

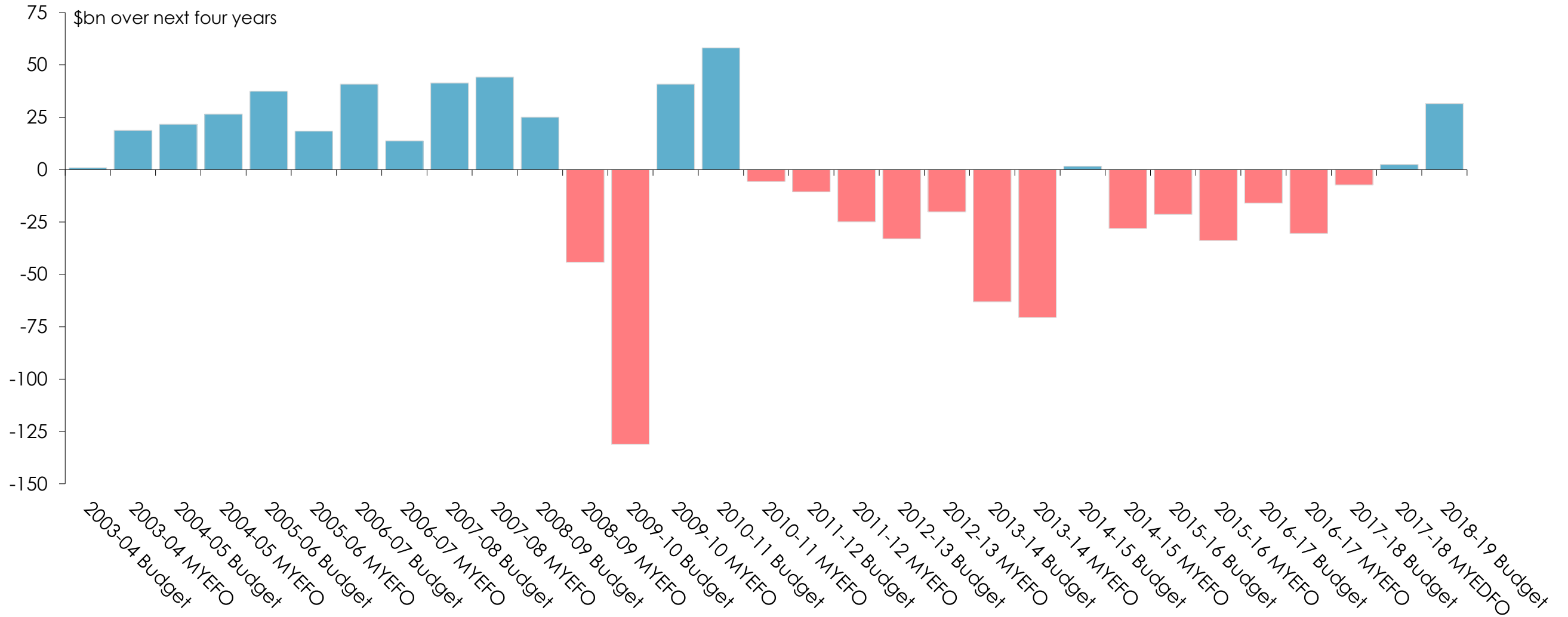
THE 2018-19 BUDGET – AN ASSESSMENT

PRESENTATION TO THE ACT BRANCH OF
THE ECONOMIC SOCIETY OF AUSTRALIA

THE COMMONWEALTH CLUB, CANBERRA
11TH MAY 2018

For the first time since the recession that didn't happen during the GFC, forward estimates of revenues have been revised upwards

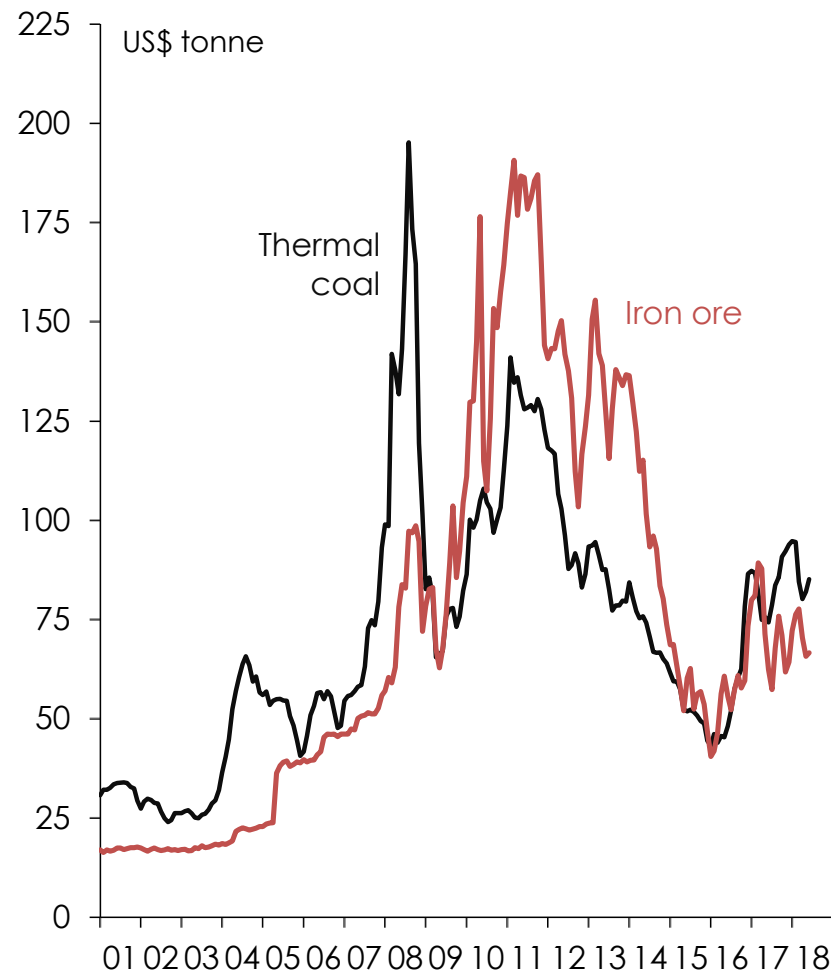
Revisions to four-year forward estimates of revenues due to 'parameter variations' in successive Budgets and Mid-Year Economic & Fiscal Outlooks (MYEFOs)



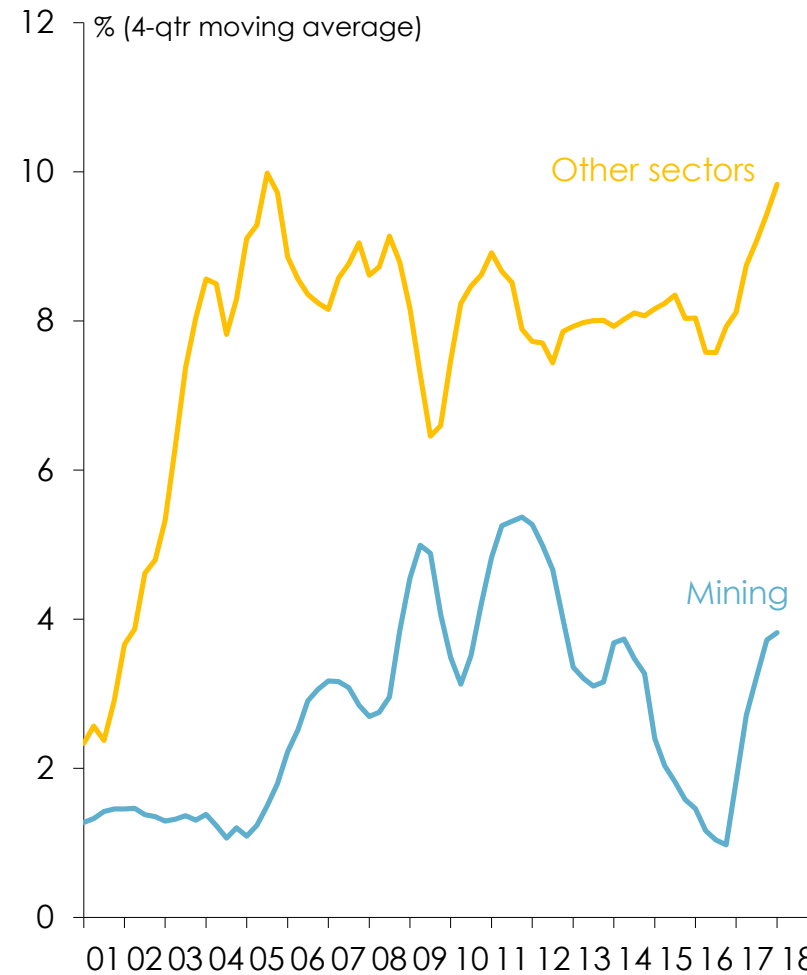
Note: data based on accrual estimates prior to 2013-14, cash estimates thereafter.
Sources: Parliamentary Budget Office; Budget and MYEFO Papers; Corinna Economic Advisory.

The unanticipated revenue surge reflects resilient commodity prices, a pick up in mining and non-mining profits, and a surge in employment

