7 reasons why ACOSS does not support tax cuts in this Federal Budget

Pre-Budget briefing, May 2018

Summary

The tax cuts

In addition to last year's cuts in company tax for small and medium sized companies and personal income tax for people earning over $80,000, the Government proposes two income tax cuts:

- Extending the company tax cut (from 30% to 25%) to those with turnover above $5 million [costing $1.8 billion in 2019, rising to $14 billion in 2026 and $65 billion over 10 years]
- (rumoured) Personal tax cuts that grow over the next ten years.

If the personal tax cuts are intended to keep tax revenue below the government's self-imposed tax revenue cap of 23.9% of GDP, they would cost around $8B in 2021-22 (but the Government appears to be impatient to bring them forward). [1]

1. The Budget is not as healthy as it appears to be

Despite talk of 'rivers of gold' (mainly due to higher company profits and employment over the next two years) Deloitte estimates that the first projected surplus (in 2020) will be $6B less than predicted, at just $4B (due to the Medicare Levy backflip and lower wage growth than predicted).

2. Governments will need more revenue to provide essential services over the coming decade, and major gaps in social security and community services remain

Even taking account of spending cuts baked into the budget, the PBO expects that from 2017 to 2027, spending on NDIS, hospitals, Medicare, aged care and schools will rise by a total of 1.2% of GDP *per year* ($21B in today's dollars). This takes no account of major gaps in social programs that have been neglected for years, such as Newstart Allowance, affordable housing, and dental and mental health.

3. More tax cuts now will lead to another round of harsh spending cuts

Any tax cuts now would come off the back of $15B that has been ripped out of social security and community services spending, including freezes in family payments, a tougher penalty system for unemployed people, longer waiting periods for payments for people with no private income, a freeze in Medicare rebates; and $1.5B per annum (in 2017) cut from essential community services. Government policy has also moved more and more people off high pension-rate social security payments, onto the woefully low Newstart Allowance, cutting even more from the social security budget. At the same time, Government refuses to fund an urgently needed increase to the base rate of Newstart and Youth Allowance, nor will it fix the inadequate indexation for these payments.

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[1] Based on budget tax revenue estimates in Deloitte Access economics Budget Monitor (May 2018). The cap is arbitrary (based on tax revenues in the Howard years).

ACOSS, Locked Bag 4777 Strawberry Hills NSW 2012 Ph (02) 9310 6200 Fax (02) 9310 4822 **info@acoss.org.au www.acoss.org.au**

Just as eight annual tax cuts during the 2000s led inexorably to the harsh 2014 Budget cuts, tax cuts before budget surpluses are well entrenched (especially if rolled out for a decade as rumoured) would starve future funding for essential benefits and services. That is not responsible budgeting.

4. **Under-funding of services is putting pressure on household living standards, and out of pocket expenses are increasing as a result**

Low wage growth isn't the only cause of financial pressure on households. Some of the largest cost of living increases over the last six years were in essential services funded by governments, including a 57% rise in child care costs, a 40% rise in out of pocket medical costs, and a 33% rise in the average cost of pre-school and primary education. If tax cuts are given before the budget can afford them, we'll pay for them through more out-of-pocket charges and rationing of essential services.

5. **Bracket creep is not the killer it's made out to be**

Personal income taxes were cut every year from 2003 to 2011. As a result, most taxpayers (the lowest 60% by income) still pay less income tax than they would have if the 2003 tax scales remained in place. The middle 20% of taxpayers only begin to ''fall behind'' in 2020, and lower income-earners are still ahead at that stage. And only after then (if surpluses are sustained) can we be confident that the budget can afford more tax cuts.

6. **Most low income-earners don't benefit from personal tax cuts**

Adults with the lowest 20% of incomes (below $20,000 – average income $8,000) pay no income tax (most rely on social security - e.g. pensions- for their income). The next 20% (up to $37,000 – average income $28,000 - e.g. low paid part-time workers), pay an average of $30pw and have little to gain from tax cuts (and everything to lose from benefit and service cuts). Any tax cuts "for low and middle income-earners" will apply also to high income-earners (who already had a tax cut this year) unless they are income-tested (e.g. by increasing the Low Income Tax Offset), but the income test imposes a hidden tax on low and middle income-earners.

7. **Company tax cuts are unlikely to improve living standards for many years, if at all**

The Treasury estimates that a company tax cut from 30% to 25% will lift household spending power by less than 0.7% (a 0.43% rise in average wages) over the long term (10 to 20 years). Many economists doubt that it will improve household incomes at all.

