Chapter 8

Taxation

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Although the economics of taxation has a long history, dating back to Ricardo and Cournot, the modern theory of taxation has developed over the past thirty years, building upon advances in microeconomic theory. Central to these are duality, general equilibrium theory and the theory of second best. This displaced the earlier tax literature, which had used simple rules to guide and evaluate policy. The new literature made social-welfare maximisation the explicit goal of taxation, and demonstrated that the rules of the earlier literature failed to take into account information and incentive constraints that governments inevitably face when designing policy.

Imperfect information about the endowments of individuals prevents governments using personalised lump-sum taxes and transfers to redistribute. With lump-sum taxes, no individual can lower their tax liability by changing their behaviour. Once lump-sum taxes are ruled out, redistribution involves efficiency costs. Equity and efficiency must be addressed simultaneously. When taxes are based on imperfect indicators of endowments, such as income or consumption, taxation changes relative prices and this is the source of efficiency costs.

In modern tax theory, information and incentive constraints are explicit. The implications for tax policy are wide-ranging: what *can* be taxed influences what should be taxed and the optimal rates of tax; taxes with narrower bases and differential rates can be superior in social-welfare terms to broad-based, constant-rate taxes; efficiency cannot be inferred from counting the number of different tax rates. Empirical analysis is now central to tax design and evaluation of reforms.

While tax economics was making rapid advances in the international literature, in Australia there was ongoing tax-reform debate that tended to draw more from the earlier literature than the new developments. A number of prominent concerns emerged:

- The base of personal income tax (PIT) had been eroded by the growth of untaxed fringe benefits and capital gains.
- Self-employed taxpayers could lower tax by splitting income with their spouse. As a result, wage and salary earners faced an increasing relative burden.
- A shift in expenditure from manufactured goods to services had eroded the base of the wholesale sales tax (WST).
- The WST omitted many goods and services and applied different rates of tax.

- Australia's greater reliance on income taxation appeared to make it an outlier in the OECD, although when compulsory contributions for retirement were included, Australia was close to average.
- The company tax rate was high compared with such tax rates in Asia, and Australia's classical corporate tax system involved double taxation, in which dividends, not deductible from profits, were taxed at the corporate rate, and dividends distributed to shareholders were taxed at the marginal PIT rate of the recipient.
- Universal transfers were criticised for not directing payments to those with the greatest need.

The most commonly advocated policy reform was a change in the tax mix to increase the revenue from constant-rate consumption taxes and lower marginal tax rates (MTRs) on personal income, particularly for high earners. The Labor government's draft white paper of 1985 advocated a 12.5 per cent broad-based consumption tax (BBCT) with compensation for low earners, and cuts in PIT accompanied by the introduction of fringe-benefits tax (FBT) and capital-gains taxation (CGT) (Australia 1985). The BBCT was rejected at the tax summit of 1985, but PIT rate reductions and base-broadening were implemented. MTRs were reduced slightly at lower income levels, but the largest reduction occurred in the top income band (60 per cent to 49 per cent). FBT was imposed at the highest marginal rate and was levied on employers. Real capital gains were taxed at marginal PIT rates.

In 1991 the Liberal–National opposition proposed the *Fightback!* tax reform (Hewson and Fischer 1991), in which a major PIT reduction was financed by a constant-rate goods and services tax (GST). Largely because of its adverse distributional impact, the proposal was rejected and the Labor government was returned at the 1993 election. The Coalition government took a modified *Fightback!* reform to the 1998 election and this was implemented in 2000. A 10 per cent GST was introduced, with Senate amendments excluding most food. Other significant items receiving special tax treatment were financial services, and education and medical expenses. Large income-tax cuts were focused on higher earners, and increased income-tested family assistance predominantly benefited single-earner families.