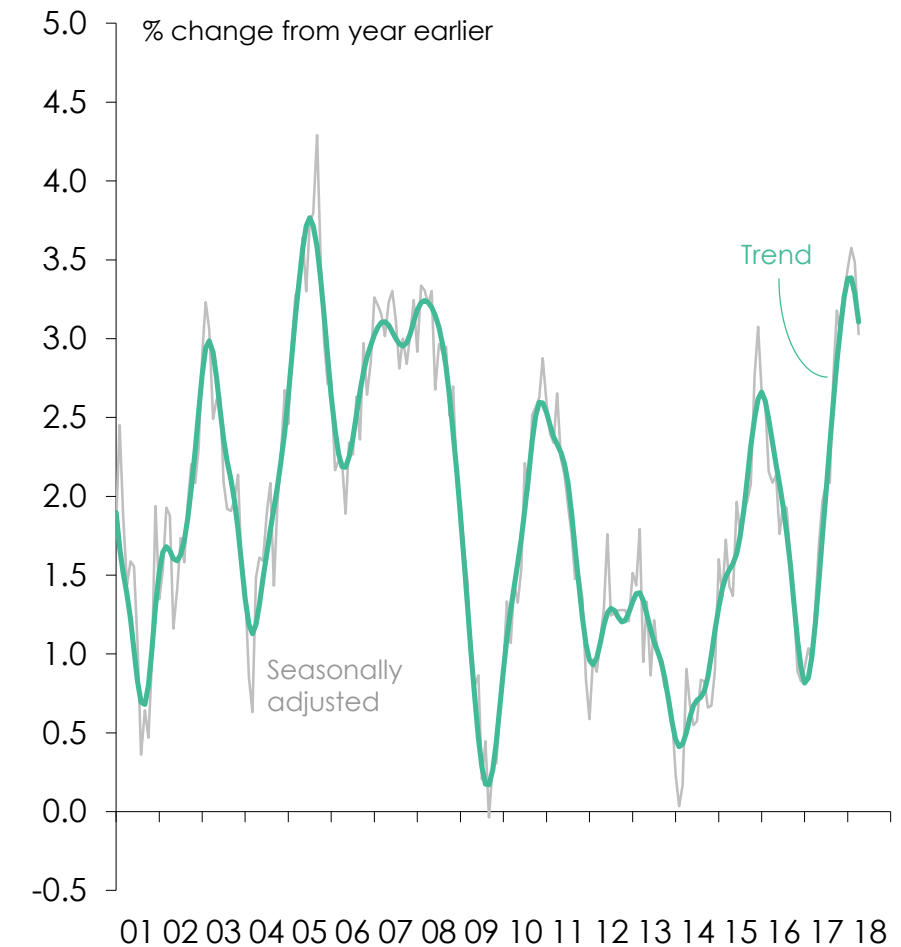
Iron ore and coal prices



Pre-tax profits



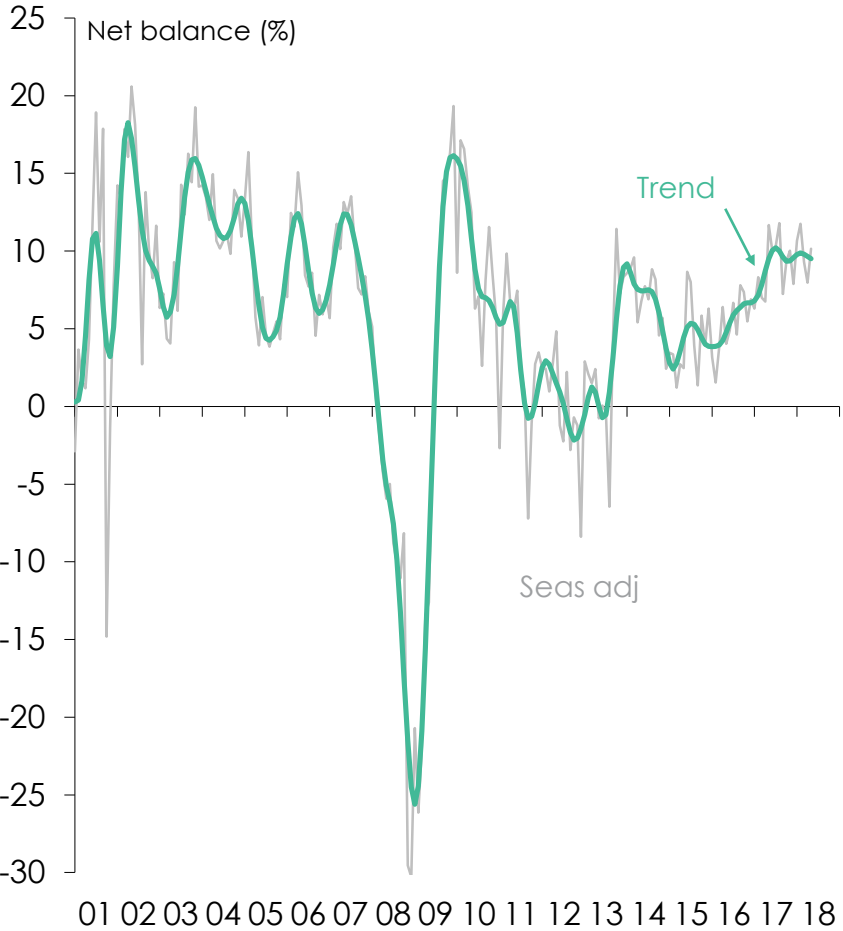
Employment



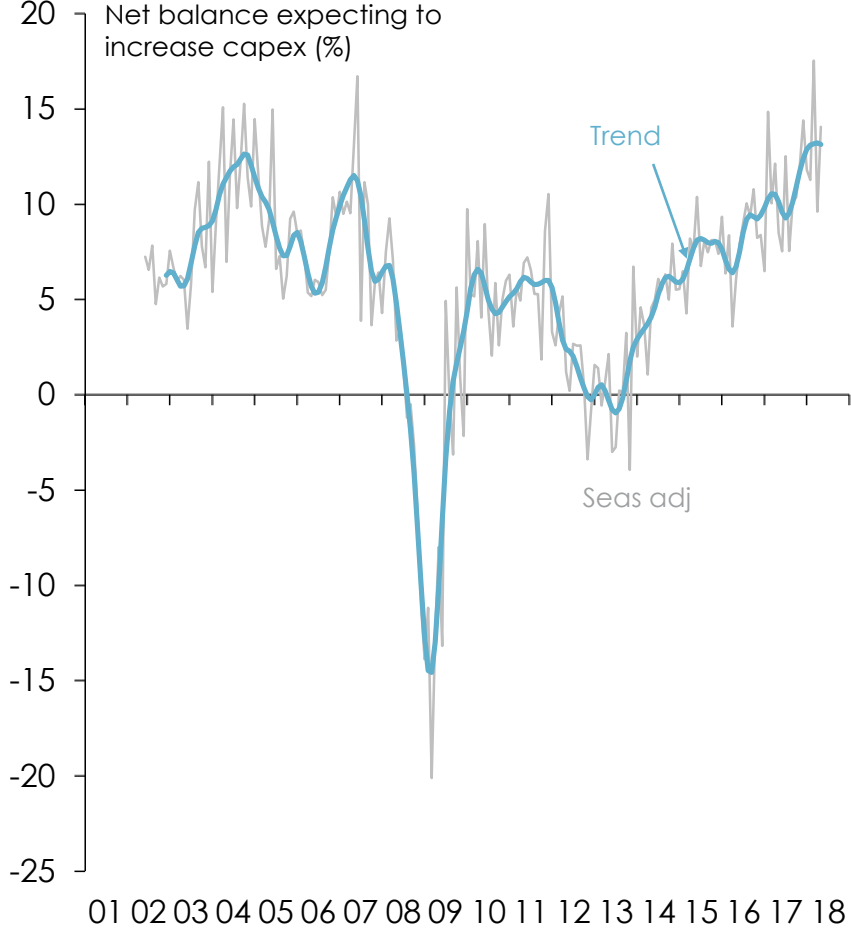
Sources: Thomson Reuters Datastream ; ABS;

And it does look like these can be sustained, at least for a while, even if not at the same strength as over the past year

