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SUSTAINABLE TAX FOR DEVELOPMENT IN A GLOBAL CONTEXT: SOME AUSTRALIAN EXPERIENCES

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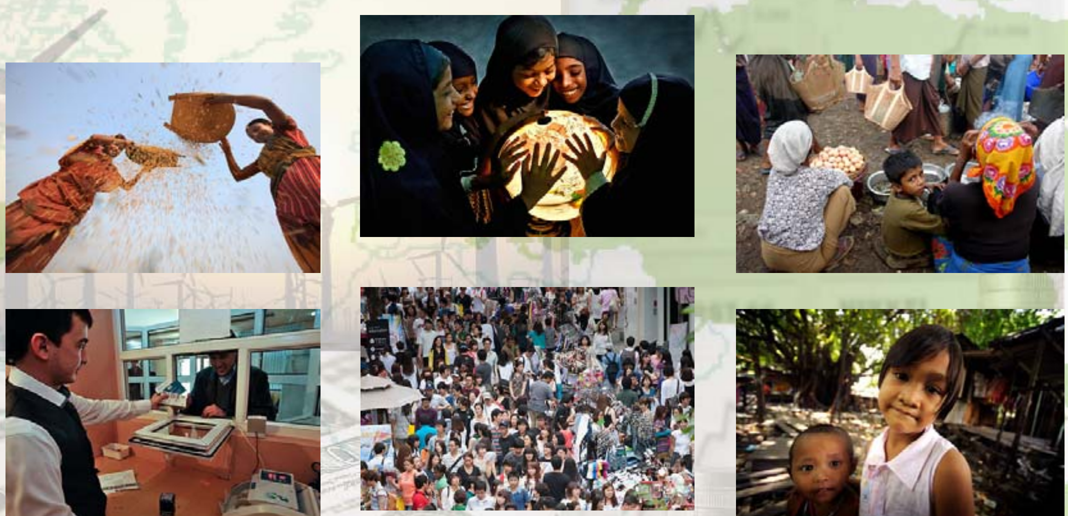

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SUSTAINABLE TAX FOR DEVELOPMENT IN GLOBAL CONTEXT

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Macroeconomic Policy and Financing for Development Division

Sustainable Tax for Development in a Global Context: Some Australian Experiences

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Abstract

Over the past decade, Australia has attempted to reform its taxation policies on a number of occasions. The outcomes of these reforms can provide some guidance for other countries in the Asia-Pacific region. This paper briefly considers four areas of tax reform undertaken in Australia: attempts by business to increase consumption taxes and reduce company income tax; taxing resource rents; improving the equity of tax expenditures; and linking tax reform to expenditure pressures. The Australian experience presents interesting insight into the international tax discussion and how we can better support tax reform in our region. In particular, it points to the need to revisit how we engage in the tax debate both domestically and internationally and what we as a region can do to strengthen domestic revenue as we seek to find new sources of finance for inclusive development.

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I. Introduction

Financing development has become central to the global development agenda. While much hope and effort is being placed on multilateral taxation and the base erosion and profit shifting (BEPS) agenda, critical to success in the Asia Pacific will be striking the right balance between tax reform that is progressive, funds growing domestic expenditures, and drives growth while ensuring economies remain globally competitive. The issues are both technical and political.

Over the past decade, Australia has attempted to substantially reform its taxation policies on a number of occasions. The outcomes of these reform processes, the success and the failures, can provide some guidance for other countries in the region. This paper briefly considers four areas of tax reform undertaken in Australia: attempts by business to increase consumption taxes and reduce company income tax; taxing resource rents; improving the equity of tax expenditures; and linking tax reform to expenditure pressures. From these experiences a number of lessons on the challenge of tax revenue can be garnered.

These lessons are relevant to the Asia Pacific region as nations grapple with the common challenge of eroding revenues and growing fiscal pressures, while also seeking new sources of growth. What is clear from Australia’s experience is that tax reform is never easy, and while technical issues surrounding tax reform are important, it has been the political economy – that is the securing of legislative and community support for reform – which has largely determined the success or failure of attempts at reform.

This experience presents an interesting insight into the international tax discussion and how we can better support tax reform in our region. In particular, it points to the need to revisit how we engage in the tax debate both domestically and internationally and what we as a region can do to strengthen domestic revenue as we seek to find new sources of finance for inclusive development.

II. The Extent of the Problem

Globalisation and the growth of services based industries in which the major output is data is making it increasingly difficult for national jurisdictions to tax corporate and personal income. The large number of different jurisdictions in which business is undertaken and the ability to shift costs and profits between these jurisdictions means corporations have greater choice over where they produce, declare profit and pay tax. There is therefore a need for countries to coordinate and share information with other countries.

The problems of leakage from the tax base and fiscal sustainability arguably affect developing countries even more than developed countries. Developed countries have greater technical capacity to investigate and deal with issues such transfer pricing and debt dumping. Even with these greater domestic resources, developed countries have struggled to combat tax avoidance by multinational companies.

Developed countries also have the advantage of being members of large well-resourced multilateral international organisations. The G20 and the OECD are, by their nature, organisations for developed countries. This has assisted developed countries take action on tax issues through processes designed to specifically deal with BEPS. Developing countries have contributed to the OECD/ G20 BEPS project and there are specific regional networks being established as part of the project. However, the problems faced by developing countries are often very different level from those faced by OECD countries.

It's important that the growing inequality that has characterised much of the growth in the developed world during this period is not repeated in our region in the period ahead.

