National Press Club Address: Women in Economics 2018 Federal Budget Reflections

UNDER EMBARGO UNTIL 12:30pm 23 May 2018

Thanks Sabra and thanks to the National Press Club for hosting this Women in Economics Budget Event.

It's exciting to once again have an all-female panel discussing budget policy. Budgets are perhaps the single most important statement of a government's social and economic priorities. And that's why having different voices in these discussions is so important.

It's been two weeks now since The Treasurer handed down the budget, and I'm sure everyone in the room is suffering from a touch of forward estimates fatigue. So today we want to step back from the headline figures and reflect more deeply on some of the longer-term policy challenges emerging from this budget.

First I want to pose the question of whether the government's Personal Income Tax Package signals the end of more substantive tax reform in Australia. Janine will follow by highlighting some of the disagreements among economists about the benefits of the government's proposed company tax cuts.

I also want to make some observations about the size of government and the credibility of the tax "cap" of 23.9% of GDP, in a world with longer term structural pressures on budgets. Lynne will take this further and discuss the health and aged care components of spending, including the policies that might be needed to ease these pressures over the long-term.

First on the personal income tax plan. The government has sold its seven year, three stage tax cut plan as addressing cost of living pressures and protecting low and middle income earners from bracket creep. If this is the goal, then it's a long time coming and will only be partially successful.

For the past six years, bracket creep has been *the* major budget repair strategy. And it's been effective, because most Australian's don't know what it is or how it works – it's effectively a tax increase by stealth.

Bracket creep is not just about people jumping tax brackets. It occurs because as wages rise, a greater share of our income is earned in our highest tax bracket which increases the average tax we pay.

Bracket creep hurts middle income earners the most. If the government did nothing and left tax rates and scales as they are today, someone earning $45,000 today – right in the middle of the income distribution –would face an average tax rate of 20 per cent in ten year's time –compared to just under 15 per cent this year.

The tax plan will cost the budget around $25 billion a year in forgone revenue once fully implemented. But this is only a partial return of bracket creep: most people will still be paying a higher average tax rate in the future than they are today.

Even under the government's plan, that same middle income earner will still be paying an average tax rate in 2027-28 that is more than 3 percentage points higher than today. In fact the only people spared from bracket creep in the next decade are high income earners: those in the top ten percent earning $120,000 or more in today's dollars. Their average tax rates stay about the same.

This means there will be a slight reduction in the progressivity of the tax system: the share of tax paid by the top 10% of income earners falls (from just over 50% to 47%), and the share paid by those in the middle rises. So the plan does make the system less progressive – but less so than some commentators have suggested.

But is this tax reform or just a tax cut?

The government claims that because it is a seven year plan and removes a tax bracket, it deserves the reform badge. Others argue its reform credentials lie in its genesis in the Henry tax review.

But a passing resemblance to something in the Henry tax review does not a genuine reform make. The Henry review recommendations for personal income tax reform were focused on simplicity and improving workforce incentives for the group that is the most responsive to tax rates: women working part-time.

The review proposed abolishing tax offsets and creating a higher tax free threshold to reduce effective marginal tax rates for low and middle income earners.

The higher tax free threshold was introduced in 2012, but the offsets persist. And indeed the budget adds a new one to the list: the Low and Middle Income Tax Offset. The Henry Tax Review was concerned about offsets, partly because they are complex, but also because they do not help incentives for workforce participation. A cheque in the mail at the end of the financial year is more likely to be treated as a windfall gain, whereas a tax cut boosts take-home pay and encourages people to work more.

And of course the Henry Tax review was about far more than just improving the structure of income taxes. It was about broadening the tax base to ensure a more sustainable and stable revenue base into the future. Since the Henry Review, the Commonwealth government has become even more dependent on income taxes – they will reach more than 50% of its tax take in the next two years – even *with* the personal income tax cuts.

The Henry Review proposed simplifying work-related deductions, a more consistent treatment of savings income, a greater reliance on taxing rents for non-renewable resources and land, and abolishing inefficient state stamp duty taxes. While an increase or broadening of the GST was kept off the table by the terms of reference drafted by the Rudd government, a close reading of the report reveals an appetite for greater reliance on consumption taxes.

And while no one expects any government to deliver a perfect package of reforms, it's disheartening to see the cherry picking of the easy changes – tax cuts – from all of the more difficult ones.

Tax *reform* would be taxing resource rents more heavily to help fund the reduction in the company tax rate. Tax *reform* would be broadening the GST at the same time as offering income tax cuts (and increasing welfare payments). Right now it's raining revenue: there's an additional $30 billion over 4 years more than expected just six months ago. So if there isn't political courage *now* to do these things as part of a seven year tax plan, when will there be?

And that brings me to the new tax speed limit and its corollary, the reduction in government spending as a share of the economy.

Does it make sense to cap the size of the Commonwealth government in this way?

To give a truly economist answer: it depends. Are the services the government provides things we want to have less of or more of as a share of our income as we get richer? At least for health, education and infrastructure, the answer seems to be more. Opinion polls suggest that people are happy to pay higher taxes in return for more services. And we see the same choices right across the developed world: every OECD country except Iceland has spent a higher share of their national income on health services as national incomes have risen over the past two decades.

In Australia, Commonwealth health spending has grown 3% a year in real terms over the decade. State health spending has grown at 3.7% a year. The ageing population has played a role but this is mainly about more and better services per person. People want more health spending because they like the things that health spending delivers: longer and healthier lives.

And inevitably an ageing population will increase demand for these services and other services like age and disability care, not to mention the age pension.

If the government is to meet its own tax and spending speed limits it will need to find a way to meaningfully slow spending in these ever-expanding programs – something Lynne will address – or spend much less in other portfolio areas.

The budget itself gives us very little idea of the government's proposed approach. There are almost no policy changes to constrain spending. Net savings measures are worth just $400 million over four years, almost a rounding error. Instead, the budget assumes that spending pressures simply dissipate without any hard work.

Once you strip out GST payments to the states, real spending growth is expected to average just 0.7 per cent a year over the next four years. That compares to 2.1 per cent a year over the past four years, and the 3.1 per cent assumed over the next four decades in the government's Intergenerational Report.

The budget has health spending growing at just 0.3 per cent a year in real terms, which looks pretty heroic given it's averaged 2.5 per cent a year over the past four. And real growth in social security spending – by far the biggest expenditure category for the Commonwealth government – is expected to grow only slightly faster in real terms, despite the very significant ramping up in spending on the NDIS and age care services. Spending on family tax benefit and job seeker income support payments are forecast to go backwards in real terms to make the numbers add up.

And we don’t even know how herculean the government’s spending control assumptions are in the medium-term: the estimate of expected spending growth over the decade was removed from this year’s budget.

That goes to the heart of my concern with this budget as a pre-election statement of priorities: the government says it stands for lower taxes, lower spending and a healthier budget bottom line…….but it hasn’t told us how it is realistically going to achieve all of those things. A speed limit that’s not enforced is just another sign by the side of the road.