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# Politics and tax reform: A comparative analysis of the implementation of a broad-based consumption tax in New Zealand, Australia and the United Kingdom

## **Abstract**

The introduction of a broad-based consumption tax in the form of a value added tax (VAT) in the United Kingdom (UK) and goods and services tax (GST) in New Zealand and Australia was politically challenging at the time. This article provides the rationale for their introduction and the process of that introduction in different political contexts. It discusses whether there are lessons that can be drawn as to the political indicators that may need to be present for implementation of significant tax reform, with particular reference to GST reform in Australia.

When the history of this Parliament, this nation and this century is written, 30 June, 1999, will be recorded as a day of fundamental injustice - an injustice which is real, an injustice which is not simply conjured up by the fleeting rhetoric of politicians. It will be recorded as the day when the social compact that has governed this nation for the last 100 years was torn up.

*Former Australian Prime Minister Kevin Rudd, then in opposition, on the introduction of the GST.*

## **Keywords**

Introducing consumption taxes, politics and tax reform, GST, VAT, economic policies

# **POLITICS AND TAX REFORM: A COMPARATIVE ANALYSIS OF THE IMPLEMENTATION OF A BROAD-BASED CONSUMPTION TAX IN NEW ZEALAND, AUSTRALIA AND THE UNITED KINGDOM**

CLINTON ALLEY\*, DUNCAN BENTLEY\*\* AND SIMON JAMES\*\*\*

The introduction of a broad-based consumption tax in the form of a value added tax (VAT) in the United Kingdom (UK) and goods and services tax (GST) in New Zealand and Australia was politically challenging at the time. This article provides the rationale for their introduction and the process of that introduction in different political contexts. It discusses whether there are lessons that can be drawn as to the political indicators that may need to be present for implementation of significant tax reform, with particular reference to GST reform in Australia.

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## **INTRODUCTION**

Significant tax reform requires leadership, courage and determination on the part of politicians. It requires sufficient concession by significant vested interests for such reform to proceed. The introduction of a broad-based consumption tax in the form of a value added tax (VAT) in the United Kingdom (UK) and goods and services tax (GST) in New Zealand and Australia was no exception. Not only have these taxes not suffered reversal, but they have now survived successfully for many years. However, there are some important differences in the way each of these countries adopted VAT/GST which might indicate that the most appropriate structure of the tax and the route for further reform may also vary significantly between countries.

This paper examines the introduction of a GST in New Zealand and Australia and a VAT in the United Kingdom. The aim is to use two comparable common law countries with which to compare the Australian experience and to determine critical factors which should be taken into account in Australian GST reforms.

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<sup>1</sup> A comment made in Parliament while then in Opposition but gleefully cited by former Treasurer, Peter Costello, who introduced the tax, in an article celebrating the first decade of its operation, 'If It's Tax Reform You Want, Try the GST', *The Sydney Morning Herald* (Sydney), 23 June 2010.

Part 1 first provides a general political rationale for introducing new taxes such as a consumption tax. In doing so, it identifies the principles that should underlie any reform. Second, it examines the rationale for introducing a consumption tax in each country and the politics which shaped that rationale.

Part 2 describes the politics and process of implementing consumption tax reform in each jurisdiction. It highlights the political issues that shaped that implementation, leading to significantly different outcomes.

Part 3 provides a comparative analysis of the importance of the politics in introducing a consumption tax in each jurisdiction. It takes into account subsequent events and draws conclusions about the political indicators that may need to be present to implement significant tax reform of this kind.

Part 4 concludes the paper by examining the Australian context and discussing how reforming the GST is possible using lessons from the three jurisdictions.

The scope of this paper is broad. It does not provide a comprehensive history and analysis. Rather it draws on the themes under each heading, and is designed to act as a catalyst for further research and debate. Increasingly and necessarily, academic research needs to cross disciplines to account fully for the nuances of tax reform.

## **PART 1: THE POLITICS OF TAX REFORM**

Former Australian Prime Minister, Paul Keating, commenting on his political position as Treasurer when he fought for the floating of the Australian dollar on 12 December 1983, said that then Prime Minister, Bob Hawke, would only agree to the float knowing that Keating:<sup>2</sup>

Was prepared to be the lightning rod with my copper spike on the top of the tower to take whatever electricity-laden cloud came along. If it fails then the treasurer goes. Hawke's political risk was over, but in this case the treasurer was prepared to take the responsibility.

Keating's remarks colourfully illustrate the politics underpinning any courageous decision. The stakes are remarkably high. The introduction of consumption taxes over the years has resulted in consequences ranging from violence and riots in developing countries, to the loss of government or elections in OECD countries.<sup>3</sup> The politics of reform are well illustrated over a long period by the introduction of a consumption tax in The United Kingdom in 1973, New Zealand in 1985, and Australia in 2000.

What is of particular interest and importance is of course that the consumption tax is seen by both policy-makers and the media as providing a stable fiscal basis for 21<sup>st</sup> century government.<sup>4</sup> Arguably, taxes on mining rents, carbon, and even citizen registration - while eliciting a furious

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<sup>2</sup> Quoted in Glenda Korporaal and Paul Kelly, 'Keating's Leap of Faith', *The Australian* (Sydney), 6 December 2013.

<sup>3</sup> This is described and analysed, for example, in relation to the US, Canada and Australia by Kathryn James, 'An Examination of Convergence and Resistance in Global Tax Reform Trends' (2010) 11 *Theoretical Inquiries in Law* 475.

<sup>4</sup> See, eg, Ruud de Mooij, and Michael Keen, "Fiscal Devaluation," Fiscal Consolidation: The VAT in Troubled Times' in Alberto Alesina and Francesco Giavazzi (eds), *Fiscal Policy after the Crisis* (University of Chicago Press, 2013) 443; Ross Gittins, 'Happy Birthday GST and Many Happy Returns', *The Age* (Melbourne), 25 June 2003.

response and often volcanic debate among interest groups and citizens - are not currently seen as catalysts for fundamental reform of the tax system.<sup>5</sup>

## IS THERE AN ENDURING POLITICAL APPROACH AS TO HOW TO IMPLEMENT REFORM?

The October 2013 International Monetary Fund (IMF) Fiscal Monitor encapsulates the issues facing policy makers and politicians in addressing policy demands while providing a realistic basis for reform:<sup>6</sup>

Taxation is always a sensitive topic and is now more than ever at the center of policy debates around the world. The key challenges are: How can taxation best help bring down debt ratios in advanced economies and respond to mounting spending needs in developing countries? And how can equity concerns be balanced—especially in hard times—with the efficiency that is needed to secure long-term growth? ... [T]he options most often chosen have been guided by expediency rather than by a desire to build stronger and fairer tax systems, and they may be storing up problems for the longer term. ... Broadening the base of the value-added tax ranks high in terms of economic efficiency (as new findings tend to confirm) and can in most cases easily be combined with adequate protection for the poor.

In 1776, Adam Smith in *The Wealth of Nations* outlined four principles of an ideal tax system.<sup>7</sup> These principles are: equity, certainty, convenience and economy.<sup>8</sup> They have formed the basis

<sup>5</sup> See, generally, as illustration of such debates, Andrew Burrell and Sarah Jane Tasker, 'Miners Launch New War on Julia Gillard's Tax' *The Australian* (Sydney), 24 July 2010; *Carbon Tax Facts*, <<http://www.carbontax.net.au>>; Peter Smith, 'Lessons from the British Poll Tax Disaster' (1991) 44 *National Tax Journal* 421-436; The International Monetary Fund, *Fiscal Monitor October 2013*, 25 <<http://www.imf.org/external/pubs/ft/fm/2013/02/pdf/fm1302.pdf>>, identifies the current significant tax contributions available to reformers to meet current deficits. While foreshadowing the future importance of effective carbon pricing (along with taxation of the financial sector), consumption taxes head the list of those most likely to have a significant impact in the short term.

<sup>6</sup> IMF Fiscal Monitor, *ibid* 9. This article does not seek to analyse the rich literature examining the interplay of political and economic drivers. See, for example, the excellent, succinct analysis of twenty years of Canadian tax reform in John G Head, "The Carter Legacy: An International Perspective" (1987) 4 *Australian Tax Forum* 143. Sceptics, such as M Hallerberg and S Basinger in "Internationalization and Changes in Tax Policy in OECD Countries: The Importance of Domestic Veto Players" (1998) 31 *Comparative Political Studies* 321, provide analysis to cast doubt on traditional interpretations. See also, for example, Duane Swank and Sven Steinmo, "The New Political Economy of Taxation in Advanced Capitalist Democracies" (2002) 46 *American Journal of Political Science* 642. Varied analysis was popular at the time of the 1985 Australian Tax Summit and this article draws on this earlier literature. See, for example, Geoffrey Brennan, "Tax Reform and Tax Limits: Political Process in Public Finance" (1984) 1 *Australian Tax Forum* 83 and Melinda Jones, "The Politics of Tax Reform" (1985) 2 *Australian Tax Forum* 147. Neither does this article purport to examine why tax systems might be a product of the institutional frameworks within political jurisdictions and the associated policy development and decision-making in relation to the formulation of that policy, see for example, Sven Steinmo and Caroline Tolbert in "Do Institutions Really Matter? Taxation in Industrial Democracies" (1998) 31 *Comparative Political Studies* 165. The focus of the article is on the practical steps politicians might take to implement a successful reform process.