Personal tax cuts might boost the economy sooner, but increases in the lowest social security payments (e.g. the $75pw rise in Newstart Allowance proposed by ACOSS) would have a bigger impact per dollar spent because most recipients spend all of their income.

This is not to say the budget can ''never ever'' afford tax cuts, but the company tax cuts are of doubtful value and personal tax cuts should wait until we've seen a few years of strong budget surpluses. In other words, wait until the government has the revenue it needs to do its job: provide essential services and reduce poverty.

Seven reasons why ACOSS does not support tax cuts in this Federal Budget

1. The Budget is not as healthy as it appears to be

Despite recent reports of ''rivers of gold'' flowing into the budget from company tax revenues ($5B more in 2018-19), personal tax ($2B more), and also lower than forecast spending ($0.5B less), the budget is not as healthy as it seems.

Deloitte Access Economics estimates that the budget deficit will be $7B lower in 2017 and 2018 than the previous Budget forecast (MYEFO in December 2017), **but that the projected surplus in 2020 will be $6B less.** They still expect a surplus in 2020 but it is only $4B rather than $10B, which could easily be wiped out by shifts in the economy (Table 1).

Table 1: Deloitte Access Economics budget estimates compared with last year's Budget figures (MYEFO)

$B change from MYEFO	2017-18	2018-19	2019-20	2020-21
Company/business tax revenue	+5.0	+4.8	+1.4	+1.6
Personal tax revenue	+1.0	+1.7	-5.0*	-9.0*
Other tax revenue	+1.6	+0.3	-0.8	-1.0
Expenditure	+0.5	-0.5	-1.8	-2.3
Overall change	+7.0	+7.2	+2.7	-6.4
Underlying balance	**-16.6**	**-13.3**	**-5.3**	**3.8**

Source: Deloitte Access Economics Budget Monitor (May 2018)

* Affected by abandonment of Medicare Levy increase (costing approx. $4B p.a.) and lower wage growth.

The above changes in budget estimates (Deloitte Vs MYEFO) are mainly due to:

- Large increases in **company tax** revenues (mainly due to higher iron ore and other mineral prices and companies running out of accrued tax losses), reducing in later years as those losses are absorbed;
- Stronger than expected **jobs growth** (approx. 400,000 extra jobs in 2017), more than offset later by lower than expected **growth in average wages.** The MYEFO predicted average wage growth of 2.3% in 2017 rising to 2.8% in 2020, but Deloitte (and many other analysts) believe that was too high. Deloitte predicts 2.1% in 2017 rising to 2.4% in 2020.
- Abandonment of the **Medicare Levy** increase (foregoing approx. $4B per year).

Despite these budget uncertainties, the Government has committed itself to an artificial ''cap'' on tax revenue of 23.9% of GDP, which is likely to be reached in 2020. This is not a responsible approach to budgeting: they should not try to restore the budget to surplus with one hand tied behind their back.

> "Tax as a share of GDP when you include all levels of government is just 27.8% in Australia. This compares to an average of 34.2% across all OECD countries. There are many options to reform taxation and derive greater value from the money diverted from private use. Placing an artificial and contrived ceiling on taxation as a share of GDP has to be both a long way down the list of sensible reforms and one that is controversial in practical implementation."
> *Professor John Freebairn (a long-standing tax expert at the University of Melbourne)*

2. Governments will need more revenue to provide essential services over the coming decade

Governments will need to spend more on health care and disability services

Looking to the future, spending in essential services such as NDIS, health and aged care will need to grow strongly in the 2020s:

- Even taking account of spending cuts locked into the budget, the Parliamentary Budget Office (PBO) projects that from 2017 to 2027, spending on NDIS will rise by 0.8% of GDP ($14B), hospitals and Medicare by 0.1% each ($2B each), aged care by 0.2% ($4B) and schools by 0.1% ($2B) – a total of 1.2% ($21B) in these four programs alone.[2]
- Since the 2014 Budget, the Government has attempted to stem growth in health spending by the crude device of freezing indexation. A freeze on growth in the Medicare rebate to GPs was continued and hospital funding to the States was limited to the sum of CPI and population growth (a freeze in real terms). This is clearly unsustainable. For example, the Government reached agreement with the States last year to extend previous indexation arrangements for hospitals funding until 2020, and the PBO assumes that the freeze will not be imposed after that.
- There is no doubt health could be funded more efficiently (by investing more in prevention, changing the funding system for care for people with chronic illness, and removing the $6B private health rebate), but even if this was done health spending will still have to rise as a share of GDP to meet the care needs of an ageing population and ensure that everyone benefits from advances in medical care.