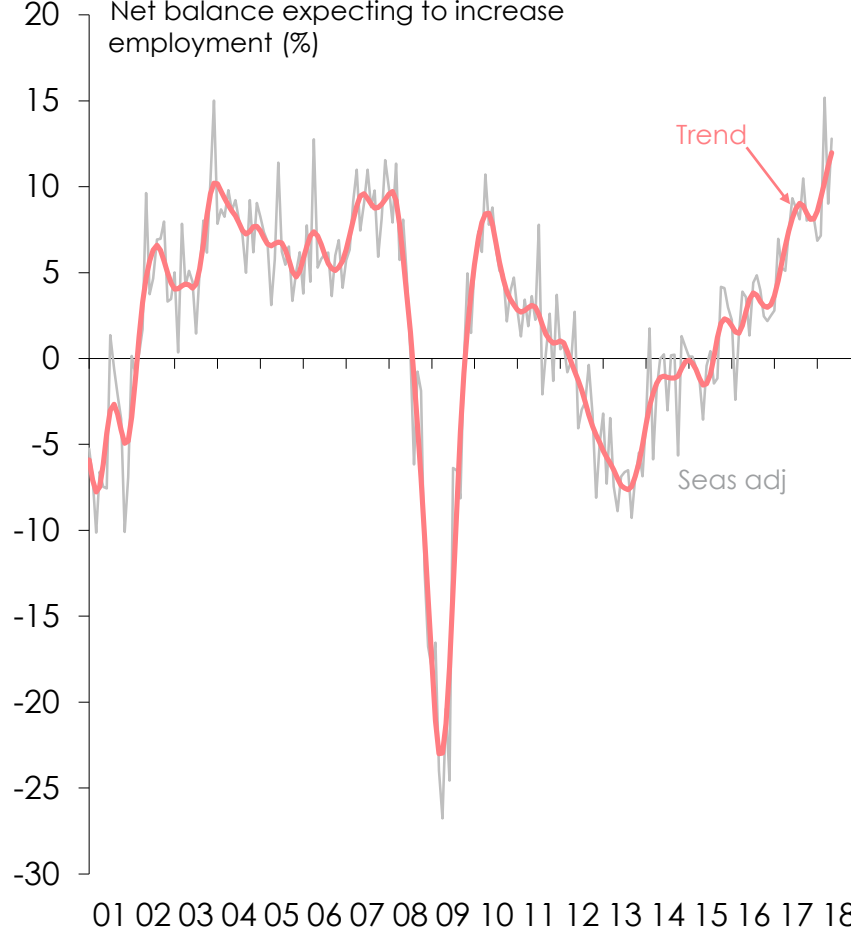
Business confidence



Business capex intentions



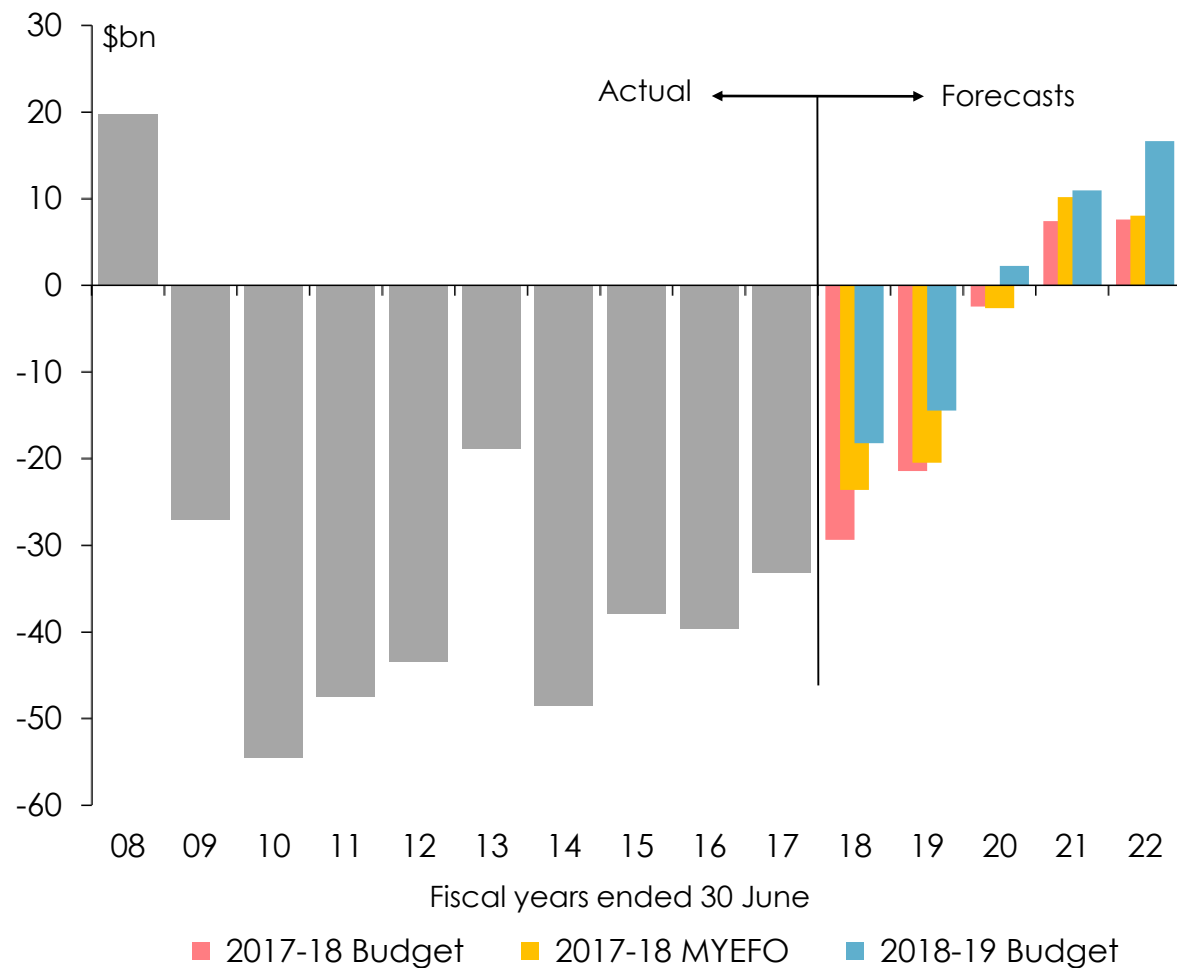
Business hiring intentions



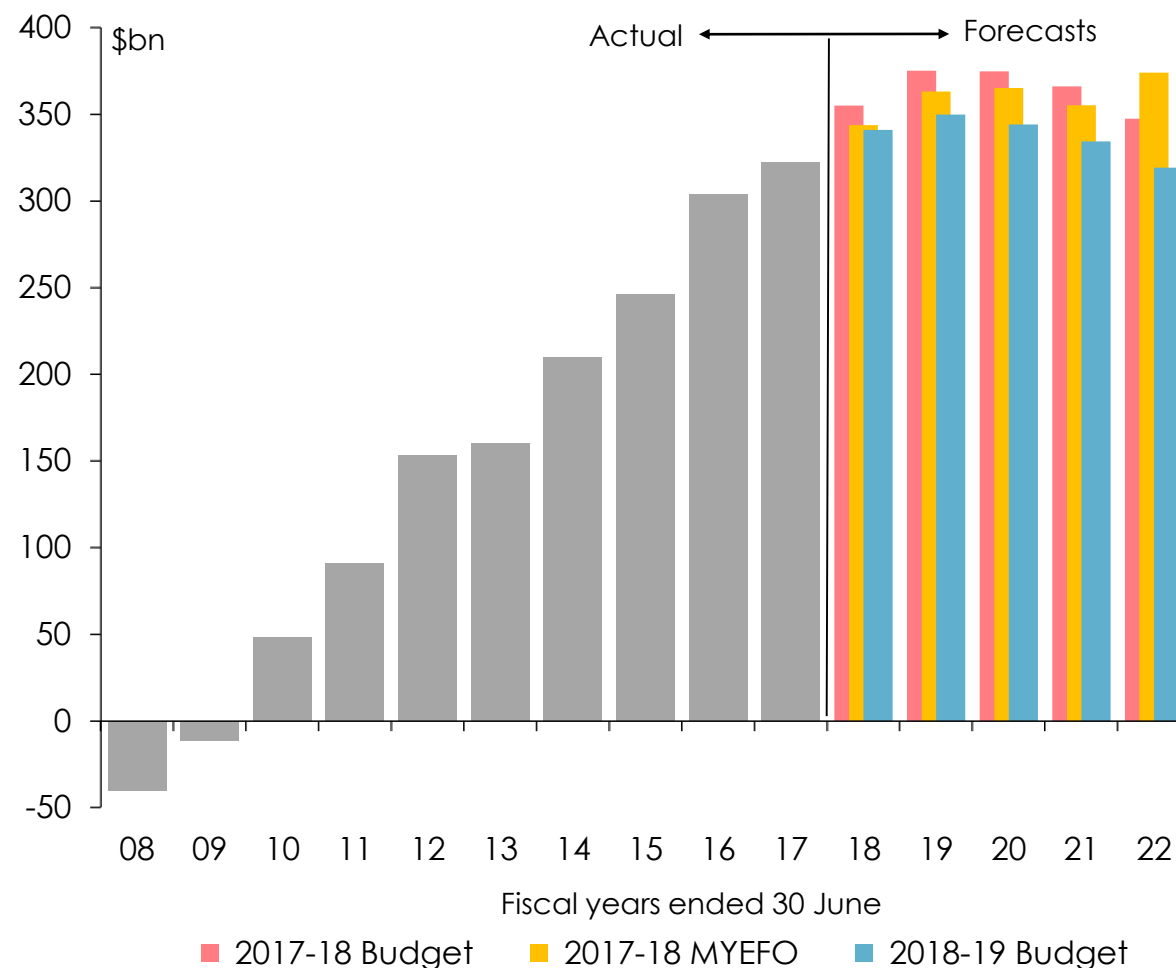
Source: NAB Monthly Business Survey.

This revenue windfall has allowed the Government to improve its bottom line, and start paying down debt sooner, and by more ...

'Underlying' cash balance



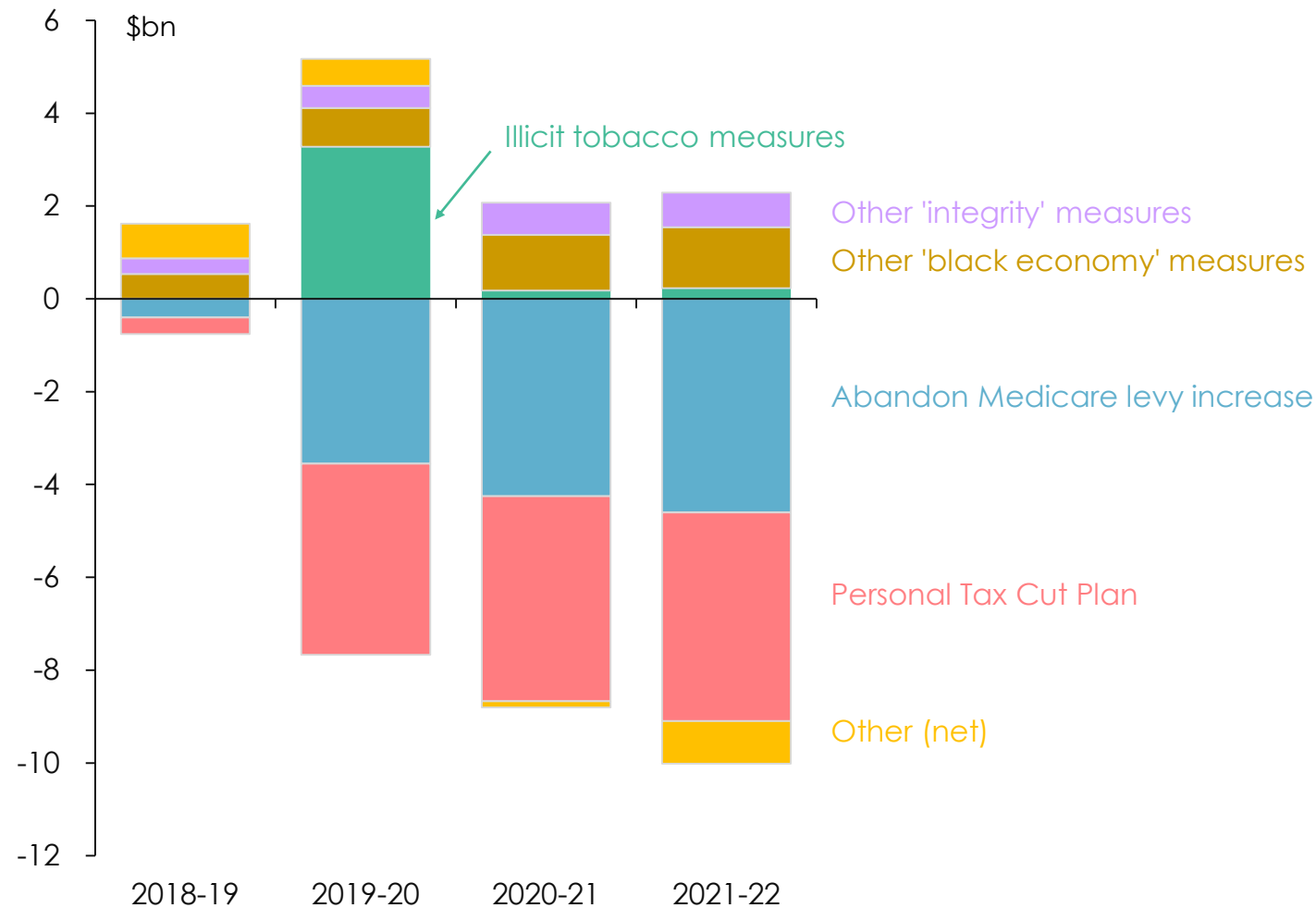
Net debt



Sources: Budget Paper No. 1, 2017-18 and 2018-19; 2017-18 Mid-Year Economic & Fiscal Outlook (MYEFO).

... and to cut taxes by \$26bn over four years, without further significant spending cuts

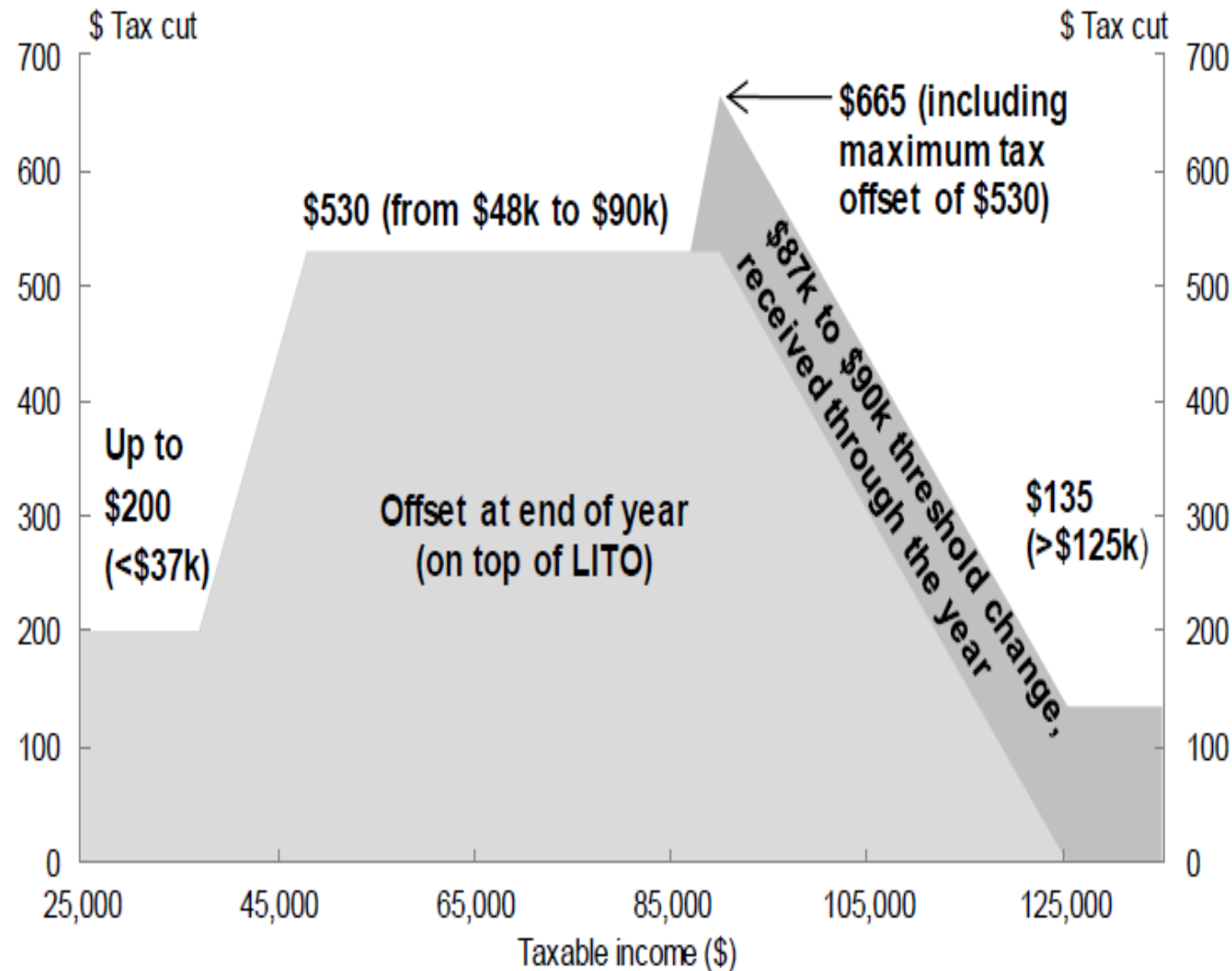
'Bottom line' impact of revenue decisions



Sources: Budget Paper No. 2, 2018-19.