Reform of the transfer system is linked to PIT reform. A major change has involved switching from a system of universal family payments to one highly targeted on household income. This effectively has moved the tax-transfer system towards joint taxation. Explicit proposals to switch PIT from an individual to joint income base had always been rejected in Australia, and subsequent proposals have focused on family payments. In 1983 a new joint-income-tested payment to working families, the Family Income Supplement (FIS), was introduced. In 1986 the Family Allowance (FA) was income-tested. In 1987, FIS payment levels were increased and eligibility extended to non-working families; FIS became FAS, the Family Allowance Supplement. In 2000, FA and FAS were combined into a single family-income-tested payment called Family Tax Benefit Part A.

The classical system of corporate taxation was replaced in 1986 by full imputation, and the rate of tax was raised to match the highest PIT rate. Resident shareholders receive a credit in PIT for the corporate tax previously paid on company profits. Distributed profits are taxed at the shareholder's MTR. The company tax rate subsequently fell.

This survey provides an opportunity to review contemporary research about taxation in Australia over this twenty-year period. We examine research in a number of areas. In each area we first summarise the major results of the modern tax literature. Section one examines consumption and income taxes and tax-transfer interactions, and section two the tax mix. In the third section we focus on the treatment of savings and property taxes, including housing. Section four surveys the Australian literature on tax evasion, and section five discusses corporate taxation.

Commodity taxation, income taxation and tax mix

Consumption-tax theory

Ramsey (1927) provided the first formal solution to the optimal indirect-tax problem for an economy of identical individuals: minimising efficiency cost requires higher tax rates on goods with relatively lower (compensated) demand elasticities (Ramsey's inverse elasticity rule). An efficient set of taxes requires equiproportionate quantity reductions, *not* equiproportional price increases. This result was largely overlooked until Diamond and Mirrlees (1971a, 1971b), in the first papers of the modern tax literature, extended the analysis to address both equity and efficiency: optimal commodity taxes should cause lower proportional reductions in demand for goods consumed by those in the lower tail of the welfare distribution. A variety of empirical analyses found considerable variation in optimal tax rates across commodities, with low and sometimes negative rates on strong necessities such as food and fuel.

Australian research on consumption taxation

Several papers argue that the WST fails on equity, efficiency and simplicity grounds, and propose a switch to a constant-rate BBCT and away from PIT (Groenewegen 1984; Bascand 1989; Chisholm, Freebairn and Porter 1990). The arguments rely on the simple rules of the earlier tax literature, especially the claimed efficiency gains. Efficiency claims for constant-rate consumption taxes are criticised with reference to the modern tax literature (Jones and Savage 1989; Creedy 1993).

The claimed employment and efficiency advantages of a constant-rate GST are examined in Freebairn (1993), who compares it to a revenue-neutral proportional payroll tax. He finds the taxes equivalent in all respects, concluding that there is no theoretical justification for replacing the payroll tax with a GST.

Chisholm (1993) calculates efficiency effects of a number of indirect tax changes, assuming an economy of identical individuals. He uses a partial equilibrium Harberger approach and adopts a restrictive preference specification. He advocates a BBCT despite deriving efficiency gains from the variable-rate, indirect tax system he claims as optimal, arguing that a variable rate would be administratively complex.

Dixon and Rimmer (1999) use a dynamic computable general equilibrium model to analyse aggregate effects of changes in indirect taxes. They find that any short-run employment gains of a GST depend critically on the wage response; and that the long-run welfare effects are likely to be negative.

A number of papers examine the distributional merits of a WST–GST substitution. Kakwani (1983) estimates the degree of progressivity of expenditure items and suggests that variation within tax categories in the WST warrants more tax rates. Warren (1986) compares the progressivity of a number of BBCT bases and finds little equity merit in exemptions except for food. Plumb (1994) estimates income elasticities of broad classes of expenditure using the 1989 *Household Expenditure Survey* (HES) and calculates distributional characteristics. Assuming fixed labour supply, he finds that the optimal set of tax rates tends towards the existing WST rates as aversion to inequality increases. Notable departures are private-education fees, which the WST undertaxes, and household supplies and services, which it overtaxes.

