

## 8. Enhancing social and market outcomes

In Australia's future tax system, the only additional taxes to those on the four broad bases described earlier would be specific taxes imposed for one of three purposes: to improve market or social outcomes by addressing spillover costs and benefits; to help counteract self-control problems (in the special case of tobacco); and to improve market efficiency through appropriate price signals. Such taxes would only be used where they are a better means to achieve the desired outcome than other policy instruments. The rate of tax would be set in accordance with the social cost of the activity. Revenue should be a by-product of such taxes, not the reason for them.

User charging would play a complementary role, as a mechanism for signalling the underlying resource cost of publicly provided goods and services and rationing individuals' access to community resources, including renewable resources. User charging can be an efficient means of financing some government-supplied goods and services, provided the user is charged the cost (or loss) that consuming the good or service imposes on others. Where users do not directly impose costs on others, as is the case with public goods, funding should be by way of general taxation.

Other existing taxes would have no place in a future tax system and should be phased out over time. The elimination of a large number of taxes that distort production decisions or add to production costs would improve the competitiveness of Australian business. Fewer taxes would also enable further automation of tax administration, reducing business compliance costs.

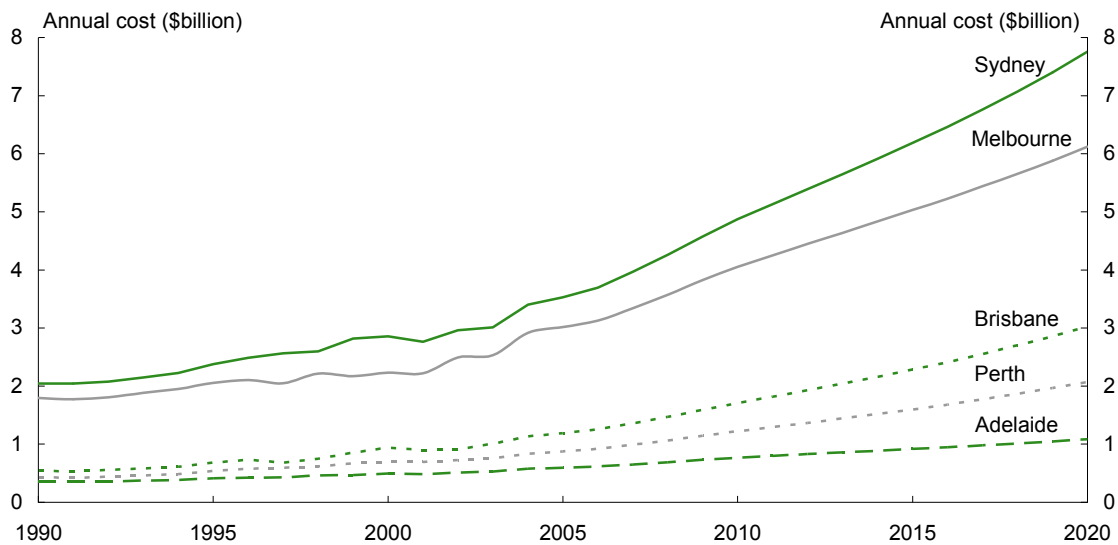
### 8.1 Road transport taxes

Current road tax arrangements will not meet Australia's future transport challenges. Poorly functioning road networks harm the amenity, sustainability, liveability and productivity of our society. Moving from indiscriminate taxes to efficient prices would allow Australia to leverage the value of its existing transport infrastructure. Less congested roads, shorter travel times and investment in road infrastructure that addresses user demand would provide a foundation for further productivity growth, improved living standards and more sustainable cities.

There are large challenges facing transport in Australia. In particular, under 'business as usual' assumptions, the avoidable costs of urban congestion may grow to around \$20 billion in 2020. This cannot be reduced simply by building more city infrastructure, as most new road space induces new traffic. Helping to manage road use, through efficient prices, provides the best long-term approach to reducing congestion.

If fuel tax is used as a variable road charge, it should apply to all transport fuels. Equally, fuel taxes should not exceed the levels justified by broadly defined social costs of use (whether of roads or environmental costs).