We are now armed with research from the IMF that shows when the benefits of growth are concentrated, overall growth is weaker. When growth is more fairly shared, overall growth is stronger.

This repudiation of "trickle down" economics from the IMF - the notion that if you give more money to the wealthy everyone will be better off - is powerful support for robust implementation of Goal 10 of the Sustainable Development Goals. This work has important implications for domestic resource mobilisation, or put another way it points to the importance of progressive taxation systems.

At the same time as there is greater pressure on revenue, developing countries in the region have a greater need for government expenditure. While infrastructure in developed countries is for the most part established – albeit in need of repair – rapid urbanisation and industrialisation in developing countries brings with it congestion, concentrated poverty, social exclusion, migrant workers and so on. This means there is a strong need for governments to access funds to provide infrastructure. There is also pressure to fund social welfare systems, particularly as the extended family unit changes and populations go from rapid growth to rapid ageing.

There is also a strong incentive for multinational companies to abandon responsibility for providing social services for local employees so as to cut costs. This experience of ‘social dumping’ increases the cost of service provision for governments.

For the Asia Pacific region these challenges are particularly stark. While the region will become the engine room of the global economy over the next decade, it also faces major challenges funding the domestic investment needed to develop and increase living standards. Asia’s share of global production will increase from around 30 per cent today to over 50 per cent by 2050. As the move of the global centre of growth to the Asia Pacific accelerates, the tax issues faced by countries in the region will grow. Large corporations are increasingly focusing their expansion strategies on the region and a greater share of profits are being derived from the region. The need for effective tax regimes in these countries will become more important.

III. Democracy Public Choice Theory and Tax Reform

It is recognised that developing countries experience very different tax environments and fiscal pressures than developed countries. There are, however, some general principles which can be drawn from the success and failure of tax measures in developed countries with democratic systems. Technical design and the implementation of policy is just the beginning of the journey. The difficult part can be how you get it done. That is, how to secure support to legislate your reforms is becoming as important, or more important, than the technical aspects of the reform. The challenge has become how to overcome the diverse vested interests who seek to secure their existing economic rents at the expense of the majority. Tax is a classic example of this.

In economic parlance, pareto optimal outcomes, where the benefits of the reform more than out-ways the costs to losers is key to driving economic growth. In democratic systems the power of interests that will lose can have a significant impact on the process and success of reform.

Public choice theory outlines the impact that organised interests which stand to lose from pareto optimal reform can have on the democratic process. Small groups in society which have one or several political issues in common and which stand to lose significantly from a reform will be well organised and well-funded. (Becker, S, 1983) While the costs of reform are often concentrated in this way on a small group, the benefits, while large in total, are small for individuals or organisations.

An example of this is the removal of tariff protection for a particular industry. The protected industry stands to lose a lot from the removal of tariffs in terms of profits and those losses are centred on one industry. Consumers and businesses that gain from the fall in the price of imported substitutes for locally produced goods gain only a small amount each. The small well organised groups of businesses regularly affected directly by the removal of tariffs can take action in a democracy to retain their privileged position.

This action can take the form of providing financial assistance or open endorsement for a political party that adopts an accommodating policy stance. It can also take the form of public campaigning through unpaid media or in extreme cases through an advertising campaign. This has been the case in Australia and is the subject of all examples in this paper.

Tariff and quota reduction provide a poignant example for developing countries. Tariffs, in an inefficient way, protect entrenched interests and employment at the same time as raising revenue for governments. They are also an example of a tax that can be influenced by a country's involvement in international organisations. Up until the Doha Round, the World Trade Organisation (WTO) provided an effective international body which could assist developed and developing countries prosecute the case for tariff reform as a domestic agenda. The break-down of the Doha Round, in particular – the failure of the development agenda through the WTO – means that there is a need for other bodies to take up the issues that the global body has failed to resolve.

Achieving a progressive tax system means challenging power elites. Frequently official institutions are afraid to take on these vested interests. So what becomes important is not just the technical design of the policy but how you secure the public's support for it. Significant structural reforms which secure inclusive growth nearly always collide with powerful vested interests.

In recent years, corporate tax rates in OECD countries have declined an average of 7.2 per cent between 2002 and 2011. There is a risk of a race to the bottom.

If wealthy developed countries like Australia have seen their tax bases eroded including by large multinational corporates and very wealthy private interests, it is going to be even more difficult for developing countries to put in place progressive tax systems. The progressive nature of taxation in developed countries that remains was put in place in an environment in which governments had much greater sovereignty and power over taxation than is the case today.

It would be a tragedy if developing countries followed the experience of some developed countries down a path of less progressive taxation and wider income and wealth concentration. Australia's examples demonstrate this with some lessons for its neighbouring region. A regional organisation can usefully draw on these and other examples to develop regional strategies for regional concerns.

IV. Examples from Australia

Australia's experience in attempting to undertake tax reform to generate a fairer and more sustainable system is instructive. In particular, Australia's experience over the past decade shows that the political economy has been equally, or even more important than technical issues in tax reform.

The juxtaposition of four specific tax debates in Australia in the past decade are examples of how these issues can play out and are instructive on factors that drive success and failure in achieving reform in a modern democracy. These examples are proposals to increase consumption tax in order to reduce company tax, the Resources Super Profit Tax (RSPT), the additional Medicare Levy to fund the National Disability Insurance Scheme (NDIS) and reform of tax expenditures.