

A Better Australia

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Brief submission re: the review of Australia's future tax system

Sirs,

We are complex systems consultants who have studied the impacts of Australia's systems of governance and taxation upon Australians and who wish to make a systems analysis and design contribution to the design of a functional and useful tax system for Australia.

In this brief submission, by 'taxation' we generally mean any income to government achieved by its coercive powers or the essential nature of the cost itself (e.g. water). Also please note we use indicative figures throughout due to a lack of coherent information provided by governments.

Our submission extends beyond the tax system itself because the system of funding connotes a need, indeed funding system should be defined and shaped by needs. We do not believe it is possible to design an effective taxation system for our future without close co-ordination with other key aspects of governance and community.

Overview

The purpose of Australia's taxation system is to fund governments to enable them to engage in activities. Currently the tax system appears to be a 'drawdown' system that allows governments to increase taxes, rates and charges etc. to fund whatever programs they wish to pursue and to cover any shortfalls created for whatever reason. There appear to be no limits on, or regulation of, the affordability of the total amount of taxes taken from the population; little or no consideration given to service type or quality; and governments demand more income from the population without first creating substantive savings by increasing efficiency or acting to create the means by which income to the population can increase. There exists a range of management mechanisms in place that continue to reinforce these characteristics such as public service incentive programs.

The overall effect of these attributes coupled with the lack of integration between the 3 levels of government, is inefficiency and excessive waste, duplication and error coupled with budget blowouts that are placing inordinate pressures on Australian taxpayers and businesses, putting housing affordability out of the reach of many, and serving to impoverish citizens.

Since providing funding connotes permission, a well designed funding system should focus on collecting what is truly needed and therefore a definition of need should encompass a taxpayers' charter of services coupled with various guarantees of service quality so that funding needs are clear. Total receipts by government (all 3 levels) should operate within a rational boundary of affordability coupled with service quality and efficiency activities that offer the best services for the least price.

Reversing the dysfunctional aspects of the revenue and funding systems could free up as much as \$100 - \$200 bn per annum.

It is our view that the taxation review represents an unequalled opportunity to recognise systemic weaknesses and to design Australia's system of funding government to deal effectively with the problem.

Systemic boundaries and connections

To the extent that the intent of taxation is to achieve needed revenues, a tax review whose outcome is a design, in our opinion, must consider:

- the purpose of the taxation ie the rationale for requiring funding,
- the real level of need for that taxation,
- the affordability to the citizens of the tax proposed and
- the context in which that taxation is taking place,

in order to arrive at meaningful conclusions sufficient to enable the design of a robust system relevant to the 21st century.

Coercive powers that raise revenue from citizens remove budgetary choice from taxpayers resulting in governments' revenue raisings creating most of the non-discretionary components of Australians' income. If the non-discretionary component becomes too large it can force citizens to fund governments at the expense of other needed items, such as food, medicine, education and shelter. The impacts of excessive costs of government thus include pushing lower income budgets into dysfunction.

In is our view that taxation can only be justified by a real need for funding. This implies that any review must also address why a particular level of taxation is necessary. A complete review should also include taxpayers' ability to pay which is particularly true if the whole cost of government exceeds a reasonable proportion of income.

Currently it appears that for many taxpayers on lower salaries (e.g. \$50,000 pa), a major expense component (ca 47%) is non discretionary payments to cover the direct costs of government. The discretionary component of income is also loaded with additional hidden price elements created by costs of government to business and costs to the economy of government created productivity losses.

As a result, we argue that where the cost of government is not necessary, it's funding by taxation is not justified. Such a view places an obligation on revenue collection system designers to create systems that help assure that revenues are genuinely necessary, governments are designed for efficiency and that revenues are affordable to the population and to businesses.

Examples of desired outcomes of such systems might include abandoning outdated operational techniques that keep costs artificially high, regulating the total costs of regulation to business, constraining the costs of management and administration to a small proportion of budgets and limiting additional costs to the private sector such as the costs of accountancy and financial help to deal with the tax system. In this light for example, we can see no justification for self assessment given Australia's existing tax system which is physically impossible for taxpayers to understand.

From a systems design point of view:

- the the need for taxation should be clear,
- the ability of taxpayers to pay the proposed taxes should also be clear, and
- the problems that a tax system is attempting to solve and/or is creating should also be clear.

As a consequence, we argue that the 21st century is time to acknowledge, measure and deliver recognisable value for taxes.