Creedy (1993) uses the 1984 HES to investigate inequality in tax regimes with varying exemptions. The largest redistributive effect arises from a food exemption, but he concludes that indirect taxation is a blunt redistributive instrument. Using hypothetical taxpayers, Quiggin (1993) shows that a tax on food is highly regressive. He argues that compensation for a GST is intrinsically difficult and likely to cause poverty traps, and that compensation in the *Fightback!* proposal is inadequate. A similar conclusion is reached by Saunders and Whiteford (1990) in their analysis of the Option C compensation package in the draft white paper of 1985.

Jones and Savage (1989) estimate a model of household behaviour on aggregate data and model equity–efficiency trade-offs from incremental movements in the variable-rate WST towards uniformity, using household data. They find that neither efficiency nor equity is enhanced by the change. Creedy (1999) uses the optimal reform approach of Ahmad and Stern (1984), and finds that equity and efficiency both influence the preferred direction of marginal reforms, with the impact of increasing inequality aversion varying by commodity.

Income-tax theory

The path-breaking paper on optimal income taxation in the modern literature is Mirrlees (1971), using an individual utility-maximising model in which individuals differ in earning capacities and labour supply is variable. Mirrlees and later Stern (1976) test the sensitivity of optimal tax rates to changes in model specification, and show how optimal progressivity increases with inequality aversion and decreases with the elasticity of substitution between consumption and leisure.

In a simple model consisting of two types of individual, rich and poor, Kesselman and Garkinkel (1978) compare universal and targeted transfers, and show that theory alone cannot determine whether an income-tested transfer is more efficient than a universal transfer. Under plausible conditions the universal scheme is more efficient than the income-tested one.

A key paper on the unit for income taxation is Boskin and Sheshinski (1983). In a household-utility-maximising model and with a tax system that allows different tax schedules for husbands and wives, they find that minimising the efficiency cost requires that married women face MTRs between one-third and one-half those of married men at the same income level. This flows from the higher compensated-labour-supply elasticities of second earners in households and is a straightforward application of the Ramsey result. The tax model in Apps and Rees (1988), which treats the household as a small economy of utility-maximising individuals and allows exchange within the household, is extended in Apps and Rees (1999a) to address heterogeneity in household productivity as well as wage rates, and show that there can be equity as well as efficiency gains from progressive individual taxation compared with joint taxation.

Australian research on the PIT rate structure

The current Australian PIT has five MTRs, ranging from 0 to 47 per cent. Prior to changes in the mid-1970s, there were more than twenty bands and there was a top rate of 66.7 per cent (Smith 1993). Over most of its history, PIT's bands have not been indexed, allowing bracket creep and giving governments the opportunity to decide the timing of tax cuts.

Creedy and van de Ven (1999) use a dynamic-cohort lifetime simulation model to examine the redistributive effect of PIT. Income taxation and unemployment benefits contribute most to redistribution both for annual and lifetime incomes, with PIT having ten times the redistributive impact of unemployment benefits over the lifetime. Harding (1993) finds PIT and cash transfers are both progressive on a lifetime basis, but are less progressive than annual studies suggest.

To explore PIT efficiency costs, several studies adopt the Browning (1976) partial-equilibrium, Harberger-type method (Findlay and Jones 1982; Bascand and Porter 1986; Freebairn 1995). Using a small number of representative households and a single labour-supply elasticity, the approach finds relatively large marginal excess burdens, particularly at the higher end of the income distribution. G. Jones (1990) criticises the technique for lack of consistency with utility maximisation, and for applying a single elasticity to aggregate-income bands and to first and second earners within each band.

Apps and Savage (1986) compare the 1985 PIT, which involved MTRs from 0 to 60 per cent, with one raising the same revenue but having a reduced zero-rate threshold and a single 35 per cent rate. The reform shifts the tax burden from single-earner to two-earner couples and has the most adverse effects for those working couples with the lowest wage rates. These distributional effects are concealed when results for one-earner and two-earner families are combined.

