

Regrettably, many of our political leaders have never had a proper job. They are now mostly professional politicians. They go to university, get a job working for a politician or a union and then become politicians themselves. The results are there for all to see. In my opinion, politicians are just managers doing a job, if they're no good they should be sacked.

Australia used to be called The Lucky Country. We rode on the sheep's back selling our wool to the world. Then came the mining boom and Australia prospered throughout the 1990s and 2000s. The big question now however is 'What will happen when the mining boom ends?'

What the end of a boom does not permit is the continuation of huge benefits for some while big sacrifices are being made by others. You realise very quickly that if something is not adding value, it is adding cost.

It's definitely not The Lucky Country for many. As we all know, it's getting harder and harder for young people to get a job, buy a house and support a family. These are core Family First policies.

Youth unemployment in some places is over 40% and house prices are now out of reach most young couples. Not only that, young people have lost faith in our political leaders to fix it.

When Australia became a nation in 1901, it had the highest per capita income in the world. Today we are No 12 on the list.

In 2007 Australia had no debt and had a cash surplus of \$17bn. Today we have a debt of \$300bn and a deficit of nearly \$50bn.

What happened? Well we all know what happened – the government spent money like there was no tomorrow. So how to fix it?

First and foremost, you cannot spend your way out of financial trouble. Families can't, businesses can't and governments can't. When a family or a business or a government is in financial difficulty the only way out of the mess is to 'shrink to viability' and build up from there.

Second, yes Australia is indeed blessed with abundant natural resources but Australia's real wealth is not beneath the ground, it is between the ears.

Which is not the same as "*education, education, education*" as the government's mantra goes. Forcing young people to stay on to Year 12 when they're clearly not enjoying it is not only economically foolish it is morally wrong. It condemns them to a life of misery. I have come across so many young lads not enjoying school, causing trouble at home, getting in trouble with the police who then start working on a building site and I can tell you by Friday night they're too tired to be hooning around in cars, setting fire to brush fences and spraying graffiti at all hours of the night! I know hundreds of trade contractors - carpenters, bricklayers, tilers, who left school at 15 and have gone on to lead very happy and successful lives. They've all got 2 or 3 investment properties, cars, boats and they send their kids to private schools. They're also members of the local CFS or surf lifesaving club and coach local football or netball teams. They are good citizens and yet they received very little in the way of formal education. As the old saying goes, "*It's not what you're good at in school that matters but what you're good at in life.*"

But despite the severe shortage of tradespeople, it's getting harder and harder for young people to get an apprenticeship. I visit some of my building sites and see guys my age laying bricks. I then call into the local Shopping Centre and see young lads on skate boards and I ask myself, "Why aren't those lads on my building sites?" What am I missing here?"

I began my working life with the South Australian Government's Highways Department in their research and testing laboratories. I was there a little over 6 years.

I must confess, working at the Highways Department didn't suit me all that well - the Public Service, lots of staff, not a lot to do. So I left and started working in the building industry which is where I came into contact with politicians and realised why our country was going in the wrong direction. So I began preparing to run for office myself. That was 28 years ago.

The 44th Parliament. The Abbott Government has a huge majority in the Lower House but will need six votes to get its legislative agenda through the Senate. In the Senate there are six new crossbenchers. I am one of them. Now we've been variously described by the media as "*a mishmash, grab bag, barnyard, liquorice allsorts, flotsam and jetsam, motley crew of Star Wars aliens!*" with calls for the Electoral Act to be changed immediately to make sure this sort of thing never happens again. In other words we should all be sacked. This is before we've even started. Which I think is somewhat un-Australian. At least let's see how this new group of non-professional Senators from everyday walks of life perform. Who knows, they might actually do a good job. Bear in mind 25% of the electorate did not vote for a major

party (it was over 40% in SA), but the non-major party senators took only 18% of the seats. The non-major parties received 25% of the vote but took 18% of the seats. If the same happens at the next election there will be 12, possibly 13 cross-benchers. Yes, people like Ricky Muir of the Australian Motoring Enthusiast Party got a tiny number of primary votes but people weren't specifically voting for him - it isn't personal, any more than it is with the major parties, people do not vote for individual Senators, they vote for the party and Ricky Muir represented all those who voted for someone other than the major parties. By major parties I mean Liberal, Labor and the Greens.

