

Taxing Times: A Political Retrospective

Richard Eccleston*

Two years after the introduction of the goods and services tax (GST) in Australia it is perhaps timely to reflect on the broader political significance of Australia's recent experience in relation to tax reform. The goal here is not to comment on the effectiveness of the new regime, but to provide an assessment of what the Australian experience tells us about the tax policy process and the broader issue of the governance of Australian economic policy. Can we interpret the eventual introduction of a GST after thirty years of struggle as a maturing of Australian politics? Alternatively, are the deadlocks and protracted political debates experienced in relation to tax reform in recent years likely to persist as future governments attempt to adapt the national tax base to the challenges of the 21st Century? The following article will shed light on these issues by applying the political science literature to identify the characteristics of the policy process which are likely to enable national governments to achieve potentially contentious tax reform proposals. Having established this framework, the study evaluates Australia's experience in relation to tax reform over the past thirty years. While the article notes several important developments between the Asprey Inquiry of the mid-1970s and the introduction of the Howard Government's A new tax system in 2000, it is argued that a combination of historical and institutional features of the Australian policy environment continue to limit the governance capacity of the Australian state. The article concludes by discussing the implications of this finding for the ongoing reform of Australia's taxation system.

* Dr Richard Eccleston is a lecturer in the School of Politics and Public Policy at Griffith University. This article was accepted for publication 27 November 2002.

The politics of tax reform: an overview

In few countries have the tensions between the need for tax reform and the political challenges associated with it been more apparent than in Australia in recent years. Indeed, the problems experienced in relation to restructuring Australia's revenue base led Prime Minister John Howard to describe tax reform as 'the greatest single piece of unfinished economic reform business on the Australian national agenda'.¹ While the political difficulties experienced in relation to achieving tax reform have been especially acute in Australia, this experience is by no means unique, with similar obstacles being encountered in a number of other countries.² At a more general level, the taxation policy literature identifies two sources of political resistance that governments are likely to encounter when embarking upon a reform agenda which involves broadening the tax base and reducing tax expenditures with a view to improving the neutrality of the tax system as a whole.

Firstly, attempts to remove historically entrenched tax concessions require governments to rise above politically powerful sectional interests in the taxation policy arena. Secondly, while broadening the national tax base should improve revenue yield and reduce economic distortions caused by taxation, such 'benefits' tend to be society wide and accrue over the medium term, while new forms of taxation associated with such reforms have an immediate effect on the economic welfare of voters.³ Indeed, these specific features of the policy environment have led researchers to describe tax reform as 'perhaps the most difficult exercise in public policy in a democratic context'.⁴

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1. Short (1997).
 2. There was a significant political backlash to the introduction of GST-style taxes in Canada, Japan and New Zealand and a similar response to the Thatcher Government's Poll Tax in the United Kingdom in the 1980s. For a summary of these experiences refer to Blount (2001).
 3. Paralleling the resurgence of neo-liberal approaches to economic policy more generally, over the past two decades there has been a growing consensus among policy experts that national tax systems ought to be as neutral as possible in their economic impact. However, it is also important to acknowledge that the underlying rationale of taxation is a normative question. While this article describes the objective of broadening Australia's national revenue base as 'tax reform', the article does not embark on a normative justification of the merits or otherwise of this policy agenda.
 4. Radaelli, (1997) p.58.

Despite these inherent difficulties associated with achieving tax reform, comparative studies demonstrate that some governments have been more successful than others in winning support for and consolidating tax reform proposals. Explaining why some countries have been quite successful in restructuring their revenue base while others, such as Australia, have been relative laggards, has led political scientists to link the successful consolidation of tax reform to what Katzenstein has described as *state capacity*, or the state's ability to achieve political objectives in the face of societal resistance.⁵ In short, governments which possess a degree of autonomy and authority relative to societal actors will be more likely to pursue and successfully consolidate comprehensive tax reform.

Given the multiple determinants of political power it should come as little surprise that the literature identifies a number of factors that influence state capacity. However, given the Australian experience in relation to taxation policy over the past three decades it is useful to concentrate on two determinants of state strength. Firstly, the institutional attributes of the policy environment seem to have had an enduring influence on the contours of Australian taxation policy. More specifically, given our interest in state capacity, there will be an emphasis on assessing the institutional basis of decision making authority in terms of the fragmentation of power within the state. Some of the characteristics of the Australian policy environment which limit the ability of policy makers to create and implement economic policy include: the number of competing political jurisdictions in a polity and the constitutional provisions for defining their respective political powers; the extent to which the bureaucracy is concentrated or fragmented; whether the electoral system allows one party to dominate politics providing incentives for particular party systems to evolve; and finally, the organisation of the executive and its relationship with the bureaucracy and the legislature.⁶

While there are no accounts that explain Australian tax policy in such institutional terms, the merit of this approach is illustrated in

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5. The concept of state capacity was outlined in Katzenstein (1977). Studies which explain the broad characteristics of national tax systems in terms of state power include; Steinmo (1989, 1993); Martin (1989, 1991); Zelizer (1998); Sandford (2000); Eccleston (2001).
 6. Weaver. & Rockman (1993); Ikenberry *et al* (1989).

