

I attended the 2020 Summit in Canberra last weekend but, to the surprise or bemusement of many, I was assigned (by whom I have no idea) to the 'Towards a Creative Australia' stream, rather than to one of the streams where an economist working for a bank might be more likely to be found.

I'm not complaining about that: indeed, I found it quite a pleasure to spend two days with a wide range of talented people who are passionate about what they do, who weren't (contrary to the impression conveyed by some commentators who weren't actually there) simply asking for more money, but who believe (as I do) that the arts, and creativity in its broadest sense, have much to contribute to objectives such as a more resilient economy, a greater sense of personal and community well-being, and a more inclusive society.

I would have found it tempting to go along to both the productivity and national security streams in order to make the point that the two are in an important sense inversely correlated: that is, much of the legislation, regulation and additional spending which have been imposed or undertaken in recent years with the ostensible aim of improving 'national security' has – without necessarily achieving that objective – materially detracted from productivity growth. But I suspect that such thoughts wouldn't have made it past the 'facilitators' whose job it apparently was to 'filter' the ideas coming up from the smaller working groups who beavered away on the Saturday afternoon.

Probably the most important 'idea' to emerge from the economy stream was that the time has come for 'root and branch' reform of the Australian tax system. Although there has been a good deal of reform of parts of the tax system over the past decade – particularly in the area of indirect tax and, to a lesser extent, corporate taxation – there has not been a comprehensive review of the personal income tax system in over thirty years.

Over the past decade, the personal income tax system has increasingly departed from the objectives of efficiency, equity and simplicity. There have, to be sure, been repeated rounds of personal income tax cuts – in the form of reductions in marginal tax rates and increases in the thresholds at which particular marginal rates become payable – made possible by the flood of revenue generated by the commodities boom, the asset price bubble, and strong economic growth more broadly.

But there has also been a growing tendency for the income tax system to be used to favour particular types of income over others, particular groups of taxpayers over others, particular areas of expenditure over others, and particular forms or economic organization over others.

Thus, for example, income from speculating (capital gains) has since 1999 been taxed at half the rate of income from working (wages and salaries) or from saving in the form of deposits (interest). People aged 65 and over, simply because they are 65 or over, have a tax-free threshold four times as high as people aged under 65. People over the age of 60, if they've been smart enough to channel all of their income through their superannuation fund, now need not pay any tax at all (and can also line up for taxpayer-funded concessions and benefits). Small businesses pay less tax on a given amount of income than large ones, simply because they're small. Investors get tax breaks for putting money into plantations which they don't if they put their money elsewhere.

The revenue foregone from these and other forms of special treatment in the tax system has risen just under \$20bn a decade ago to over \$50bn in the current financial year, and is expected to top \$60bn by 2010-11.

That's equivalent to almost one quarter of all Commonwealth Government spending. Yet, unlike the spending side of the Budget, these 'tax expenditures' are not reported in detail in the annual Budget Papers, they're not subject to scrutiny by the Auditor-General, and (once entrenched in legislation) they're not regularly reviewed in the Parliament.

The growing use of the income tax system to confer favourable treatment on particular taxpayers has never been subject to any overall assessment of its impact on the complexity or fairness of the tax system, or of its effects in distorting decision-making (that is, prompting people to arrange their affairs or to do things solely in order to access favourable tax treatment). It's time that it was.

*(This was originally published as an op-ed article in The Age on Friday 25<sup>th</sup> April 2008)*

- Saul Eslake  
Chief Economist, ANZ