The new crossbenchers have met, we talk to each other and we are all committed to doing a good job. I believe each of the new senators will be their own people – Palmer United Party Senators Glenn Lazarus, Jacqui Lambie and Dio Wang and the Motoring Enthusiasts Party representative Ricky Muir. Now no-one can predict what will happen but the six new crossbenchers are committed to developing good working relationships with each other and other senators. If the government is half smart it will not team up with Labor and the Greens to change the Electoral Act to prevent minor parties getting elected. That would certainly get us off on the wrong foot.

Tax. The first thing to say about taxation is that we need less of it, not more of it. As has been widely acknowledged – most recently by the Treasurer Joe Hockey, governments in Australia do not have a revenue problem, they have a spending problem. So if I were Joe Hockey, I would dispel all the rumours and announce at the presentation of the upcoming Budget, that the Government is declaring a moratorium on any new tax increases - and not just in this term, but in any future terms that voters may grant it. As they have said many times, you cannot tax your way to prosperity.

True, the previous Labor Government bequeathed to the Government a real mess and the government should certainly address the budget deficit - and the use of asset sale proceeds is an acceptable way to do this, but targeting current taxpayers to make up for past excesses and the failings of previous governments, is as unjust as it is futile. I will explain why shortly.

The one tax change most often proposed by economists, business people and, of course, State Treasurers, is to raise and/or broaden the GST. Economic considerations aside, why the Commonwealth would even consider such a proposal is beyond me. The Federal Government would bear all the pain, and the States would enjoy all the gain, which they would no doubt spend as extravagantly as they have done with the existing GST proceeds.

Over and beyond that *political* reason for not going near the GST, there is the fundamental economic reason and that is a lift in the GST rate, or a base-broadening change, would simply give State governments more of our money. Why on earth should any sensible person want that?

These Treasury officials, economists and business people will of course say that they're not looking to raise **more** revenue, they just want to raise more from the GST and then offset that by reducing other taxes. The problem with that argument is the same as it was when the GST was originally introduced; namely that, by the time you have "compensated" everybody who says they will be worse off as a result of the rise or broadening of the GST, you are left with only a portion of what the GST increase will raise. The result, as it was in 2001, would be a higher level of expenditure, a higher level of taxation and no reduction in other taxes. This has been the experience with consumption taxes around the world.

There is however one small change to the GST which might be justified, and that is to reduce the \$1,000 level of on-line purchases that are currently GST-free. Perhaps down to \$100.

So, with that very minor caveat, the Government should make it crystal clear that it will **not** be raising the GST rate, nor will it be broadening its base, either in this term of office or in any future terms.

Tax Reform. It goes without saying, that attempts at tax reform in the past have been disappointing to say the least. The introduction of the Goods and Services Tax in 2000 resulted in a big increase in tax revenue – it will generate \$50bn this year - a sum that was beyond the wildest imagination of even its most enthusiastic proponents. Getting States to abolish many of their taxes, as they had promised to do as part of the GST introduction package, has however been much more difficult. One of the main problems is the fact that 70% of Local, State and Federal taxes are spent on salaries. It's no wonder we haven't seen a new reservoir in 40 years. And of that 70% less than half is spent on essential services like nurses, teachers and police. As we know, whenever cuts in government spending are called for, politicians respond with "well how many nurses, teachers and police would you like us to cut?" They rarely ask how many media advisers you would like them to cut.

Presently, the Commonwealth raises around 80% of all taxation revenue in Australia, leaving the States with just 20% to fund their responsibilities. 20% is less than half of the revenue needed to fund State Government services. The balance is supplied by Commonwealth grants, many of which come with conditions attached.

Federal fiscal arrangements are undeniably dysfunctional.

Tax Law. There is a growing irrelevance of the law and its institutions. I saw tax law described by one leading tax barrister as 'unintelligible'. And the High Court now seldom grants leave to appeal in federal tax cases virtually giving up hope of keeping the tax system subject to legal principle and normal adjudication methods.

The sheer quantity and ever-changing content of tax legislation has undermined its credibility. It is practically impossible to know what the law is and what it means.

Before the First Uniform Tax Case in 1942 the legislation occupied just 81 pages. It is now over 10,000 pages, (20,000 if you include fringe benefits tax, capital gains tax and superannuation provisions).

It goes without saying that rules and sanctions should be clearly specified in advance so people know how they are supposed to behave and what will happen to them if they don't.