- ❑ The two major 'tax cuts' in the 2018-19 Budget will 'cost' \$26.2bn over the four years to 2021-22
 - abandoning the Medicare levy increase proposed in last year's Budget 'costs' \$12.8bn
 - and 'Step 1' of the Government's 'Personal Income Tax Plan' will cost \$13.4bn
- ❑ \$10bn of this 'cost' is offset by measures targeting the 'black economy', and others aimed at strengthening the 'integrity' of the personal and company income tax systems
 - of which the most important is a one-off \$3.3bn gain in 2019-20 from changing the point at which duty on imported tobacco is collected
- ❑ By contrast there is 'only' \$3.6bn of net savings from spending policy decisions in the 2018-19 Budget
- ❑ In total, the Budget 'gives away' about 40% of the revenue windfalls – with the other 60% going to improving the 'bottom line'

The first part of the Government's 'Personal Income Tax Plan' is cleverly structured to benefit only low- and middle-income taxpayers



- ❑ 'Step 1' of the Government's 'Personal Income Tax Plan' is delivered via a new 'Low and Middle Income Tax Offset', which will be paid as a lump sum after those eligible have lodged their income tax returns (rather than as a reduction in their PAYE instalment deductions)
- ❑ By comparison with the alternative of cutting the 19% and 32½% rates, or raising the thresholds at which these rates become payable, this structure ensures that taxpayers with taxable incomes above \$125,000 don't get any benefit
 - which reduces the 'bottom line' impact, and makes it easier to 'sell' politically
- ❑ And by structuring the tax cut as a refund, the revenue impact doesn't hit the 'bottom line' until 2019-20
 - the year in which the budget returns to surplus
 - conveniently, the year in which the \$3¼bn one-off impact from changing the timing of tobacco duty payment is felt

Sources: Budget Paper No. 1, 2018-19.

The first part of the Government's 'Personal Income Tax Plan' is cleverly structured to benefit only low- and middle-income taxpayers

The three stages of the Government's 'Personal Income Tax Plan'

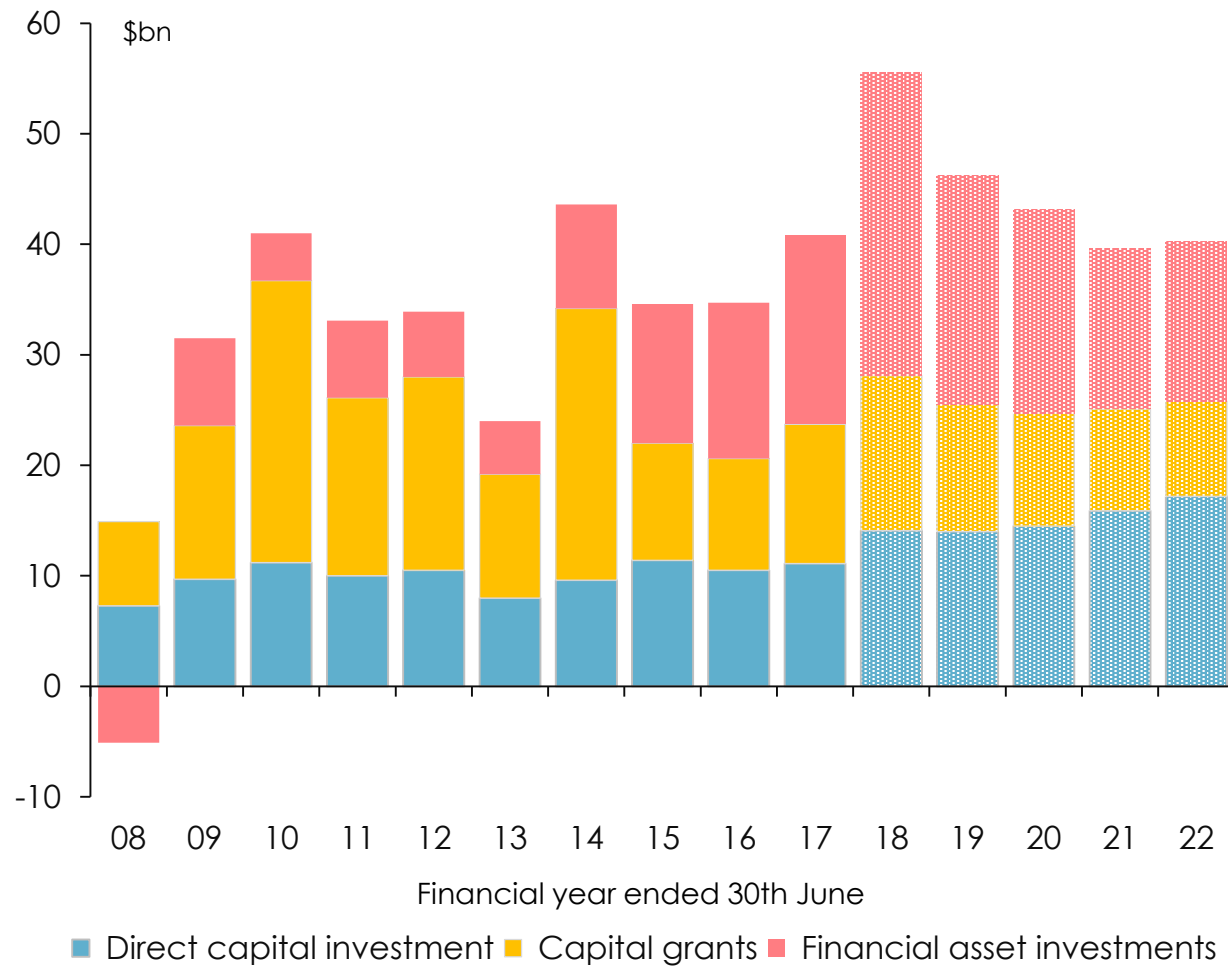
Rate (%)	Current tax thresholds Income range (\$)	New tax thresholds From 1 July 2018 Income range (\$)	New tax thresholds From 1 July 2022 Income range (\$)	New tax thresholds From 1 July 2024 Income range (\$)
Tax free	0 - 18,200	0 - 18,200	0 - 18,200	0 - 18,200
19	18,201 - 37,000	18,201 - 37,000	18,201 - 41,000	18,201 - 41,000
32.5	37,001 - 87,000	37,001 - 90,000	41,001 - 120,000	41,001 - 200,000
37	87,001 - 180,000	90,001 - 180,000	120,001 - 180,000	-
45	>180,000	>180,000	>180,000	>200,000
Low and middle income tax offset	-	Up to 530	-	-
LITO	Up to 445	Up to 445	Up to 645	Up to 645

- ❑ The total cost of the proposed personal income tax cuts is reported to be \$130bn over ten years (although this figure is not in the Budget Papers)
- ❑ The second and especially the third stages will be harder to 'sell' politically, because they imply a lessening in the progressivity of the income tax scales
 - for example post July 2024, a taxpayer on \$80K gets an annual tax reduction of \$540 (equivalent to 0.7% of taxable income), whereas a taxpayer on \$150K gets \$3375 (2.3%), one on \$180K gets \$4725 (2.6%) and one on \$200K or more gets \$7,225 (3.6% of \$200K)

Sources: Budget Paper No. 1, 2018-19; 'Tax Relief Calculator' at www.budget.gov.au.

The Budget includes further increases in infrastructure spending – although whether all of this is ‘good’ spending is questionable

Commonwealth Government capital spending

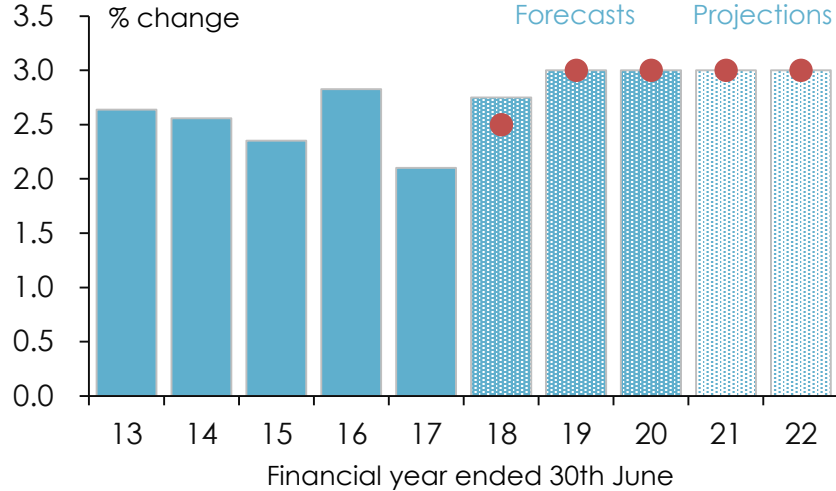


Source: 2018-19 Budget Papers. Statement No. 4.

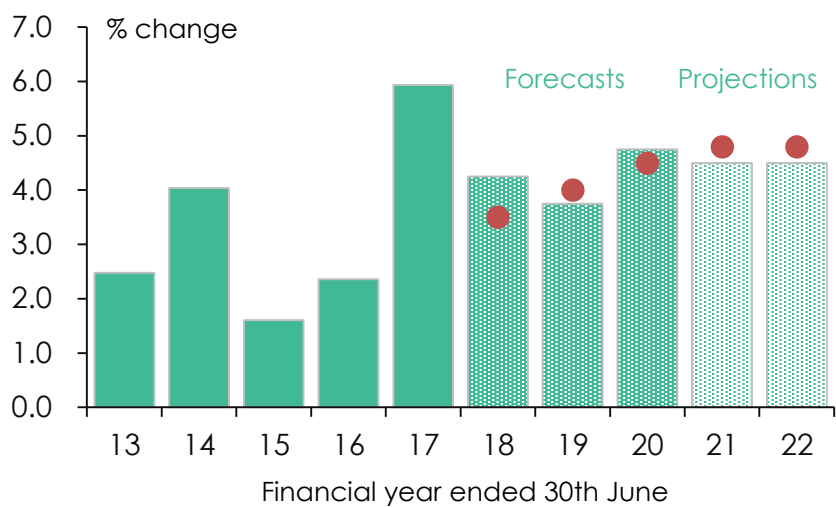
- According to the Budget Papers the Government will spend \$169bn on ‘capital investment’ over the four years to 2021-22
 - however capital investment in each of these years will be less than in 2017-18
- The Budget Papers say that ‘all spending should be assessed for its quality [which] requires a commitment to rigorous project assessment and program evaluation’ and that ‘infrastructure spending should be focussed on improving productivity’
 - it’s not clear that these strictures have been consistently followed – eg the ‘Inland Rail’ project, or ‘porno-scanners’ at domestic airports
- Over 40% of the Government’s capital spending will occur ‘off budget’ via investments in government-controlled companies (eg Inland Rail, Western Sydney Airport and Snowy 2.0)
 - this spending isn’t included in the ‘underlying’ cash balance
 - and typically attracts less scrutiny

