



Commonwealth Budget 2018: tax reform or just tax cuts?

**ESA Post-Budget event
Danielle Wood, Grattan Institute
16 May 2018**

Commonwealth Budget 2018

Personal Income Tax package

- Modest tax reductions in first four years
- Large tax cuts for top end on the never-never
- BUT cuts are less than bracket creep for most taxpayers

The economic case for reforms

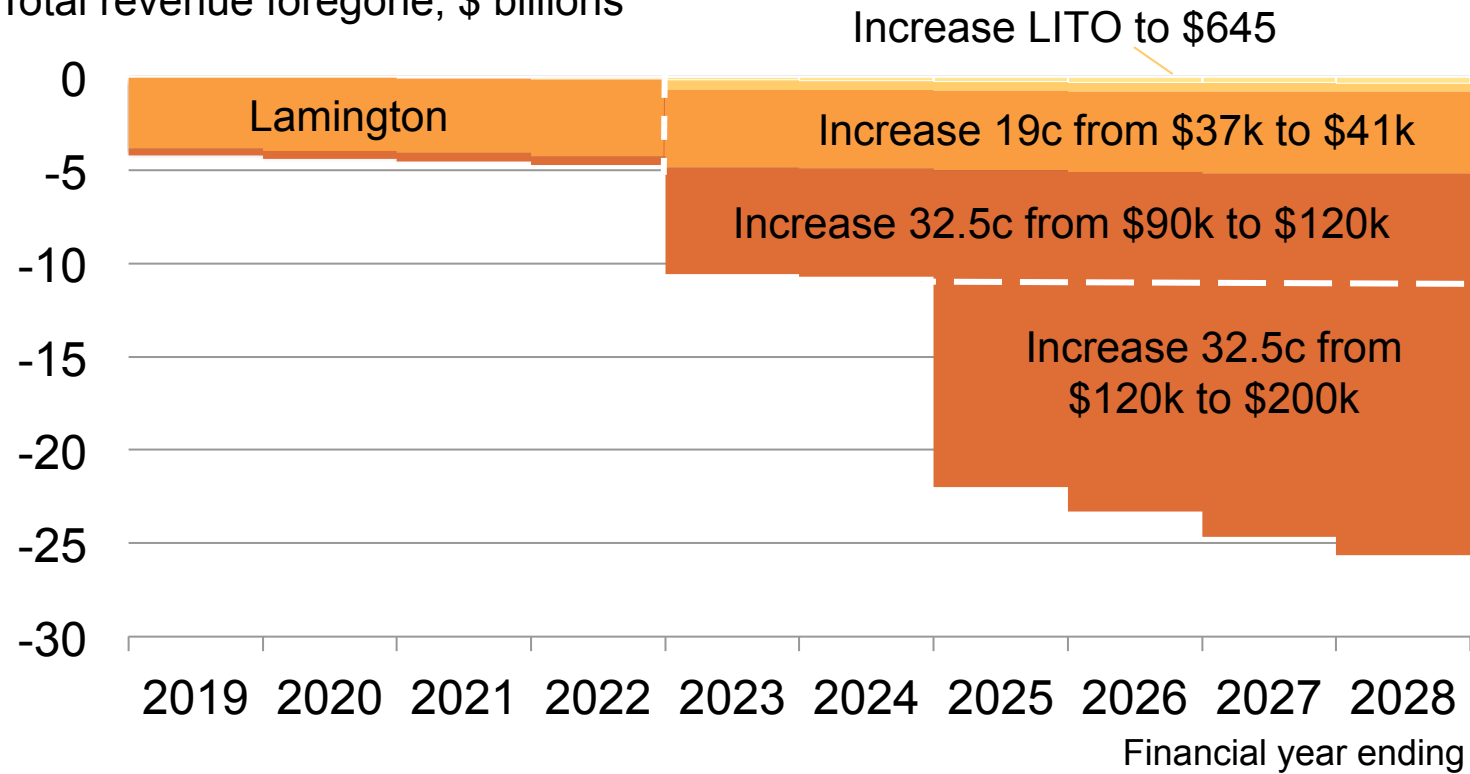
- Similar bracket structure to Henry Review recommendation: but without simplification
- But literature suggests tax rates for lower income earners (part-time women) are what matters for incentives

