National Press Club: Women in Economics 2019 Federal Budget Reflections

Thanks to Sabra and thanks to the National Press Club for hosting us.

So here we are, a little short of a year since the last Women in Economics Network budget address where we called for long term thinking around the budget position. A move from a reliance on commodity prices and sugar-hit tax cuts to building a more sustainable revenue base. A move to more innovative funding approaches in areas like health. A move to ensure that government chooses the infrastructure projects with the highest economic and social returns, not just the political ones.

So can we expect to see any such moves in next week's budget?

I think it's unlikely.

The budget will show us on track for the long promised 2019-20 surplus. If all goes well we can look forward to next year's Treasurer announcing an *actual* rather than a forecast surplus.

Higher revenues have done the budget repair heavy lifting since the Coalition took office. Indeed, revenues have increased by 2% of GDP since 2013.[1] Most of the growth is from increases in personal income tax collections through bracket creep. As a strategy to extract maximum revenue with minimal squealing, bracket creep has been an undisputed winner for this government. But no economist would nominate it as the most efficient way to boost revenue.

Revenues have also been temporarily lifted by higher commodity prices. Deloitte Access Economics estimates these will help company and profit taxes outperform official forecasts by $2.3 billion this financial year.[2] But these commodity windfalls look like proving as irresistible to this government as they have been to its predecessors.

The government will almost certainly use the budget to announce further tax cuts. These cuts have been hiding in plain sight in the $9.2 billion in 'revenue decisions taken but not yet announced' line in December's

[1] Mid-Year Economic and Fiscal Outlook 2018-19, Appendix D, Table D6.
[2] Deloitte Access Economics Budget Monitor, March 2019: https://www2.deloitte.com/au/en/pages/media-releases/articles/budget-monitor.html

Mid-Year Economic and Fiscal Outlook.[3] The question is whether the government can resist 'topping up' these tax giveaways with some of the money flowing in from higher iron ore and coal prices.

Matching Labor's announcement of a higher tax offset for low- and middle-income Australians would cost around $5.8 billion over four years.[4] Bringing forward the legislated increase in the top threshold for the 32.5% tax bracket to $120,000 from 2022 to July this year would cost another $12 billion over four years.[5]

Perhaps desperate political times call for desperate measures, but where does yet-more political expediency leave Australia in the medium to long-term?

Nicki will talk more about the medium-term outlook for the budget and the need to make room to accommodate more investment that delivers returns for the community. Angela will discuss the reforms she would like to see to social policy. But today I want to talk the long game. What is the fiscal future our children will inherit?

The tens of thousands of young people who were protesting at the school climate strike two weeks ago know that they have been left a stonking great environmental mess to clean up. But I suspect that many are yet to appreciate that this is not the only mess they'll be left with.

Australia's tax and welfare system supports an implicit generational bargain.[6] Working-age Australians, as a group, are net contributors to the budget – they pay more in taxes than they receive in either welfare benefits or spending. These contributions support older Australians who take a lot more out in spending and pension payments than they contribute in taxes. Today's working-age Australians of course anticipate that the generation after them will support them in the same way as they age.

But this longstanding bargain is under threat.

Demographic change will substantially increase the burden of the bargain on current and future young Australians.

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[3] Mid-Year Economic and Fiscal Outlook 2018-19, Appendix A, Table 1.
[4] ALP 2018: https://www.alp.org.au/tax_refund_for_working_australians
[5] Grattan modelling taking Budget 2018-19 as the baseline.
[6] Daley and Wood (2014): https://grattan.edu.au/report/the-wealth-of-generations/.

The number of working-age Australians for every person over 65 fell from **7.4** in the mid-1970s, to **4.4** in 2015, to a projected **3.2** in 2055.[7]

Now this is just bad luck for today's young people. I can accept the argument that there are all sorts of generational swings and roundabouts that we all live with. BUT what I find less easy to accept is a series of policy decisions that have substantially increased the size of the transfers to older households – expanding their good fortune at the expense of subsequent generations.

Let me tell you how.

First, future pension costs have been increased by policy decisions to boost the rate and expand eligibility for the pension. The pension has increased as a share of average weekly earnings from 30% to 37% over the past two decades.[8]

The ever-widening gap between the rate of the pension and Newstart, and the eligibility for these payments, speaks to the political perception of deserving and undeserving welfare recipients. Newstart recipients now live on $40 a day compared to $65 for full-rate pensioners.[9]

Second, is growing health spending. In Australia, Commonwealth health spending has grown 3% a year in real terms over the decade.[10] State health spending has grown at 3.7% a year.[11] The increase in spending has been particularly stark for those in their 70s and 80s – with average health spend per person increasing by over $4,000 in just 12 years.[12]

Most Australians support higher health and pensions spending. But to ask the question that every economist must – who pays? And this is where the rubber hits the road on growing generational transfers.