Most of the economic forecasts and projections underpinning the Budget look reasonable – except for the projections for wages growth

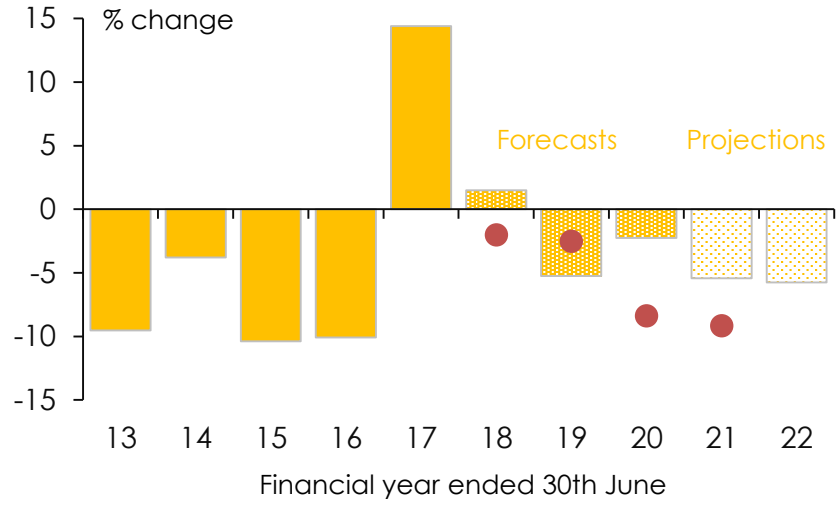
Real GDP



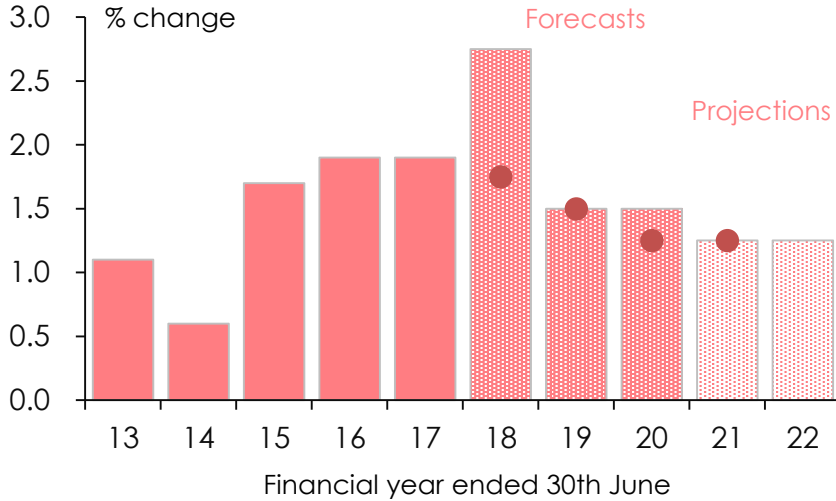
Nominal GDP



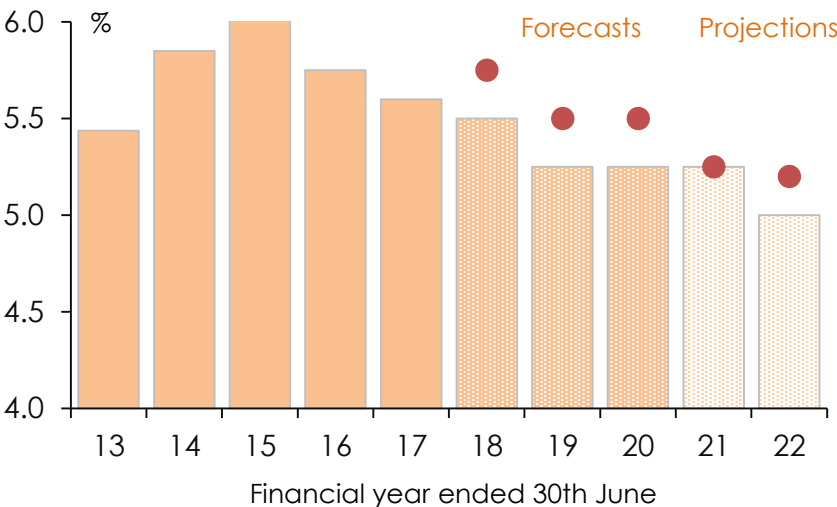
Terms of trade



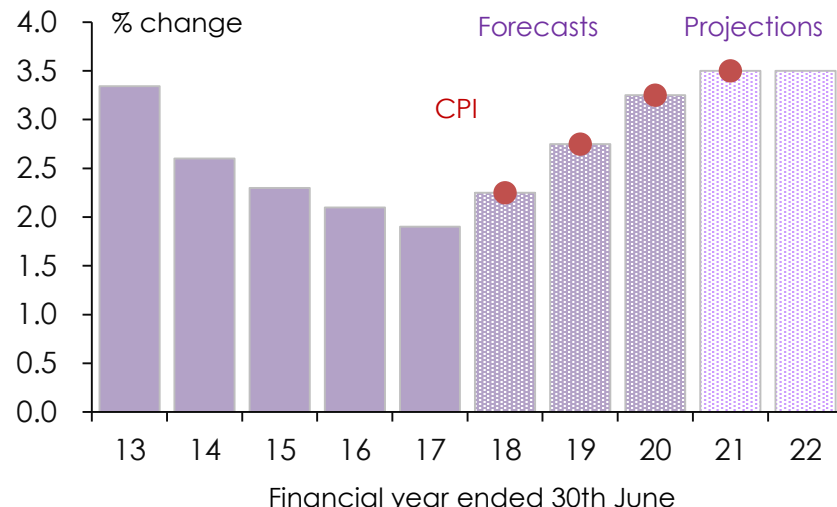
Employment



Unemployment



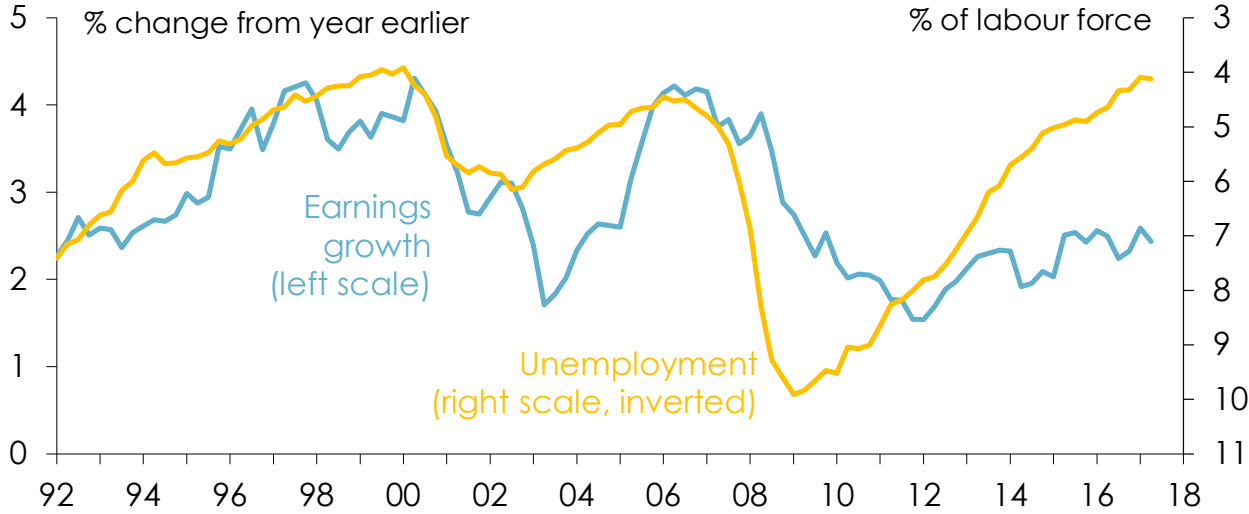
Wages



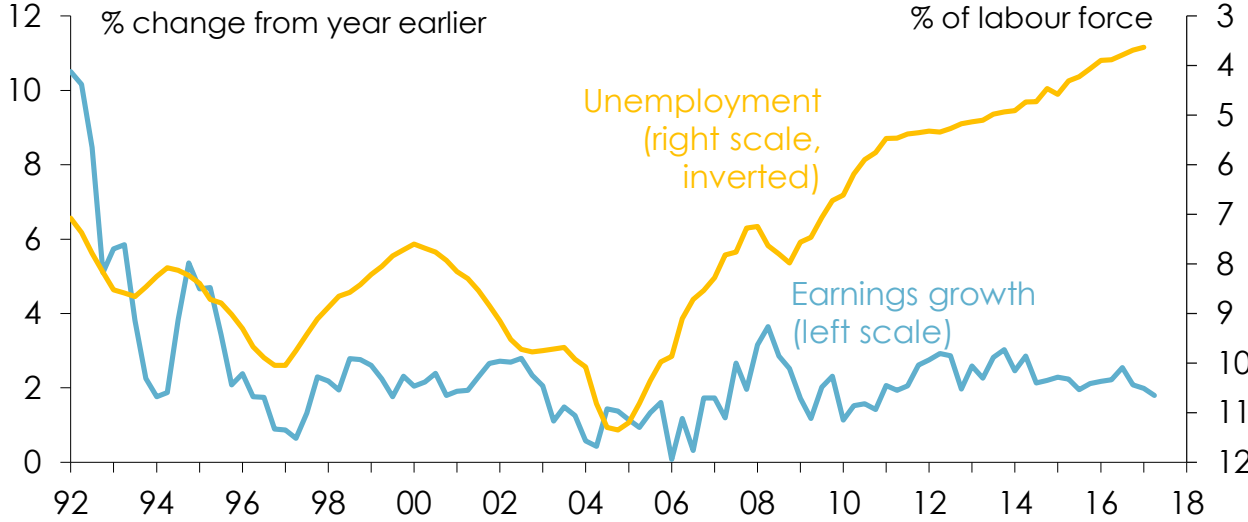
Note: Dots in the above charts are the forecasts/projections in the 2017-18 Mid-Year Economic & Fiscal Outlook (MYEFO).
Sources: ABS; 2018-19 Budget Papers, Statement No. 2, and 2017-18 MYEFO.