Also, importantly, rules must apply equally to everybody. But the rules governing tax liabilities have become so tangled and complex that nobody can be sure any longer what the rules say or how they will apply in any given case. And behind the vast volume of laws – the actual legislation, looms an equally massive bulk of ATO public determinations, public rulings, bulletins, interpretative decisions, policy papers, circulars, administrative guidelines and practice statements. Some of these are supposed to be binding on ATO officers, and in general ATO staff rely on these sources, rather than on the legislation, thereby giving them in practice something close to the force of law. The ATO no longer simply implements a known set of rules, but rather it develops and amends the rules case by case. In effect, the ATO makes its own rules. In fairness, the ATO is probably just trying to make an unworkable law work but the net result is confusion and uncertainty. As a consequence, we live with laws which have lost their intelligibility, certainty and predictability. Tax law is not real law as we've come to understand it.

The resultant attitude of many taxpayers to all this is to treat the law and the courts as irrelevant. *“Forget legal advice, just give me an ATO ruling that will protect me from penalties or prosecution.”* Many taxpayers, of course, just surrender and pay up.

Systems which are complex in their application, debilitating in the sense that the more you earn the less of each dollar you keep, and unfair and unreasonable in the sense that people feel penalised for working, are destined to failure in the long term. As I said earlier, anything not based on economic reality is doomed to failure. I believe the Australian Tax Act is such a system.

Take Australia's cash economy. It is estimated at 15 percent of GDP, one of the largest in the developed world. An underground economy of that magnitude requires the involvement not only of a lot of businesses, but also of millions of consumers. As we know, laws only work when people believe in them and clearly they have no respect for our tax laws.

Despite what many advocating increases in tax would have us believe, the total tax take in Australia is quite high. Some say that compared with other developed economies, Australia is a 'low tax' country and that workers and companies could comfortably pay more. Not true. When it comes to taxing incomes, Australia is up there with the Europeans and is way ahead of most of our neighbours in the Asia-Pacific region.

For the 2012 financial year all Australian taxes levied were approximately \$400 billion which represented just over 30 per cent of Gross Domestic Product. That 30% figure hasn't changed since 1975. In fact, just 3 years earlier, in 1972, ie before Gough Whitlam, it was 23%. Eminent economist Colin Clark once said economic growth declines if taxation, 'in all its forms' is more than 25 per cent of GDP. It's also been said, *“When the taxes of a nation exceed 20% of the people's income there is a lack of respect of government. When it exceeds 25% we see lawlessness.”*

If you view the Budget as an 'Income & Expenditure Statement', the government has both its income and its expenditure strategy wrong. They don't know how to raise revenue and they don't know to manage expenditure.

For example, over the past 20 years, there has been a 50% increase in real average incomes. Given that fact, you would think that people would be in a better position to fund more of their own health, education and retirement but that has not happened. Public sector spending in these areas has risen – instead of in areas like infrastructure – reservoirs, roads, ports, power stations and defence.

As for its income or revenue strategy, raising taxes is the wrong way. High tax rates undermine enterprise and destroy the will to work. You don't have to be a Laffer Curve true believer to accept that behavioral response is a reality. When you add to this the corrosive effect on the moral relationship between the state and its citizens, the case for fundamental tax reform becomes even more compelling.

There comes a point when the prospect of giving up half or more of any additional earnings leads people to decide that it is simply not worth it. Taxation then starts to produce gross inefficiencies as people stop working as much or as hard as they used to, and governments find their taxes are not producing the revenue they expected. Politicians who lack real world experience and an understanding of how an economy and markets work, are drawn into a vicious spiral, jacking up tax rates to try to compensate for the falling revenues that their high tax demands have created.

Similarly, many on welfare benefits decline opportunities to work because of the punitive effect small earnings and high tax rates have on the security of their welfare benefits and the value of extra work.

And people on very low incomes fare worst of all, for as they increase their earnings, higher rates of income tax combine with the loss of means-tested benefits deprive them of up to 80 cents of every extra dollar they earn.

If we are to extricate ourselves from this dysfunctional system, the goodwill of the public needs to be restored by getting tax levels back to something which most people would see as reasonable. To achieve this, I would recommend three specific policy changes:

1. In order to remove one of the most significant tax avoidance avenues, align personal tax rates with company tax rates,
2. So that nobody pays tax until they have at least earned enough to live on, raise the tax-free threshold to at least \$20,000; and
3. Probably the most radical, but hear me out – introduce a single-rate tax system.