Committing to such a strategy and organising the tax system accordingly, is one way of assuring that the actions of government are more relevant to the needs of its citizens, rather than the convenience to service deliverers or perceived populist support for 'sound bite' positions. The

current financial stresses that exist should alone deliver an imperative for useful change.

Overall the publicly available evidence indicates that Australia has a major systemic problem, [in part created](#) by the way that federal, state and local governments operate and are funded, and in part due to regulatory and control failures.

Cost blowouts

A critical systemic problem is that the total costs of government have increased to over 60% of GDP, even at a time when taxpayers' incomes are decreasing, and there is no regulation in Australia's system that assures the government powers to raise revenues are constrained within taxpayers ability to pay, or within government capacities to deliver valued services.

A significant proportion of the total costs (>10%) is created by government created waste and productivity losses both of which impair taxpayers' ability to pay taxes, or to earn more income.

Failure to deal effectively with such systemic problems could lead to a collapse in Australia's ability to govern effectively, and/or to grow as a nation. Symptoms of those kinds of problem are already evident in our ballooning debt and imbalance of trade.

Some characteristics of an effective tax system

Any effective tax system for Australia should demonstrate to its citizens that monies collected are necessary, that payments of taxes produce real value to taxpayers, that taxes are used to improve both government and private sector productivity and that governments are focussed on vital resources and services without which Australians would be worse off (e.g. water). In short, taxpayers should perceive that they get genuine value for taxes.

In our view, an effective tax system should:

- significantly reduce the overall cost of government to Australians by only funding what is necessary and sufficient, and by operating efficiently and effectively,
- contains administrative and management costs to a competitive proportion of budget
- define necessary services so that funding is constrained to that which is necessary
- help assure increases in government service quality that help to deliver value for taxes paid,
- improve government and private sector productivity to enable citizens to earn more by reducing their costs and thus stimulate the economy,
- increase business and Australia's competitiveness to aid in economic health and reductions in gaps in balance of trade,
- increase and focus performance on community and Australia wide benefits by funding those initiatives that are most worthwhile, and
- increase citizen satisfaction with government and its works
- distinguish Australia as a leader in provision of government service.

Measured against such criteria, Australia's existing tax system performs poorly and funds government systems and actions that themselves increase costs to the citizenry.

Existing systemic problems

We believe that there is compelling evidence that the whole costs of government to Australia are

excessive and unsustainable and are impoverishing our communities, damaging our competitiveness and helping to drive innovative businesses offshore.

Even now, in a recession, governments are acting to [increase the costs of government](#) to communities without regard to how taxpayers will pay for the increases. They are doing this with a range of actions and policies including increasing prices of essentials, increasing various penalties while reducing necessary services. The result is to increase non-discretionary costs and place pressure on the discretionary components of household budgets such as food and education.

We argue that these kinds of result are dysfunctional and need addressing urgently through structural and funding reforms.

Total costs of government are excessive and unregulated

Overall Australia's multiple layers of government combine to create a direct cost close to 47% of income for a wage earner on \$50,000 pa. (income taxes, rates, GST, state charges etc). This is reflected in the national accounts by adding together all of the income streams to all levels of government.

The high cost of government is compounded by losses of productivity due to under performing government services (e.g. public transport, road networks, communication systems), direct costs created by under performing services (e.g. hospital wait lists) and direct and indirect costs created by government actions (e.g. loss of Murray Darling Basin productivity through overallocation of water, economic losses due to explosion of W.A. Varanus Island gas system after safety inspection failures by government).

In addition, Australian businesses must bear uncompetitive compliance costs ([reported](#) at over \$86 bn in 2005) which are passed on to consumers via pricing mechanisms, while taxpayers must make up to \$70 bn of tax subsidies provided as relief for various groups. The result of these classes of cost is to impair our businesses ability to compete both internationally and nationally, with governments often buying goods from overseas because they are 'cheaper'.

Government thus creates the conditions for making Australian businesses less competitive then drives business and employment offshore by failing to support them. This results in lower tax incomes that then must be made up from the now diminished pool of taxpayers. This is a vicious cycle in operation.