[2] Parliamentary Budget Office (2017), Medium term budget projections, Report No 2/2017.

- It is also clear that the NDIS is under-funded, since the quality of support packages available for one third of recipients is below expectations.[3]

In a recent survey, 55% of respondents said they be prepared to pay *more* tax to improve health services.[4]

Major gaps in social security and community services remain

These include decades of neglect and underfunding in:

- Unemployment payments (frozen in real terms for 24 years, now just $270pw);
- Affordable housing (virtually no increase in social housing dwellings since 2014 and Private Rent Assistance is just $68pw for a single adult on a low income);
- Dental health (not included in Medicare, and dental care for adults with low incomes has been cut);
- Mental health (where services still fall well short of growing needs).

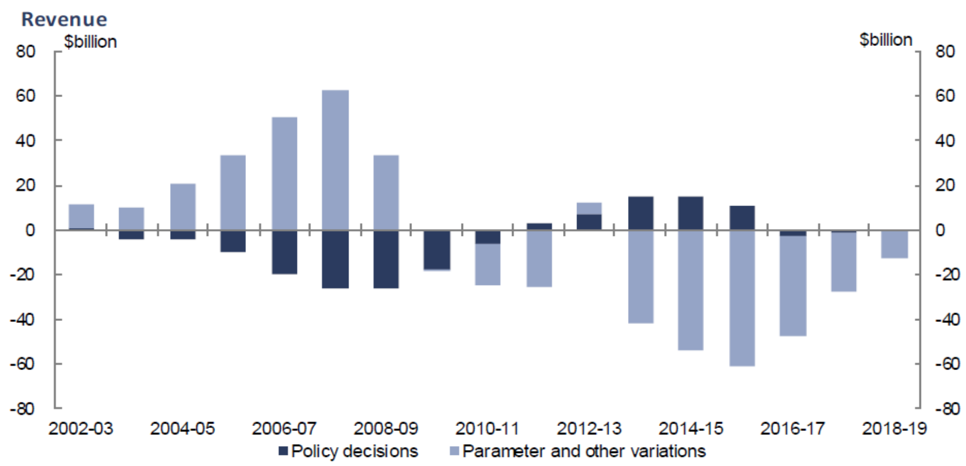
"There remain real questions about adequacy of the unemployment benefit, real questions about the affordability looking ahead for family payments, and real questions about the complexity of our retirement income system, particularly the way the Age Pension interacts with super," Dr Henry, now the chairman of National Australia Bank, said. "I'm not sure on the right expression but it seems to me absurd, theatrically absurd, that we know we're going to have to raise taxes but we're having an argument about which taxes to cut."
Ken Henry, Chairman of National Australia Bank and former Treasury Secretary, The Australian, 2/4/18

3. More tax cuts now will lead to more harsh spending cuts later

We've been here before: in 2003 ACOSS warned that repeated income tax cuts would lead to harsh spending cuts later on. Eight successive annual tax cuts followed, and the proceeds of a temporary boom in company tax revenue were baked into permanent reductions in personal tax rates (Figure 1). The inevitable budget problems after the boom subsided were used to justify harsh cuts in social spending by the Abbott Government in 2014.

[3] One third of recipients of NDIS packages reported that the services they received did not improve post-NDIS, or that they declined in quality http://www.flinders.edu.au/sabs/nils/research/projects/evaluation-of-the-trial-of-national-disability-insurance-scheme.cfm
[4] Per Capita (2018), Tax survey 2018.

Figure 1: The impact of eight annual tax cuts (2003-11) on the budget



Source: Parliamentary Budget Office (2016), 'Impact of policy divisions and parameter variations on the Budget outlook.' Dark shaded bars show the impact of policy decisions (tax cuts and increases and the light bars show the impact of the boom (before 2008) and subsequent downturn.

From 2014 to 2017, **over $15B was ripped out of social security and community services**, including:

- $12B in social security cuts over four years (from 2013) including freezes in family payments for the poorest families, a tougher penalty system for unemployed people, and longer waiting periods for payments for people with no private income;
- The ongoing freeze in Medicare rebates;
- $1.5B per year cut from essential community services, including Aboriginal and Torres Strait Islander services, community legal centres and refuges for victims of domestic violence.