<sup>7</sup> Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Hackett Publishing Co, first published 1776, 1993 ed) 450.

<sup>8</sup> *Ibid*.

for most tax reviews, albeit in expanded form with varying definitions.<sup>9</sup> They are important to the creation of tax policy, as they have helped over time and across jurisdictions both to assure the purpose of a tax system and to provide a robust political rationale.

In 2005, Alley and Bentley<sup>10</sup> analysed how the principles have been developed through their use in reports and the tax literature. The authors recommended more systematic use of the principles as set out below with appropriate definitions.<sup>11</sup> The principles provide a clear and enduring political explanation for tax reform which politicians would do well both to understand and use explicitly in selling reform. Given the issues and sensitivities identified by the IMF, the principles also form a useful backdrop to the analysis of the discussion of the politics of consumption tax reform that follows. The principles are:

### **Equity and fairness**

- Taxation system design should take account of horizontal and vertical equity.
- It is important that the public perceives the tax system as fair.
- Inter-nation equity should be considered for international elements.

### **Certainty and simplicity**

- Tax rules should not be arbitrary.
- Tax rules should be as clear and simple to understand as the complexity of the subject of taxation allows, so that taxpayers can anticipate in advance the tax consequences of a transaction including knowing when, where and how the tax is to be accounted. There should be transparency and visibility in the design and implementation of the tax rules.

### **Efficiency**

- Compliance and administration costs should be minimised and payment of tax should be as easy as possible.
- A tax should be due at a time and in a manner that is most likely to be convenient for the taxpayer. Convenience of payment encourages compliance.

### **Neutrality**

- The tax system should not impede or reduce the productive capacity of the economy. Business decisions should be motivated by economic rather than tax considerations.

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<sup>9</sup> The common understanding of the principles underlying tax reform are explored in Clinton Alley and Duncan Bentley, 'A remodelling of Adam Smith's Tax Design Principles' (2005) 20 *Australian Tax Forum* 579.

<sup>10</sup> Using specifically: Committee on Fiscal Affairs, *Electronic Commerce: Taxation Framework Conditions* (1998) OECD <[www.oecd.org](http://www.oecd.org)>; Tax Policy Concept Statement 1, 'Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals' (2001) *The Tax Division of the American Institute of Certified Public Accountants* 6.

<sup>11</sup> Alley and Bentley, above n 9, 621.

Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.

- Capital import neutrality and capital export neutrality should be considered.

### Effectiveness

- The system should collect the right amount of tax at the right time without imposing double taxation or unintentional non taxation at both the domestic and [the] international levels.
- The system should be flexible and dynamic to ensure a match with technological and commercial developments.
- The potential for active or passive non-compliance should be minimised while keeping counter-acting measures proportionate to the risks involved.

These principles will always compete and overlap with each other. The art of taxation design is to balance the principles most effectively to achieve the intended purpose. For example, vertical equity (where people who have a greater ability to pay taxes should pay more) is often sacrificed to achieve other principles. Some of the objectives are in conflict, in the sense that movement toward one goal may be to the detriment of another. A simultaneous realisation of all the goals in some degree will constitute success if the appropriate compromises adequately reflect the (informed) consensus. However, the detail will always remain the subject of debate, disagreement and ultimately negotiation between the different influencers of tax system design.

The discussion below will demonstrate the evolution of public thinking: people do not always comprehend what the best solution is, although they intuitively know what is fair. It will be shown that the role of politicians, civil servants and stakeholders is often about educating the public about what is the “best fit” for individual citizens and the country in general. If what is best for them is convincingly and honestly explained it may well become what they want. The rest of this Part examines the explanation put forward for introducing a consumption tax in each of the United Kingdom, New Zealand and Australia.

### THE UNITED KINGDOM

The explanation for reform in the UK in 1973 was partly based on similar fiscal developments to those found more generally. Historically, indirect taxes tended to be levied on goods rather than services<sup>12</sup> because, of course, in less developed economies services generally form a relatively small proportion of output that is easily taxable. However, as an economy develops the service sector grows and so the anomaly of taxing goods but not services becomes more pronounced. Furthermore, as economic development continues, it becomes administratively easier to widen the administrative net to include both.

The intellectual argument for change was thus based firmly on economic principles in that indirect taxation should, as far as possible, be levied at the same rate on all goods and services in order to reduce economic distortions. In the UK in 1966 there was an attempt to rectify the

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<sup>12</sup> Carolyn Webber and Aaron Wildavsky, *A History of Taxation and Expenditure in the Western World* (Simon and Schuster, 2006).

situation by the introduction of the Selective Employment Tax (SET)<sup>13</sup> which discriminated against services. Unfortunately this was a very unsatisfactory tax and there was a clear need for further fundamental reform.

In addition to the basic economic argument regarding tax distortions, and the need to repeal SET, there were two other important factors behind the introduction of VAT in 1973. One was European tax harmonisation which involved the adoption of a VAT by each of the member states. The other was to promote UK exports by zero rating them so that producers could reclaim all tax paid on their inputs but did not have to charge VAT on outputs that were exported.

It is also relevant that the UK was entering the European Economic Community following a period of relatively low economic growth. The general acceptance for accession was predicated on the understanding that the economy required the boost that would be provided from entering the free trade agreement. Introduction of the VAT and tax harmonisation was part of that process.

## New Zealand

Prior to 1984 New Zealand was “faced not only with a number of serious economic problems but a tax system that was in a mess, created by decades of ad hoc decisions and bad political compromises”<sup>14</sup> a legacy of National Prime Minister Robert Muldoon. According to Dickson,<sup>15</sup> Muldoon did not understand (or chose to ignore) the collective physical impact of National Superannuation<sup>16</sup> and the extent of the government borrowing, which was an emerging symptom of the decline in the New Zealand economy then well underway.<sup>17</sup> In contrast to Muldoon, The Hon Sir Roger Douglas (the Labour Government’s Minister of Finance from 1984-1988) had “technical skills and [a] deep personal commitment to reform [that] made him very popular in the Treasury”.<sup>18</sup>

When the Labour Government came to power in 1984 a high proportion of tax revenue was gained from individual income tax, and “[d]espite the fact that New Zealand’s tax take was relatively low compared with many OECD countries, this was not the public’s perception. New Zealanders felt the tax burden personally and experienced its disincentive impact because of high tax rates being applied to personal incomes”<sup>19</sup>.

In 1984 there was general consensus within the Labour Government that:<sup>20</sup>

- a switch from direct taxes to more indirect taxes was necessary;

<sup>13</sup> WB Reddaway, *Effects of the Selective Employment Tax, Final Report* (Cambridge University Press, 1973).

<sup>14</sup> Hon Sir Roger Douglas, ‘The New Zealand GST Policy Choice and its Political Implications’ in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) 4.

<sup>15</sup> Ian Dickson served in the New Zealand Treasury from 1977-1986.

<sup>16</sup> The universal unfunded pension at age 60 set at 80% of the average wage for a married couple – introduced in 1976.

<sup>17</sup> Ian Dickson, ‘The New Zealand GST Policy Choice: An Historical Policy Perspective’ in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) 46.

<sup>18</sup> Ibid 48.

<sup>19</sup> Jeff Todd, ‘Implementing GST – Information, Education, Coordination’ in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) 27.

<sup>20</sup> Douglas, above n 14.



- any package would need to be self-balancing;
- the reform package had to be seen to be fair;
- any new tax had to be as simple to operate as humanly possible;
- a new tax needed to be broad-based so that the rate could be as low as possible; and
- tax reform would see the end to the wholesale sales tax and the distortions to both production and consumption that it had brought about.

According to Douglas, the introduction of GST in New Zealand was helped by using “quality people throughout the exercise”<sup>21</sup>. In his view “[p]olicy starts with people. It emerges from the quality of their observation, knowledge, analysis, imagination and ability to think laterally so as to develop the wider range of options.... People involved in the introduction of GST were appointed for their knowledge and skill, not any political leanings they might have had”<sup>22</sup>.

### Australia

In Australia, the underlying explanation for reform, beginning in 1975 and evident on the introduction of the GST in 2000, was similar to that in the UK and New Zealand. However, it was framed carefully to take account of the politics and this highlights the different context. It also demonstrates the nuances between jurisdictions and how important it is to shape both the tax reform and its politics to the jurisdiction and its time and place.<sup>23</sup>

Although difficult to pin down, given that the introduction of the GST was shaped by a series of political campaigns over nearly two decades, the final underlying explanation is encapsulated in the Treasurer’s Second Reading Speech introducing the Bill to the House of Representatives.<sup>24</sup> The key themes can be summarised as follows:

- The GST comprised part of a comprehensive reform of the Australian tax system designed to address the needs of the 21<sup>st</sup> century and supported by the Australian people;
- A fundamental component of the package was to restructure Commonwealth/State relations and funding to ensure enduring sustainability of the federal system of government;

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<sup>21</sup> Ibid 5.

<sup>22</sup> Ibid.