Nothing done on broadening base

- Government increasingly reliant on income tax revenues
- Missed an opportunity to 'buy' more comprehensive tax reform

Changes to the middle tax brackets account for most of the cost of the PIT plan

Total revenue foregone, \$ billions



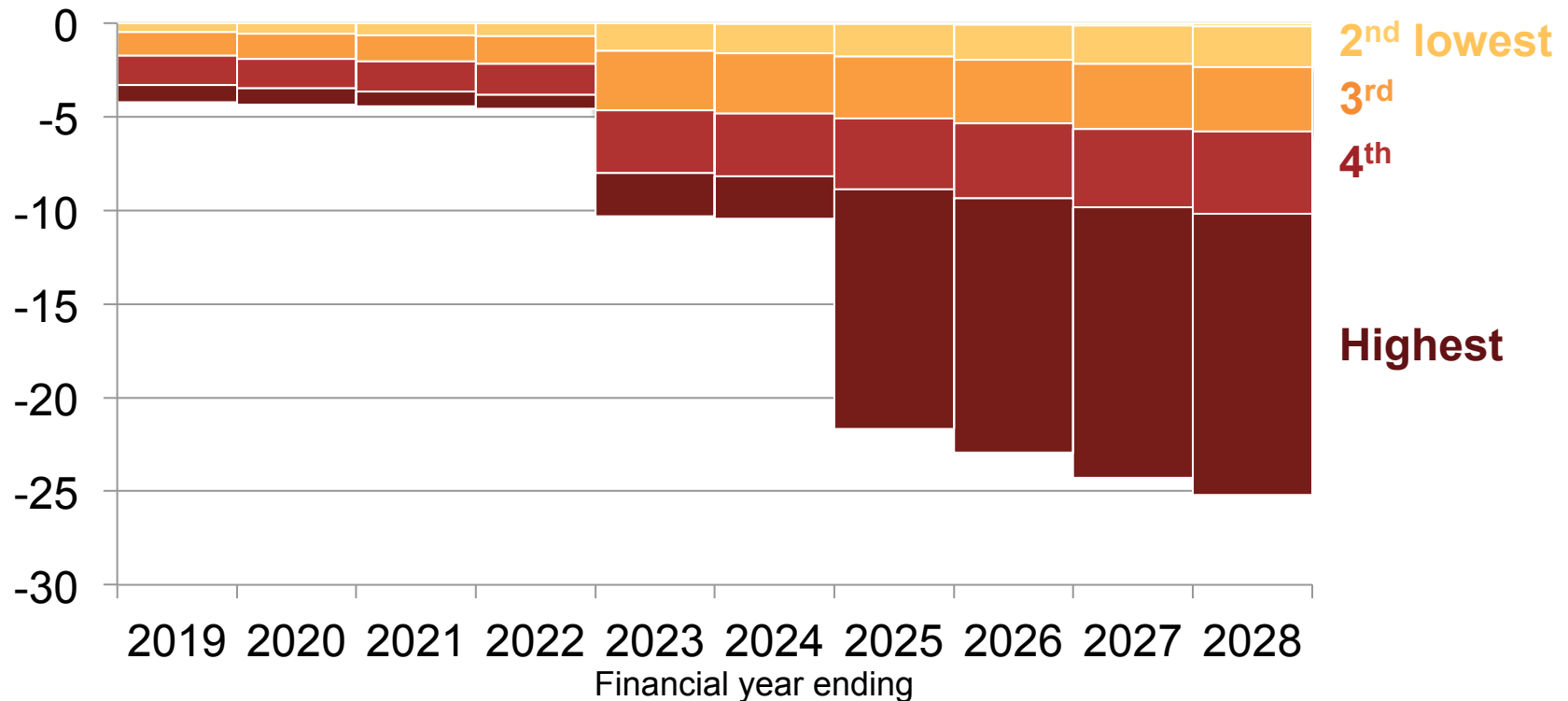
Note: Excludes interaction effects (<\$½ b in any year)

Source: Commonwealth Budget Papers, 2018-19; Grattan analysis of ATO sample file 2015-16.