Steinmo's comparative study of taxation in The United Kingdom, The United States and Sweden.⁷ Steinmo confirms that differences in the institutional structure of decision making authority can explain variation in the tax regimes within each of these countries. His central claim is that the coherence and efficiency of a tax regime is related to the state's institutional authority, which itself is a key determinant of state capacity. For example, the political stability and negotiated approach to policy making associated with corporatist government in Sweden resulted in an efficient and rational tax system capable of meeting the state's medium term fiscal requirements and policy goals. This is in contrast to the pluralist policy environment of the United States where the state is fragmented and beholden to ever changing coalitions of interest groups resulting in an *ad hoc* tax system featuring numerous anomalies and loopholes.⁸ Overall Steinmo argues that the American state lacks the capacity to implement comprehensive reform, resulting in a more reactive style of taxation policy. While this article contends that such findings are relevant to the Australian case where, like the United States, institutional vulnerability seems to have constrained government attempts to reform the national tax base, there is also compelling evidence that less formal attributes of the policy environment have also hampered reform attempts. In particular the Australian state's inability to foster constructive relationships with key actors in the tax debate and with the broader community has also limited the power of Australian governments to broaden the national tax base. At this level it is important to move beyond a narrow institutional focus and to assess how the *relational capacity* and *social embeddedness* of the Australian state has influenced the trajectory of tax reform.

Relational capacity is the product of consensual policy networks in which state and societal elites can collaborate and engage in the mutually beneficial exchange of political resources.⁹ This process of capacity building through symbiotic state-society interaction is an especially important adjunct to state capacity in the Australian context,

7. Steinmo 1989, 1993.

8. It should be noted that Martin has demonstrated that within the broadly pluralistic policy environment that exists in the United States the state, through forging strategic alliances with key sectors of business, was able to build sufficient capacity to reform the US corporate taxes. Martin (1989). This is consistent with the central contention of this article that relational dynamics are especially important in a pluralistic policy environment.

where the porous nature of formal institutions leaves the state vulnerable to veto coalitions opposing the state's reform objectives. Beyond the importance of reform orientated networks, the case at hand, where there has been a gradual increase in community acceptance of tax reform, demands that we assess the effect of changing state-society relations on social learning and public opinion. This is where the concept of social embeddedness, or 'the capacity of the state to actually penetrate civil society and to implement political decisions through the realm' becomes central.¹⁰ The claim here is that state actors can bolster their capacity through cultivating a political environment in which the interests of key state and societal actors coincide. Given this literature and its emphasis on how reform orientated works can enhance both the state's relational capacity as well as promoting broader electoral support (and hence social embeddedness) for tax reform, it becomes necessary to evaluate both the impact of institutional dynamics and state-society relations on the contours Australian taxation policy. These analytical themes inform both the empirical account of the Australian tax reform experience below and the analysis in the final section of the article.

The Australian Experience

In stark contrast to the policy stability of the post-war period, the rapidly changing economic circumstances of the 1970s prompted renewed political debate relating to taxation reform. The fact that accelerating inflation left pay-as-you-earn (PAYE) taxpayers shouldering greater real taxation burdens, while at the same time unprecedented numbers of Australians were engaging in tax evasion and avoidance, led economists, politicians and the majority of taxpayers alike to question the efficiency and fairness of the Australian taxation system. Reinforcing this domestic discontent with the taxation *status quo* were international developments. The diffusion of ideas from high profile

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9. The term *relational capacity* is borrowed from Bell (2002), while Hobson (2000, 207) describes the phenomena as *governing capacity* or *domestic agential state power* and Weiss (1998) uses the term *governed interdependence*. While the concept of *relational capacity* is similar to Peter Evans' notion of *embedded autonomy* it is broader in that it not only refers to state interaction with business interests, but all groups in civil society who wield political power (Evans 1995; Hobson 2000; Seabrook 2001).
 10. Mann (1987) p.5; Mann (1993), p.55; Hobson (2000) p.198; Seabrook (2001).

taxation reviews overseas contributed to a consensus among Australia policy makers that reform should attempt to improve the neutrality and efficiency of national tax systems through a systematic broadening of the tax.¹¹

By 1972, these developments prompted the McMahon Government to commission the first comprehensive review of the taxation system since 1934.¹² In a strategy designed as a political circuit breaker,¹³ the Taxation Review Committee under the chairmanship of Justice Asprey was appointed to provide purposeful recommendations in relation to tax reform (Wallace 1975, 564). The central recommendation proposed by the Asprey Committee in May 1975 was to increase consumption tax yield through the introduction of a GST (Asprey 1975). In addition to this shift in the tax mix, the Inquiry also argued that personal income tax rates could be reduced further if the direct tax base was also broadened through the introduction of a Capital Gains Tax (CGT).¹⁴