Using an applied general equilibrium model incorporating public goods, Piggott and Whalley (1987) show that large tax cuts cause welfare losses because suboptimal public-goods provision outweighs gains from tax cuts. Using the ORANI general equilibrium model, Agrawal, Meagher and Parsell (1990) simulate short-term employment effects of flatter taxes and expenditure reductions. The macroeconomic effects depend upon fiscal and wage-fixing assumptions but the reforms are consistently regressive, with losses for all but the highest income ranges.

Several papers simulate the welfare effects of reforms using an explicit utility-maximising model estimated on individual data. Jones (1990) simulates a flatter tax regime funded by lump-sum taxes and finds modest efficiency gains but social-welfare losses even at low inequality aversions. Savage (1993b) models revenue-neutral reforms to the zero-rate tax threshold and finds social-welfare gains only for reforms that claw back the threshold at higher income levels. G. Jones (1993) focuses on the PIT

changes in *Fightback!*, finding modest efficiency gains if revenue losses are ignored. If revenue neutrality is enforced, efficiency falls and inequality rises, and social welfare is lower at all inequality aversions.

There has been interest in the removal of PIT deductions motivated by perceived inequity between taxpayers and with the aim of simplifying PIT to reduce compliance costs. In a study of work-related PIT deductions, Baldry (1994b) finds that half the growth between 1978 and 1991 is due to superannuation deductions. He argues that, because of their arbitrary nature, all work-related deductions be removed. The total compliance costs of personal income taxation in Australia in 1986–87 were estimated to be between 7.9 and 10.8 per cent of revenue (Pope and Fayle 1990).

Tax-transfer interactions and the tax unit

The interaction of PIT and income-tested transfers causes high effective MTRs (EMTRs), work disincentives and poverty traps. EMTRs are frequently over 70 per cent, and sometimes over 100 per cent, and the highest rates tend to fall on low-income, second earners. Creedy and Disney (1989) provide evidence of savings and work disincentives caused by the interaction of the income and asset tests of the age pension and PIT, reporting EMTRs of up to 80 per cent.

Expanded targeting over the past two decades, particularly of payments to families with children, has increased the number of families facing these high EMTRs, with the impact almost totally confined to families in the lower half of the distribution (Harding and Polette 1995). The third decile of family income is the worst affected, with more than a third having EMTRs exceeding 80 per cent. Dawkins, Beer et al. (1998) argue that full integration of the tax and transfer systems using a pure negative income tax appears not to provide a solution to high MTRs, because an unacceptably high PIT rate is required if social-security recipients are not to be made worse off.

Apps and Savage (1986) show how income-splitting reduces tax rates for single-earner couples and increases them for two-earner couples. The use of household income as the tax base is the source of a fundamental distributional problem because it fails to provide a reliable measure of family living standards. Household income omits household production and therefore is an inadequate base for taxation, for income-testing transfers and for judging distributional impacts. Jones and Savage (1996) simulate a revenue-neutral income-splitting reform taking account of female work disincentives and show that income-splitting increases inequality and inefficiency.

Piggott and Whalley (1996) challenge the claim that, on efficiency grounds, taxing individuals is always preferred to taxing households in a progressive income tax. They use a simple numerical example and a small general equilibrium model that introduces household production. Apps and Rees (1999b) show analytically that this result fails to hold in a more general model of labour supply and household production.

Fringe-benefits and capital-gains taxation

There are limited data to model FBT and CGT. Consequently the Australian research in the area is largely descriptive in nature. Collins (1989) provides a general overview of the FBT. Lloyd and McDonald (1986) apply the irrelevance-of-who-pays principle to refute the argument that the tax should be imposed on employees rather than employers. The advantages and disadvantages of alternative design features of the CGT are discussed in Head (1984) and Swan (1984). Swan argues that an ideal CGT requires full adjustment for inflation, taxation on accrual and full loss offsets combined with a cash-flow-based company tax.