<sup>23</sup> The tendency is to assume that the characteristics underlying the introduction of a consumption tax are translatable both in time and place and to draw generalisations not necessarily supported by the evidence. Although taught in most logic classes, this tendency has become popularly understood through the work of Nassim Nicholas Taleb. *The Black Swan* (Random House, 2<sup>nd</sup> ed, 2010); Daniel Kahneman, *Thinking, Fast and Slow* (Penguin, 2011). This article seeks to avoid that trap.

<sup>24</sup> Commonwealth, *Parliamentary Debate*, House of Representatives, 2 December 1998, 1087 (Peter Costello). For a comprehensive and insightful history of the implementation of the GST in Australia, see Kathryn James, ‘We of the “never ever”: The History of the Introduction of a Goods and Services Tax in Australia’ [2007] *Brit Tax Rev* 320 and ‘We of the ‘Never Ever’: The history of the introduction of a goods and services tax in Australia from 1970 to 2005’, in *Studies in the History of Tax Law*, Volume 3, John Tiley (ed), (Hart Publishing, 2009), 139.

- The package was designed to overcome the regressive components of the GST with tax cuts, exemptions and a range of other benefits to ensure minimal negative impact on families and average wage earners;
- The package would reduce the costs of exports, enhance productivity and competition and thereby increase employment and living standards; and
- The package included agreement from the States to abolish nine taxes, which were described as inefficient and an unnecessary burden on taxpayers, to be replaced by a GST, which was modern, efficient, simple, broad based and at a low rate

## PART 2: THE POLITICS AND PROCESS OF IMPLEMENTATION

The reasons for reform in all three jurisdictions can be seen to fall squarely within accepted principles. However, as noted above, the political and economic reality shaped the competition between those principles and the sacrifices of principles that were made to effect the implementation of reform.

This Part describes the process of implementing consumption tax reform in each of the United Kingdom, New Zealand and Australia over a period of thirty years. It highlights the political issues that shaped that implementation, leading to significantly different outcomes by virtue of time, place and context. Nonetheless, it also seems true to say that the theoretical principles remain the same and the public and political view of their relative importance in each country is influential in shaping different outcomes.

### The United Kingdom

In the UK, the Government was aware that VAT was a new form of taxation and would involve many more people in its administration than had the two taxes it would replace – Purchase Tax and Selective Employment Tax. The Government published a Green Paper<sup>25</sup> giving details of the proposed tax two years before VAT was to be introduced. A period of consultation followed which generated a large number of contributions and led to the publication of a White Paper<sup>26</sup> that set out the proposals in far more detail. The next stage was the provision of considerable publicity and taxpayer assistance which did a great deal to ease the introduction of VAT.

It soon became clear that the general aim of achieving a very broadly based tax was going to be considerably tested. There are economic arguments that some forms of expenditure such as that on education and health should receive favourable tax treatment in order to reflect the additional benefits they confer over and above that for which consumers are prepared to pay. However, in the UK it soon became clear that the key political issue was the extent to which the aim of economic efficiency in the form of a broadly based tax would have to be modified to take account of UK taxpayers' perceptions of fairness. The effect was that the public perception of fairness trumped the perceived need for certainty, simplicity and efficiency of the proposed VAT.

The possible taxation of items such as food, children's clothes and domestic fuel and power aroused considerable opposition primarily on the grounds of fairness. By avoiding the taxation of

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<sup>25</sup> Green Paper (1971) *Value Added Tax*, Cmnd. 4621, HMSO, London.

<sup>26</sup> White Paper (1972) *Value Added Tax*, Cmnd. 4929, HMSO, London.

a whole range of such items, VAT was levied on only just over half of consumer expenditure<sup>27</sup> and the proportion has not increased a great deal since its introduction. Nevertheless, this had the political benefit that the perceived effects on income distribution were much more acceptable to taxpayers than some had predicted. This was partly because those on low incomes spent a relatively high proportion of their income on items that were either zero rated or exempt from VAT. It was also partly because those on higher incomes spent a higher proportion on items that were not.

## New Zealand

New Zealand was in a very difficult position economically in 1984 when GST was first mooted: a position recognised by the electorate.<sup>28</sup> This ensured that there was political awareness of and buy in to the need for tax reform. The explanation for reform identified above also ensured that the principles of fairness and simplicity were generally understood. In particular, the importance of having a broad base and as low a rate as possible were stronger political drivers than the need to cater for the exemptions because of the political strength of interest groups.

A *White Paper* outlining the proposals for the administration of GST was published in March 1985. The paper provided a simple technical description of the way the tax was to be applied, and the tasks which would be required for business and self-employed people. Submissions were allowed until May 17: a very short period.

A high-profile, three-person Advisory Panel was formed to write a report made on 4 June. Despite the short time period, the fact that the independent panel considered 1,067 written submissions demonstrated the consultation. The form of the report was designed to help the connection between business and government. A second report was issued in July, again after a short period of consultation. This condensed period of consultation differs markedly from that in the UK and was followed in Australia. However, unlike Australia, subsequent activity by interest groups was not permitted to derail the structural principle of a broad-based, low rate GST.

Introduction of the GST was deferred for six months to 1 October 1986, to allow a GST Co-ordinating Office to operate for 18 months over this period of introduction (June 1985 to December 1986) to develop and implement the public education and information program and to coordinate the overall introduction. As with the Advisory Panel an experienced and independent three person team was appointed to run the Co-ordinating Office.

The GST Act came into force on 1 October 1986 at a rate of 10% along with a reduction in the top personal income tax rate to 48%, an increase in personal rebates, the introduction of the Family Support Tax Credit for low-income workers and beneficiaries, and a 5% increase in benefit levels. This was perceived by the public to address adequately the need for fairness in the new system.

Introduction of the GST also allowed the abolition of an antiquated Wholesale Sales Tax. This tax had imposed a dozen different specific and seven ad valorem rates from 10%-60% on an arbitrary selected one-third of total personal consumption. It distorted both production and

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<sup>27</sup> Evan Davies and John Kay, 'Extending the VAT Base: Problems and Possibilities' (1985) 9 *Fiscal Studies* 1.

<sup>28</sup> Douglas, above n 14.

consumption, virtually ruining for example the boat-building and caravan industries, which was politically relevant in gaining acceptance for GST as its replacement.<sup>29</sup>

In 1988, following the share market crash (1987), the GST rate was raised to 12.5% eight months after a reduction in the top personal income tax rate to 33%. No compensation was given in higher income tax rebates or Family Support Tax Credits.<sup>30</sup> There was little publicity and even less reaction to the lack of compensation. The GST had become part of the fabric of the tax system and the public had a broad acceptance from the experience of the introduction of GST that a relatively small increase in rate would have little general price impact.

## Australia

In Australia the GST debate commenced in 1975, shortly after the UK introduced the VAT. The influential Asprey Taxation Review Committee recommended in its report (Asprey Report) that Australia adopt a broadly based consumption tax.<sup>31</sup> It was a long gestation to its introduction in 2000, which was driven both by politics and the economic context for each attempt at introduction. This Australian section is more detailed to provide context for the recommendations for Australian reform in Part 4.

The Asprey Report recommendations were not taken up until 1980 when then Treasurer in the Fraser Government, John Howard, proposed to explore the introduction of a broadly based indirect tax as part of a change to the tax mix. The Treasurer announced that broad consultation and examination of the analysis available to the Government, including the Asprey Report, had led to the conclusion that the introduction was not feasible at that time given the Government's purpose:<sup>32</sup>

We particularly had in mind whether the time had come to shift a greater burden of the revenue raising effort towards general consumption taxes, thus enabling reductions in personal income tax. The purpose of that exercise was to assess the desirability of altering the mix or combination of taxes, to the extent possible, in the context of reducing the overall burden of taxation; it was not to bring about an increase in the overall taxation burden.

Also of importance was to ensure that the change in mix did not fuel inflation or unnecessarily add to administration or compliance costs.<sup>33</sup>

The rationale for not proceeding was politically important at the time. The spectre of inflation still loomed large, the economy was struggling and public concern with the complexity of the tax system had not gained widespread support.

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<sup>29</sup> Ibid 6.

<sup>30</sup> See Robert Stephens, 'Flattening the Tax Rate Scale in New Zealand', in John Graeme Head and Richard Krever (eds), *Flattening the Tax Rate Scale: Alternative Scenarios and Methodologies* (Longmans, 1990); Robert Stephens, 'The Economic and Equity Effects of GST in New Zealand' in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) 68.

<sup>31</sup> Commonwealth Taxation Review Committee, Federal Parliament, *The Asprey Report: Full Report January 31 1975* (1975). A more detailed analysis can be found in James (2007), above n 24, 327.

<sup>32</sup> Commonwealth, *Parliamentary Debates*, House of Representatives, 12 March 1981, 758 (John Howard).

<sup>33</sup> Ibid. See further, John Harrison, *Background Paper No.1 1997-98: The GST Debate – A Chronology*, (Economics, Commerce and Industrial Relations Group, 1997).