In 'advanced' economies where unemployment is already below the 'full employment' level, wages growth remains very sluggish

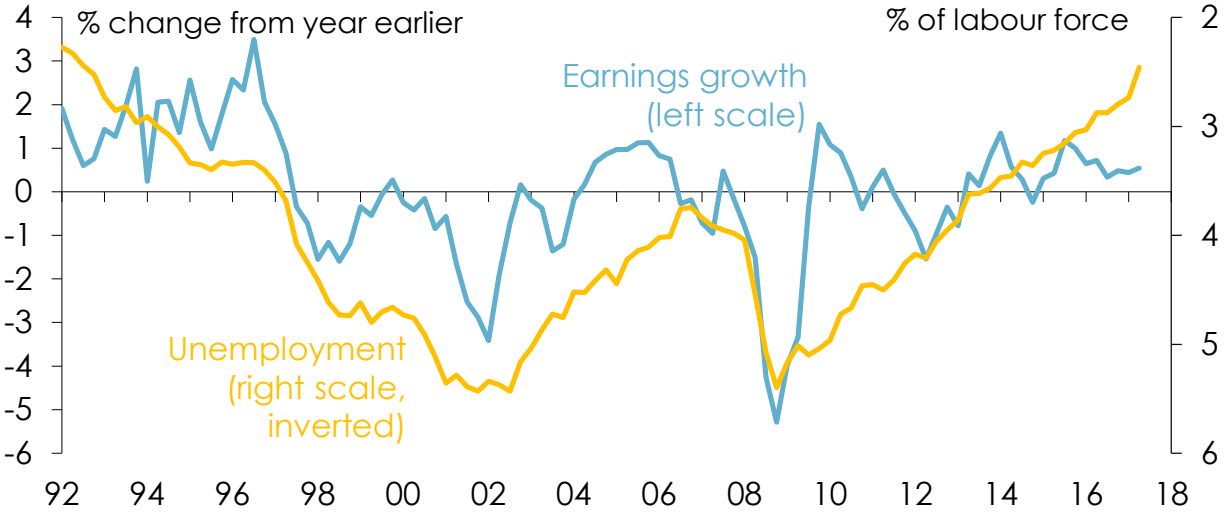
United States



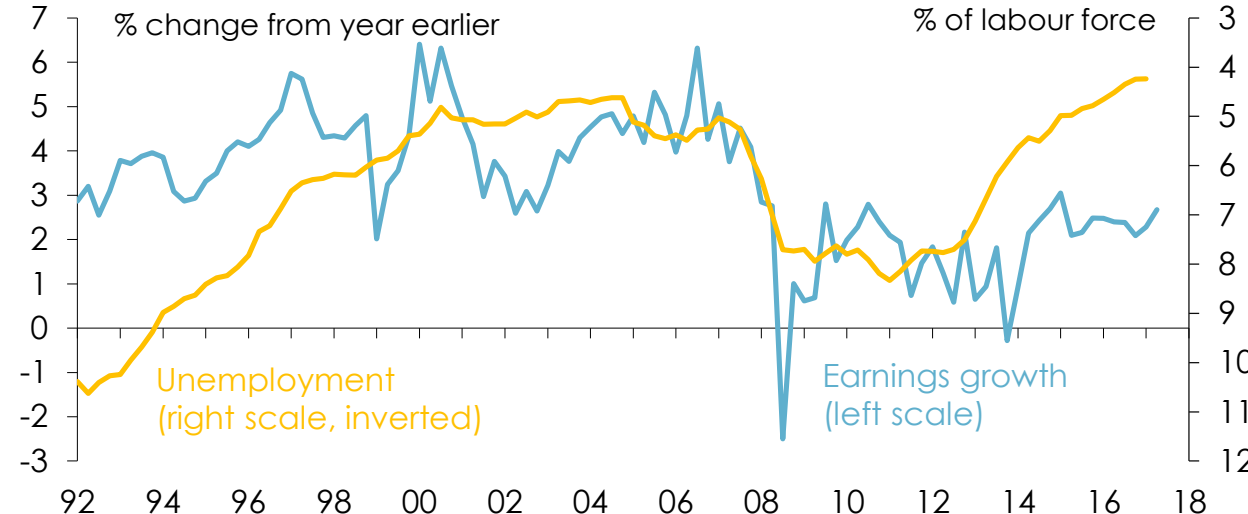
Germany



Japan



United Kingdom



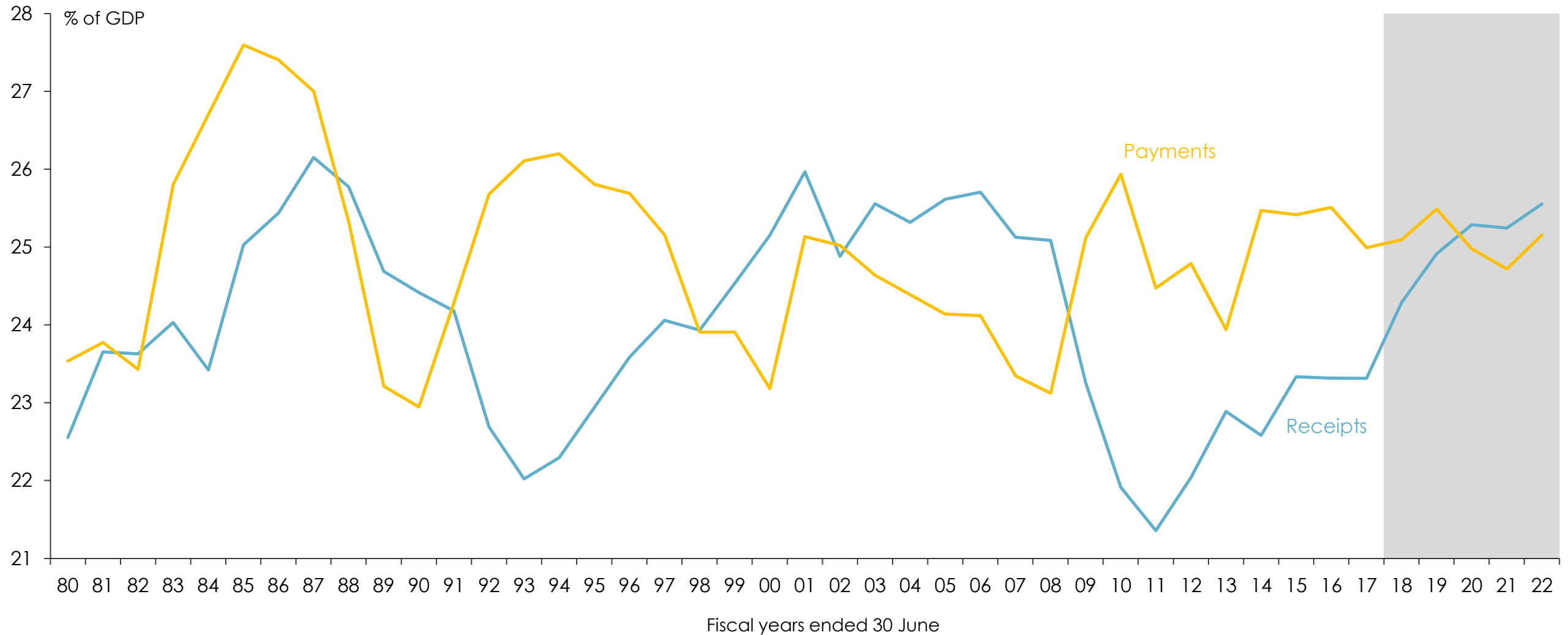
Sources: US Bureau of Labor Statistics; Japan Labour Ministry; Bundesagentur für Arbeit; UK Office of National Statistics; OECD.

Some things that perhaps should have been in this year's Budget, but weren't

- ❑ **There was nothing in this year's Budget about housing affordability**
 - Housing was a major focus of last year's Budget
 - Most of the measures foreshadowed in last year's Budget are yet to be implemented, apart from the 'super for housing' scheme (which will likely make the problem worse, at the margin, not better)
 - There is absolutely nothing about housing in this year's Budget
 - The new 'National Housing and Homelessness Agreement' with States and Territories which commences in 2018-19 did not include any increase in funding for affordable rental housing
 - Nor was there any increase in Commonwealth Rent Assistance (to pensioners and others renting privately)
- ❑ **No adjustment to Newstart Allowances**
 - Over the past 20 years the Newstart Allowance has fallen from over 90% of the single age pension to about 66%
 - The Government has again refused to narrow this gap, despite support from across the spectrum of public opinion (from ACOSS and the ACTU to the BCA)
- ❑ **Greater transparency regarding, and more rigorous assessment of, spending on 'security'**
 - The Productivity Commission's latest *Trade and Assistance Review* makes a timely call for 'periodic systemic review by an agency without active involvement in security policy', noting there is 'very little visibility of the costs created by national security measures'
 - It is just ludicrous that the amount of additional spending in the Budget on ASIS cannot be disclosed for 'national security reasons'

'Budget repair' since 2011 has owed much more to increases in receipts and less to reductions in payments than in previous fiscal consolidations

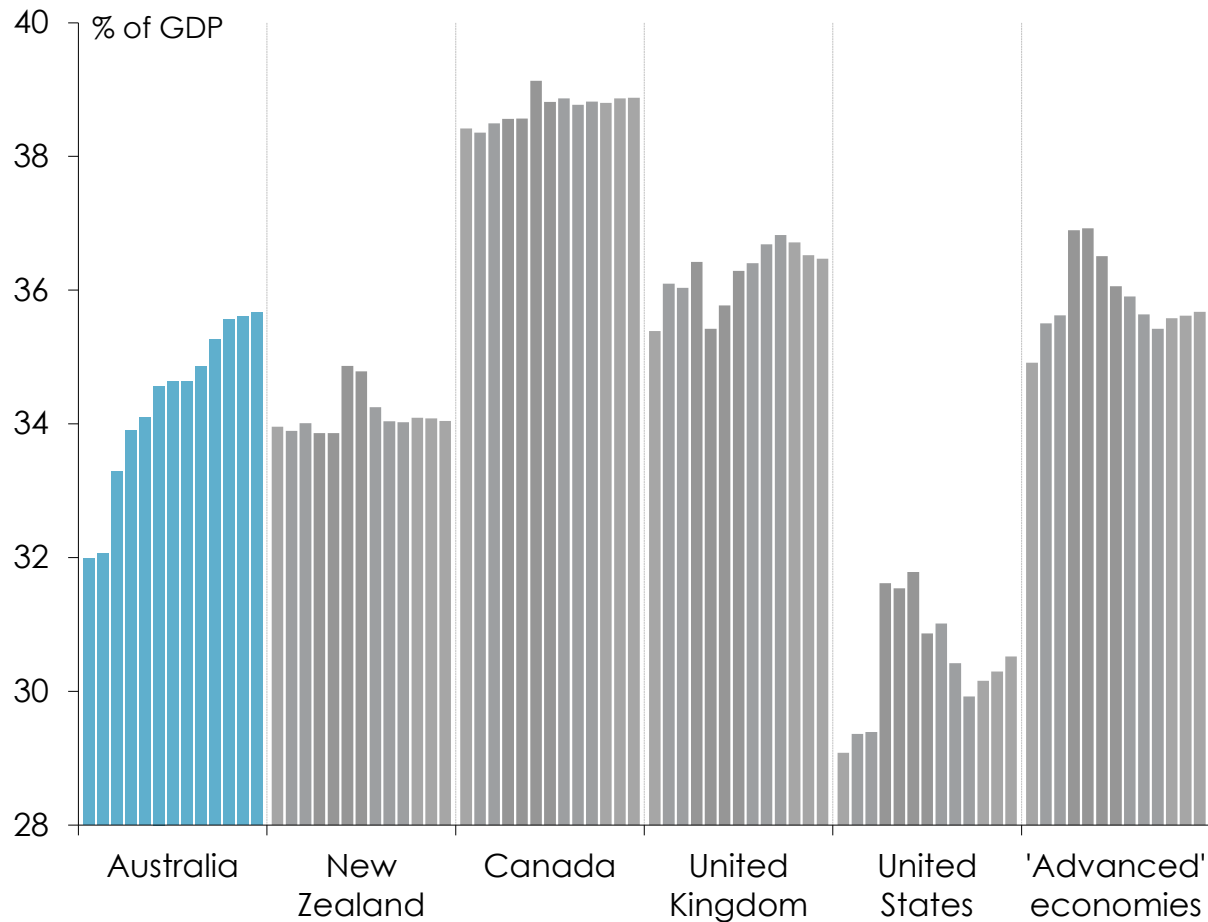
Cash receipts and payments as a pc of GDP