Top 20% of income earners account for 60% of revenue foregone under the PIT Plan

Budgetary impact of May 2018 tax proposal, \$b

Quintile of taxfilers

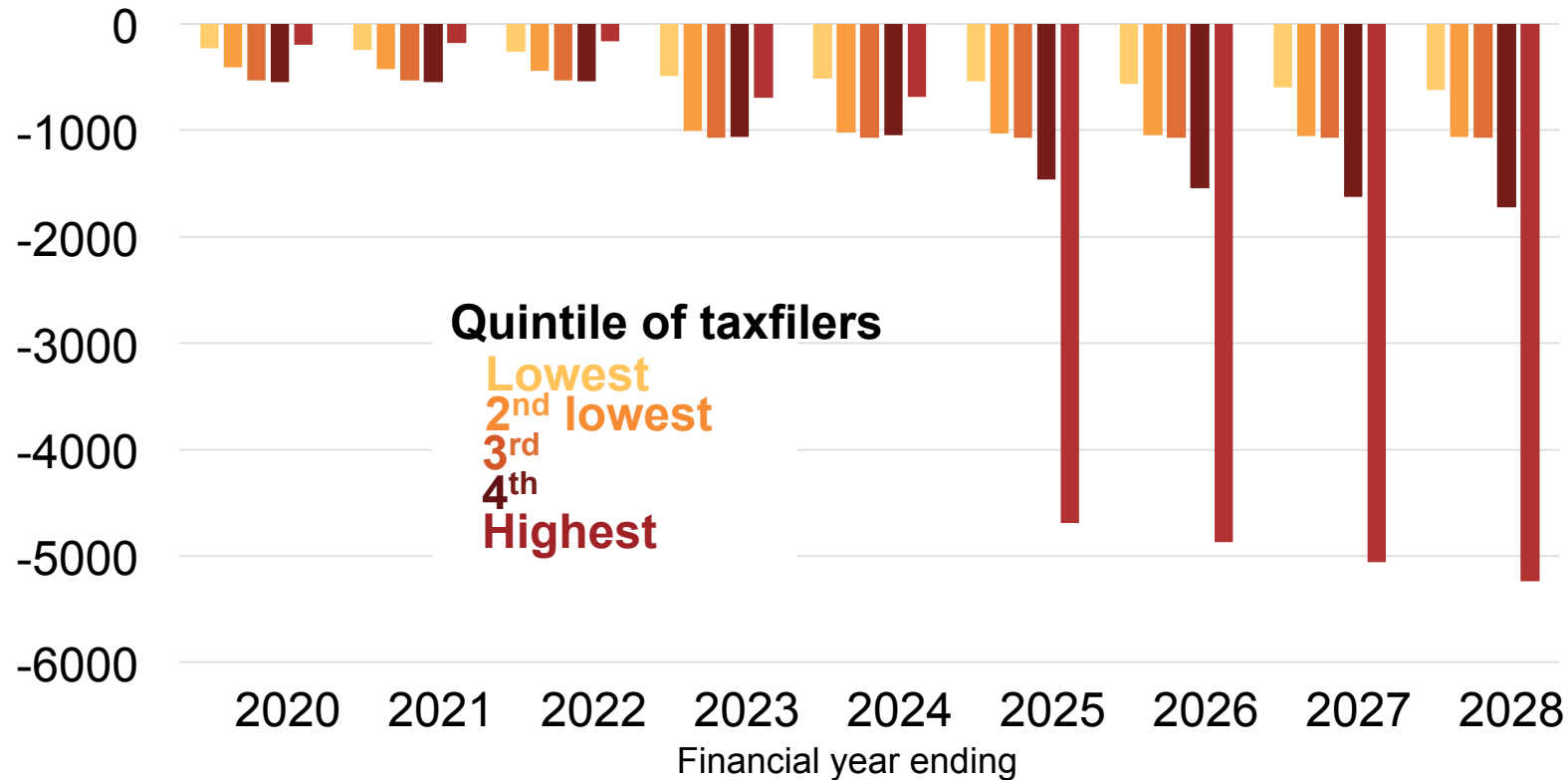


Note: Bottom quintile of taxfilers have taxable income less than \$18k, and so pay no tax

Source: Commonwealth Budget Papers, 2018-19; Grattan analysis ATO Taxation Statistics 2015-16