A broad based consumption tax was put forward at the 1985 Taxation Summit, convened by the Hawke Government, but it was not included in the recommendations from the summit.<sup>34</sup> Interestingly, the objections demonstrated the beginnings of the shape of the rationale for when the GST was introduced. The Australian Council of Trades Union (ACTU) questioned whether the pain of the introduction of a broad based consumption tax was worth the relatively small decrease in personal taxes; welfare lobby groups questioned whether the compensation for social welfare recipients was sufficient to counter the regressive nature of the tax; and business lobby groups, while supportive of a consumption tax, queried the extent of other tax impositions on business.<sup>35</sup> Changes to indirect taxes instead focused on improving the effectiveness of the existing Wholesale Sales Tax, in the context of a much more politically controversial step to introduce tax on capital gains and fringe benefits.

The journey towards introducing a consumption tax remained firmly in the political arena when former Economics Professor, John Hewson, became leader of the opposition. Two subsequent elections were fought on political platforms focusing on the economy, with a central plank being the introduction of a broad based consumption tax in the form of a GST.<sup>36</sup>

John Hewson's was the first of these two comprehensive election packages containing a GST and it was dramatically called *Fightback!*. On its release, *Fightback!* appeared to capture the mood of the public and polling was initially favourable. However, this may have been as much due to disillusion with the Hawke government as acceptance of the 650 page platform. Paul Keating toppled Bob Hawke as Prime Minister in December 1991 and was savage in his attacks on *Fightback!*. *Fightback!* was re-launched but the 1993 election was thought to have been lost both because of the complexity of the reform package and Dr Hewson's relative political inexperience.<sup>37</sup>

The essence of the *Fightback!* package continued to firm the political narrative for the introduction of a broad based consumption tax. The 15% rate was seen as high, but acknowledged to be lower than that in many similar systems; it was connected to a substantial personal income tax cut; there was compensation for social welfare recipients; the second version removed application of the tax to food and childcare; it was combined with cuts on other 'inefficient' taxes; and it was associated with more general reform to improve Australia's productivity.<sup>38</sup> However, it fell down in its failure to take into account the concerns of the states, who were critical stakeholders in the tax debate.<sup>39</sup>

Naturally, a GST, as the central plank of the *Fightback!* package was then seen as politically untouchable. However, as Eccleston points out, politics cannot be insulated from economics, and shortly after his political assassination of a consumption tax, Prime Minister Keating was forced

<sup>34</sup> Harrison, above n 33 and James (2007), above n 24, 330.

<sup>35</sup> Harrison, *ibid.*

<sup>36</sup> Liberal Party of Australia & National Party of Australia, *Fightback!* (Canberra, 1991), updated for the March 1993 election. For a selection of political broadcasts and speeches, see <<http://australianpolitics.com/tag/fightback>>.

<sup>37</sup> See, eg, Michael Baume, 'The Lessons of Fightback!' *Australian Financial Review* (2012). Discussed in and James (2007), above n 24, 337.

<sup>38</sup> *Fightback!*, above n 38.

<sup>39</sup> Paul Kelly, *The End of Certainty: Power, Politics and Business in Australia* (Allen & Unwin, 2<sup>nd</sup> ed, 1994) 604.

to make significant extensions to the Wholesale Sales Tax to meet a recession-induced fiscal gap.<sup>40</sup>

The slow strengthening of Australia's economic position over the 1990s provided a double benefit. First, it identified the need for reform of the tax system to meet a growing fiscal gap,<sup>41</sup> a need identified and driven by both the business community and the welfare lobby. This culminated in a joint tax reform summit in 1996 hosted jointly by the Australian Chamber of Commerce and Industry (ACCI) and the Australian Council of Social Service (ACOSS) at which the need for a consumption tax with compensating welfare benefits was broadly agreed.<sup>42</sup> Indeed, Eccleston notes that electoral support for a GST rose from 28% during the 1993 election campaign to 59% in May 1997.<sup>43</sup>

The experience of the Hawke Government in 1985 had demonstrated the need for adequate compensation for the introduction of a consumption tax. This was implicit in the *Fightback!* package and explicit in the ACCI/ACOSS summit. The second benefit of a growing economy was that earlier reforms and continued prudent management placed government in the fortunate position of being able to increase expenditure substantially while maintaining the trajectory towards and into surplus.<sup>44</sup>

However, this put the politicians in a difficult position. After the 1993 election a GST was politically untouchable. In 1995, prior to the 1996 election, which he won, John Howard categorically ruled out the introduction of a GST, a statement that later came to haunt him.<sup>45</sup> Nonetheless, public and interest group support for broad tax reform increased to such an extent that in a climate where the political fortunes of the government were declining, tax reform was brought back onto the political agenda.<sup>46</sup>

In August 1998, the Government released its tax package *Tax reform: not a new tax, a new tax system*, which it put forward as the "biggest single remake of the Australian taxation system since Federation"<sup>47</sup> The package demonstrated quite clearly both the politics of the time and a desire not to make the mistakes of the past. It was broadly well received, although strongly opposed by Labor in opposition.<sup>48</sup> *The Age* newspaper summed up the general sentiment and picked up on the key issues as follows:<sup>49</sup>

<sup>40</sup> Richard Eccleston, 'Taxing Times: A Political Retrospective' (2002) 17 *Australian Tax Forum* 287, 298. This article provides a comprehensive and insightful analysis of the political chronology. See further by the same author, *Taxing Reforms: The comparative political economy of consumption tax reform in the United States, Canada, Japan and Australia* (Edward Elgar, 2007).

<sup>41</sup> For an analysis of the economic background behind the introduction of the GST see, Alan Fenna, 'Governing in Good Times: Fiscal Policy and Tax Reform in Australia: 1996-2006' (2007) 42(2) *Australian Journal of Political Science* 329 and Eccleston (2007), above n 42. For a historical analysis, see James (2007), above n 24, 340.

<sup>42</sup> Eccleston (2002), above n 42, 298.

<sup>43</sup> Ibid 299.

<sup>44</sup> Fenna, above n 43.

<sup>45</sup> See, eg, 'Galleries: Broken Political Promises', *The Australian* <<http://www.theaustralian.com.au/news/photos-e6frg6n6-1226011992172?page=4>>.

<sup>46</sup> Harrison, above n 33 notes the support of the National Commission of Audit, the Productivity Commission and State premiers, but see Eccleston, above n 42, 300.

<sup>47</sup> 'Unfinished Tax Business', *Sydney Morning Herald* (Sydney), 14 August 1998, 18.

<sup>48</sup> 'Beazley Attacks', *Illawarra Mercury* (NSW), 14 August 1998, 3.

<sup>49</sup> 'A Tax Revolution Worthy of the Name', *The Age* (Melbourne), 14 August 1998, 12. See further, James (2007), above n 24, 343.

The tax overhaul that the Howard Government announced yesterday is a bold attempt to remedy long-acknowledged deficiencies in the system. There is a shrinking revenue base because of the opportunities available to those who are not pay-as-you-earn taxpayers to avoid payment of direct tax, so that those who are PAYE taxpayers have borne a disproportionate burden. That burden has been augmented by bracket creep that successive governments have been content to use to their advantage. There has been a plethora of indirect taxes, some levied by the states but none allowing the states and the territories genuine financial independence from the Commonwealth. And the taxation and the welfare systems have failed to mesh: there is often a disincentive to seek better-paid work, because the combination of a new tax bracket and a loss of benefits means family income may in fact be reduced. The tax-reform plan does not tackle all these problems with equal success, but the taxation system it proposes reflects, better than the existing system, the economic and social realities of contemporary Australia.

As with New Zealand, the economic realities made this package politically possible. Inflation, recession, growing deficits and increased debt were receding in the public mind with economic growth.<sup>50</sup> However, the 1997 Asian Financial Crisis had served as a salutary reminder of the importance of prudent and effective economic management. Yet, the strongly favourable economic position meant that the Government could make the introduction of a consumption tax and associated reforms palatable at a scale simply not open to its predecessors, while remaining economically responsible.<sup>51</sup>

Politically, as the extract from *The Age* article above indicates, tax reform had general support. The proposed package had sufficient compensatory adjustments for a broad range of interest groups to give it wide appeal: it was difficult to identify big losers. The tax proposed appeared simpler than its predecessor; the detail of which Dr Hewson himself had appeared hard pressed to explain in interviews. Most important perhaps was a neat manoeuvre by the Commonwealth to bring the States on board.

Always a fractious relationship, with the bulk of taxing powers in the hands of the Commonwealth and much of the spending required in the hands of the States,<sup>52</sup> the High Court of Australia had added to the tension by striking down State excise taxes on constitutional grounds in 1997.<sup>53</sup> Accordingly, the decision to hand most of the proceeds of the proposed GST to the States to meet their spending needs was a game-changer in Federal State relations.<sup>54</sup> It also opened the way to removal of multiple state taxes and consequent simplification of the overall Australian tax system.

The Howard Government was re-elected in 1998 by a relatively narrow margin and moved swiftly to legislate its proposed tax reforms. The Commonwealth achieved agreement from the States at a Special Premiers Conference on 13 November 1998, shortly before the Bill introducing *A New Tax System* to Parliament.<sup>55</sup>

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<sup>50</sup> Fenna, above n 43.

<sup>51</sup> Ibid.