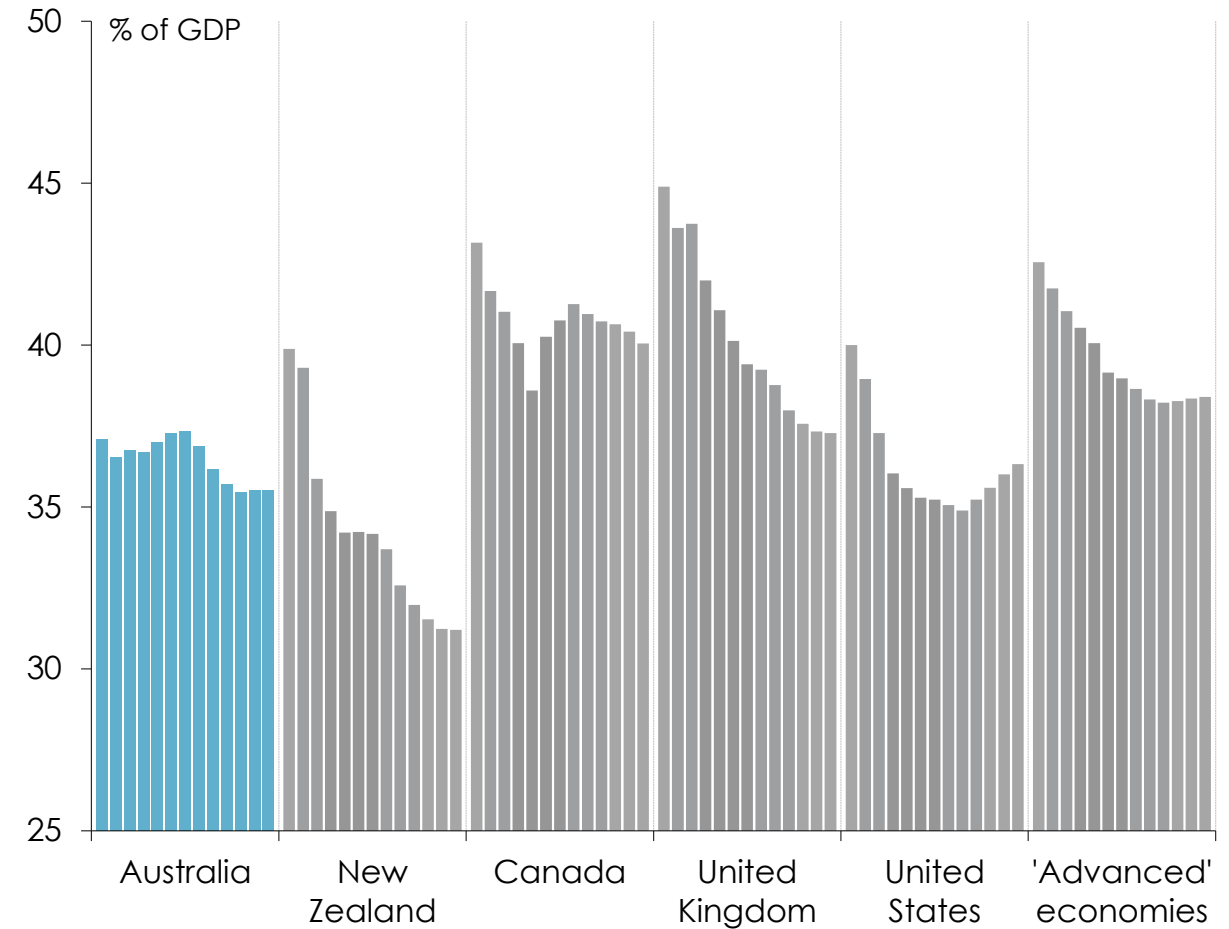
Source: 2018-19 Budget Paper No. 1, Statement No. 11.

By contrast, in most other 'advanced' economies, most of the fiscal consolidation has been on the expenditure side

General government revenue as a pc of GDP, 2011-2023



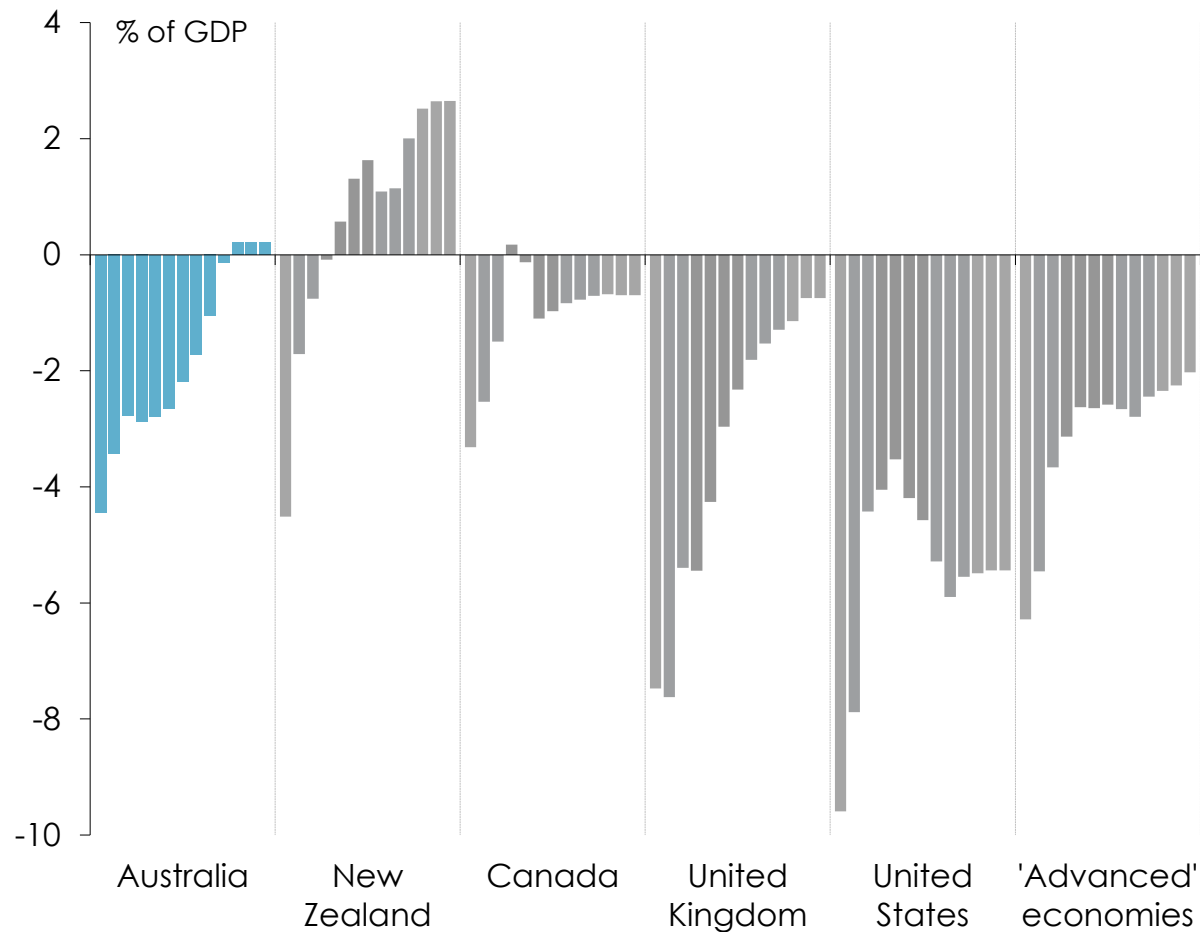
General government outlays as a pc of GDP, 2011-2023



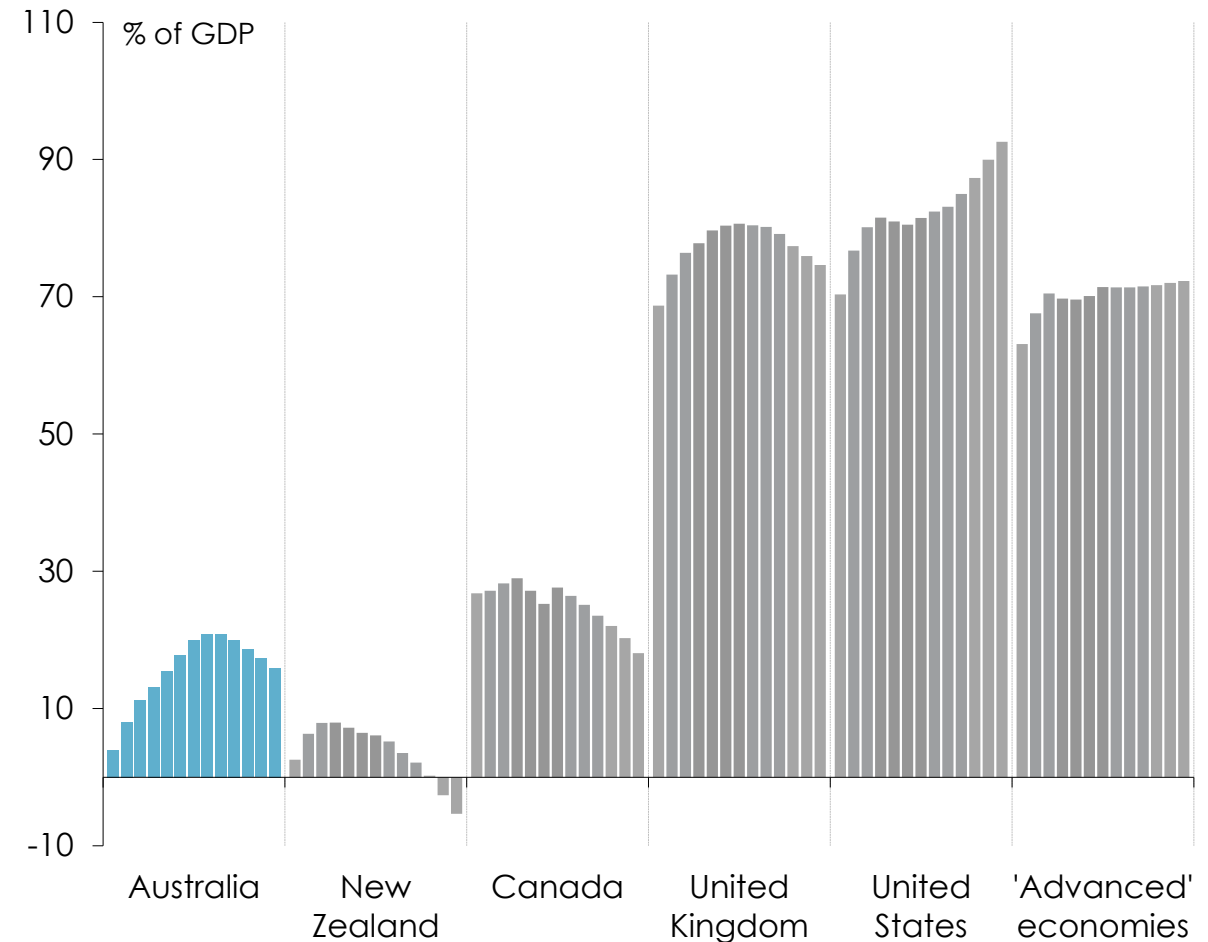
Source: IMF, *Fiscal Monitor*, April 2018. Note that 'general government' includes sub-national governments (ie, state or provincial, territory and local governments); and that the figures for Australia pre-date the 2018-19 Budget.

