

Opening statement by Grattan CEO John Daley to the Senate Economics Legislation Committee Inquiry into the Treasury Laws Amendment (Personal Income Tax Plan) Bill 2018, Wednesday 6 June

I appreciate the opportunity to address the Committee which has before it the largest tax cuts proposed in any budget in Australia's history.

In my opening remarks I would like to focus on two issues: fairness, and the economic effect of different kinds of income tax cuts.

Fairness

When income tax scales change, it's inherently about redistribution. Any change to tax rates is a decision about who should bear less – or more – of the tax burden. And because of bracket creep, any decision *not* to change tax rates is also a decision to shift the tax burden.

At the very least we should be honest about this redistribution. Unfortunately much of the discussion about the Tax Plan proposed in this legislation has used arguments that *conceal* the level of redistribution.

Those on the right conceal that they want the poor to bear a greater share of the tax burden. Those on the left conceal that they want the rich to bear a greater share of the tax burden.

I do not express a view about what is the “right” level of redistribution. But I do believe that this choice should be made in the light of day rather than in the shadows. And the choice should be made free of a number of received myths about income tax.

The simplest analysis of redistribution is in Table 3.1 on p.7 of our submission. This shows that overall, bracket creep over the next 10 years will move over 2% of the tax burden from the top to the middle, and after the Tax Plan, almost 3% of the tax burden will be moved from the top to the middle.

To understand this in more detail, I would direct the Committee to Figure 3.2 on p.8 of our submission. This graph shows how *average* tax rates would change for people across the income distribution. The top orange line shows the effect of bracket creep over 10 years. Those at the 40th percentile would see their average tax rate increase by 6 percentage points over 10 years. These are true middle income earners – on around \$36,000 a year. For taxpayers between the 70th and 100th percentile, bracket creep will typically only increase average tax rates by about 3 percentage points.

This brings me to **myth 1. Bracket creep does not hurt high income earners more.** It hurts middle income earners most, because they have the biggest gap between their *average* tax rate and their *marginal* tax rate (helpfully illustrated on p.6 of the Treasury's submission).

The middle brown line of Figure 3.2 shows how average tax rates will change given bracket creep, *and* the Tax Plan. This shows over the next 10 years, assuming the Tax Plan is implemented, average tax rates will increase for middle income earners by around 4 or 5 percentage points, but will barely move for those in the top 10% of income earners.

The bottom red line shows the difference between the orange and brown lines. It isolates the long term impact of the Tax Plan. This shows that the Tax Plan reduces average tax rates by about 1 percentage point for everyone between the 20th and 65th percentile, but reduces tax rates by 2 to 3 percentage points for high income earners between the 80th and 99th percentile. Much of the other modelling before this committee is consistent with these conclusions.

The only modelling I'm aware of that is *not* consistent is analysis by Deloitte which is cited in the submissions by the BCA, CIS and IPA. Deloitte's analysis claims that the Tax Plan will redistribute about 2% of the tax burden from the bottom to the top. We have tried to reproduce the Deloitte's analysis, and unfortunately we cannot reconcile the numbers. We have taken into account that Deloitte looked at 2024-25 rather than 2027-28, and looked at all adults rather than just everyone who files a tax return. But when we do this analysis we still find that bracket creep and the tax plan redistribute about 2% of the tax burden from the top 20% of adults to the 2nd quintile – bearing in mind that the remaining 60% of Australia's adults don't pay tax, because most of them don't work, often because they're retired.

But instead of looking at whether tax changes are progressive or not, much of the rhetoric about the Tax Plan focuses on how many taxpayers will be moving into a high tax bracket.

This is **myth 2. The tax system is not “hitting the top” just because more people are in a high tax bracket.** Bracket creep means that the proportion of taxpayers in a high tax bracket increases over time. So of course the proportion of tax paid by people *in that bracket* increases. But at the same time the proportion of tax paid *by the top 10% of taxpayers ... falls.*

On the other hand, some have attacked these tax cuts as unfair because they are bigger for high income earners.

This is **Myth 3: Tax cuts are not inherently “unfair” just because they are bigger for high income earners than low income earners.** A moderately *progressive* tax change overall would still give more to high income earners, in absolute dollars, as a percentage of the budget cost (as the Australia Institute analysed), and as a percentage of post-tax income (as discussed in the ANU submission). Those on higher incomes pay a higher proportion of the tax take, so pretty much any tax change – including a highly progressive change – will give them a bigger tax cut, at least in absolute dollars. Those who claim that the tax cuts are unfair using these analyses need to explain why they think it is inherently “fair” that ultimately a very small number of people should pay all of the income tax.

Economic impacts.

May I turn briefly to the economic impact of the Tax Plan, although it is not covered in our written submission. Many of the submissions – such as those from EY, the BCA, and CIS, assert that a high marginal rate for top income earners has a big economic cost because it discourages people from staying in Australia, depriving Australia of their talent.

This is **myth 4. Australia's high top marginal tax rates do not materially affect decisions to work more, or to live in Australia.** The AfrAsia Bank *Global Wealth Migration Review* released recently looked at migration of millionaires around the world. It found that 10,000 millionaires moved to Australia last year, and almost none left (p.23). This is the highest net migration of millionaires to any country last year – in *absolute terms*, let alone correcting for population. And this in a year where - as all these submissions point out - Australia's top marginal rate was relatively high, and cut in at a relatively low income. Singapore, with its famous 15% tax rate, only attracted 1,000 millionaires.

If you want tax cuts with a big economic payback – and that is *not* the only reason for income tax cuts – then you would focus the tax cuts on middle income earners (remember, those earning \$50,000 not \$80,000) That's because their decision to work is more sensitive to effective marginal tax rates, after taking into account the withdrawal of welfare benefits, and the net cost of childcare (see Miranda Stewart and Emily Millane). EMTRs are typically much higher for middle income than high income households because of our highly means tested welfare system. I note that this is also the conclusion of the Treasury submission. Incentives for high income earners matter less, because they're probably working full-time anyway

Conclusion

In conclusion, this Committee has a choice. Members can retreat into their party trenches. They can cite the misleading statistics that suit their preference for more or less redistribution without being open that that's what they want. They can play on the myths I've outlined. Or they can be honest. This means being clear that

- Bracket creep hurts middle income earners (i.e those on \$50,000 a year) more than those on high incomes
- Even though more people will be in high marginal tax brackets, high income earners will not be bearing more of the tax burden
- Tax cuts are not inherently “unfair” just because they give more to those on high incomes than low incomes
- Cutting top marginal tax rates in Australia will not materially affect economic outcomes, but a tax cut focused on middle income earners (those on \$50,000 not \$80,000 a year) will have more of an effect on the economy.

The key facts are that bracket creep will reduce the progressivity of the tax system, and the Tax Plan doesn't materially unwind this. Having agreed that fact-base – on which there is a broad consensus – members can argue openly about whether reducing the extra burden on high income earners, but increasing the proportion of tax paid by middle income earners, is “fair”.