<sup>52</sup> *Income Tax Act 1942* (Cth); *States Grants (Income Tax Reimbursement) Act 1942* (Cth).

<sup>53</sup> *Ha v New South Wales* (1997) 189 CLR 465.

<sup>54</sup> Stephen Bartholomeusz, 'Bold Attempt to Soothe States' *The Sydney Morning Herald* (Sydney), 14 August 1998.

<sup>55</sup> Commonwealth, above n 24; *The Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations set out in Schedule 2, A New Tax System (Commonwealth-State Financial Arrangements) Act 1999* (Cth).

Despite arguments from the government that the electorate had voted to accept a broad-based consumption tax, political reality rapidly intruded in the form of the minor party of the Australian Democrats and the independent members holding the balance of power in the Senate. They combined with the opposition Labor Party to water down the Bill as drafted. The Bill was ultimately passed with a number of changes, the most significant being the exemption of basic food products.<sup>56</sup> Important from a political perspective was the emphasis by the minor parties on concessions for education, health and even greater focus both on social welfare payments to compensate the disadvantaged and regulation to prevent exploitation of the change (through the Australian Competition and Consumer Commission). The GST came into force in Australia from 1 July 2000.

### **PART 3: INTRODUCING A CONSUMPTION TAX: HOW IMPORTANT IS THE POLITICS? A COMPARATIVE ANALYSIS**

This paper has described the introduction of a consumption tax in three jurisdictions over some thirty years. In each case, a fundamental shift to a fully-fledged consumption tax was driven by the economic imperatives and shaped by the politics. Key features of this interplay of the economic and political can be analysed using the principles set out in Part 1.

#### **Equity and fairness**

It is clear that in all three jurisdictions a perception of equity and fairness was fundamental to the implementation of a consumption tax. Two aspects are particularly important politically: consultation, education and understanding in the community and the regressive or unfair nature of any changes.

#### **Consultation**

It is interesting that consultation, ostensibly a key criterion for fair implementation, was treated so differently in each country and yet apparently seen as fair despite that different treatment. It suggests that the political requirement is a perception of consultation on important issues, often achieved through education, discussion and transparency.

In the UK, the Government announced its intention to introduce a VAT some two years before it was to be operational. A Green Paper was published setting out details of the proposals so that consultation could take place with those who would be affected by the new tax. That process of consultation continued for a 12 month period. This consultation resulted in a White Paper which set out the structure of the tax, draft clauses and schedules for further discussion. Clearly, the greater the consultation the more there is an opportunity to satisfy the political need for public perception of transparency and openness.

However it is possible that extensive consultation may perhaps lead to too many compromises with special interests. How is this achieved without undermining public support? Richard Green, the expert in tax law on the New Zealand Advisory Panel, compared the time limits within which the changes were made:

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<sup>56</sup> It passed on 28 June 1999 as *A New Tax System (Goods and Services Tax) Act 1999* (Cth). For discussion of “Veto Players” see Hallerberg and Basinger, above n 6 at 338.



The final result in the United Kingdom is a VAT that because of, among other things, exemptions and different rates, is much more complex than the New Zealand GST. The original proposal in the United Kingdom was also for a simple tax. The original aim was not achieved in that country to the same extent that it was in New Zealand. Perhaps the short period for refinement assisted that result!<sup>57</sup>

A contrasting feature of the introduction of GST in New Zealand was the incredibly tight time limits within which submissions and recommendations had to be made. The Australian Government learnt both from the New Zealand experience and the political difficulty in gaining acceptance for *Fightback!*. The idea of a GST was widely debated, discussed and taken to a Federal election, but debate on the detail was largely confined to the six months between the introduction of the Bill in December 1998 and its passage in June 1999. Once the public had accepted the idea, the politicians debated the detail.

By contrast, the consultative process in New Zealand was aimed at improving the quality of the product (GST) that was being introduced. “It was a consultative process – ‘how do we make it better?’ – rather than a consensus building exercise – ‘how can we buy your opposition off?’”<sup>58</sup> In Australia, it was very much a process of buying off the minor parties in the Senate so that the legislation might pass. The latter was a clear indication that, although ACOSS and the public generally had understood and accepted a broad-based, comprehensive GST with appropriate compensation for low income earners and welfare beneficiaries, the opposition parties were by no means convinced.

A further contrasting feature in the GST introduction in New Zealand was the establishment of a Co-ordinating Office. The Australian opposition in putting forward the *Fightback!* package with a broad community coalition was unable to garner sufficient support in educating the community. The role of New Zealand’s Co-ordinating Office was essentially to help the public understand how the tax reform package would affect them.<sup>59</sup> Many years later Roger Douglas would state:<sup>60</sup>

...the establishment of a GST Co-ordinating Office to explain GST to the people was vitally important. They did not have a particularly easy job, given it was the people who would pay the tax.... [W]ithout the office, acceptance [of the tax], which went from 35% to 65% within two weeks of introduction, would never have occurred.... An important political lesson that came out of this process was that you should “never fall into the trap of selling the public short.” Successful reform does not become possible until you trust, respect and inform the voters. You have to put them in a position to make sound judgments. That’s what the GST Co-ordinating Office managed to do.

It is interesting to note the politics of the name “GST” in New Zealand; “The IRD wanted to call it value added tax but the Treasury strongly opposed that. This was because we wanted to make a clear distinction from the British VAT that had received a lot of adverse publicity in New Zealand over the years.”<sup>61</sup>

<sup>57</sup> Richard Green, ‘Consulting the Public in Developing a GST’, in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) 24.

<sup>58</sup> Douglas, above n 14, 8.

<sup>59</sup> Todd, above n 19, 32.

<sup>60</sup> Douglas, above n 14, 9-10.

<sup>61</sup> Dickson, above n 17, 50.

### ***Perceptions of fairness and equity***

There was much debate in all three jurisdictions on the regressive nature of a consumption tax. In the UK and Australia it resulted in the zero rating or exclusion, for example, of food, despite both jurisdictions starting with the aim of introducing a broad-based comprehensive consumption tax.

In New Zealand, the argument to justify the inclusion of food and clothing is summarised by Dickson<sup>62</sup> as one of presentation, so the public could be shown:

- Not the percentage of income spent on food by low and high income households, but the actual dollar value, to demonstrate the increased tax take from high income households; and
- That exemption of food represents payment of a benefit of that higher amount to high income households; whereas an actual benefit can be paid of something equivalent to the actual GST spent on food to the lowest income households.<sup>63</sup>

Jeff Todd of the GST Co-ordinating Office stated that the limited exemptions feature, perceived fairness of the tax and the associated reforms greatly simplified the task of selling the GST and were key to its successful implementation.<sup>64</sup> “The exemptions issue was perhaps the most important and the most difficult. Why not exempt necessities? We were well aware of the complications that arise when exemptions are introduced and boundaries set between taxable and exempt items.”<sup>65</sup>

The UK and Australian debates became more complex and ended with agreement to zero rate or exempt specific areas of expenditure including education, health and food. In the UK they extended to children’s clothing. In Australia they were driven by the political demands of minor parties holding the balance of power in the Senate.

As a result, any ambition to broaden the base of the GST/VAT in Australia and the UK now has a significant first hurdle of persuading both the public and many politicians that long-held perceptions of both fairness and effectiveness are best dealt with by broadening the scope of the tax.

### **Certainty and simplicity**

In New Zealand, Jeff Todd of the GST Co-ordinating Office stated:<sup>66</sup> “We were committed to keeping it simple. We were aware of the British experience where, by mid-1973, within just a few months of the introduction of VAT, the system required about 400 pages of Customs and Excise notices to explain it.”

In the UK, children’s clothing is not subject to VAT but there are complex problems in drafting the rules that set the boundaries. For example, from a literal interpretation of the rules for zero

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<sup>62</sup> Ibid 51.

<sup>63</sup> Roger Douglas noted that “[o]nly 15% of the benefit from an exemption for food in New Zealand would have gone to the bottom 20% of households by income. Eighty-five percent of the benefit would have gone to 80% of households who were better off than those people.” See Douglas, above n 14, 8.

<sup>64</sup> Todd, above n 19, 30.

<sup>65</sup> Ibid.

<sup>66</sup> Ibid 29.

rating children's clothing in the UK "one could conclude that a young child's non-humorous hat trimmed with one-sixth untanned dog skin would be safely exempt from the tax. But a child's coat one quarter trimmed with Mongolian goat skin would undoubtedly be subject to VAT."<sup>67</sup> There are similar examples of complexity across all areas of exemption in both Australia and the UK. However, the weighing of the principles is at the crux of a decision to forgo certainty and simplicity in favour of fairness. In Australia, the opposition parties' perception of the unfairness of including in the GST items such as food, health and education, trumped their perceived need for certainty and simplicity (and efficiency).

## Efficiency

At the time of introduction of VAT/GST all three governments sought a broadly based tax rather than a series of specific, inefficient taxes on particular products.

The New Zealand example illustrates the inefficiencies of the tax system. Before 1985, each tax base had been eroded by a series of tax exemptions, incentives and rebates. The 1984 budget estimated that personal income tax expenditures (that is tax exemptions, incentives and rebates) amounted to 9.1% of personal income tax revenue, with the majority of these going to upper income groups.<sup>68</sup> The narrowest tax base was for goods and services with a wholesale sales tax that excluded the service sector as well as value added by retailers.