Top 20% of income earners get the biggest tax cuts

Average reduction in income tax paid by year under PIT by income quintile, \$

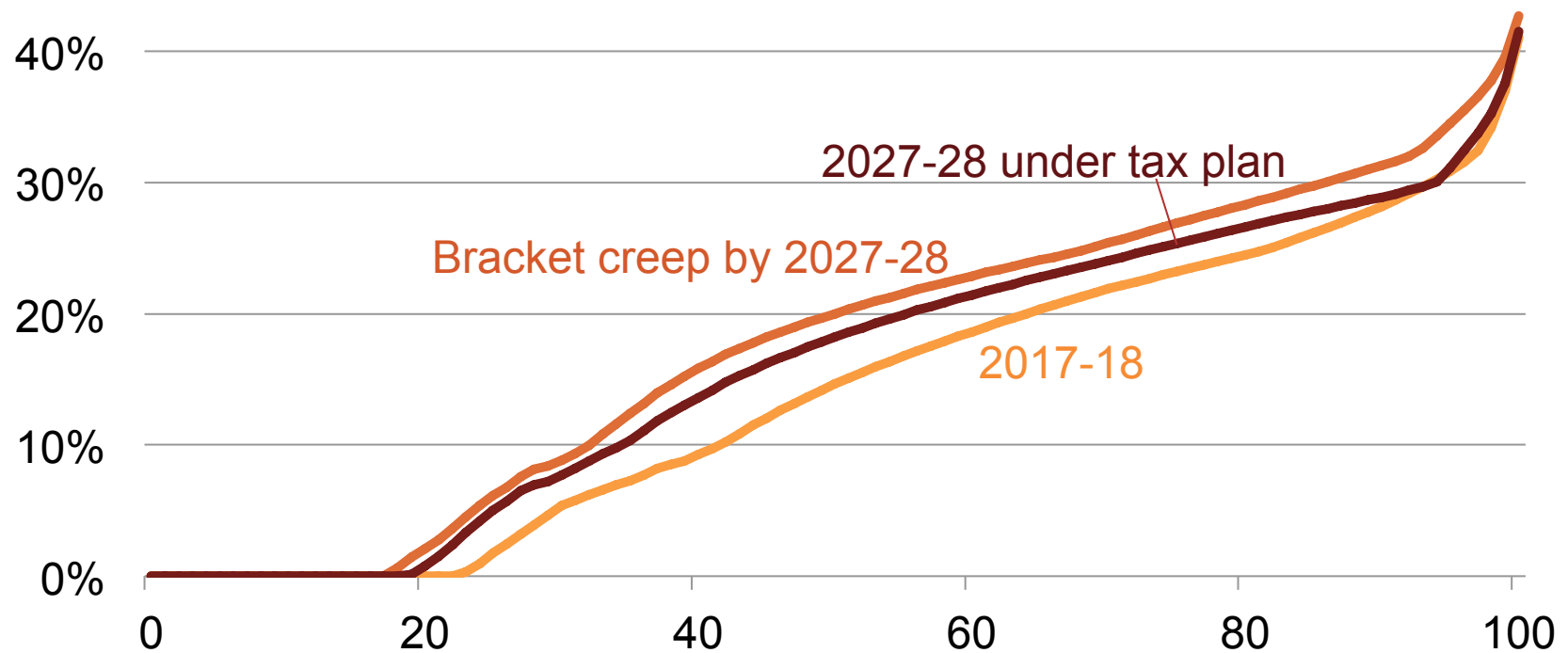


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Bracket creep hurts middle incomes most; tax plan doesn't unwind this