While these proposals formed the nucleus of the tax reform agenda that dominated Australian politics for nearly a quarter of a century, at the time they failed to win the support of either of the major political parties, leading stakeholders or the broader electorate. This was partly because the Asprey Inquiry was dominated by the Commonwealth Treasury, which managed to perpetuate its historical dominance of Australian economic policy making. Institutionally this autocratic approach and the propensity to advise the executive with an 'almost doctrinal force and persuasiveness' frequently left governments advocating technocratic and unpopular policy proposals.¹⁵ Secondly, the

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11. Domestic policy experts were well aware of comprehensive taxation reviews that had recently been conducted in Canada in 1966, New Zealand in 1967 and the United Kingdom in 1971. Refer to: Taxation Review Committee (1967); *Taxation in New Zealand: Report of the Taxation Review Committee*. and the *Draft White Paper: Reform of Personal Direct Taxation*. (1971).
 12. The Taxation Review Committee (1972-1975) is referred to as the Asprey Committee (after the Committee's chairman, Justice Kenneth Asprey) both within the literature and this article (Asprey 1975).
 13. Groenewegen (1985) pp.137-138.
 14. Secondary recommendations included the introduction of the partial imputation of company tax and the integration of Federal and State death and gift duties. Groenewegen (1982) pp.26-27; Groenewegen, (1974); Wallace (1975); Prest (1975); Norman (1976) & Thomson (1976).
 15. Royal Commission on Australian Government Administration (1976) as quoted in Bell (1997) pp.33-34.

Committee's deliberations were complicated by the lack of consensus among the hundreds of interest groups who made submissions to the review.¹⁶ Business groups were the worst culprits owing to the differential impact of the proposed changes on various firms and industrial sectors. When this inherent fragmentation was combined with a parochial business culture and the lack of effective associational structures in the 1970s,¹⁷ it is perhaps unsurprising that the Asprey Inquiry failed to strike a popular chord. The final and perhaps most significant reason why the Asprey agenda fell on deaf ears was the fact that by 1975 the Australian economy was in the midst of an inflationary crisis which reshaped the economic policy environment.

By November 1974 rising inflation had recast the interests and priorities of voters prompting Prime Minister Whitlam to appoint a specialist committee to investigate the impact of rising prices on the taxation system.¹⁸ The Mathews Inquiry initially made recommendations that income tax scales and rebates be indexed to the rate of inflation, thus holding real taxation burdens constant in times of rising money prices.¹⁹ Significantly, the clarity of the Inquiry's recommendations, combined with widespread political support, enhanced the prospects for their implementation.²⁰ Thus, in terms of state capacity, and unlike the Asprey Inquiry, we can explain the initial implementation of the Mathews' proposals in terms of the business and broader electoral support for these reforms.²¹ While Treasury and sections of the Whitlam Government expressed reservations,²² the Coalition, on the verge of regaining office, was committed to implementing the Inquiry's recommendations, thus eliminating the partisan opposition which is so often a product of Australia's two-party system.

Despite implementing a significant portion of the recommendations of the Mathews Inquiry on gaining office, overall the Fraser Government failed to consolidate significant reform. The indexation

16. Groenewegen (1980) p.115; Prest (1975) p.576.

17. Eccleston (2000).

18. Mathews (1975).

19. Irwin & Lamble 1975, 2; Thompson 1976, 83; Groenewegen 1980, 121.

20. There was isolated criticism of the technical analysis in the Mathews report. Refer to Swan (1978).

21. ACTU 1974, ACMA 1975.

22. *Australian Financial Review* 27/5/1975.

provisions introduced in the 1976-77 budget were partially abandoned within 12 months and completely removed by April 1981 when 'indexation of the rate scale once again ranked below the political advantage of discretionary tax cuts'.²³ The Fraser Government's reluctance to put tax reform ahead of political expediency was also illustrated by its willingness to offer opportunistic tax cuts, most notably in the 'fist full of dollars' 1977 election campaign.²⁴ Finally, in terms of the GST, which was at the centre of the Asprey recommendations, while a determined Treasury was able to win the support of the then Treasurer John Howard, the Government's reformist resolve soon evaporated in the face of a concerted campaign from the Retail Traders Association.²⁵

Overall, the 1970s witnessed a reactive approach to tax policy. The state, owing to its lack of institutional authority, was largely captive to ever changing political circumstances and electoral pressures. By the early 1980s, after a decade of rhetoric, partial implementation and policy reversals, academic experts and journalists alike wondered if the Australian tax system could be reformed.²⁶ Yet dissatisfaction with the existing taxation regime remained high throughout the decade ensuring reform remained on the national policy agenda, effectively forcing political actors to reflect on the failures of the 1970s and adapt their strategies accordingly.²⁷

