

Why Japan's balancing act on China is more sure-footed

**Virtual meeting
Shinzo Abe
can help Scott
Morrison
adopt a less
adversarial
approach to
maintaining
the strategic
equilibrium in
the region.**



John McCarthy

Scott Morrison will have a virtual meeting with Japanese Prime Minister Shinzo Abe tomorrow, to be followed by an official visit to Japan when COVID-19 permits. Morrison is taking Japan seriously. Good.

It is widely assumed here that our relationship with Japan is fundamentally economic – albeit containing a strategic dimension, given our shared status as American allies.

It is more than that. Japan and Australia have led the way in the creation and growth of the major regional organisations such as the Asia-Pacific Economic Co-operation forum. We revived the Trans-Pacific Partnership regional trade agreement when it was abandoned by the United States.

We have a successful and growing program of bilateral defence co-operation. In the past 15 years, the military contingent in Australia's Tokyo embassy has grown from two to about a dozen. Joint exercises and policy exchanges have proliferated.

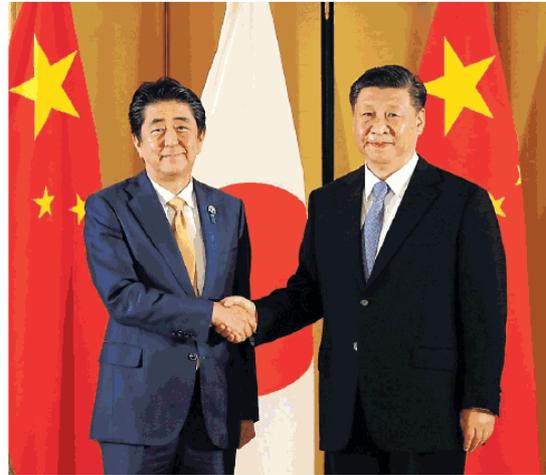
For Australia, the projection of American power, even under Donald Trump, remains the prime factor in preserving strategic equilibrium in Asia. But we need to better appreciate Japan's significance in maintaining that equilibrium.

In this connection, we understand Japan's role as a host of American forces, its military competence, its continuing wealth and its democracy. However, there is insufficient recognition in this country of two other factors

The first is Japan's example in managing China. In this task it is more mature and sure-footed than Australia or the US, especially given the harsh realities of the Sino-Japanese relationship.

Any Japanese government has to shape its China policy in the context of its deep-rooted historical differences with China, including contested claims to the Senkaku Islands in the East China Sea and festering issues from World War II – impediments with which Australia does not have to deal.

Japan also has to accommodate a range of internal views on China – from those of anti-Chinese nationalists to the pacifists, including those in the government's junior coalition partner, the New Komeito party. Japan's approach towards China has



Japanese Prime Minister Shinzo Abe with Chinese President Xi Jinping in the Great Hall of the People in Beijing. Abe has spent much of his time as leader trying to repair his country's relationship with China. PHOTO: AP

varied. But particularly during the tenure of prime minister Junichiro Koizumi (2001-06) and Abe's second term (from 2012), it has been tough-minded, but not confrontational.

In 2015, for example, Japan reinterpreted its constitution to permit "collective self-defence" – giving it greater freedom of action to act as an ally of the US if the latter were attacked.

These periods have cost Japan in its dealings with China, but it has sought to maintain a balance in its relationship with its neighbour. Abe made an official visit to China in 2018 and a reciprocal visit by President Xi Jinping remains on the cards.

The Japanese are also careful about the tone and context of public statements about China, and the company in which these are made. For example, they have not sought

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publicly to sheet home the blame for COVID-19 to China.

In response to the recent passage by China of the national security law on Hong Kong, Japan chose to express concern not in

one of the two Anglosphere statements (both involving Britain, Canada and Australia and one including the US) but through its own statement and in a G7 communique.

Moreover, even in difficult times for government-to-government dealings, Japan's ruling Liberal Democratic Party has maintained associations with the Chinese Communist Party, and there's a plethora of ongoing personal, political, academic and business links – which noted China scholar Richard McGregor refers to as "catcombs of communication" – between the two countries.

By contrast, in Australia there is criticism of those in business who argue for restraint in our dealings with China, and denigration of organisations such as China Matters that seek to assist the propagation of unbiased knowledge about China.

If China is indeed to be our enemy, let us at least, like Japan, know it.

The second factor we tend to ignore here is that Japan's statecraft and business skills provide a balance to China in south-east Asia, compensating in some measure for America's declining diplomatic input and dramatic loss of reputation in that region over the past decade.

Japan is no longer seen in Asia as the high-handed regional actor of the 1970s and '80s. Abe made a point of visiting all 10 ASEAN members in the first year of his second term. A poll of ASEAN attitudes six months ago by the Singapore think tank the IEAS-Yusof Ishak Institute picked Japan as the most trusted extra-regional power, with twice as many positive responses as the US and four times as many as China.