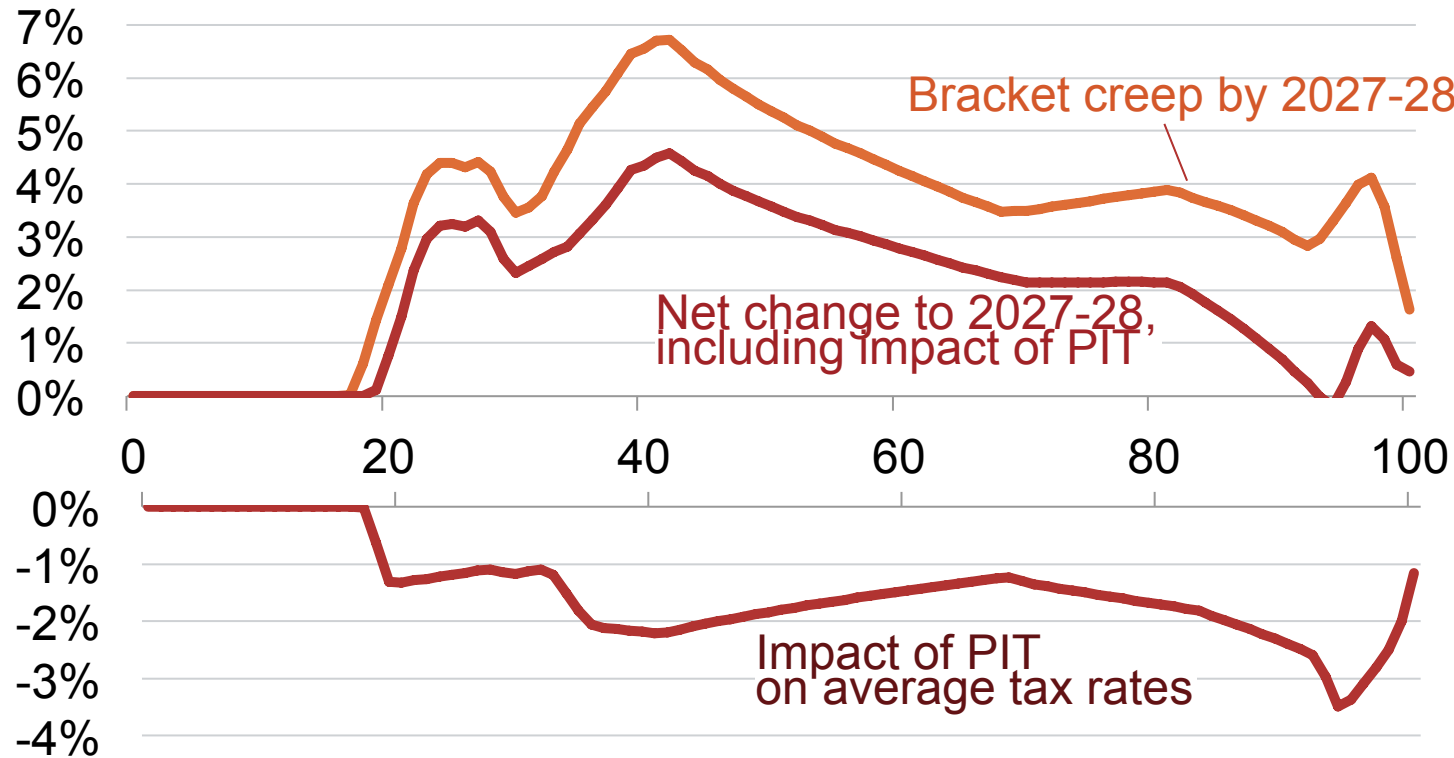
Average tax rates by taxable income percentile, %



Source: Commonwealth Budget Papers, 2018-19; Grattan analysis of ATO sample file 2015-16.

Bracket creep hurts middle incomes most; tax plan has similar effects, except top decile

Change in average tax rates by taxable income percentile, %



Source: Commonwealth Budget Papers, 2018-19; Grattan analysis of ATO sample file 2015-16.

Bracket creep reduces the progressivity of the tax system; tax plan doesn't undo it

Share of total personal income tax paid by income decile (%)

Decile	2017-18	2027-28 (no change to tax rates)	2027-28 PIT Plan
1	0	0	0
2	0	0.04	0.01
3	0.4	0.8	0.7
4	1.6	2.3	2.1
5	3.4	4.3	4.1
6	5.7	6.3	6.2
7	8.5	8.7	8.8
8	12.1	12.2	12.3
9	17.8	17.9	17.8
10 ex top 1%	32.9	32.2	31.8
Top 1%	17.5	15.3	16.0