The mix of income and consumption taxation

Theory of optimal tax mix

Atkinson and Stiglitz (1976) show that income tax dominates a combination of income and consumption taxes, if goods and leisure are weakly separable. Without separability and with a fairly inflexible income tax, consumption taxes play a distributional role: if goods consumption and wage rates are related, goods for which high-wage individuals have a relative preference should attract higher rates of tax. Atkinson and Sandmo (1980) introduce time and establish that there is no efficiency rationale for a lower rate of tax on capital rather than labour income. When individuals differ in their endowments, tax rates on labour and capital income should be modified to achieve equity.

Australian research on tax mix

In Australia, research on tax-mix change is largely directed to modelling specific proposals. In a fixed-incidence analysis of a number of tax substitutions, Warren (1990) argues that because of its regressivity a BBCT should not be viewed as a means of flattening marginal PIT rates but solely as a WST replacement. Freebairn explores the use of a GST for general revenue-raising, finding that a tax-mix change brings uncertain net-efficiency gains and has politically contentious redistributive effects, and, if it is to maintain vertical equity, the new PIT rate schedule must be more progressive than the one it replaces (Freebairn 1997, 1999). Creedy and McDonald (1990) argue that unless the PIT threshold is increased, a revenue-neutral tax-mix change will induce wage increases. In an impact analysis of the *Fightback!* tax-mix change, Savage (1993a) shows that, when funding and timing are taken into account, 80 per cent of lower-income and middle-income earners lose, with large gains for those in the top 10 per cent of the income distribution.

Using the ORANI model, Meagher (1986) analyses macroeconomic effects of an Option C-type tax-mix change. In the absence of a fall in post-tax real wages, the change increases inflation, reduces employment, and pushes the balance of trade towards deficit, with larger effects the more the tax cuts are appropriated as increases in post-tax wages. Meagher and Parmenter (1993) use ORANI to model the Option C and *Fightback!* reforms and find similar results.

Savings and retirement

Savings and retirement-income theory

There are two types of retirement-incomes policy: a pay-as-you-go (PAYG) system, where current taxpayers fund benefits for current retirees, and a fully funded (FF) system, where individuals fund their own retirement. FF schemes can achieve intertemporal reallocation for individuals within each generation, but cannot transfer resources between generations.

In a simple overlapping-generations model, where each individual within a generation is identical, transfers between generations may be necessary to promote efficient resource-allocation by adjusting intertemporal consumption and savings to the required growth rate. This maximises the sustainable level of individual lifetime utility across generations (Samuelson 1975). Optimal retirement-incomes policy must involve PAYG to some extent.

Australian research on savings and retirement

Atkinson, Creedy and Knox (1995) analyse investment incentives for superannuation and non-superannuation savings on retirement. The optimal decision depends on: the valuation criterion, the level of benefits, the individual's income level, the means test, the tax rates on income and superannuation benefits, and the person's life expectancy, as well as lifetime earnings and post-retirement rates of mortality. Atkinson, Creedy and Knox (1996) compare lifetime redistribution and progressivity of occupational superannuation against a means-tested age pension (the government strategy) with a universal pension and a corresponding smaller role for occupational superannuation (Institute of Actuaries' strategy). In terms of lifetime inequality and progressivity, they find little difference between the two.

Bateman and Piggott (1992) examine the complex interactions between the tax system, the social-welfare system and superannuation provisions. They conclude that superannuation reforms have reduced various dimensions of risk facing retirees. In contrast to most countries, where retirement benefits from pension saving must be taken as an annuity, Australia allows lump-sum benefits but has tax incentives encouraging annuities. Bateman, Kingston and Piggott (1993) conclude that the incentives are ineffective because they are nullified by provisions of the broader tax and social-security framework. Fitzgerald and Harper (1993) also examine the impact of government sponsorship of superannuation saving, and conclude that any impact on overall savings will be small because increases in private savings are, at least, offset by reductions in public savings caused by tax concessions to superannuation.