**Chart 8.1: Social costs of congestion for Australian metropolitan areas**  
Base case projected estimates (1990–2020)



Note: Projected costs for Canberra, Hobart and Darwin are less than \$1 billion in 2020. Time costs are based on deadweight losses for current congestion. That is, social costs refer here to the estimated aggregate costs of delay, trip variability, vehicle operating expenses and motor vehicle emissions — associated with traffic congestion — being above the economic optimum level for the relevant network.  
Source: BITRE (2007).

In major cities, location-specific congestion charges should vary according to the time of day. City roads would be less congested during peak periods, with travel at higher speeds and shorter travel times, saving time for road users, reducing vehicle costs and greenhouse emissions. The revenue from congestion charges on existing roads should flow back to the community, initially to finance public transport in affected areas.

Heavy vehicle charging would ensure that individual trucking operators pay their own specific costs, no longer cross-subsidising or being subsidised by other operators. Truck operators would have incentives to avoid route choices and vehicle configurations that cause the highest costs, but would have access to roads and bridges they are willing to pay for. Revenue from road-wear would directly fund road owners' maintenance.

In addition to helping manage demand for transport, reforms could be considered to ensure that spending on roads matches anticipated need. This should be determined according to strategic planning and comprehensive and transparent benefit-cost analysis. This would help ensure new roads are built where needed, and roads are maintained to minimise total life cycle costs, including costs to road users. Road users with specific needs could enter commercial agreements with road suppliers.

Existing institutions have not led to the most efficient use and supply of roads. Prices are essential to making the best use of roads, but they must be coupled with improved governance that better serves the needs of road users, now and in the future. New investment based on economic criteria and accountability for investment decisions would help ensure that roads are constructed and maintained in accordance with future needs.

## 8.2 Taxes to improve the environment

Our environment underpins our standard of living. People and businesses often do not take into account the environmental costs imposed on others, through pollution or other degradation, in the consumption and production choices they make.

Taxes can help to address environmental problems by providing people with a price signal that reflects the damage they cause to the environment and gives them an incentive to alter their behaviour. Where such corrective taxes are effective, they can be highly efficient – delivering greater environmental benefits for a given cost to the community than other forms of intervention. However, effective environmental taxes can be difficult to design and implement. Therefore, they are likely to be only one part of the response to addressing unacceptable environmental damage, along with regulation or other market-based mechanisms.

Once introduced, the Carbon Pollution Reduction Scheme (CPRS) will be the largest environmental intervention in Australia. It will be a cost-effective way to reduce Australia's carbon emissions. The effect of the CPRS should continue to be monitored, and opportunities taken to make it more efficient, to reduce other taxes (as revenues permit), and to remove supplementary measures including regulatory imposts.