In March 1983 Bob Hawke claimed the first of five successive election victories for the federal ALP. During the ensuing 13 years of Labor Government there would be two concerted attempts to win support for comprehensive tax reform. The Hawke Government's second term in office between 1984 and 1987 was dominated by taxation policy. Indeed veteran political commentator, Paul Kelly, described the debate as 'one of the most intense public policy debates in Australian history'.²⁸ During the 1984 election campaign Prime Minister Hawke gave an undertaking to prepare a policy paper on taxation reform which in turn would be discussed at a summit of stakeholders in 1985.²⁹ However, despite this rhetorical commitment to

23. Groenewegen (1985) p.120.

24. Groenewegen (1980) p.136; Abjorensen (1993) p.69.

25. Rechner (1979); Groenewegen (1982) p.14

26. Groenewegen (1985); Smith (1993); Head (1977).

27. CAI (1982).

28. Kelly (1994) p.155.

consultation, the preparation of the Government's policy document, *The Draft White Paper*, like the recommendations of the Taxation Review Committee a decade earlier, was dominated by Treasury and largely overlooked business and community input.³⁰ In the words of the former Minister in the Hawke Government, Graham Richardson:

Paul Keating and his Treasury Colleagues had made up their minds about this a long before the review even started. For twenty years, Treasury had waited for the chance to bring in a consumption tax, and now they had a powerful Treasurer whose success record in cabinet was second to none.³¹

Despite the need to build electoral support for reform through consultation, institutional obstacles remained. Firstly, the bureau responsible for policy formation remained highly concentrated and committed to an autocratic style of policy making unsuited to negotiation and compromise. Secondly, the prospects for collaborative policy making were still limited by the fragmentation of stakeholders generally and of business interests in particular.

Unfortunately for the Hawke Government their proposed reforms, like the recommendations of the Asprey Inquiry, did not enjoy wide community support. Business groups were particularly concerned about broadening the direct tax base to include capital gains and fringe benefits taxes, while Labor's traditional constituents, such as the union movement and the welfare sector, were concerned about the equity implications of introducing a broad based consumption tax.³² The Government's prospects of negotiating a pre-summit compromise were dealt a final blow when the presidents of five of the most significant national business associations released a statement 'expressing considerable alarm at the potential cost impact of the Government's proposals upon the business'.³³ Beyond concerns in relation to the impact of the proposed capital gains and fringe benefit taxes, business

29. *Draft White Paper* (1985) p.2; McCathie (1984).

30. *Business Review Weekly* (7/6/1985); Edwards (1996) p.267.

31. Richardson (1994) p.176.

32. It must be noted that the Hawke Government proposed a 12.5% Retail Sales Tax (or BBCT) on goods and services sold for final consumption, which unlike a Value Added Tax, or GST, does not require an elaborate system for claiming tax credits. Carew (1988) p.119; ACTU (1985) p.30-35; Groenewegen (1985) p.119.

33. *Australian Financial Review* (20/6/1985).

was dissatisfied with the lack of consultation and choice in the Draft White Paper.³⁴

While Prime Minister Hawke pleaded with business leaders to compromise and to 'hold some capacity for the broader view and some tempering of narrower short-term sectional interests' this was in vain.³⁵ The emerging consensus among business was that personal income tax rates should be funded by lower public spending rather than imposing excessive burdens on the business sector.³⁶ Such a proposal was politically and ideologically unacceptable to the Labor Government which opted to broaden the income tax base without consumption tax reform.³⁷ While the Hawke Government achieved an important policy objective in broadening the direct tax base, it had been spectacularly unsuccessful in terms of its main goal of introducing a broad based consumption tax to fund income tax cuts.

In the aftermath of the 1985 Summit the ALP abandoned any ambitions of introducing a GST in order to reduce Australia's relatively high dependence on direct income taxes.³⁸ While the Hawke Government could not move on indirect tax reform, this was not true of the Coalition. After the ascendancy of 'dry' interests within the Coalition, and especially once John Hewson attained the leadership of the Liberal Party, there was renewed political support for the indirect tax reform agenda, this time from the opposition benches.³⁹ Once elected to the leadership of the Liberal Party in 1990 John Hewson held a level of political power which was unprecedented among Australian opposition leaders.⁴⁰ By November 1990 the rapidly deteriorating economy and the growing leadership tensions within the ALP Government contributed to Hewson becoming the first Coalition leader since 1983 to enjoy a higher popularity rating than incumbent Prime Minister Bob Hawke.⁴¹ This position of electoral strength enabled the Opposition Leader to exercise his own autonomous style of

34. Bowden (1985).

35. Singleton (1990) p.161.

36. Kelly (1985).

37. Edwards (1996) p.276-277; Kelly (1994) 171.

38. Although Senator John Button unsuccessfully attempted to persuade the Hawke Cabinet to revisit the GST issue in 1989. Weller (1999) pp.220-222.

39. Kelly (1994).

40. Kelly (1994) p.598.

41. Abjorensen (1993) p.158.

policy making. Believing ‘that Australia was in an economic crisis and that national governments had been too weak for too long’, Hewson made few attempts to build consensus through negotiating with leading stakeholders.⁴² Yet this was a high risk strategy as it overlooked both the institutional limits to state authority in the Australian policy environment and the importance of coalition building to sustain political support.

