
REVIEWS

An Optimal Tax Burden?

*Patrick J. Caragata, Why Are Your Taxes So High?,
Seascope Press, Auckland, 1998*

Reviewed by Angela Ryan

IN this little book written for the lay reader, Patrick Caragata, a former adviser on taxation policy with New Zealand's Inland Revenue Department, claims that economic growth will be maximised if taxation is reduced to between 15 per cent and 25 per cent of GDP. If the dead hand of taxation could only be lifted from the backs of hard-working Kiwis, he argues, growth would take off and self-reliance could blossom as the churches, the family, the community and voluntary organisations reclaimed the ground from which they have been crowded out by big government. But some taxation is necessary to finance growth-enhancing government spending on defence, a legal system and some infrastructure.

Caragata presents a colourful and unashamedly personal treatment of the issue of whether New Zealanders are getting good value for the taxes they pay. Much of the literature on the subject is not readily accessible to a broad section of the community; and the author is to be congratulated for attempting to inform a wider public in a readable format. Otherwise heavy subject matter is lightened by the use of fascinating anecdotes linking the burden of tax to historical events such as the signing of the Magna Carta, Lady Godiva's escapades and the story of William Tell.

But for all that, it is most unfortunate that Caragata has not provided more substance in his book. Having seized the reader's attention with an entertaining style and his claim on the book's cover that it contains no less than 'the most important economic discovery of the 20th century', he turns out to be a great disappointment. Underneath the bravado and backslapping (and there is a lot of this: Caragata certainly likes to mention his colleagues' names on every possible occasion), there is a sense of a job half done.

The main conclusion of the book concerns the size of the tax burden that is most conducive to economic growth (although Caragata confuses the ratio of tax to GDP with that of public spending to GDP, using them interchangeably on occasions as if they were the same thing). But this is to put the cart before the horse. Surely the optimal tax burden will flow from the optimal level of government spending. The amount of tax we need to pay depends on the role we see for government. This is likely to vary between countries (because of such factors as the stage of development) and across time (because of changes in circumstances, including such factors as wars or famines). It seems unlikely that a 15-25 per cent range is broad enough to meet all such circumstances.

Evidence cited in the book itself is not always consistent with the 15-25 per cent range. For example, V. Tanzi and L. Schuknecht are quoted as stating that public spending may be beneficial up to the range of 30-40 per cent of GDP; and a citation from the OECD suggests much more modest impacts of taxation on growth. The apparent contradictions are not even acknowledged. There is also little if any reference to the fact that the burden of tax varies with the kinds of tax. A 20 per cent tax burden imposes much higher economic costs (and reductions in growth) if it is raised at high rates from narrow bases than at low rates from broad bases.

Moreover, the more telling academic criticisms of the results from the studies that Caragata cites (the main one is by Professor Gerald Scully) are dismissed by appeal to credentialism. 'Professor Scully was chosen because of his outstanding academic reputation (he is listed in *Who's Who in Economics*) ... I emphasise his credentials because his work provoked several unwarranted, personal attacks — which were carefully rebutted point by point' (p. 63). Given the very public controversy over the findings from Scully's study in New Zealand, Caragata should surely have referred to the critiques of it, such as the one by Ted Sieper commissioned by the New Zealand Treasury in 1997. Nor is the methodology used by Scully (and the subsequent studies on which Caragata relies) described anywhere in the book. True, the book was written for the lay reader; but a technical appendix could have been included.

I was also concerned about the assertion that, given three ways of measuring the optimal tax burden, 'if entirely different methodologies lead to similar conclusions, then the criticisms are generally irrelevant' (p. 62). Sieper claims that some of the problems in Scully's study are common to all three methodologies, though he was not given access to the data required to test his concerns. The problems related, among other things, to the use of restricted regressions (unrestricted regressions were not reported), collinearity between regressors, the use of the unconventional CPI deflated series rather than the conventional constant-price GDP growth numbers, and some unexplained divergences between the data provided by the Inland Revenue Department and those actually used by Professor Scully.

Caragata estimates the 'marginal excess burden' of taxation at \$2.64 per dollar, but as the models used in the studies he cites do not consider the form taken by taxation, they could not possibly estimate marginal excess burdens, which conventionally measure distortions caused by variations in specific forms of taxation. Because the book says so little about the methodology employed, such misunderstandings are likely to be common among readers who have not read associated material.

Overall, the book is worth reading, but only as an opener for discussion. If the author wanted the book to be taken more seriously than that, he needed to do more than cite his credentials and those of his colleagues to convince the reader of the value of the academic material used.

Angela Ryan is Director, Taxation, at the Australian Society of Certified Practising Accountants.