On the assumption that the 'best' pension tax is to tax benefits under PIT, Doyle, Kingston and Piggott (1999) propose a 'withholding tax' arrangement that has a similar incidence to a benefit tax and addresses cash-flow concerns of the revenue authorities. Simulations show that equity across contributors in different wage bands is broadly maintained by the policy.

Apps (1991) simulates the effects of alternative tax reforms in an ageing population, taking account of changes in the child-dependency ratio as well as the aged-dependency ratio. She shows that there will be no fiscal crisis associated with ageing, provided government policy does not discourage the labour supply of second earners through high EMTRs. The result takes account of the fall in demand for domestic childcare and consequent rise in wives' labour-force attachments and tax contributions, associated with demographic change.

Research on the tax treatment of housing

The current Australian tax system does not tax imputed rent, nor does it allow mortgage interest deductibility or tax the capital gains of owner-occupiers. It is often said to favour owner-occupied housing over business investments, and high-income, low-debt households over others.

Taxation of net imputed rent from owner-occupied housing and the deductibility of mortgage interest payments have been advocated in Australia on grounds of efficiency and equity. Anstie, Findlay and Harper (1983) set up a model of tenure choice and show that the mortgage interest-rate ceiling, removed following recommendations of the Campbell Report in 1981 and Martin Report in 1984, does not remove the distributional bias in the housing market in favour of the wealthy without the introduction of an imputed rent tax. Albon, Findlay and Piggott (1984) consider tax breaks on owner-occupier equity and debt, and argue that removal of the mortgage interest-rate ceiling may not result in a welfare gain without indexation of the income-tax base, and that the taxation of imputed rent would have to be accompanied by the deductibility of interest payments. Bourassa and Hendershott (1994) also support imputed-rent taxation and deductibility of interest based on an analysis assuming perfect capital markets.

In contrast, Yates (1982) finds that taxing imputed rent would have adverse distributional effects and make the tax system less progressive. Apps (1992) also rejects these policies as inefficient and inequitable, in an analysis that takes account of capital-market constraints and recognises that housing is a strong necessity and wealthy households tend to be highly geared.

Tax minimisation

Literature on evasion

Key variables in models of tax evasion are the penalty, the probability of audit and the rate of tax. Allingham and Sandmo (1972) show that increasing the probability of audit and the penalty decreases evasion, but the effect of changing the tax rate is ambiguous. Evasion increases with the tax rate if absolute risk aversion increases with income. These results run counter to the conventional wisdom that reducing tax rates will decrease evasion and that evasion will increase with income. The results are also sensitive to the penalty function. If the penalty is not a simple proportion of the amount evaded, the effect of the tax rate on evasion is ambiguous, even with decreasing absolute risk aversion. The optimal penalty rate should be greater or equal to the odds of *not* being audited times the tax rate.

Research on avoidance and evasion

The view that a significant proportion of the population evade their tax liability was part of the justification for base-broadening via FBT and CGT, as well as the expansion of consumption taxes. An overview of the theoretical literature on avoidance and evasion and a pessimistic evaluation of empirical research internationally and in Australia are presented in Baldry (1994a). Groenewegen (1984) argues that a shift from direct to indirect taxation reduces tax evasion. This argument is disputed in Head (1985) and Warren (1990). Kesselman (1993) constructs a theoretical general equilibrium model and calibrates it to Australian data to show that a tax-mix shift does not reduce evasion.

Wickerson (1994) provides a discussion of approaches to quantifying the extent of tax evasion and some estimates for Australia. Hepburn (1992) provides estimates of the size of the cash economy in Australia over the period from 1950–51 to 1989–90 and uses this to estimate income-tax revenue losses and to examine the factors that influence the incentive to evade income tax. He concludes that the cash economy has grown rapidly to approximately 8 per cent of GDP in 1990, with implied tax-revenue losses of approximately $6 billion.