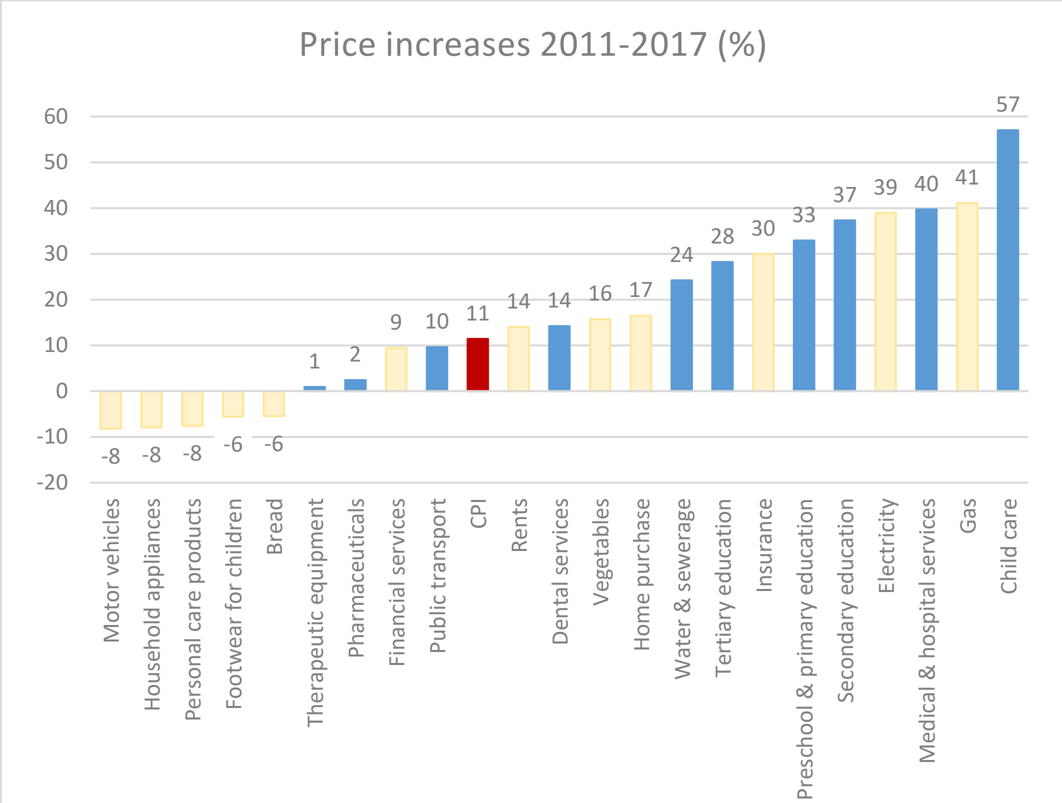
More cuts are still on the books but have so far rejected by the Senate, including:

- A 3 year wait for social security for new migrants with no source of income;
- Cuts to payments to assist people of working age on pension payments to study;
- Abolition of the $4-7pw Energy Supplement for pensioners and unemployed people.

4. Under-funding of services is putting pressure on household living standards

Sluggish growth in wages and high housing and energy costs are not the only reasons many low and middle-income households are under financial pressure. **Some of the largest price increases over the last six years were in essential services funded by governments**, including a 57% rise in child care costs, a 40% rise in out of pocket medical costs, and a 33% rise in the average cost of pre-school and primary education (Figure 2).

Figure 2: Some of the highest price rises have been for publicly funded services



Source: ABS, Consumer Price Index. Average price increases over the last six years (not per year).