Structural impediments

The structural reasons for this situation appear in large part due to the way that federal/state/local governments operate. Rather than acting as an integrated system, Australian government is more like a set of fiefdoms each struggling to increase its own importance and revenues while reducing its own costs without reference to the effects of the whole on the country or its citizens. When confronted with an example of taxpayer monies lost, one senior government representative stated 'Oh yes, but that's not all Commonwealth money is it?' to which we responded 'No but it is all taxpayers' money.' The focus should be on the impacts on the citizens of Australia, rather than the narrow boundaries of responsibility created by our outmoded system of government.

From a systems perspective we note that:

- Individual levels of government appear uncaring about their impacts on the whole
- Service levels to taxpayers are usually unspecified and contain no quality criteria
- Management and administrative costs are not reported separately from operational costs

- Public service performance incentives mainly reward size, cost reductions and revenue increases rather than the achievement of community valued outcomes
- Governments use coercive powers to increase their income via charges & taxes instead of achieving real efficiencies to create savings that can be applied to new needs
- There is no regulation to constrain total government collections which can consequently be said to be out of control
- Governments are shifting costs of essentials off budget (e.g. water) to the private sector without providing any commensurate tax relief
- Total costs to the community of government are neither reported nor measured yet have a major impact on taxpayers' ability to pay
- Costs of government error are neither reported nor measured and appear out of control despite their having an important impact on taxpayers' ability to pay
- Regulatory compliance costs are excessive and are themselves unregulated and out of control
- Overall costs to business are making businesses uncompetitive and are limiting Australia's competitiveness and compounding our balance of payments problems by driving businesses offshore
- Government facility planning can ignore necessary items (e.g. parking) thus directly increasing costs to local communities
- Policies claim to support free markets while tax rates, subsidies and exemptions clearly suggest a more Socialist intervention role
- Levels of tax subsidisation are excessive and self fulfilling as they create higher taxation levels elsewhere in the system thus further justifying the need for subsidies
- Low levels of government productivity increase overall private sector costs

In general, the systemic problems may be expressed as a failure to regulate the regulators.

A failure to regulate the regulators leads directly to co-ordination, budgeting and performance failures. It also leads directly to taxpayer alienation and distrust as those paying for the 'service' are too often treated like suspects while those providing the 'service' are often excused from error that taxpayers themselves must subsequently pay for.

To that extent, the politics of Australia have thus become the politics of dissatisfaction and avoidance, our regulatory methods punitive rather than motivational or empowering and our costs ballooning instead of contained. One example of cost increases due to government is the high cost of housing which is [putting home ownership out of reach](#), in part due to a significant component of the costs being high government charges that are also fuelling homelessness (see attached diagram).

Dealing with these problems is, in our view, a matter of national priority and designing a tax system for Australia's future presents an unequalled opportunity to recognise and address these issues in whole, or in part.

The magnitude of the problem and potential savings

Australia's federal tax collection system returns around \$300 bn pa. In addition, States and Local government charge extra amounts for their existence and services – while we have no published totals we understand this figure to be about \$50 bn pa. Australia's regulatory compliance costs were

reported as \$86 bn pa in 2005, while the costs of subsidies have been reported as \$70 bn pa. These costs (or income foregone) total over \$500 bn or 48% of GDP.

On top of this, significant costs are created by losses of productivity created by under performing government systems. Sydney's traffic systems have been cited as [creating 27,000 sickies](#) pa valued at \$16 million per day or \$3.5 bn per year. Add in the losses to businesses stuck in traffic, [wasted employee time](#) on public transport, and costs of uncertainties created by transport delays and the costs for Sydney alone could easily exceed \$5 bn per year. Double that for Melbourne, Brisbane and so on and we get costs of well over \$10 bn just for the transport inefficiencies.

Other unreported costs include the costs of lost productivity created by extended hospital wait queues, lost time waiting for court cases and so on. Other errors such as our ships, planes and helicopter's unreadiness for combat could also cost Australia dearly.

The costs of government errors which would be avoidable had it done its mandated job are also high. For example the loss of the Murray Darling Basin's productivity due to water over allocation has been valued at \$10 bn per annum. The failure here was a lack of a system wide resource audit and a failure of governments to assure that water allocations were within available supplies.

We estimate the overall value of these errors could well exceed \$50 bn per annum.

Hence the actual costs of government to the community could exceed 60% of GDP and returning substantial error, waste, corruption and losses of productivity.

We suggest that the overall cost of government should be contained to 40% of GDP or lower, thus creating the opportunity for a 20% increase in Australia's economic performance from the savings made. By eliminating waste, error and rework, integrating efforts and making government services relevant, valued and competitive and by focussing government on helping communities and businesses to improve their performance, Australia could easily achieve those kinds of savings and more.