Despite the fact that by 1993 Australian business was politically more organised and, unlike the 1970s, was willing to support reforms which firms perceived as being in the medium term national interest, the wider community remained sceptical of a GST. In contrast to Hewson’s doctrinaire approach, the Labor Government, facing electoral defeat, adopted more strategic tactics. Given the political backlash against a consumption tax in 1985, the ALP quickly focussed on the Coalition’s GST proposal as a source of political vulnerability.⁴³ Even more opportunistically, the Government went beyond simply opposing the GST, making a commitment to matching the income tax cuts offered by the Coalition.⁴⁴ Beyond this blatant appeal to the hip pocket nerve, the Keating Government also sought to build an effective anti-GST coalition from the interest groups who had successfully opposed the proposal in 1985. The approach comprised both a carefully orchestrated attack on the Opposition from the union movement and a concerted effort to forge less formal network style alliances with the increasing constellation of interest groups alienated by Hewson. This latter group included the welfare sector, the multi-cultural and women’s lobby, indigenous and arts groups, the education sector and the environment lobby.⁴⁵

On Saturday 13th March 1993, the Keating Labor Government was returned to office with a 1.5 percent swing in the nation-wide two-party preferred vote. From a commanding electoral position in mid-1991, John Hewson had lost what was widely regarded as an ‘unloseable election’. Yet the Coalition’s failure to gain sufficient electoral support for their ambitious reform agenda was by no means an automatic outcome. Undoubtably the Keating Government was an important

42. Kelly (1994) p.604.

43. Blewett (1999) p.13.

44. Henderson (1995) p.112.

45. ALP (1992); Wallace (1993).

catalyst, successfully mobilising political opponents of a GST. Thus, it appeared that not only was there latent opposition to the tax in the broader community, but the institutional structure of Australia's two-party system provided incentives for the ALP to abandon its support for a tax which it had advocated in 1985.⁴⁶

While Keating's opportunistic attack on the GST was a short term political triumph, within a matter of months the Labor Government, confronting a recession-induced fiscal crisis, was forced to revoke its commitment to provide income tax cuts without increasing indirect taxes. The prospect of \$16 billion deficit by 1996-97 shocked the Keating Government into increasing Wholesale Sales Taxes (WST) and alcohol, fuel and tobacco excises by 3 billion dollars in the 1993-94 budget.⁴⁷ This about face not only demonstrated that taxation policy can never be completely insulated from the broader economic context, it also prompted key opponents of a GST to reassess their opposition to the controversial tax. Given that the indirect tax increases introduced in the 1993-94 budget were even more regressive in their impact than the GST proposal the Coalition took to the 1993 election,⁴⁸ those who had opposed broadening the indirect tax base on equity grounds reassessed their position.⁴⁹ It had become very clear that either the national tax base would have to be broadened to raise adequate revenue in the new low inflation environment, or expenditure would have to be cut.

By 1996 business groups and the welfare sector had come to the realisation that Australia's antiquated indirect tax base was in need of reform. Beyond this growing recognition of the need for a GST, interest groups also demonstrated an awareness of the political obstacles which stood in the path of reform. In October 1996 the Australian Chamber of Commerce and Industry (ACCI) and the Australian Council of Social Service (ACOSS) jointly hosted a community summit to establish a series of common tax reform objectives.⁵⁰ The summit was successful, with compromises including the concession by welfare groups that a low rate, broad based consumption tax should be a part of a wider tax reform package, and agreement by business the tax

46. Kelly (1994) p.xi.

47. Williams (1997) p.10 & 39; Quiggin, (1998); Edwards (1996) p.522.

48. Quiggin (1998) pp.10-11.

49. Aubin (1999) p.197.

50. ACOSS (1996).

treatment of trusts would have to be tightened to fund a reduction in corporate tax rates.⁵¹ Indeed, a combination of the Keating Government's indirect tax increases after the 1993 election and the welfare lobby's recognition of the need to broaden indirect tax base after 1996 saw broader electoral support for a GST increase from 28 percent at the height of the 1993 election campaign, to 59 percent in May 1997.⁵² Despite this unprecedented interest group activism and the turning tide of public opinion in relation to tax reform, the Howard Government maintained that the political risks were too high, especially following Howard's politically expedient 1995 commitment to 'never ever introduce a GST'.⁵³

Ironically it was political vulnerability rather than authority which saw Howard confront the so called 'thirty year problem'.⁵⁴ Twelve months after a landslide victory, the Prime Minister's electoral fortunes had deteriorated dramatically.⁵⁵ With senior members of the Canberra press gallery asking 'why will he not lead, or for that matter, why will he not even follow?', Howard's approval rating as preferred PM collapsed to a lowly 20 percent.⁵⁶ The reversal in Howard's political fortunes had been dramatic. Howard responded to this crisis in confidence on the 18th of May 1997 by boldly stating that 'you can't have tax reform unless you look at all the options'.⁵⁷ While Howard's leadership was now assured until the 1998 federal election, it remained to be seen whether the Prime Minister could formulate a tax reform package that a majority of Australian's would endorse, thereby avoiding the fate of Keating's and Hewson's tax proposals.