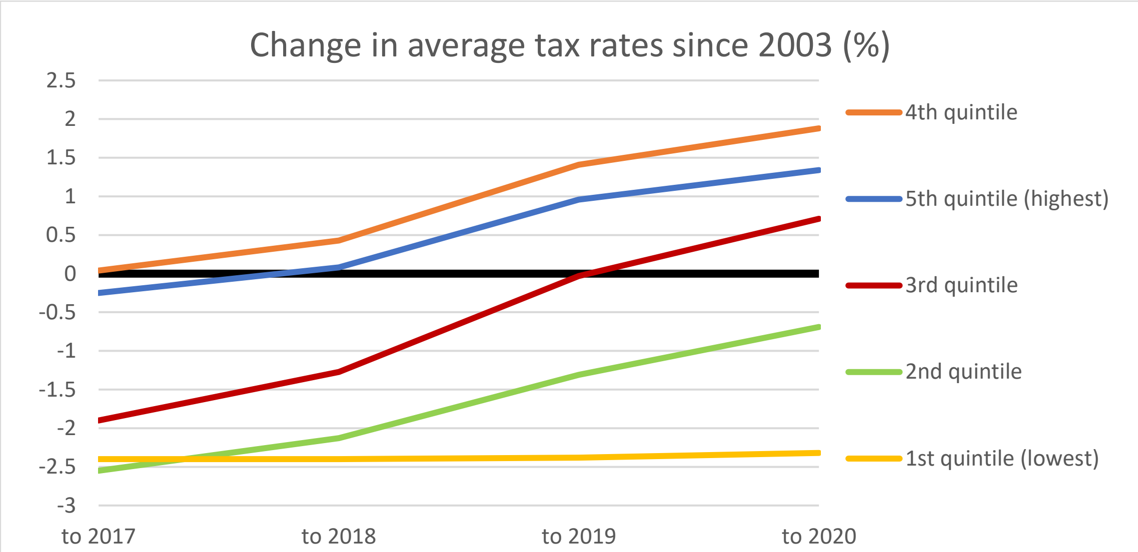
We have a choice: pay for essential services according to our capacity through the tax system, or pay more for them up front when we visit the doctor, or need child care or aged care services. Those on the lowest incomes will suffer most if these out-of-pocket costs keep rising.

5. Bracket creep is not the killer it's made out to be

Personal income taxes were cut every year from 2003 to 2011. As a result, **in 2018 most taxpayers (the lowest 60% by income) still pay less income tax than they would have if the 2003 tax scales remained in place** (Figure 3 and Table 2). The middle 20% of taxpayers only begin to ''fall behind'' in 2020, and lower income-earners will still be ahead at that stage.

Higher income-earners benefited from last year's tax cut, when the $80,000 tax threshold was lifted to $87,000 at a cost of $4B a year (not included in the PBO analysis below).

Figure 3: Impact of bracket creep on average tax rates for individuals with different incomes



Source: Parliamentary Budget Office (2017), Changes in average personal income tax rates: distributional impact, Report No 03/2017.
This shows the change in average tax rates, compared with what would have been paid if the 2003 tax rates and thresholds remained in place. Note that average tax rates (the tax paid on all income) are lower than marginal tax rates (the tax paid on income within a person's tax bracket).

The effect of bracket creep can be seen in the rising average tax rates from 2017 to 2020 as shown in Figure 3. However, virtually all taxpayers still paid less tax than they would have under the 2003 tax scale in 2017 (on the left hand side of the graph, all except the fourth quintile are below the 'no change' or zero line).

Table 2: Impact of bracket creep on average tax rates for individuals with different incomes

Taxable income range (2017–18)	From 2003 to 2017	From 2003 to 2018	From 2003 to 2019	From 2003 to 2020
1st quintile (lowest)	-2.40	-2.40	-2.38	-2.32
2nd quintile	-2.55	-2.13	-1.31	-0.69
3rd quintile	-1.90	-1.27	-0.03	0.71
4th quintile	0.04	0.43	1.41	1.88
5th quintile (highest)	-0.25	0.08	0.96	1.34

Source: Parliamentary Budget Office (2017), Changes in average personal income tax rates: distributional impact, Report No 03/2017

6. Many low income-earners won't benefit from personal tax cuts

Under our progressive income tax system, **the lowest 40% of individual adults receive little benefit from income tax cuts because they currently pay little or no income tax** (Table 3). Most of the taxes they pay are indirect taxes such as the GST).

Table 3: Incomes and tax paid for each 20% of individual taxpayers (2017)

Taxpayers by income group	Taxable income range (2017–18)	Average income ($pa)	Average tax rate (%)	Average tax paid ($pw)
Lowest 20%	Up to $20,000	8000	0	0
2nd 20%	$20,000 to $37,000	28000	5.5	30
3rd 20%	$37,000 to $56,000	46000	14.9	132
4th 20%	$56,000 to $85,000	69000	21.9	291
Highest 20%	$85,000 and above	156000	32	960

Source: Parliamentary Budget Office (2017), Changes in average personal income tax rates: distributional impact, Report No 03/2017

Table 3 shows that, among all adult individuals in 2017:

- The lowest 20% paid no income tax;
- The next 20% paid an average of $30pw (this includes many who pay zero income tax).

