The Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

8 March 2011

Dear Sir

SUBMISSION TO SENATE FLOOD LEVY INQUIRY

Please find attached a brief submission for consideration by the Senate Economics Committee on the issue of the proposed 2011-12 flood levy.

Sincerely,

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SUBMISSION TO SENATE FLOOD LEVY INQUIRY

I submit the following brief points for consideration.

- This proposed levy, estimated to raise $1.8 billion in 2011-12, is effectively a temporary income tax increase, and therefore represents a further tinkering of the federal income tax system.

- Although the expected additional revenue will not be large in the context of projected total Commonwealth revenue of $356.4 billion for 2011-12, it has significant implications in the context of the tax reform debate.

- By effectively raising marginal income tax rates for a large proportion of the workforce, this levy runs counter to Recommendation 2 of the Henry Tax Review, which proposed a constant marginal tax rate be introduced, combined with a high tax-free income threshold, to provide greater transparency and simplicity to Australia's tax system.

- High marginal tax rates limit productivity growth by adversely affecting work incentives, risk taking and skills acquisition, and cause resources to be wasted in pursuit of income tax minimisation.

- There are two main alternatives to the flood levy in 2011-12:
  (i) cut unproductive public outlays, or
  (ii) not take any explicit fiscal policy action, and thereby allow the 2011-12 federal budget deficit to increase by a further $1.8 billion.

- Of the above, both options (i) and (ii) are preferable to imposing a temporary marginal income tax increase under the name of a Flood Levy. Cutting public expenditure, particularly on industry assistance, is in turn preferable to allowing the budget to slip further into deficit.

- It should not be difficult to identify public expenditure cuts in a federal budget which has projected outlays of $364.6 billion in 2011-12.

- An increased budget deficit arising from additional public spending on infrastructure repair work will, other things being equal, raise Australia's public debt by the same amount.

- Higher public debt can become a net drain on national income, except when the higher public debt is matched by capital assets that are at least as productive as the cost of their public funding. Not all expenditure on flood damage repair is likely to meet this test. Hence, although both are preferable to the Flood Levy, on balance, option (i) above is preferable to option (ii).

Tony Makin
March 2011