ACOSS, the ACCI and the State Governments (on the proviso that Commonwealth-State financial relations were a central focus of any reforms) 'applauded' the announcement, while predictably, and

51. ACCI President, Graeme Samuel. *Business Sunday* 6/10/1996.

52. Blount (2000); McAllister & Bean (2000).

53. Megalogenis (1999) p.99.

54. Short 1997.

55. This fall from grace was attributed to the Government's failure to publicly repudiate the populist One Nation party, a Ministerial travel entitlements scandal and slow progress on industrial relations and tariff reform undermined both the Prime Minister and his Government. Aubin (1999) pp.218-235; Neighbour (1998); Adams (2000) p.19.

56. Aubin 1999, 216.

57. Aubin 1999, 247; Neighbour 1998.

continuing the tradition of opportunistic partisan politics, the federal ALP leadership responded that 'a GST was unnecessary and would impose a very heavy burden on middle Australia'.⁵⁸ Despite the unprecedented interest group mobilisation and the greater prospects for productive state-society relations, the Coalition's commitment to consultation remained remarkably superficial. In a clear example of how historical practice and state structure influences the prospects for collaborative policy making, the Coalition's reform package was developed by a small task force of senior bureaucrats under the direction of Treasury, 'well out of the public's eye'.⁵⁹

On 13th August 1998, after over a year of public debate and intense speculation, John Howard released the tax reform package that would determine the fate of his Government.⁶⁰ It featured a 10 percent GST with very few exemptions that would raise a projected \$27.2 billion in 2000-01.⁶¹ Perhaps the most unexpected aspect of the package was the proposal to restructure fiscal federalism by allocating all of the GST revenue to the States via the Grants Commission in lieu of their general purpose grants provided that they abolish nine existing State-based indirect taxes.⁶² Compensation for these radical reforms to Australia's indirect tax base took the form of income tax cuts and family tax rebates worth \$14.5 billion, a 4 percent across-the-board increase in social security payments along with other lesser measures.⁶³ So, while the proposal posed political risks in defying the business-welfare

58. Megalogenis & Hawes (1997).

59. The taxation task force was led by Dr Ken Henry of Treasury and included officers from Treasury, Prime Minister and Cabinet, the ATO, Costello's office, and the Cabinet Policy Unit. Government members which liased with task force included John Howard, Peter Costello, John Fahey, Tim Fischer and Robert Hill. Aubin (1999) pp.251-252; Neighbour 1998).

60. ANTS (1998).

61. Exemptions, or products which were to be 'zero rated' included health, education, childcare and local government rates. Goods to be input taxed included residential rents and financial services. The ANTS package proposed a 10% GST on all food and clothing. ANTS (1998) Ch. 2.

62. The fact that GST revenue was expected to grow faster than the combination of Commonwealth grants and indirect State taxes which it replaced, meant that the fiscal imbalance between the States and Commonwealth was forecast to improve by \$2.25 billion by 2005-2006. The package did not fund the abolition of state pay roll taxes for which business groups had long been lobbying. ANTS (1998) p.79.

63. ANTS (1998) p.67; Shanahan & Megalogenis (1998).

consensus not to alter the tax mix in favour of consumption, the Government had heeded some of the welfare sector's demands in terms of broadening the FBT tax base and moving towards the elimination of the use of trusts for tax avoidance.

While the Government claimed that the package would make everyone better off, there was no doubt that the main beneficiaries would be the aspirational middle income earners on which Howard depended for his reelection.⁶⁴ The broader political reaction to this package was relatively predictable. Australian Chamber of Commerce and Industry (ACCI) executive director Mark Patterson commented that 'it is clear that the Government has listened to the concerns of the business community and it has sought to provide a package of reforms that moves away from taxing business inputs', while the welfare lobby were more reserved stating that while they supported tax reform 'there was too little in the package to improve fairness'.⁶⁵ There were certainly no surprises when the ALP, determined to repeat its successful campaign of 1993, described a GST as 'inherently unfair' and 'a tax we do not need'.⁶⁶

While a significant proportion of the electorate remained apprehensive about a GST, the most significant development of the period between 1993 and 1998 was the widespread recognition that the indirect tax base in particular needed to be modernised. Indeed, the most dramatic intervention of the campaign proper was ACOSS's scathing critique of the ALP's alternative package, which did not tackle the politically difficult issue of consumption tax reform.⁶⁷ Michael Raper, ACOSS president argued:

The major flaw in the package is that it fails to comprehensively strengthen the tax system.. ACOSS does not accept Labor's argument that the tax system is not 'broken'. We believe it is in such disrepair that it needs comprehensive rebuilding, not just patching up.⁶⁸

