CHAPTER 7 TAXES TO ENHANCE SOCIAL AND MARKET OUTCOMES

7.1 Selective taxes

The Henry Review devoted substantial attention to the use of *selective taxes* as a way for governments to intervene in markets to achieve more equitable or efficient outcomes. The Henry Review considered that selective (narrow-based) taxation may be appropriate to correct for negative social or economic costs that are not adequately factored into private transactions.

A *selective tax* is simply a tax that targets a particular commodity, activity or type of taxpayer. Some selective taxes may also aim to capture economic rents derived by a particular industry or sector, for example the resource sector or gambling industry. The Henry Review considered selective taxes including taxes to improve the environment, road transport taxes, and taxes on alcohol, tobacco and gambling.

The Henry Review recommended adoption of user charging in some cases where governments provide a specific good or service and this can be properly priced. It observed that public goods should generally be financed through general taxation but government costs associated with administration and enforcement of regulation for specific sectors could be recovered by targeted charges or taxes (Henry et al 2010b, 339). Cost recovery taxes or user charges need to be subject to regular and systematic review to ensure that they properly reflect the cost of the service or good.

Selective taxes may be highly effective in increasing the price of activities that generate negative externalities that affect society as a whole. However, they present design challenges in accurately identifying the source and economic cost of the negative externality and hence the appropriate base and rate for the tax. Poorly designed selective taxes risk not achieving intended societal outcomes while still detracting from economic efficiency. They need to be weighed against other alternative policy levers that have the potential to achieve the desired behavioural change.

The Henry Review supported the use of selective taxation or pricing to address negative spillovers or externalities for the environment. On this basis, the Review supported the CPRS (now repealed) as an effective market-based mechanism that would be 'the most cost-effective way to reduce Australia's carbon emissions' (Henry et al 2010b, 343).

On the other hand, the Henry Review generally opposed the use of tax concessions with environmental objectives which 'tend to lack transparency, be poorly targeted, impose costs on all the community rather than just polluters and reduce the efficiency of the taxation system' (Henry et al 2010b, 353).

Henry Review principles for taxes to improve the environment

Environmental taxes (or emissions trading schemes) should:

- Be used to address environmental objectives, rather than to raise revenue;
- Have their revenue recycled to reduce the associated tax (and transfer) distortions, should governments wish to avoid increasing the aggregate burden of tax; and
- Be integrated with existing taxes and transfers.

An environmental tax is more likely to be appropriate in situations where:

- Environmental damage due to economic activity is relatively constant;
- The factors causing the environmental damage are measurable/verifiable by both the tax authorities and the agent causing the damage…;
- The only cost-effective way the taxpayer can reduce their tax liability is to reduce the activity causing the damage (rather than, say, simply dumping waste illegally); and
- Other instruments (such as spending and regulation) have been considered and found to be more costly.

Henry et al 2010b, 353; Recommendations 58, 59 and 60

7.2 Road transport taxes

The Henry Review strongly supported the development of road pricing or transport taxes to aid future transport challenges. In particular, the Review supported road network charges for commercial or heavy vehicle use (such as freight trucking). These charges should be used to correct market failures in the transport sector. Recommendations 61 to 67 addressed road transport taxes including congestion charging and heavy vehicle road pricing. In exchange for a comprehensive reform introducing road use charges, it was suggested that taxes such as motor vehicle registration and stamp duties could be abolished.

The development of effective road transport taxes calls for substantial further research and policy development. The Henry Review observed that the challenge of comprehensive transport tax reform is 'formidable' requiring coordination across all levels of government, but would promote the best investment in and use of roads, lift national productivity and improve wellbeing (Henry et al 2010b, 373-4). There are signs that some State governments are interested in reform; for example, the South Australian State Government has said that it will consider road transport charges for heavy vehicles as part of a tax review in 2015.[29]

7.3 Alcohol, tobacco and gambling

The Henry Review made recommendations to improve alcohol, gambling and tobacco taxation in Australia (Recommendations 71 and 72, 76 to 78).