Corporate taxation

The literature on corporate taxation

In a competitive model, input taxes are not optimal. Consequently the literature on corporate taxation examines the effects of taxation on the financial choices of firms. The interaction of PIT and corporate tax affects the cost of capital to the firm, and may influence investment behaviour and the mix of debt and equity. In a certain world without taxes, the value of the firm does not depend on the mix of debt and equity. With a classical corporate tax system, firms use only debt financing because debt is deductible but the interaction with PIT can reverse this, depending on the corporate tax rate and MTRs applying to dividends and capital gains (Stiglitz 1973). King (1977) examines the large variation by industry of effective corporate profits tax rates arising from deduction and subsidy provisions. Another stream of the literature regards the corporate profits tax as a tax on the supply of capital to the corporate sector and analyses incidence in the general equilibrium framework pioneered by Harberger (1962).

Australian research on corporate taxation

Hawtrey (1993) provides a survey of the taxation of financial transactions in Australia. In an Australian application of the Ramsey result, Tran and Reece (1989) estimate direct and cross-price elasticities for a model of ten financial assets and derive optimal tax rates for these transactions from 1967–68 to 1984–85. Diewert and Lawrence (1998) calculate dynamic deadweight losses for capital taxes in Australia, based on an econometric model of the production sector, and suggest that reforms since the mid-1980s have fallen relatively heavily on capital and that the excess burden of capital taxation has increased markedly.

Most of the remaining research focuses on the move from the classical system of corporate taxation to full imputation. Swan (1983) investigates the tax advantages to investors of retained versus distributed profits caused by the non-taxation of capital gains and the classical system of corporate taxation. He advocates integrating the corporate tax and PIT, arguing that it would be more equitable and more efficient. Officer (1990) describes the form of imputation introduced in Australia and discusses potential effects on dividends, financing and investment policy, depending upon the residency of shareholders.

Using the King–Fullerton method, the effects of a move to imputation on effective rates of tax on saving and investment options are examined by Freebairn (1988), Mayo (1989) and R. Jones (1993). Benge presents a model of an optimising firm and examines the effects of full imputation combined with CGT provisions, and presents numerical estimates of costs of capital under Australian depreciation provisions (Benge 1997, 1998).

Looking ahead

Contrary to the common perception that we are highly taxed, Australia's tax–GDP ratio is one of the four lowest among OECD countries. But more important than the average level is the profile of tax burdens across different groups. Prior to the 1980s, Australia combined a highly progressive individual income-tax system with universal family allowances. Although the excessive use of tax minimisation schemes created an urgent need to reform the tax system, appropriate changes have never been at the centre of the tax-reform agenda, and promised reforms to the taxation of trusts have been abandoned. Instead the focus has been on increasing consumption taxes, reducing the progressivity of income tax, and switching to a highly targeted family-benefit system. The tax burden has shifted towards lower-income groups. The increased use of family income as the basis for phasing out benefits has moved the system away from its individual basis, increasing the tax burden on low and middle earners, particularly second earners in families.

Current debate suggests that future changes will involve more of the same. A wage–tax trade-off has been proposed as a means of reducing unemployment. The proposal (Dawkins, Lambert et al. 2000) involves a fall in pre-tax real wages for the low paid, compensated by an Earned Income Tax Credit (EITC) – a crucial feature being its withdrawal on the basis of family income. The effect is to extend targeting further across the income distribution, shifting the cost of welfare support for a growing group of working poor to families on low to middle incomes. In the US the EITC has been effective in increasing participation for low-wage sole parents. For married couples, however, the effect has been to increase work disincentives (Eissa and Hoynes 1999). Adverse effects on work disincentives for second earners would be more pronounced in Australia because the income-tax unit is the individual rather than the family.