64. Kelly 1998; Quiggin 1998.

65. ACOSS (1998).

66. Broad (2000) p.75; Mcgregor (1998).

67. Warhurst (2000b) p.167.

68. ACOSS (1998).

In the final analysis, the campaign remained tenuously balanced until election day, with John Howard leading the Coalition to a narrow victory, thus gaining a historic mandate for indirect tax reform.⁶⁹ While the GST had been identified as the most significant reason why voters would not support John Hewson in 1993, by the 1998 election a narrow majority of voters preferred the Coalition's stance on tax reform relative to the ALP's.⁷⁰ The fact that the Coalition were net beneficiaries from the tax reform debate in 1998 enabled Howard to cling to office despite a mediocre first term. A combination of changing economic conditions, the Keating Government's consequent deceit in relation to indirect taxation, and the disciplined promotion of the need for reform by the welfare-business coalition from 1996 convinced a majority of voters that indirect tax reform was necessary. In the words of Warhurst: 'unlike 1993, the GST was no longer unpopular enough' to deliver the ALP Government.⁷¹ While the Howard Government's tax reform package faced the scrutiny of an antagonistic Senate in 1999, the Coalition were able to negotiate a deal with the Australian Democrats that finally saw a proposal for a GST pass into law.

The capacity for reform: Explaining the politics of Australian taxation policy and implications for governance

The Australian experience in relation to tax reform outlined above largely conforms with existing institutionalist accounts of public policy in that the fragmentation of decision making authority limited the state's capacity to push ahead with reform proposals in the face of societal opposition. While numerous points of institutional vulnerability were identified, perhaps the most significant factor in the analysis was the adversarial nature of Australia's two-party system which, over the study period, effectively ensured that rival parties had a strong political incentive to campaign against tax reform.

While the broad contours of Australian taxation policy can be explained in institutional terms, the more subtle variations in state power since the 1970s suggests the need for more detailed analysis of the changing patterns of state-society relations over the period. The

69. Megologenis (1999) p.101; Milne (1998)

70. McAllister & Bean (2000) p.391; Crosby (2000) p.66.

71. Warhurst (2000a), p.9.

central contention here is that patterns of interaction between key state and societal actors can have a significant impact on the ability of governments to achieve their political goals. In terms of the prospects for building *relational capacity* it seems that Australia's fragmented state structure, a liberal political culture and a lack of interest group mobilisation impeded the formation of network relationships that could have enhanced the prospects of achieving tax reform. Despite the fact that there was evidence of interest groups reassessing their political strategies, to the extent that there was a greater willingness to act collectively in the pursuit of tax reform, overall the state's reluctance to forge closer relations with societal actors hindered the formation of reform orientated policy networks. While at this level the state did not really increase in its relational capacity over the study period, that is not to say that the increased mobilisation of stakeholders did not improve the viability of tax reform.

By the late 1990s the GST had become so politicised that winning a mandate for its introduction was clearly going to require the support of key stakeholders *and* the broader community. At a theoretical level this demands careful evaluation of the *social embeddedness* of the state, or the extent to which the broader community shared its political goals. In these terms, the Howard Government's successful implementation of tax reform can be explained by the increasing community acceptance of a GST, rather than through the state increasing its capacity in a conventional sense. In other words, while the power of the state relative to society did not change significantly over the study period, the need for the state to 'act strong' diminished. However, the greater community acceptance of a GST itself requires an explanation which involves issues that go to the heart of theoretical debates concerning the relationship between the state and civil society. The Australian experience described above supports the claim that the state, and perhaps more accurately the state-society complex, are catalysts for developing social embeddedness. Indeed, as Seabrook has recently argued, this is where neo-Weberian explanations of interest formation and legitimacy differ from pluralist theory, in that the state, and societal actors responses to the state, have the potential to shape the policy agenda and public opinion rather than simply responding to it.⁷²

72. Seabrook (2001) p.23.

In terms of the case at hand, the state was not responding to societal demands when setting the tax reform agenda. In a similar vein, the abovementioned formation of reform orientated coalitions among leading stakeholders in the 1990s demonstrated that interest groups are able to respond to state vulnerability by pursuing strategies designed to enable the state to achieve its policy goals.⁷³ Such findings represent an important development in neo-Weberian theory which, until very recently, largely overlooked the issue of legitimacy and the state's important role in building social embeddedness. So while institutional autonomy is clearly a cornerstone of state capacity, in a pluralistic policy environment such as Australia, where the state lacks these organisational resources, then promoting a particular policy agenda and nurturing public support may be the most viable political strategy available to the state.

Given that political challenges similar to those posed by tax reform will continue to confront Australian governments into the twenty first century, the final objective of this article is to assess the implications of these findings in terms of the future governance of the Australian state. Indeed, in the present age of internationalisation, nation states are confronting greater economic and political challenges from abroad, while at a domestic level unprecedented electoral volatility and declining faith in public institutions pose significant threats to state legitimacy. Under these circumstances cultivating a degree of state capacity will be central to the Australian state's prospects of being able to respond to the demands of the next century.⁷⁴

While there can be no certainty in complex social systems, from the historical analysis provided in this article it seems very likely that the Australian state will continue to lack institutional autonomy. For example, even modest institutional reforms that would grant the state more autonomy, such as introducing a four year electoral term, have been resoundingly defeated.⁷⁵ Moreover, in terms of the two-party system, despite the increasing popularity of minor parties over the study

73. Bentham (1991) p.16. argues that when societal actors voluntarily embed themselves in the state-society complex, this results in a stronger form of social embeddedness than if interest groups were persuaded to assist the state. Seabrook (2001) p.19.