That could amount to an over \$150 billion per annum boost to our economy that would be available to reinvest to produce productive outcomes and improve our competitiveness. Until such strategies are in place, we argue that no further tax or revenue increases can be justified.

Some tax system design strategies (in short)

1. Determine what revenues are necessary
 1. Examine and raising levels of government productivity
 1. Regulate the regulators
 2. Make incentives relevant to value for taxes
 3. Mandate effective methods and processes
 2. Assure that tax funded services are necessary and adding value
 1. Test services for value
 2. Apply quality and similar techniques
 3. Report value delivered
2. Set levels of taxation
 1. Determine whole costs of government to taxpayers
 1. Determine how government policies are affecting Australia's competitiveness and productivity

2. Determine what levels of revenue raisings are affordable to taxpayers
2. Review the need for subsidies
3. Create a simple tax system and make tax to be paid easy to calculate
3. Create motivation by delivering value for taxes to taxpayers and citizens

Using tax policies to repair the system

While it can be argued that many of the problems are structural, a review of taxation policies at the federal level provides an excellent opportunity to recognise and deal with the various losses, costs, waste and inefficiencies created by Australia's unintegrated system of government. It can be said that providing funding goes hand in hand with giving permission, consequently funding agencies must take responsibility for the way that the system performs.

Creating a new taxation system while leaving the system in its current state would be an major opportunity lost, and would severely limit Australia's ability to play off its debts and create lasting wealth.

The key point is that it is entirely possible to change Australia's system effectively through mechanisms of fiscal distribution and collection. While the various government agencies and departments continue to grow and engage in defensive routines to protect their turf, the population is becoming ever more impoverished and resentful of inefficient government. The prevailing official view of system performance appears to be of huge numbers of 'one off' problems, disconnected from central policies.

There are well tried and proven methods to integrate disparate activities and raise service quality while significantly decreasing costs however we will not attempt to describe them in this submission. In any case there is little point until, and unless, the federal government indicates some willingness to deliberate upon the need for, and benefits of, such initiatives. Implementing such changes requires determined and skilled leadership without which little will be accomplished.

Some actions to design a tax system relevant to 21st century

- Regulate total costs of government to a reasonable % of GDP (e.g. 40%) and require all increases to be offset by savings in efficiency etc. Include costs of essentials into the mix.
- Differentiate and publish all non-operational costs as a percentage of total budgets
- Integrate budgets and activities via performance contracts, incentives and similar so that taxes are more likely to deliver benefits
- Base critical service budgets on population and similar statistics (e.g. health)
- Specify types, levels and qualities of all government services available to taxpayers
- Create government incentives that are driven by community valued outcomes. Eliminate perverse incentives such as rewarding size of budget (an incentive to increase budgets) or service reductions (rationalised as cost reductions) or revenue increases (increased cost to community).
- Create incentives for public service innovations that reduce community and business costs, or that increase community and business productivity
- Measure and report on the whole costs of government to the community including waste, errors, rework and losses of productivity.

- Factor in Australian businesses real contribution to our economy and society when making government purchase decisions – this can be done with simple calculations
- Mandate the use of effective planning, open reporting and comprehensive tendering processes
- Regulate the total costs of compliance in Australia to maintain our competitiveness and increase ability to pay taxes
- Review all subsidies and their effects on overall taxation levels.
- Finalise either a free market/low tax environment, or a high tax/limited market model
- Increase government productivity and efficiency and reward public servants for such achievements when it results in lower private sector costs or greater private sector benefits
- Exhibit national leadership and support taxpayer rights, service levels and quality.

The Republic concept is another major opportunity to revamp the way that Australia works to advantage citizens, businesses and our community.

By integrating initiatives via a comprehensive vision, reducing costs and increasing service levels are both entirely achievable.

Expressing the real opportunities and creating a motivational atmosphere for effective change is the role of good leadership.

We strongly urge that you, and your review, identify and highlight these opportunities and the benefits that they would bring to so many. Redesigning the tax system systemically would enable Australia to move from the constraints of the past to a new future consciously chosen, and would enable us to continue to improve our performance through time and remain relevant and competitive in the future.

If you have any questions or require further information, please let us know.

Sincerely,

Mike Bolan

Director