Many will be surprised to learn that the 40% of people with the lowest incomes have less than $37,000 in taxable income. Most of this group rely on social security payments including age pensions. Others receive superannuation benefits which are not included in taxable income, while still others have business losses.

These groups pay little or no income tax due to the tax-free threshold of $18,200, the Low Income Tax Offset, the exclusion of most income support payments from income tax, and special tax concessions for Seniors (including the tax free status of superannuation).[5] Effective tax free thresholds for singles are approximately $20,000 for people of working age generally, $27,000 for Newstart Allowance recipients, and $32,000 for Seniors (in addition to superannuation benefits). These thresholds are higher for couples.

[5] The average tax paid in 2015 by all households (whose average *household* income was $2,261pw) was $395pw; for those relying 90% or more on social security (average income $709pw) it was $1pw, for those relying on social security for 50-90% of their income (average income $1,044pw) it was $7pw. Source: ABS income distribution survey (2015-16), income includes imputed rent for home-owners.

Table 4 shows the share of adults in each tax bracket, and their share of overall tax paid.[6]

Table 4: Personal tax scale (2017) and average tax paid in 2015

Income tax scale (2018) Taxable income		% of tax-payers (in 2015)	% of income tax paid (in 2015)
$0- 18,200	0c	19%	0%
$18,201 – 37,000	19c	23%	2%
$37,001 – 87,000*	$3,572 +32.5c	37%*	28%*
$87,001 – 180,000	$19,882 + 37c	18%	40%
$180,000 +	$54,232 + 47c	3%	30%

Source: ATO Taxation Statistics (2015-16 – latest available).
* Increased from $80,000 in 2017; so the share of taxpayers in this bracket is probably higher now. Otherwise the tax scale was the same in 2015 and 2018.

Income tax cuts are difficult to 'target' to those on the lowest incomes, in part because many pay no income tax, and in part because any change in the lower tax thresholds and rates benefits others all the way up the tax scale.[7]

The solution to low growth in wages for low income-earners is higher wages (including the minimum wage), not income tax cuts. Improvements in social security payments for the poorest (such as the $75pw increase in Newstart Allowance proposed by ACOSS) would have a more impact on economic growth than a tax cut because those on the lowest incomes have to spend every extra dollar they receive on the essentials of life.

[6] The Treasurer has raised concerns about the share of income tax paid by high income-earners. Table 4 shows that in 2015, the 21% of taxpayers with the highest incomes paid 70% of all income tax. This is the desirable outcome of a progressive income tax system which levies tax according to ability to pay. However, when indirect taxes such as GST and Stamp Duties are included, the overall rate of tax paid by households at different income levels is almost the same. See ACOSS (2016), Tax and inequality.
[6] ACOSS (2018) Briefing on company tax cuts.
[7] This could be avoided by increasing an income-tested rebate like the LITO, but that leads to a higher hidden tax rate over the income range where the income test applies: in effect a higher tax rate for low to middle income earners.

7. Company tax cuts are unlikely to improve living standards for many years, if at all

Treasury estimates this company tax cut will lift household spending power by less than 0.7% over the long-term (that is 10 to 20 years).[8] This is equivalent to a 0.43% wage rise.[9] Further, recent reports suggest an even lower one-off long-term gain of $150 per person per year on average.[10]

These outcomes depend on a complex sequence of events: more foreign investment in Australia, higher investment in equipment and other productive assets by the companies that receive this investment, more productive workplaces, and higher wages for workers. Unlike direct investment in productive infrastructure by governments, this chain could easily be broken at any point. Some experts doubt whether company tax cuts will improve community living standards at all. [11]

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[8] Kouparitsas, M et al (2016): *Analysis of long term effects of a company tax cut* Treasury Working Paper 2016-02
[9] Peter Martin, *Sydney Morning Herald*, 22 March 2018: *The best case for the company tax cut just isn't that good*
[10] *Ibid,* citing recent modelling by Dr Chris Murphy
[11] Prof Peter Swan, *The Age*, 22 March 2018: *Federal economist raises questions over benefits of company tax cut*; Prof Janine Dixon, *Centre of Policy Studies*, 22 March 2018: *Why small business tax cuts aren't likely to boost jobs and growth*