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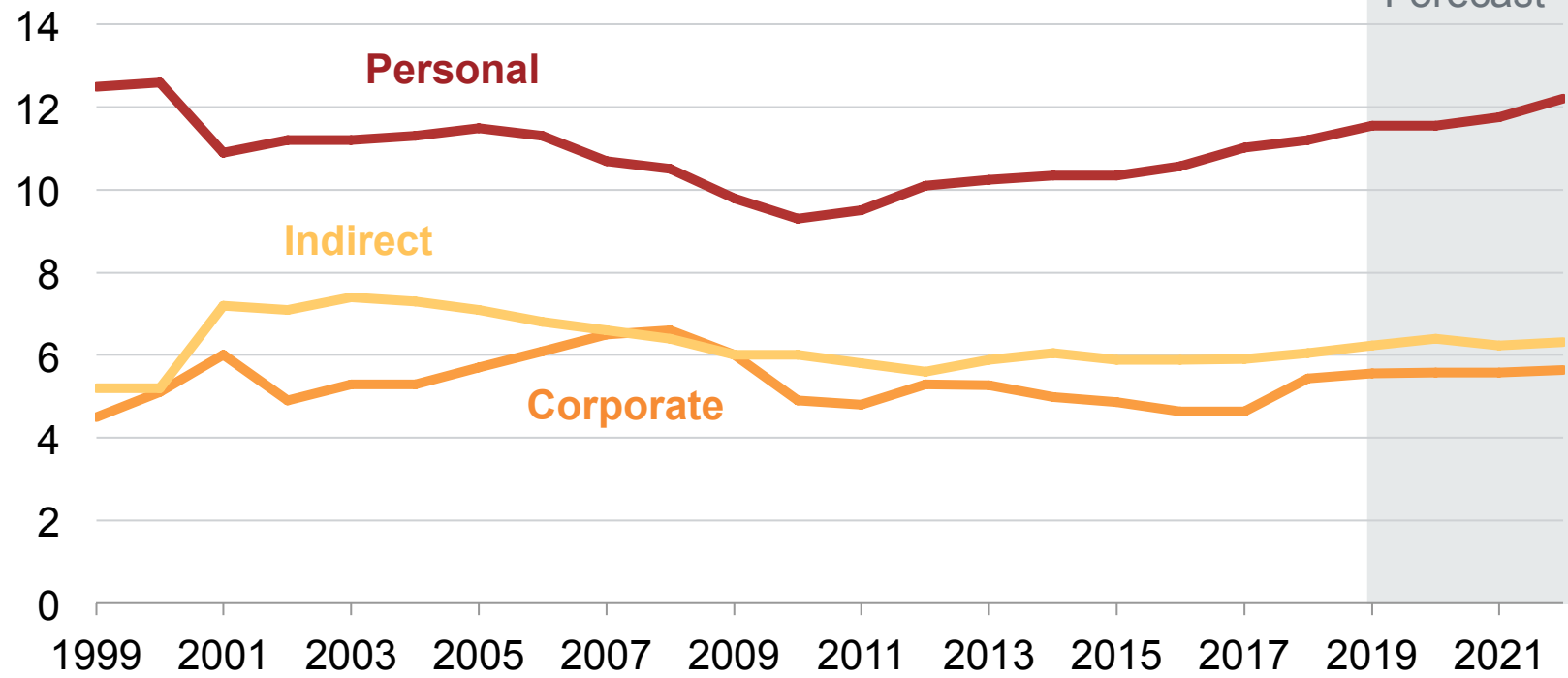
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Tax base is more reliant on personal income taxes even with PIT package

Commonwealth taxation trends

Per cent of GDP



Source: Budget Paper 1, 2018-19 Budget

Past governments have “bought” tax reform

GST (2000)

GST raised **\$30 billion**

Compensation:

- **\$25 billion** - other taxes (wholesale sales and state indirect taxes) abolished (or proposed to be)
- **\$13 billion** reduction in personal income taxes
- **\$2 billion** increase pensions and social security changes
- **\$2.5 billion** increase in family payments

Total household overcompensation estimated around **\$12 billion year**

CPRS (2009)

CPRS raised **\$4 billion**

Compensation:

- Objective: fully to offset the cost of living increased for low income households and meeting a share of increase in costs for middle income households
- **\$2 billion** – household compensation inc higher family payments, pensions, tax cuts
- Fund ease transition costs business and community organisations
- Package **overcompensated households** – average assistance **\$10.10 per week**, average cost increases **\$9.90 per week**

Selling a good news package is much easier



Typical families with either one or both parents in the workforce, will be \$40 to \$50 a week better off even after the GST.