Single-rate flat taxes are gaining popularity. Treasury officials around the world like the idea of a single-rate flat tax.

One UK Treasury official stated, *"A single-rate flat tax rate increases economic efficiency by reducing distortions and allowing the market to function more naturally, improving the overall allocation of resources and encouraging labour supply. The reduction would stimulate economic growth."*

Another UK Treasury official said there could be an "economic mini-boom" if a single-rate flat tax were introduced.

A paper published by the Adam Smith Institute stated, *"If you look at the experience of those who have introduced a single-rate flat tax, and also the tax reforms of the 1980s which took place in Britain and America, reducing tax rates causes revenues to rise."*

As has been demonstrated many times, when taxation rates are reduced revenues do not fall. When the Australian company tax rate was cut from 39 to 30 percent, revenues went up not down. The famous Reagan tax cuts from 70% to 30% in the 1980s produced a \$9 billion increase in revenue when a \$1 billion shortfall had been forecast. Russia is another example, where the move to a 13 percent flat rate tax in 2001 increased revenues from 9 to 16 percent of GDP. When Sweden halved its company tax rate from 60 per cent to 30 per cent company tax revenue tripled.

Resistance to paying tax declines as people view the tax system as fair and reasonable.

But you ask any politician about the possibility of having a single rate flat tax and they frown and say: *"Hmm. Interesting idea, but it would be perceived as just a tax cut for the rich which is a tough sell."*

They don't understand how economies work. Like Bob Carr's 'Vendor Stamp Duty' idea in 2004. It resulted in a dramatic slump in real estate sales and less revenue, not more. It was scrapped after just 12 months.

The classic of course is a tax on imports – tariffs, to 'save local jobs'. As we know tariffs have the opposite effect.

Single-rate flat tax regimes have now been adopted in over 30 countries and counting. As each domino falls, another country is forced to respond to the new-found vigour of its neighbour.

In a research paper commissioned by the Association of Chartered Certified Accounts, Australia's Professor Sinclair Davidson concluded: *"Our existing tax system is flawed and unsustainable.... A single-rate flat tax with a generous tax-free threshold would be a major improvement on the current Australian tax system."*

Over the past 20 years we have seen numerous proposals for reforming our tax system. Of course, no reasonable person would expect a Government to reform our tax system overnight but people have every right to expect four things:

First, that the Government next month should clearly and unequivocally commit to significant tax reform.

Second, it should clearly set out that reform's key objectives.

Third, it must lay out a broad timetable for reform.

And fourth, it should take the first steps towards those objectives straight away.

In 2006, then Treasurer Peter Costello commissioned an inquiry headed by leading businessman and Chairman of the Board of Taxation, Dick Warburton, and Australian Chamber of Commerce chief executive Peter Hendy, to benchmark the Australian taxation system against systems applying in other major trading nations. Warburton and Hendy highlighted the need for major tax reform.

Warburton said, *"I believe we should be looking at major tax reform - not just tax cuts, but reforms that look at the whole structure of the tax system. One of the ways you can do that is broaden the base and cut the rate."*

Hendy called for personal tax rates to be cut over time to equal the company tax rate.

There is certainly a pressing need to start reducing the current 30 per cent company tax rate. I accept it can't be done overnight, but the Government would do well to start cutting the rate by one percentage point in this Budget, and then announce its intention to make a similar reduction every year it is in office. That would hold out the prospect of a 20 per cent company tax rate and, if it is really serious about an internationally competitive tax system, a 20% personal tax rate by 2024.

Nobody enjoys paying taxes but in the 1950s and 1960s, relatively low taxation and a comparatively simple set of tax rules meant that most people paid what was due without too much complaint. Today, however, the Government and the ATO find themselves locked into a destructive relationship of repression and resistance with ordinary taxpayers. Where people can avoid tax by exploiting loopholes, they will do so; where they can't eg PAYG taxpayers, they become resentful at the unfairness of it all.

Thank you.

Note: I am indebted to a number of people and organisations for their help in researching this paper at short notice – Peter Saunders, Geoffrey de Q Walker, John Stone, Bryan Pape, Sinclair Davidson, Des Moore, the CIS and the IPA.