74. The argument that the pressures of globalisation are making national governments more rather than less important has gained greater credence of late. A key exponent of this thesis is Weiss (1998).

period, it seems that both of the major parties are responding to electoral competition by becoming more reactive in terms of policy making. The implication of this move away from historically established policy platforms and party values is that it has enhanced the opportunistic nature of party politics. Yet despite this fragmentation of political power, a central finding of this study is that where actors, and the state in particular, pursue political strategies aimed at promoting closer state-society relations, then governments will be more likely to realise their political goals. It seems that the state would be able to adopt a more proactive and strategic stance in relation to any number of contested policy issues if it consciously sought to promote collaborative activity with both stakeholders in civil society and rival political groupings. While a combination of the organisational structure of the policy environment, the deeply embedded norms relating to both the Westminster tradition of executive authority and a broader liberal state culture have retarded attempts to establish a culture of negotiated policy making, it seems apparent that such approach is the way forward for governance in the Australian context.

Despite the finding that state actors have been reluctant to embrace a consensual approach to policy making, this is not to say that it is impossible, because while organisational context and history influence state strategy, we cannot claim that state strategy is determined exclusively by these factors. For example, recently there has been a belated example of political learning in relation to the politically problematic issue of tax administration and the ongoing disputes between the Australian Taxation Office and business, with the Prime Minister admitting that:

I think we can do better in this area, ... make the tax office and the business community interact in a more positive fashion with each other, I don't think we've done that well enough in the past and I think we have a great opportunity now and with a special ministerial focus for that to occur.⁷⁶

75. Jaensch (1992) pp.57-58. In early 2002 the issue of four year parliamentary terms was discussed at a conference of the Federal Liberal Party. Again, party leaders, including the Prime Minister, were reluctant to promote the issue.

76. John Howard, press conference November 23rd 2001. The transcript of this press conference is available at URL: <http://www.pm.gov.au/news/interviews/2001/interview1287.htm>

So despite the impediments, it appears the state is at least capable of engaging in more collaborative styles of policy making. While there may be moves in this direction in some policy arenas, the greatest institutional constraint in relation to taxation and macroeconomic policy is the bureaucratic authority and autocratic culture of the Federal Treasury. For example, it is interesting to note that on the one occasion over the study period when the state did achieve a degree of embeddedness, in the lead up to the 1993 election, it was the executive led by Prime Minister Paul Keating that developed strategy and devised policy. Yet it seems that occasions when there is executive control of the Treasury are rare. While the capacity of governments to implement macroeconomic reforms might be enhanced if central state agencies were more responsive to their political masters and society more generally, it is important to acknowledge that there are risks associated with a collaborative approach to policy making. The problem here is that if the state lacks autonomy it will be vulnerable to being captured by powerful private interests resulting in successful rent-seeking, or what Evans has called 'over-embeddedness', compromising the prospects of developing policy that is in the public interest.⁷⁷ Indeed, we need only to consider the Australian experience in relation to tariff policy in the 1960s to find an example of state capture.⁷⁸ What then is required is not a hollowing out of state agencies and their associated bureaucratic resources, but rather a sea-change in terms of their culture and willingness to openly engage with the executive and the broader constellation of stakeholders.

In the broadest terms this demands that political strategy is tailored to the policy issue, the institutional context and the state's level of social embeddedness. For example, in relation to tariff reform, despite the significant consequences of industrial restructuring, a combination of the bi-partisan support and the fact that traditional manufacturing interests were politically weak allowed the state to effectively 'act strong' and persevere with tariff reductions.⁷⁹ In contrast to tariff policy, this article has argued that consumption tax reform in particular was never

77. Evans (1995) p.57.

78. While the study does not analyse more recent developments concerning the recommendations of the Ralph Review of Business Taxation, the Howard Governments reluctance to tax discretionary trusts as companies may be another example of policy being captured by powerful vested interests.

79. Bell (1993); Capling & Galligan (1992).

electorally popular and became less so during the 1990s when the ALP actively campaigned against a GST. In such a contested and open policy arena, where the state lacks both capacity and social embeddedness, then cultivating closer patterns of state-society relations becomes an imperative. Given that the future promises an increasingly pluralised and cynical electorate, it seems likely that the Australian state will actively have to build both its relational capacity and social embeddedness if it is to achieve purposeful policy change. Thus, in terms of governance, in many ways Australia is at a crossroads: will the state be able to reinvent itself and respond to the challenges of the twenty-first century, or will it continue to be bound to historically entrenched practices which reinforce the institutional vulnerabilities of the Australian state?

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