It also drove the New Zealand ambition to embrace a tax with no exemptions. Arguably, this makes the New Zealand version of the consumption tax the most efficient of the three jurisdictions, although this is discussed in more detail below. The New Zealand view is expressed by Roger Douglas,<sup>69</sup> "The decision to go for a quality product - by that I mean to have a value added tax that had virtually no exemptions - was fundamentally important. This determination was clearly demonstrated by the inclusion of the government sector in the tax base and our treatment of residential dwelling, local government and tourism." Few goods and services fall outside the tax net and those that do, for example domestic rental accommodation and financial services, were made exempt for practical reasons (such as reduction in the cost of compliance).

## Neutrality

Historically, indirect taxation developed as the taxation of goods rather than services.<sup>70</sup> In less developed economies goods were more easy to see, value and tax, than services. Furthermore, service industries in general were a less important part of overall economic output than they were in more advanced economies. In the UK, goods had been subject to Purchase Tax but over a period of time goods as a proportion of economic output had declined and with it the indirect tax base. The anomaly that goods should be taxed but not services became increasingly obvious as the service sector expanded. In the UK this led to the introduction in 1966 of an ill-fated attempt to redress the balance. This was the Selective Employment Tax (SET), soon dubbed the 'Silliest Ever Tax', by which all payrolls were taxed, but the tax was refunded to the manufacturing industry.<sup>71</sup>

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<sup>67</sup> Ibid 30.

<sup>68</sup> Roger Douglas, *Budget 1984, Financial Statement* (Government Printer, 1984).

<sup>69</sup> Douglas, above n 14, 4.

<sup>70</sup> For further discussion see, eg, Webber, above n 12.

<sup>71</sup> For an analysis see, Reddaway, above n 13.

A similar payroll tax was introduced by Robert Muldoon in New Zealand in 1970 and quickly abolished by the Labour Party in 1973 when it was realised that the resulting capital investment was leading to increased unemployment.<sup>72</sup>

The UK Government's *Green Paper* proposing the introduction of VAT stated that the existing system had become too 'complex and discriminatory'. It was therefore intended to replace the existing 'system of indirect taxation by a more broadly-based structure which, by discriminating less between different types of goods and services, would reduce the distortion of consumer choice.'<sup>73</sup> A similar approach was taken in Australia, where the GST aimed to allow the abolition of nine State and Federal taxes, including the Wholesale Sales Tax.<sup>74</sup>

The aim of a very broadly based tax was not met in either the UK or Australia. To secure its political acceptability, as discussed above, many concessions were made either by exempting items from GST/VAT or by subjecting them to a zero-rate. In the UK, as a result of the extensive exemptions and zero rating only just over half of consumer expenditure was covered by VAT<sup>75</sup> and the proportion has not increased much since its introduction. There have been no significant changes to the scope and rate of the Australian GST since its introduction in 2000.

The New Zealand GST rate increased from 12.5% to 15% from 1 October 2010. This was part of a switch in the tax mix from income tax to consumption tax announced in the 2010 Budget. The GST rate was previously increased in 1989 from 10%. The increase in the New Zealand GST rate in 2010 was designed to be neutral with accompanying reductions in rates of income tax and increased social welfare benefits and tax credits. The Minister of Finance promised these income tax cuts would "more than offset the rise in GST - and low, middle and high income groups [would] broadly receive the same proportionate increase in disposable income".<sup>76</sup>

A particular feature in the effort of the UK to move to import and export neutrality was the need for the UK to consider harmonisation with Europe. At the time of the discussion about the introduction of VAT, there were only six members of the European Economic Community (EEC) and each had adopted a VAT system. It was clear that they required a mutually acceptable system of indirect taxation that would operate without causing distortions to the trade between them. Furthermore the Scandinavian countries were moving in the same direction. The UK then had about 40% of its trade with countries either having or proposing to have a VAT<sup>77</sup> so whether or not it joined the European Community the tax would be relevant to the UK. It also appeared that the 'general experience of the tax [in 1971] in the seven countries which have adopted and operated it for a year or more is that, after the initial teething troubles, the tax is not found to be unduly difficult to work in practice'.<sup>78</sup>

<sup>72</sup> An interesting if brief summary of the problems of the Muldoon governments before the introduction of GST by the Labour Party is given in Dickson, above n 17, 46.

<sup>73</sup> *Value-added Tax* (HMSO, London, Cmnd. 4621, 1971) 3.

<sup>74</sup> *The Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations set out in Schedule 2, A New Tax System (Commonwealth-State Financial Arrangements) Act 1999*, above n 57.

<sup>75</sup> Evan Davies and John Kay, 'Extending the VAT Base: Problems and Possibilities' (1985) 6 *Fiscal Studies* 1-16.

<sup>76</sup> As reported in, Chris Daniels, 'Budget 2010: Income tax slashed, GST to 15 pc', *New Zealand Herald* (Auckland), 20 May 2010, <[www.nzherald.co.nz/business/news/article.cfm?c\\_id=3&objectid=1064604](http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=1064604)>1.

<sup>77</sup> National Economic Development Office, *Value Added Tax*, (HMSO London, 2<sup>nd</sup> ed, 1971) 4.

<sup>78</sup> *Ibid* 9.

Politically, the neutrality component of the introduction of a consumption tax appears to have less impact, perhaps because it does not seem to affect voters directly or cannot be shown to do so. However, the increase in on-line retailing across borders means that it is likely to become more important, as the impact becomes more evident. This is discussed further below.

## Effectiveness

The effectiveness of a consumption tax in coping with increasingly flexible and dynamic trends in consumption of goods and services means that this may become a catalyst for significant political debate. As technology drives consumption both in the nature of goods and services and their delivery across borders, the same political issues that have attached to anti-avoidance activity for taxation of capital and income, will likely also attach to taxation of consumption.

### Political systems and the effect on change

Political systems and the political landscape will often shape the form in which a tax can be imposed.<sup>79</sup> The government structure and voting system in a country have a direct influence on the ease with which laws can be introduced and changed. Nonetheless, the electoral cycle is also important, as can be seen below from the political impact in the UK of changes to VAT and in New Zealand and Australia the changes to GST.

The UK has a bicameral parliament, which provides two layers of government. However, following the Parliament Act of 1911, the House of Lords is unable to block fiscal legislation. Again, provided there is a majority government, the political impediment to passage of changes to the VAT is found in ensuring that it does not become an election issue.

In the UK attempts to extend the coverage in any significant way have met with substantial political opposition. However, since this has meant the tax has generally conformed to UK taxpayers' politically expressed ideas of fairness, increases in the standard rate have met with much less opposition. Indeed it was quite remarkable that the increase of VAT in the UK from 17.5% to 20% in January 2011, which was expected to raise an additional £13 billion, aroused remarkably little observable protest or resistance. This provided a considerable contrast with the ferocious opposition that often greets increases in other taxes involving only a tiny fraction of that amount.

The increase to 20% in the VAT rate also meant that the standard rate had doubled from the initial rate of 10% in 1973. Between 1974 and 1979 there were numerous changes as anomalies and administrative costs from disparities in rates were slowly reduced.<sup>80</sup>

In the UK, VAT has been used as an instrument of macroeconomic stability,<sup>81</sup> and as an instrument of public policy.<sup>82</sup> However, changes have been restricted to the rate rather than the scope of the tax, as these have proved politically far more acceptable.

<sup>79</sup> Kathryn James, in 'An examination of convergence and resistance in global tax reform trends', *Theoretical Inquiries in Law*, (2010) 11(2) 475 analyses a number of factors that can both "contribute to tax policy convergence and provoke fierce resistance" (at 486ff). She examines factors such as the environment, power distribution, culture and institutions.

<sup>80</sup> There was a 1974 rate cut to 8% but introduction of a luxury rate of 25% in 1975. The latter was reduced to 12.5% in 1976. The two rates were amalgamated at 15% in 1979 and then increased to 17.5% to allow elimination of local government tax.

At the time of the introduction of GST in New Zealand, a simple first past the post voting system was in place (this has since changed to a mixed member proportional system). This voting system generally led to majority governments. Even more importantly, New Zealand has a unicameral parliament, which means there is only one (national) layer of government. A member of parliament in New Zealand sits in the one parliament, which is responsible for passing all laws in New Zealand. This meant that both the introduction of the GST in 1986 and the subsequent increase in the rate of GST in 1988 were accomplished relatively easily by virtue of having majority governments. Even with the introduction of Mixed Member Proportional representation, the 2010 GST rate changes occurred with the support of minor parties.

Australia is more complex than the UK and New Zealand, with a bicameral parliament in a Federation of six states and three self-governing Territories, which each have their own parliaments, some unicameral and some bicameral. Australia also has a preferential voting system, which makes it unusual for the party of Government to control the Senate as the upper house of parliament. Significant legislative changes rely on negotiation to gain assent. Usually, taxing powers are the province of the Federal Government, but, as noted above, in the case of the GST, changes were agreed to be subject to the agreement of the States, which makes any change to the GST even more difficult.<sup>83</sup>

In the UK and Australia, therefore, the emphasis on public and political support for any change has been more important than in New Zealand. The size and diversity of both the UK and Australia perhaps adds a further dimension to the complexity of political debate.