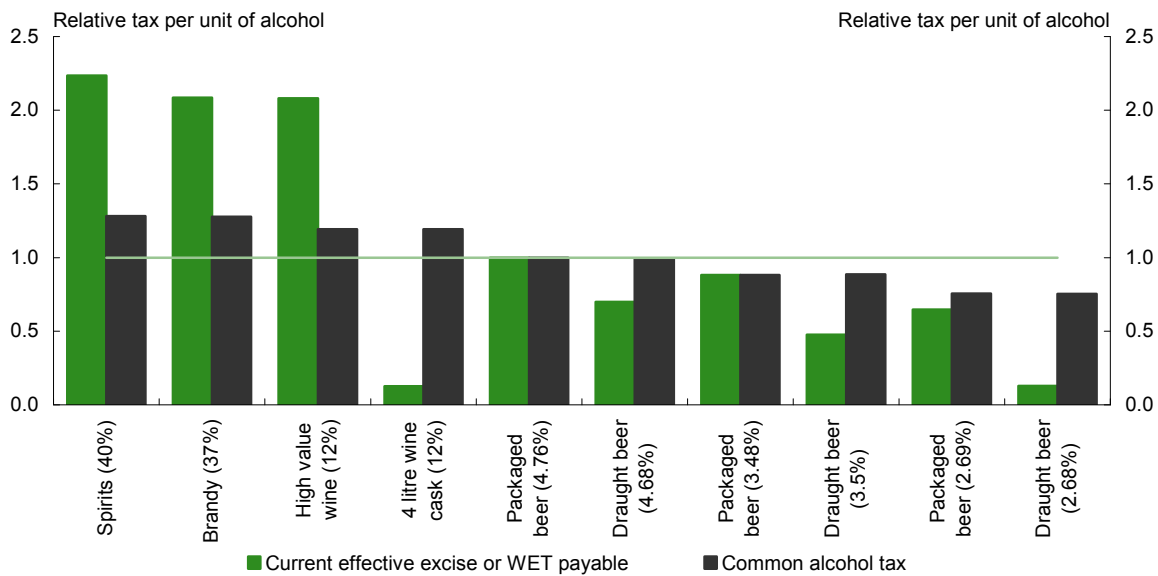
## 8.3 Alcohol taxation

Taxes on alcohol should be set to address the spillover costs of alcohol abuse, when this delivers a net gain to the community's wellbeing and is more effective than alternative policies. The tax rate should be determined by reference to evidence of spillover cost and based on a common volumetric standard applied to all forms of alcohol consumed in Australia.

The social costs of alcohol abuse by individuals are not effectively targeted by current tax and subsidy arrangements for alcohol. In particular, the wine equalisation tax, as a value-based revenue-raising tax, is not well suited to reduce social harm. For example, a two litre wine cask costing \$10.99 includes roughly \$1.59 of wine equalisation tax. An equivalent volume of alcohol in full strength beer would attract \$7.48 in excise, and in spirits, \$16.45.

A common volumetric tax on alcohol would better address social harm through closer targeting of social costs. The rate should be based on evidence of net social costs. Moreover, by removing the distinction between different manufacturing processes, the compliance and administration cost of the existing excise system would be reduced.

**Chart 8.2: Relative taxation of alcohol under a common alcohol tax<sup>(a)</sup>**  
By beverage type (alcohol by volume)



(a) The tax per unit of alcohol is measured relative to full-strength packaged beer.  
 Note: The 1.15 per cent low alcohol threshold reduces the effective tax payable on beer below the statutory rate. For example, the effective excise payable on full-strength packaged beer is  $1 - (1.15/4.9) = 76\%$  of the statutory excise rate. This treatment would be extended to all beverages under a common alcohol tax. The effective WET liability is calculated based on a 750 ml bottle of high-value wine retailing at \$40 and a 4 litre wine cask retailing at \$12.99.  
 Source: Treasury estimates and ABS (2009c).

A common alcohol tax should be phased in over a long time, to ensure that sudden price rises or price falls do not adversely affect production or consumption decisions. However, shifting wine taxation from an *ad valorem* to a volumetric basis should be pursued as a priority.

## 8.4 Tobacco taxation

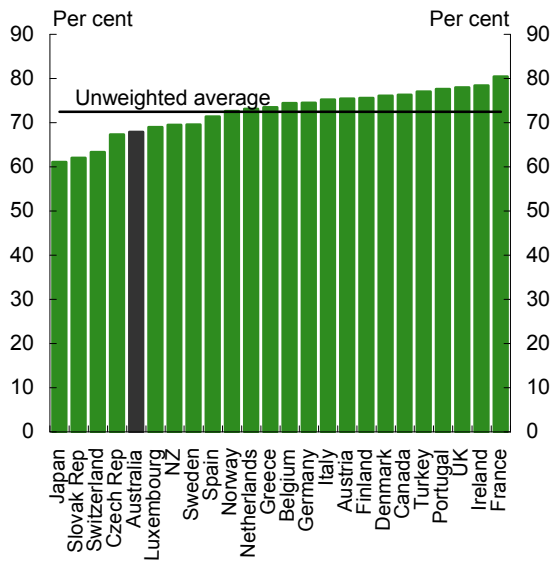
The strongly addictive qualities of tobacco, its serious health impacts and its uptake by minors, justify government intervention in the tobacco market. The costs that smoking imposes on non-smokers also support the case for government intervention. Tobacco taxes raise prices and reduce both smoking rates and smoking intensity.

There is a strong case for a substantial one-off increase in tobacco excise. Australian retail prices for cigarettes are moderate by international standards and taxes constitute a relatively small share of the retail price.