A series of tax policy decisions over the past two decades – tax-free superannuation income in retirement, refundable franking credits and

[7] Commonwealth Government, Intergenerational Report (2015, p.12) and ABS population projections (2017).
[8] Grattan analysis of the maximum basic rate and maximum pension supplement for a single pensioner compared to average weekly total earnings (ABS 6302.0).
[9] Social Security Guide common benefit rates (http://guides.dss.gov.au/guide-social-security-law/5/1/8/20) and common pension rates (http://guides.dss.gov.au/guide-social-security-law/5/1/8/10).
[10] Grattan analysis of Commonwealth Budget Papers, various years, estimates of expenses by function.
[11] Grattan analysis of State Budget Papers, various years, estimates of expenses by function.
[12] Grattan analysis of ABS 6537.0 (Government Benefits, Taxes and Household Income), 2003-04 to 2015-16, reported in 2015-16 dollars.

special tax offsets for seniors – have meant we now ask older Australians to contribute a lot less than we once did.

Incomes for households over 65 have more than doubled over the past twenty-five years, substantially faster growth than for households under 55.[13] But households over 65 pay virtually no more income tax than people that age did 25 years ago.[14] Indeed, the share of older households paying *any* tax has fallen from 27% in the mid-1990s to 17% today.[15]

And that has contributed to a tax system where someone's date of birth is almost as important as someone's income in determining their tax contribution.

An older household earning $100,000 a year pays on average less than half the total tax of a working-age household earning the same amount. Or considered another way, an older household on $100,000 pays about the same tax as a working-age household on $50,000.[16] And these calculations exclude franking credit refunds that largely benefit older Australians. There is simply no policy justification for this degree of age segregation in the system.

One argument that is sometimes advanced to defend age-based tax breaks is that older Australians have 'paid their taxes'. But in a generational sense, this argument does not hold water. Younger households today are underwriting the standard of living of older households to a much greater extent than in the past.

People born in the late 1940s, at the beginning of the baby boom generation, reached their peak contribution to the tax system in their early forties – and at that point they were contributing an average of $3,200 a year to support older generations in retirement. An average 40-year-old today, born at the tail end of Generation X, is paying $7,300 a year.[17] That

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[13] Grattan analysis of ABS 6537.0 (Government Benefits, Taxes and Household Income), 1988-89 to 2015-16.
[14] Ibid.
[15] Grattan analysis of ATO Taxation Statistics 1994-95 to 2015-16 and ABS estimated resident population for the same period.
[16] Grattan analysis of ABS 6537.0 (Government Benefits, Taxes and Household Income), 2015-16, household final income vs. total taxes (direct and indirect).
[17] Per person contribution by age to net benefits for all households aged 65+. Net benefits include both cash and in-kind transfers minus taxes. The contribution of each age group to total net benefits for households 65+ is based on the proportion of tax paid by households in each age group for a given year. Grattan analysis of ABS 6537.0 (Government Benefits, Taxes and Household Income), 1988-89 to 2015-16.

is more than they are contributing to their *own* retirement through compulsory superannuation contributions.[18]

Under current policy settings, the child of today's 40-year-old will need to pay around $11,400 a year by the time they reach 40 just to sustain current levels of benefits.[19]

In an economy that is growing, it can be sustainable for each generation to take out more than they put in, but the sheer size of this growth in transfers far exceeds that capacity.

That's why we have an Intergenerational Report every five years to remind us just how ugly business-as-usual looks.[20] Without policy changes, deficits grow ever larger and net debt expands to uncomfortable levels.

And let's remember this unwanted fiscal inheritance falls on the generation of Australians that have seen their incomes and wealth stagnate. The generation who missed the bus on the property boom and are entering the workforce during a period of flatlining real wages.

So what would a budget look like that seriously tackles this issue?

First, it would wind back some of the tax concessions for older Australians who can afford to make a contribution. It is simply no longer sustainable for comfortably off older Australians to opt out of taxes for two or three decades after retirement. The obvious place to start would be a tax on superannuation earnings in retirement, and winding back the seniors and pensioners tax offset.[21]

Of course, the politics isn't easy. The reaction to Labor's franking credit policy gives a sense of what governments face when trying to wind back these transfers. The public hearings for the inquiry into the franking credits policy sometimes look more like the frontline in a generational war than a staid government inquiry.

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[18] ABS 6302.0 average weekly earnings by age multiplied by 9.5% compulsory superannuation contribution.
[19] Grattan analysis factoring in population growth, health cost growth (based on Productivity Commission estimates) and pension cost projections (as per Treasury's Intergenerational Report 2015 'currently legislated' scenario).
[20] Treasury 2015: https://treasury.gov.au/publication/2015-igr
[21] Daley et al. (2015): https://grattan.edu.au/report/super-tax-targeting/; Daley et al (2016): https://grattan.edu.au/report/age-of-entitlement/; and Daley et al (2018): https://grattan.edu.au/report/money-in-retirement/.

Here the contrast with the climate strike is difficult to ignore: while older Australians picket for their franking credits, young people are protesting for their very future.

Second, there would be no decisions that further undermine the structural position of the budget. If there is one lesson to take from the past two decades it is that commodity windfalls come and go. We should not lock in higher recurrent spending, or offer another round of tax cuts, every time revenues surprise on the upside. Nor should we pile uneconomic infrastructure investments off budget. To do so is to further weaken the generational bargain.

I'll conclude by saying I hope I'm wrong. I hope this government *will* use this budget and its election commitments to take on these long-term economic challenges. I hope that we *can* discuss generational fairness without it descending into generational warfare. Because I don't think any of us would want our legacy to be mortgaging our children's environment *and* their economic future.