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The Cambridge Handbook of Social Sciences in Australia

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CAMBRIDGE
UNIVERSITY PRESS

PUBLISHED BY THE PRESS SYNDICATE OF THE UNIVERSITY OF CAMBRIDGE
The Pitt Building, Trumpington Street, Cambridge, United Kingdom

CAMBRIDGE UNIVERSITY PRESS
The Edinburgh Building, Cambridge CB2 2RU, UK
40 West 20th Street, New York, NY 10011–4211, USA
477 Williamstown Road, Port Melbourne, VIC 3207, Australia
Ruiz de Alarcón 13, 28014 Madrid, Spain
Dock House, The Waterfront, Cape Town 8001, South Africa

http://www.cambridge.org

First published 2003

Printed in Australia by Ligare Pty Ltd

Typeface Joanna (*Monotype*) 10.5/13 pt. *System* QuarkXPress® [PK]

A catalogue record for this book is available from the British Library

National Library of Australia Cataloguing in Publication data
The Cambridge handbook of the social sciences in Australia.
Bibliography.
Includes index.
ISBN 0 521 82216 5.
1. Social sciences – Australia. I. Hassan, Riaz.
II. McAllister, Ian, 1950– . III. Dowrick, Steve.
IV. Title: Handbook of the social sciences in Australia.
300.994

ISBN 0 521 82216 5 hardback

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Preface and Acknowledgements

As the title makes clear, this is a book that examines the current state of social-science research about Australia. The aim of the book is to provide a comprehensive summary and evaluation of what we know about Australian society at the beginning of the twenty-first century. Most contemporary works dealing with the social sciences take an explicitly international perspective: for example, world summaries can be found in the *World Social Science Report* (UNESCO, 1999), the *Handbook of Social Science Research*, by Gary Bouma and G.B.J. Atkinson (Oxford, 1996), and the *Social Science Encyclopedia*, by Adam Kuper and Jessica Kuper (Routledge, 1989). Particular studies dealing with individual disciplines have also generally followed this international emphasis. Why, then, a book that examines Australia only?

While Australian social science – like that of its overseas counterparts of similar size – has been derivative of the international social sciences, the past half century has seen the emergence of a more independent, innovative research culture with specific contributions to make. In many important respects, this distinct contribution has been lost or ignored in international works of social-science scholarship, and often only those contributions by Australians that address international problems have warranted attention. Yet Australia has maintained a social-science research culture for at least as long as its international counterparts, with a research council being formed during World War II and a research-only faculty immediately afterwards. After the natural scientists, social scientists are the largest group of scholars working in Australian universities.

A second reason for examining social-science research about Australia is the international contribution social science has made in dealing with distinctively Australian problems. The relative newness of the country, the comparatively small size of the political and governmental elites, and a longstanding tradition of constructive interchange with government at all levels on matters of policy have all combined to make Australian social scientists more influential at a practical and policy level than many of their counterparts overseas. Distinctive Australian contributions, stemming from the analysis of local conditions and problems, have been particularly innovative. For example, Australia's academic contributions to social welfare, to the study of immigration and ethnicity, and to the design of electoral systems have all stemmed from our distinctive local conditions, and from a readiness on the part of government and the bureaucracy to formulate policy based on the results of this research.

Any overview of an area as diverse and complex as the social sciences is necessarily likely to be selective. When the overview is based on the social sciences within a single country, the selectivity is likely to be even more marked. The chapters that constitute this *Handbook* contain many insights and observations, but many other works are necessarily excluded, either because of space limitations or because of the structure of the chapters. We combine the contributions around the three core social sciences – economics, political science and sociology – and the introduction discusses why we have

followed this tripartite distinction. But throughout the *Handbook*, we treat these three fields as generic; each incorporates much overlap, between each of them, and also with other areas of scholarly research.

An intellectual endeavour as large and complex as the *Handbook* incurs many intellectual debts. First and foremost, we are grateful to Peter Debus, from Cambridge University Press, who offered both encouragement and patience as the project took shape. We are also grateful to three anonymous referees for the original proposal, who all provided important insights and constructive comments that were invaluable at the planning stage. Kate Hoffmann assisted in the preparation of the sociology section of the book. Most obviously, we are grateful to the forty-five contributors who provided the entries contained herein.

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