**GST
(2000)**

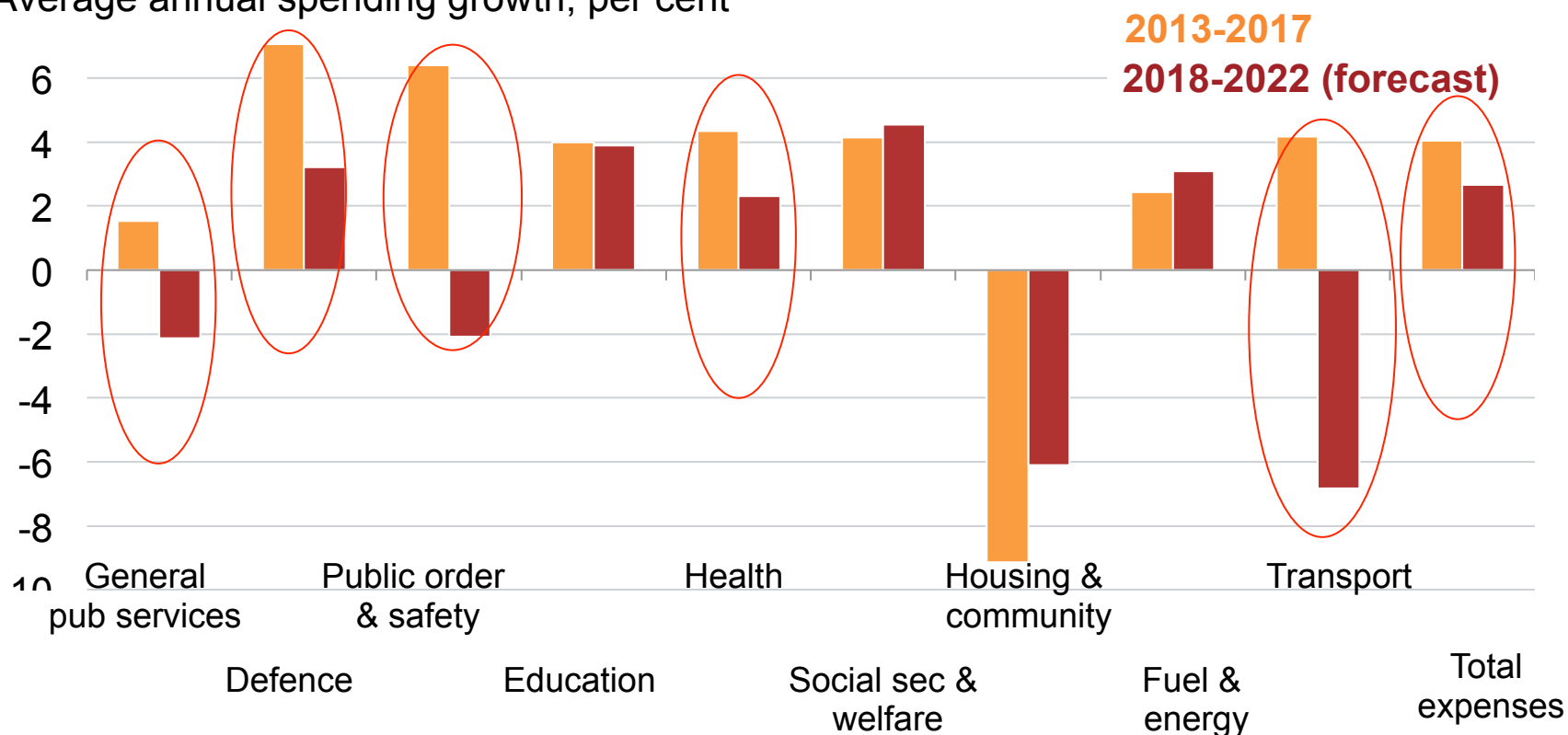
**CPRS
(2009)**

No low income family will be worse off and 90% of them ... will receive windfall compensation.