In all three jurisdictions, the nature of the political system means there is the phenomenon of the “Vote Motive”<sup>84</sup>. The “vote motive” suggests that changes in legislation are more likely to happen as a result of trying to buy votes at the time of a government election than being based on a desire to achieve the fairest, most efficient and effective tax system. This is accentuated in Australia (at the federal level) and in New Zealand, with a three-year election cycle compared with five years in the UK.

#### PART 4: THE AUSTRALIAN GST: IS REFORM POSSIBLE?

The Australian GST has an inbuilt rigidity, which was part of the attraction for agreeing to it in the first place. One of its major selling points has proven a major inhibitor for any talk of change. It was simply put by the then Treasurer, Peter Costello in his Second Reading Speech:<sup>85</sup>

<sup>81</sup> For a temporary reduction of the standard rate from 17.5 to 15% between 1 December 2008 and 31<sup>st</sup> December 2009. This relative flexibility is explained by the majoritarian polity in the UK, reflected also at the time of introduction of the GST in New Zealand, see Steinmo and Tolbert, above n 6, 174.

<sup>82</sup> Luxury rates and, more recently, reduced rates of tax on items such as domestic fuel and power, home insulation materials and certain health products.

<sup>83</sup> *The Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations set out in Schedule 2, A New Tax System (Commonwealth-State Financial Arrangements) Act 1999*, above n 57. See also “Veto Players” in Hallerberg and Basinger, above n 6 at 338. For an explanation of the effect of shifting coalition politics on the political process, see Steinmo and Tolbert, above n 6, 174.

<sup>84</sup> The “Vote Motive” has been promulgated by Gordon Tullock as the equivalent in politics of the profit motive in business. See, Gordon Tullock, *The Vote Motive* (The Institute of Economic Affairs, revised edition, 2006). Reductions to the income tax rates and/or thresholds are frequently seen in election years. See also Steinmo and Tolbert, above n 6, 180, particularly on the incentives in different forms of political institutions to “buy off political allies”.

<sup>85</sup> Commonwealth, above n 24.

Part of the Commonwealth-state agreement is a process to lock in the rate of the GST. Any request for a change to the GST rate would need to be made to the Commonwealth unanimously by all state governments, it would need to be endorsed by the Commonwealth government of the day and relevant legislation would need to be passed by both houses of parliament.

All of the elements that came together to allow successful introduction of the tax in the first place, as discussed in Part 2, would likely have to come to bear for any substantial change to the rate and scope of the GST. Thus far, amendments to the GST legislation have been technical and limited. The nature of the Australian Constitution is that Parliament cannot bind itself and could theoretically pass another law removing this restrictive process for changing the GST.<sup>86</sup> The politics of achieving this make it unlikely and the Australian Federal Government will almost certainly follow the legislated procedure to achieve any change.

The basis for changes to the GST in Australia is set out in the GST legislation and focuses on covering the principles of certainty and simplicity, efficiency and effectiveness:<sup>87</sup>

1. The rate of the GST, and the GST base, are not to be changed unless each State agrees to the change. Such changes to the GST base should be consistent with:
  - a. maintaining the integrity of the GST base; and
  - b. administrative simplicity; and
  - c. minimising compliance costs for taxpayers.

The political system implicitly ensures that the principle of equity and fairness is observed. Reform of the Australian GST is possible.

### **Is there political momentum for change?**

The GST was not the harbinger of congenial relations on funding between the Commonwealth and the States that it was supposed to be. As expenditure on health and education has expanded and tax revenue has reduced, the tension between the Commonwealth and States has grown.<sup>88</sup> Australia is no longer in the strong economic position it was when the Howard Government could provide significant compensation for introducing tax reform. Rather, there is a sense of community and business uncertainty.

International economic influences have further clouded both the reality of domestic politics and the scope of significant reform federally where the impact on trade and investment has become important domestically. In its early days of office, the 2013 Abbott government had to make

<sup>86</sup> For a more detailed discussion, see Duncan Bentley, *Taxpayers' Rights: Theory, Origin and Implementation* (Kluwer Law International, 2007).

<sup>87</sup> *Section 11 A New Tax System (Commonwealth-State Financial Arrangements) Act 1999* (Cth).

<sup>88</sup> It was a focus of the 2013 Federal Election and resulted in the Commission of Audit being briefed to review Commonwealth/State relations. See, Jennifer Menzies, 'Securing Australia's Future: Governance and State-Federal Relations' (December 2013) *The Conversation*, <<https://theconversation.com/securing-australias-future-governance-and-state-federal-relations-19903>>.

major foreign policy,<sup>89</sup> foreign investment<sup>90</sup> and security decisions,<sup>91</sup> in which the media alluded to the economic consequences.

The IMF *Fiscal Monitor* notes that through the period following the 2007-2008 financial crisis, tax reform generally has been 'guided by expediency rather than by a desire to build stronger and fairer tax systems'.<sup>92</sup> Nonetheless, as in the mid-1990s, a groundswell of support is building for further tax reform, with a focus on the GST. Some state premiers are vocal in their support for rate increases or a broadening of its scope, particularly given the increase from offshore online retailers.<sup>93</sup> Policy advocates, such as the Grattan Institute, are putting forward proposals that support significant tax reform, including a broadening of the scope of the GST.<sup>94</sup>

The Abbott government is adamant however, that it will take any tax reform agenda to the next election, due in 2016. The Treasurer has said:<sup>95</sup>

We will consult widely with key stakeholders and deliver a taxation reform program that keeps to our core principles of fairness and simplicity. We will then seek endorsement from the Australian people for our plan at the next election.

### How should an Australian Government negotiate the change?

As in the past in Australia, as in the UK and New Zealand, it is likely that the success of passing any reform will be driven primarily by the politics. Although this may be driven by factors reflective of the power balances in Australia's political institutions, from a practical standpoint, it means that the Government must first build relational capacity with the electorate and key influencers: a strong network of relationships that can draw together the fragmented interest groups across Australian society to act collectively in pursuit of commonly agreed tax reform.<sup>96</sup>

This could be done in several ways. Arguably, the New Zealand approach of establishing an independent office to build on the recommendations of the Henry Review could be a first next step.<sup>97</sup> The aim would be not only to consult on a detailed package of reform with the

<sup>89</sup> George Roberts, 'Indonesia Considering Cutting Australian Beef Imports in Wake of Spying Scandal' (November 2013) *ABC News*, <<http://www.abc.net.au/news/2013-11-26/indonesia-considering-cutting-australian-food-imports/5117970>>.

<sup>90</sup> Glenda Kwek, 'Joe Hockey Decision on GrainCorp Bid Threatens Investment' *Sydney Morning Herald* (Sydney), 30 November 2013.

<sup>91</sup> 'Bishop Sees Trade as Still Outweighing Flight Zone Dispute', *The Australian* (Sydney), 8 December 2013.

<sup>92</sup> IMF *Fiscal Monitor*, above n 5, vii.

<sup>93</sup> 'How Do You Increase the GST Without Increasing the GST?' (September 2013) *PolitiFact Australia*, <<http://www.politifact.com.au/truth-o-meter/statements/2013/sep/21/colin-barnett/how-do-you-increase-gst-without-increasing-gst/>>. There is apparent unanimity on lowering the threshold for online imports, Philip Coorey and Lucille Keen, 'Pressure Grows to Expand Online GST', *Australian Financial Review* (Melbourne), 26 November 2013. Although willingness to come out in favour of GST Reform is still politically sensitive. See, Peter Van Onselen, 'The first rule of states' rights club: don't talk publicly about GST reform', *The Australian*, 10 October 2014, <<http://www.theaustralian.newspaperdirect.com>>.

<sup>94</sup> John Daley, *Balancing Budgets: Tough Choices We Need*, (Grattan Institute, 2013).

<sup>95</sup> 'Hockey Flags Tax Reform Agenda', *Business Spectator* (online), 16 October 2013 <<http://www.businessspectator.com.au/news/2013/10/16/politics/hockey-flags-tax-reform-agenda>>.

<sup>96</sup> Eccleston, above n 42, 303.

<sup>97</sup> Eccleston, above n 42, 303.



Commonwealth, States and appropriate government agencies such as Treasury, the ATO and department of Social Services, but also with key interest groups such as ACOSS, Business Council of Australia and, very importantly, all parties and independent members in Federal and State Parliaments. An associated component of the work would be to provide transparency and information on key concepts. If this is done over the period before the next Federal election it would build both collective agreement and electoral understanding. It would allow full exploration and testing of base broadening, rate changes, or a combination.

Second, reform will be driven by how embedded the reforms have become in the social mindset: the extent to which the broader community shares the political goals of the reform.<sup>98</sup> This should be done by using the networks and influencers developed in the first stage of the reform process and focusing on the equity and fairness of the reform package.<sup>99</sup> It would require the government and other champions of reform to own and drive it. A feature of the reforms discussed in both Australia and New Zealand has been the importance in the politics of personality: whether it was Prime Minister Keating in opposing the *Fightback!* package in Australia or Treasurer Douglas in successfully selling the GST to the New Zealand electorate. Taking this approach will cater to what have proven to be critical principles for success: of fairness and equity.