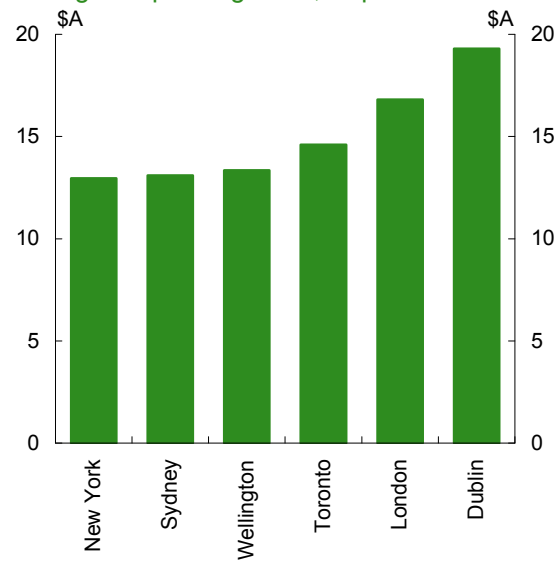
To maintain its policy effectiveness tobacco excise should be indexed to wages rather than consumer prices. Indexation of excise to consumer prices means that excise will fall as a proportion of average wages over time.

**Chart 8.3: Tobacco taxes and prices in OECD countries**

**Panel A: Tobacco taxes as a percentage of price, 23 OECD countries**



**Panel B: Price of 30 cigarettes in six English-speaking cities, September 2008**



Note: Tobacco taxes in Panel A include VAT, and Australia's GST, as well as tobacco-specific taxes. Many European countries have much higher VAT rates than Australia's 10 per cent GST rate, so that the differences between total tax rates on tobacco products and other products are smaller in those countries than in Australia. In Panel B, prices are for popular brands from medium-priced stores.

Source: Panel A: Scollo & Winstanley (2008); Panel B: National Preventative Health Task Force (2009).

## 8.5 Gambling taxation

Government restrictions on the supply of gambling services, implemented through licensing arrangements, mean that some gambling businesses can earn excess profits (economic rent). Economic rent is an efficient tax base and should be appropriated by the government, either through licence fees or taxation.

The rationale for continuing to impose specific taxes on gambling is to capture any economic rents that have not been captured by licence fees. Unlike tobacco excise, taxation may not be an appropriate mechanism to address problem gambling. It is not clear how problem gamblers react to higher taxes. In some forms of gambling, the price of gambling is not easily observable. Even if problem gamblers do observe changes in price, it is not clear that they respond by reducing the amount they lose.

Nevertheless, gambling taxes constitute an important revenue source for State governments and, as they do not currently have access to many high quality sources of revenue, they may be reluctant to reduce the amount of revenue they collect from them.

If so, they may have to make difficult choices in balancing revenue raising with regulating gambling in a way that limits problem gambling. For this reason, the Australian and State governments should explore options for the regulation and taxation of gambling that would minimise conflicts in policy-making between revenue raising and addressing problem gambling.

Even if the current tax burden on the gambling industry as a whole is considered appropriate, the way it is raised across the industry may not be. Current rates of tax on

different forms of gambling differ markedly without clear reason. If State governments retain gambling taxes, they should be designed with a clearer focus on capturing economic rent.

## 8.6 Rationalising other taxes

Taxes with narrow bases tend to be inefficient unless they effectively correct for a failure in a particular market or unless, in their effect, they function as user charges for particular goods and services.

Australia has several other taxes that should be phased out over time, including insurance duties and the luxury car tax. Imposing specific taxes on insurance deters people from insuring their property and encourages them to bear unnecessary risks, rather than pooling risk with others. Rates of non-insurance (for building and content insurance) generally are higher at lower incomes, yet low-income people are less able to bear the risk. The luxury car tax discriminates against a particular group of people because of their tastes. It is a complex and ineffective way of redistributing income from rich to poor.

There are also more than 90 minor taxes, levied by the Australian and State governments that should be subject to a systematic review against the principles set out in this Report. This Review should be coordinated with the introduction of the proposed system-wide Tax and Transfer Analysis Statement (see Part Two, Section G5 Monitoring and reporting on the system).