But the Budget assumes significant spending restraint

Average annual spending growth, per cent

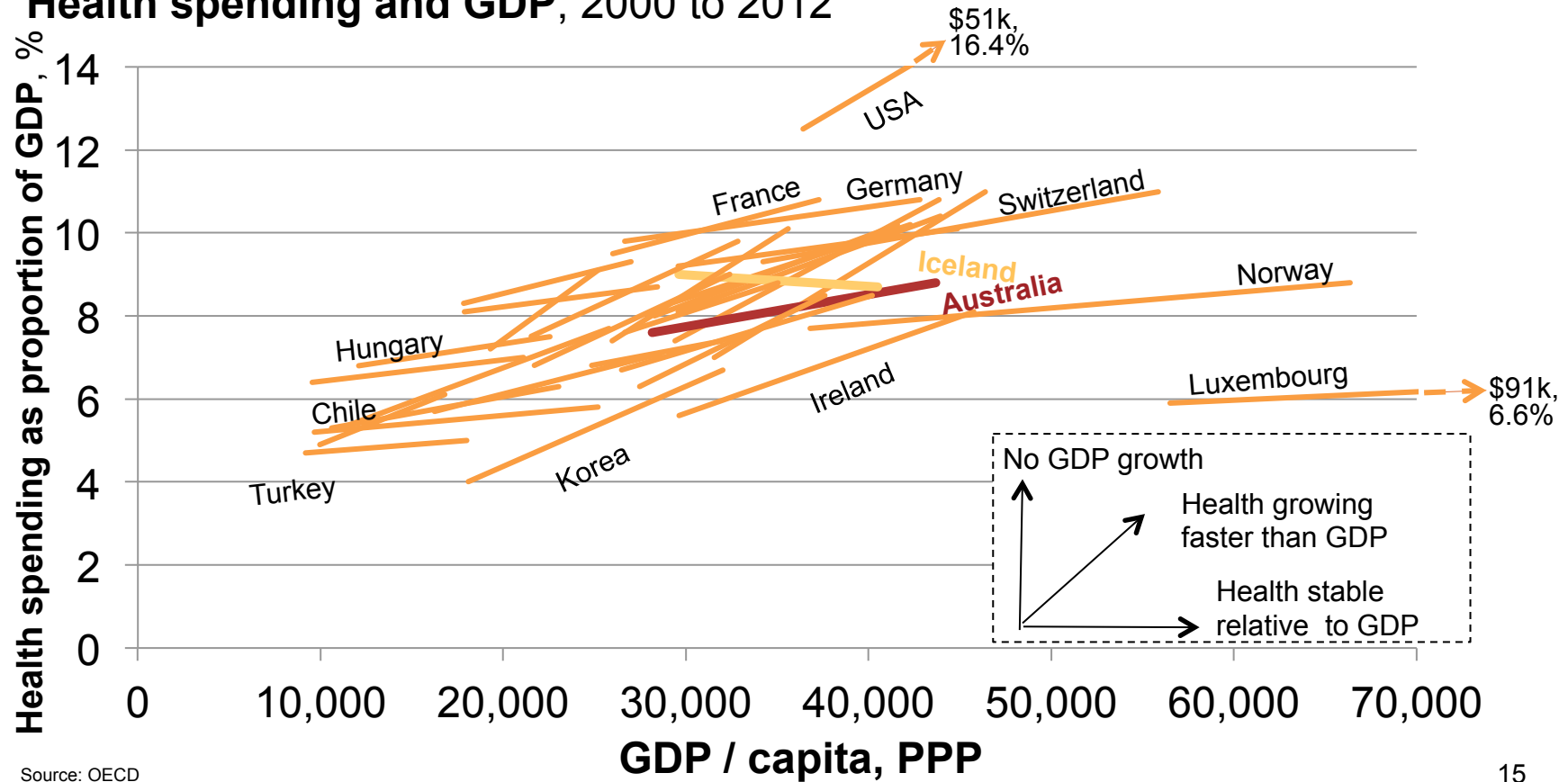


Notes: Excludes some of the smaller functions and expenses for 'other purposes' (largely GST payments to the states). Total expenses growth is also calculated excluding 'other purposes'.

Sources: Commonwealth Budget Papers. 2018-19: Grattan analysis.

As all OECD countries got richer, they spent more on health (except Iceland)

Health spending and GDP, 2000 to 2012



Source: OECD