Third, the Commonwealth must meet the fundamental legislative criteria in order both to satisfy the States and pass the legislation. Any change must ensure the integrity of the GST base and administrative simplicity, while minimising compliance costs for taxpayers.<sup>100</sup>

This three-pronged approach represents a political challenge for governments, but has been shown to provide a basis for success.

Assuming that the Government decides to move ahead with tax reform and the reform includes changes to the GST, from the experience of the UK and New Zealand, what reforms have the greatest potential for success?

In May 2009, the Victoria University of Wellington Tax Working Group (TWG)<sup>101</sup> was established by Victoria University of Wellington's Centre for Accounting, Governance and Taxation Research, in conjunction with the Treasury and Inland Revenue. Although an independent group, it was formed with the support of the Ministers of Finance and Revenue to identify the major issues that Ministers will need to consider in reviewing medium-term tax policy and to better inform public debate on tax.

The "Conclusion and a way forward" of the TWG report states:<sup>102</sup>

As part of a redesign of the New Zealand tax system, the TWG considered the pros and cons of increasing GST. The Group concluded that increasing the GST rate would have merit on efficiency grounds because it would result in reducing the taxation bias against saving and investment as against consumption. However, data indicate that while on a life-time basis the incidence of a higher GST seems to be broadly proportional, in terms of current income it tends to be slightly regressive. Also, some people would be particularly disadvantaged by a higher GST rate. As a result, the TWG recognises that any increase in

<sup>98</sup> Eccleston, above n 42, 303.

<sup>99</sup> Ibid.

<sup>100</sup> Section 11, above n 89.

<sup>101</sup> Victoria University of Wellington Tax Working Group, *A Tax System for New Zealand's Future: Report of the Victoria University of Wellington Tax Working Group* (Centre for Accounting, Governance and Taxation Research, Victoria University of Wellington, Wellington, 2010).

<sup>102</sup> Ibid 66.

the GST rate would need to be accompanied by measures to offset adverse equity implications of a rise in GST. These measures would significantly reduce the net revenue raised from a higher GST.

The TWG considers that any compensation should be by way of increases in benefit levels and reductions in the personal tax scale. The Group rejected the idea of exempting certain categories of items from GST. Narrowing the GST base (for example by exempting food) would substantially reduce the efficiency of the tax and increase compliance and administration costs, while having limited impact on equity.

Following the TWG recommendations<sup>103</sup> the 2010 Budget increased the rate of GST to 15% along with a reduction in individual tax rates. The effects of the global financial crisis, however, meant a lower revenue gain than expected from the GST. There was a reduction in the personal tax rates and a shift in the incidence of tax away from the productive sector but this was met by a reduction in domestic consumption.

Implicit in the New Zealand analysis is an assumption of a broad based GST and this is an area of significant possibility in Australia. The view that broadening the base of VAT/GST is a desirable element of future tax reform has been expressed in recent years, for example by the European Commission<sup>104</sup>, the Mirrlees Review<sup>105</sup> in the UK and the Grattan Institute<sup>106</sup> in Australia. There is little doubt that, at least in general terms, a broad based consumption tax is likely to be more economically efficient than one with a narrower base, though there are some important exceptions. It is also true, in principle at least, that it would be more effective to help the less well off with a system of income redistribution that is specifically directed at them rather than a system of tax preferences that can benefit rich and poor alike.

However, it does not necessarily follow that the combination of a consumption tax system focused on achieving economic efficiency together with direct help for the less well-off is the best solution given the wider context of government policy, the tax system as a whole and the socio-economic environment in which it has to operate<sup>107</sup>. However desirable these two aims are, governments normally have a much wider range of policy aims and objectives which may involve the use of the tax system in other ways. Both Federal and State governments also have to negotiate changes through a political system that is designed for consensus. It could take substantial time to generate the national consensus that exists in New Zealand for a broad based GST and which the UK has failed to achieve over 40 years, despite the existence of the New Zealand example for nearly 30 years.

It is interesting to note from the discussion above that, both in the UK and New Zealand, rate increases have passed through the respective parliaments without significant opposition: certainly insufficient to cost an election. That may differ in Australia given the requirement to build such a far-reaching consensus. However, history has shown that the States can be induced into

<sup>103</sup> Ibid 11. See also, Neville Bennett 'Inflation Helps Poor Get Poorer' *National Business Review* (Auckland), 8 April 2011, 20.

<sup>104</sup> European Commission, *A Retrospective Evaluation of Elements of the EU VAT System, Final Report*, TAXUD/DE/328 (2011), 14  
<[http://ec.europa.eu/taxation\\_customs/resources/documents/common/publications/studies/report\\_evaluation\\_vat.pdf](http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/report_evaluation_vat.pdf)>.

<sup>105</sup> Sir James Mirrlees, *Dimensions of Tax Design: The Mirrlees Review* (Oxford University Press, 2013).

<sup>106</sup> Daley, above n 96.

<sup>107</sup> Simon James and Alison Edwards, 'Developing Tax Policy in a Complex and Changing World' (2008) 38(1) *Economic Analysis and Policy* 35-53.

agreements given sufficient compensation, which in this case would be funded directly from any rate increase.

We suggest that the growing support for ways to reduce budget deficits could provide the rationale for reform, using the three-pronged approach outlined above in the method for reform. It is useful to attach reform to an issue that has already established a groundswell of support among important networks and has captured the public imagination. The broader reform package can build on this existing momentum.

The Australian State Governments, sections of the media and the retail sector seem convinced by the need to lower the GST threshold for online imports.<sup>108</sup> A 2011 Productivity Commission Report, *Economic Structure and Performance of the Australian Retail Industry* was accepted by the Federal Government, which consequently commissioned, with state government support, the July 2012 *Low Value Parcel Processing Task Force Report*. The latter recommended reduction of the low value threshold GST exemption for imported goods as part of a package of reform which would see improved systems and collection processes to keep the system as simple, efficient and cost effective as possible.<sup>109</sup> This has resulted in a joint Federal and State working group to determine how to implement these recommendations.<sup>110</sup> There is agreement, widespread public support and a potential vehicle to develop support for wider reform.

The Australian political landscape suggests that there is appetite for tax reform to meet the budget deficits. The GST has been identified from a range of sources as the obvious means to achieve this. In doing so, creating a public perception of fairness will be essential. The question is what reform to the GST is possible and how could it be brought to fruition?

The Report of the Henry Review, *Australia's Future Tax System*<sup>111</sup> made numerous recommendations for reform and, in the context of the GST, noted Australian Bureau of Statistics data that "absolute actual expenditure on GST-free food is almost six times greater for the highest than the lowest income groups". The Report emphasised the significant complexity that this adds to the GST and noted that while a broad-based consumption taxes is one of the least damaging to economic growth, Australia's failure to tax on a comprehensive basis significantly undermines its efficiency.<sup>112</sup> However, assertions of this nature need to be generally accepted by the public and key interest groups before they will be accepted. Experience in the UK and New Zealand suggests that rate reform is also politically potentially feasible, provided the public sees both the need for the reform and is persuaded by its fairness.

However, in any reform of the GST, it is important from experience in both Australia and other jurisdictions that the regressive impact is seen to be ameliorated for the least well-off. Based on the analysis from the UK, New Zealand and Australia's own experience, if the Federal Government does: build relational capacity with the electorate and key influencers to draw together fragmented interest groups to act collectively in pursuit of commonly agreed tax reform; embeds the sense of need for reform by using networks and influencers to focus on issues of

<sup>108</sup> See, above n 95.

<sup>109</sup> See, Low Value Parcel Processing Task Force, *Commonwealth, Low Value Parcel Processing Task Force Final Report: Executive Summary and Recommendations* (2012) 1.

<sup>110</sup> Mike Baird, 'NSW Welcomes Commonwealth Agreement for Action on Infrastructure and Online GST' (Media Release, 27 November 2013).

<sup>111</sup> *Australia's Future Tax System: Report to the Treasurer December 2009* (Commonwealth 2010) D2-1, <[http://www.taxreview.treasury.gov.au/content/Content.aspx?doc=html/pubs\\_reports.htm](http://www.taxreview.treasury.gov.au/content/Content.aspx?doc=html/pubs_reports.htm)>.

<sup>112</sup> Ibid.

equity and fairness; and clearly satisfies the legislative change requirements; it stands a reasonable chance of succeeding.

The development of tax reform should take account of the political process itself. James E Meade, joint winner of the Nobel Memorial Prize in Economic Sciences in 1977, once stated: 'I am an economist and have tried to give you an economic solution for an economic problem. Please do not argue that I am a rotten economist on the grounds that the economic solution is politically unacceptable. The really difficult part of our present problem *is* political'<sup>113</sup>. This article therefore addresses how governments have implemented and made changes to broad-based consumption taxes in Australia, New Zealand and the UK. In doing so, it proposes a practical approach for the Australian Government to effect changes to the GST.

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<sup>113</sup> JE Meade, 'Stagflation in the United Kingdom' (1979) 7(4) *Atlantic Economic Journal* 1.