Not surprisingly, I support strongly the points made by Professor Harcourt in his email to you of Wednesday 28th September. However, the main purpose of this email is to comment on statements made by two participants, Dr. Robert Carling and Professor Neil Warren. My comments relate to personal tax, transfer payments, business tax and state taxes.

Dr. Carling argues that his proposed program of reforms "could only be phased in over a long period, consistent with maintaining fiscal sustainability. The fact that it could not be implemented fully in the near future should not be an obstacle to adopting it as a long-term goal. In this long-term context, an important part of the financing of reform would need to come from a much lower rate of growth in real government outlays than the historical trend rate of growth".

I disagree strongly with his belief that financing the reforms would require a much lower rate of growth in real government outlays. Financing the reforms depends on growth in productivity. The division of expenditure between the public and private sectors is not relevant to productivity growth. The key question is what the expenditure in the public and private sectors is used to achieve. There is no reason why public sector expenditure should not be self-financing if it is spent for appropriate purposes. A strong case can be made for borrowing in order to finance improvements in physical and human capital and especially for "borrowing" from the Reserve Bank. This will increase the productivity of the economy and raise living standards. Hence it will also increase the capacity to pay taxes, and hence the ability to reduce the public debt if that is thought desirable.

How important is it to pay off the public debt or at least to prevent it from rising? In the case of Australia not at all. A large public debt can, in certain circumstances, limit government policy options, but this not a relevant consideration in Australia. A brief quotation from an article published earlier this year makes this point clear.

"Apart from that of Luxemburg, Australian public debt is the lowest in the OECD. In 2008 it was less than 10 per cent of GDP, or total production. Compare this, for example, with the case of Canada, another Western country where commodity exports are a high proportion of total exports. In Canada the ratio of public debt to GDP was 60 per cent in 2008. Because Australia has such a low level of public debt, it has more ability than the large majority of Western economies to use deficit financing to fund desirable educational and physical infrastructure with no need ever to pay back any borrowing involved, though this may be desirable to reduce aggregate demand in a situation of overfull employment. Not only are the claims that this will place a burden on future generations false, but exactly the opposite is true. If the federal government finances desirable infrastructure from taxation, this puts a burden on the present generation who will be paying now to finance completely expenditure which will benefit future generations. Moreover, expenditure on improvements in physical and human capital will increase the future productivity of workers employed as a result by maintaining or even increasing their skills. It will also reduce the numbers of unemployed. Both these things will increase the productivity of the economy and raise living standards. The consequent increase in GDP will raise taxation revenue even if rates remain unchanged, and hence the ability to reduce the public debt if that is thought desirable." (Nevile, J.W. and Kriesler, P. (2011) 'Why Keynesian policy was more successful in the fifties and sixties than in the last 20 years' *Economic and Labour Relations Review*. 21(1), 2011, pp13-14.)

My second comment is on the submission by Professor Neil Warren. I agree with the points he makes but there is an important point with respect to the division of taxes between the state and federal governments. It is highly desirable that the federal government keeps for itself income taxes and that the states are given indirect taxes which are indirect taxes not sensitive to the level of economic activity. The basic argument is that because of the much more limited ability of the states to finance deficits, state taxes on income will prevent automatic stabilisers from working effectively.

However, there are other more subtle elements involved which are set out in Nevile J.W. (1974) "A Theory of Fiscal Decentralization" in R.L. Mathews (ed.), *Intergovernmental Relations in Australia*, Angus and Robertson, Sydney, pp121-130.

Yours sincerely

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