And Japan never has been a laggard in terms of investment in the region. A widely published survey by Fitch Solutions in June last year noted that, in the crucial infrastructure sector, Japanese-backed investment in the six biggest ASEAN economies was 1.5 times as big as that of China (\$US367 billion as opposed to \$US235 billion).

John McCarthy is a former Australian diplomat who served as ambassador to Vietnam, Mexico, Thailand, the United States, Indonesia and Japan, and high commissioner to India.

Here's how the GST can be both bigger and progressive

Taxation reform

An expanded consumption tax won't be regressive if it's combined with a \$7500 GST-free threshold for everyone.



Rosalind Dixon



Richard Holden

As Australia marks the 20th anniversary of the goods and services tax, reform of the GST is back on the table. And not.

The Thodey review, like many reviews before, observes that Australia's value-added tax is more efficient than other taxes such as stamp duty (perhaps the worst offender) and taxes on labour income.

At 10 per cent and covering roughly half of all goods and services in the economy, it is also much lower than value-added taxes in other advanced economies.

Raising the rate and broadening the base of the GST would provide scope to cut other more distorting taxes. This is the case for reform.

On the other side of the debate is the observation that the GST, by taxing consumption, has a relatively larger impact on lower-income households. Opponents of an increase in the rate of the GST argue that it is, in this sense, a "regressive" tax.

Both sides have a point. But a little creative thinking, coupled with Australia's sophisticated payments system, offers a way to cut this Gordian knot.

One could try to provide compensation to lower-income households, or exempt certain "essential items" from the GST. But this is a policy rabbit hole – one that started with John Hewson's contortions about how birthday cakes would be taxed. It also sparked debates about taxing tampons and selective compensation for older Australians or tradespeople.

What is required is a clear, robust policy that addresses fairness considerations but is

not subject to lobbying and rent-seeking. Our idea of a "progressive GST" does just that. Here's how it would work.

Each Australian adult would receive a \$7500-a-year "GST-free" spending threshold. That is, the first \$7500 of consumption would attract a GST rate of 0 per cent.

Beyond that, all goods and services would be taxed at a rate of 15 per cent – including those that are currently exempt such as fresh food, health, and education.

Those on lower incomes typically spend a relatively larger share of their income on consumption.

Those on lower incomes typically spend a relatively larger share of their income on consumption – especially on essential items such as food. But because the \$7500 per person, per annum exemption is given to all adults irrespective of income, the changes to the GST would be progressive.

A broader GST would raise more than \$60 billion a year, according to analysis by PricewaterhouseCoopers. By our calculations, the compensation stemming from the \$7500 exemption would be around \$20 billion. This leaves the government with

\$40 billion a year in fiscal improvement from the progressive GST.

This additional revenue could be used for a combination of tax-reduction or spending measures. In particular, personal income tax rates could be reduced. As economists of every stripe know, taxing something means one gets less of it. Income tax, while important for revenue-raising, is a tax on labour supply – a tax on work.

These taxes can be particularly distorting when one considers the "effective marginal tax rates" for parents going back into the workforce after care responsibilities, or expanding the time or days they work.

It would also remove the distortions and the compliance burden of the existing GST where some goods and services (or even some components of them) are subject to the GST and others are not.

An important practical question is how the \$7500 exemption would be implemented. Filling in forms and waiting for refund cheques would be a nightmare.

But thanks to Australia's world-leading payments system, the exemption could be implemented very efficiently. Any Australian adult could register any debit or credit card in their name. Each time such a card was tapped at, say, the supermarket checkout, the user's GST-exemption balance would be looked up electronically, and, provided there was sufficient balance remaining, the GST applicable to their transaction would be removed.

Would this mean that cash transactions would not be not eligible for the GST

exemption? You bet. The loss in tax revenue from the "black economy" is often estimated to be \$6 billion a year or more. The progressive GST would provide an incentive to move some of those transactions onto the electronic payments system, providing an extra boost to government revenue.

There is simply no legitimate reason for tax-dodging through under-the-table cash transactions in a world where the New Payments Platform would allow real-time person-to-person transfers. Close to all point-of-sale transactions can already be made electronically.

There is little doubt that the tax system is in need of reform. We still rely too much on some of the most distortionary forms of taxation.

That's not merely a matter of economic purity. How we tax, not only how much we tax, affects the overall size of our economy and the type of benefits and services the government can provide.

The post-COVID-19 era will be one where economic growth is in even shorter supply than before, and where it is even more necessary as a means of providing prosperity for all Australians.

A progressive GST would help move our tax mix to a more efficient one while ensuring that the tax burden is still fairly distributed.

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