A key reform proposal that has not yet been implemented is comprehensive and consistent alcohol taxation, on the basis of volumetric alcohol content 'across all forms of alcohol, regardless of place, method or scale of production'. This would best support revenue and social policy goals.

The Henry Review found that current tax and subsidy arrangements for alcohol are 'complex and distort production and consumption decisions with no coherent policy justification' (Henry 2010b, 438). It was particularly critical of the current wine equalization tax. The need for reform of Australian alcohol taxation has been supported by recent health and economic modelling (for example, Doran et al 2013).

Increasing tobacco prices through taxation is one of the most effective measures that can be taken to reduce premature death and disease due to smoking, to reduce consumption and deter young people from starting smoking.[30] In respect of tobacco taxation, the Henry Review recommended an increase in the tobacco excise and its indexation to average weekly earnings instead of the consumer price index. These recommendations have been implemented. The indexation method for tobacco taxation has been changed effective 1 March 2014. Excise rates were increased by 25 per cent in 2010 and commencing from 1 December 2013, four staged 12.5 per cent increases are being implemented (to be completed on 1 September 2016).

Increased taxes on tobacco bring with them an increased risk and reward for smuggling and black market production and sales. These cause increased administrative costs and policing and criminal law costs, which should be monitored to ensure that taxation is at an optimal level.

In respect of gambling taxation, the Henry Review recognized that gambling taxes constitute an important revenue source for many State governments (as shown in Table 6.1 above). Unlike its stance on tobacco taxation, the Henry Review noted that the social policy argument for gambling taxation is not clear and emphasized that regulatory goals in relation to gambling should be distinguished from taxation of the gambling industry to raise revenue. It recommended that States should review gambling taxation to ensure it is consistent with social policy goals and raises adequate revenue from economic returns. Further research is needed into the merits, economic and distributional aspects of gambling taxation in general, and specific types of gambling taxes, as opposed to other approaches to regulation and licensing of gambling activity.

In general, the Henry Review opposed other forms of selective taxation such as luxury taxes, which it argued are inefficient, ineffective and arbitrary. In general, luxury goods are substitutable—if one is taxed, demand may shift to another good. Australia has few luxury taxes. The Review recommended that the luxury car tax be abolished (Recommendation 80).

29 http://www.abc.net.au/news/2014-11-10/new-road-transport-charges-proposed-for-sa-heavy-vehicles/5878398.

30 See Department of Health, http://www.health.gov.au/internet/main/publishing.nsf/Content/tobacco-tax.

7.4 Financial transactions tax

One type of selective tax that has received significant attention since the GFC is a financial transactions tax. In the European Union, eleven countries agreed on 14 February 2013 to introduce a tax on a range of financial transactions on a harmonized basis, as proposed by the European Commission.[31] The countries are Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia. Annual revenues of such a tax have been estimated to be as much as EUR 30 to 35 billion, or 0.4 per cent of the GDP of the participating member states. However, there remains significant controversy.

This EU proposal and the enhanced cooperation approach of the eleven countries have not proceeded beyond the Council Working Group at this stage. They have been criticized as contrary to international tax rules (including a challenge from the United Kingdom) and even if they are legislated, the start date is currently deferred until 1 January 2016.

The Henry Review considered the case for a tax like the Financial Transactions Tax, on financial or currency dealings (known as a Tobin Tax). The policy goals of such a tax must be carefully defined. The goal of a Tobin Tax on currency or speculative financial dealings is to dampen speculative dealings, to put 'stand in the wheels' so as to stabilise the financial system. If the transaction tax succeeded, it would raise very little revenue.

On the other hand, it has been suggested that a Tobin Tax or Financial transactions tax could raise revenue to fund global public goods. However, unless they are levied on a global and comprehensive basis, such taxes could likely be avoided through the use of untaxed jurisdictions or tax havens. They would be unlikely to raise the revenue anticipated and could be inefficient and have unintended effects.

31 See European Commission, http://ec.europa.eu/taxation_customs/taxation/other_taxes/financial_sector/index_en.htm.