Nonetheless, Australia's fiscal position is stronger than that of most other 'advanced' economies, except for NZ (and Scandinavian countries)

General government overall balance as a pc of GDP, 2011-2023



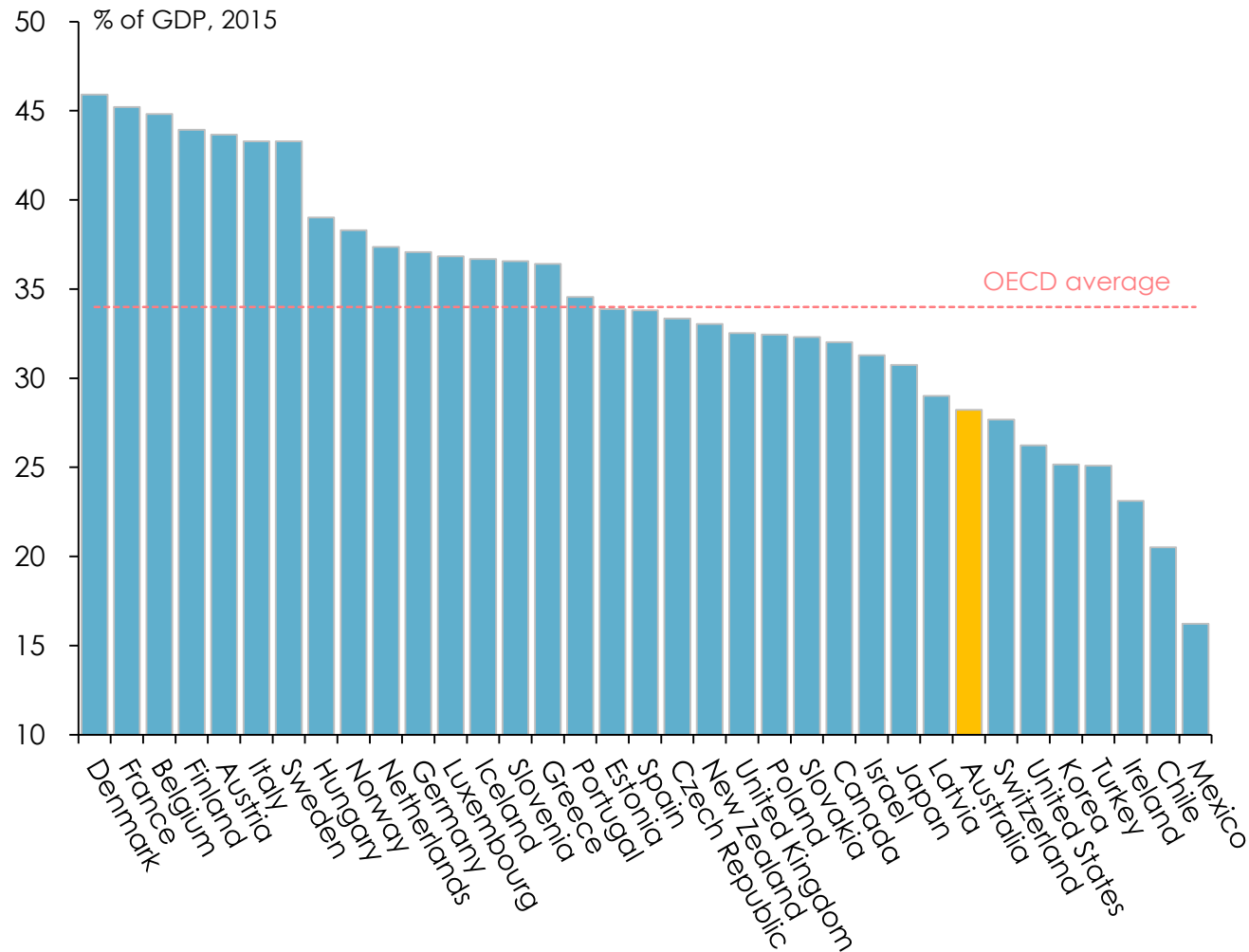
General government net debt as a pc of GDP, 2011-2023



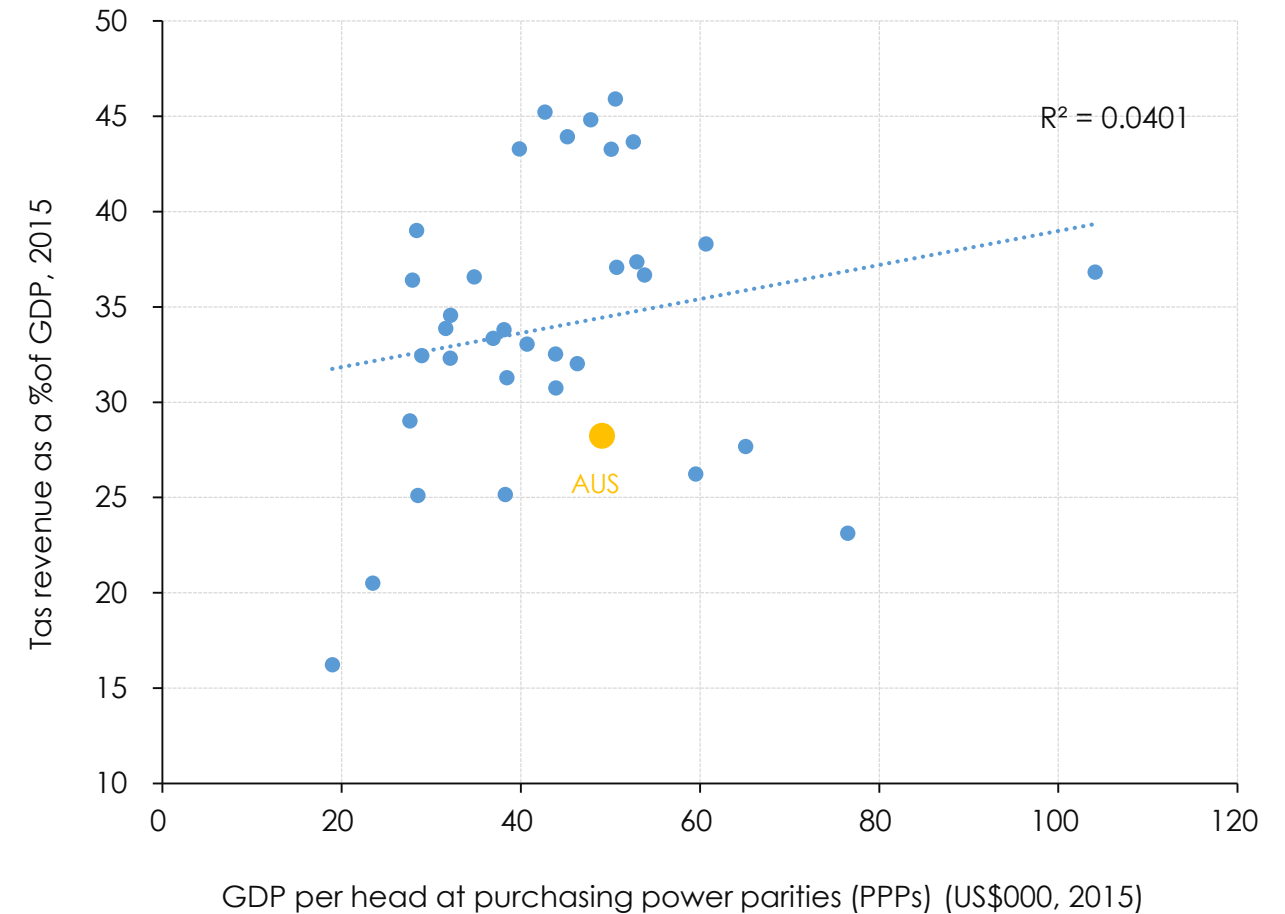
Source: IMF, *Fiscal Monitor*, April 2018. Note that 'general government' includes sub-national governments (ie, state or provincial, territory and local governments). Australian figures pre-date the 2018-19 Budget.

Australia isn't a high tax country, by 'advanced' economy standards – and there's no correlation between the tax take and GDP per head

Total tax revenue as a pc of GDP, OECD countries, 2015



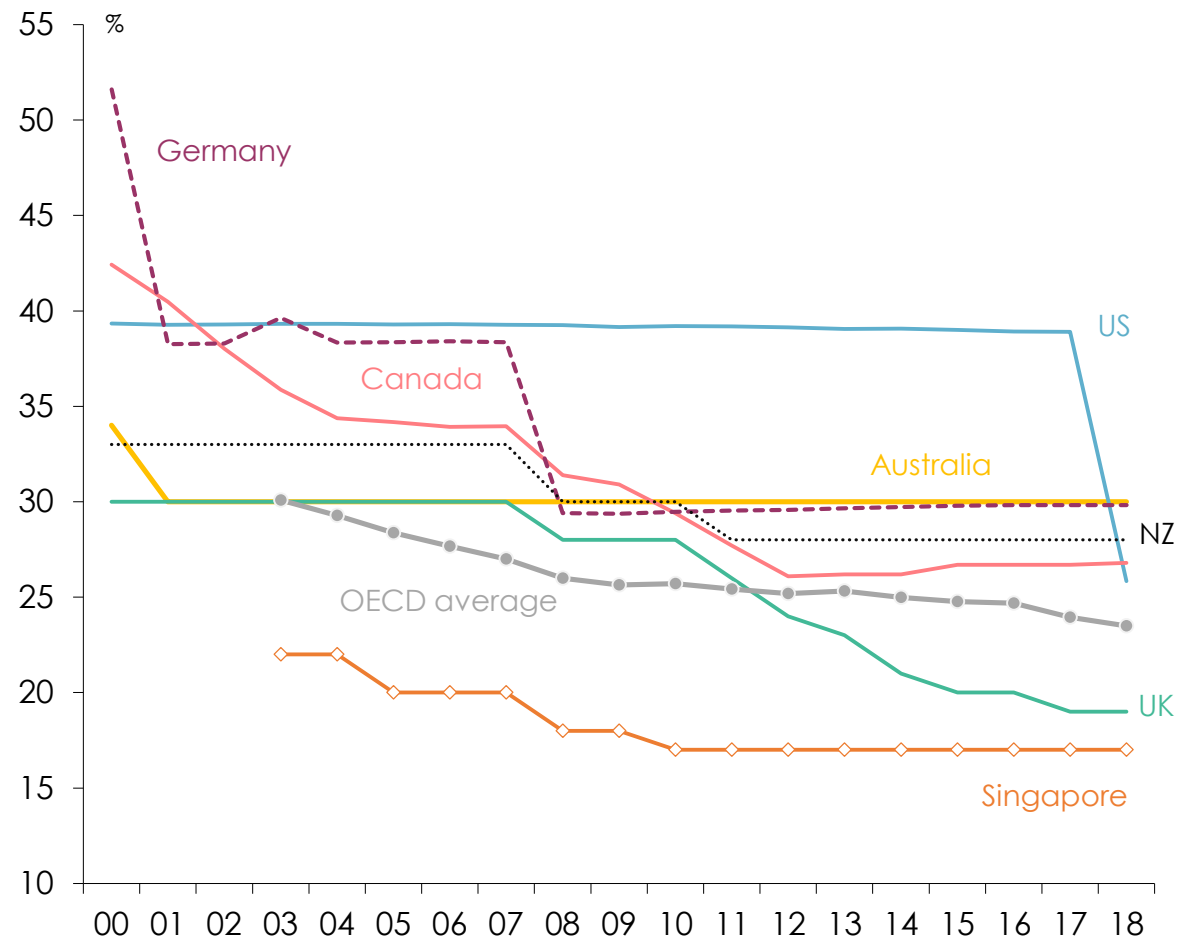
Tax revenue as a pc of GDP and GDP per capita, OECD countries, 2015



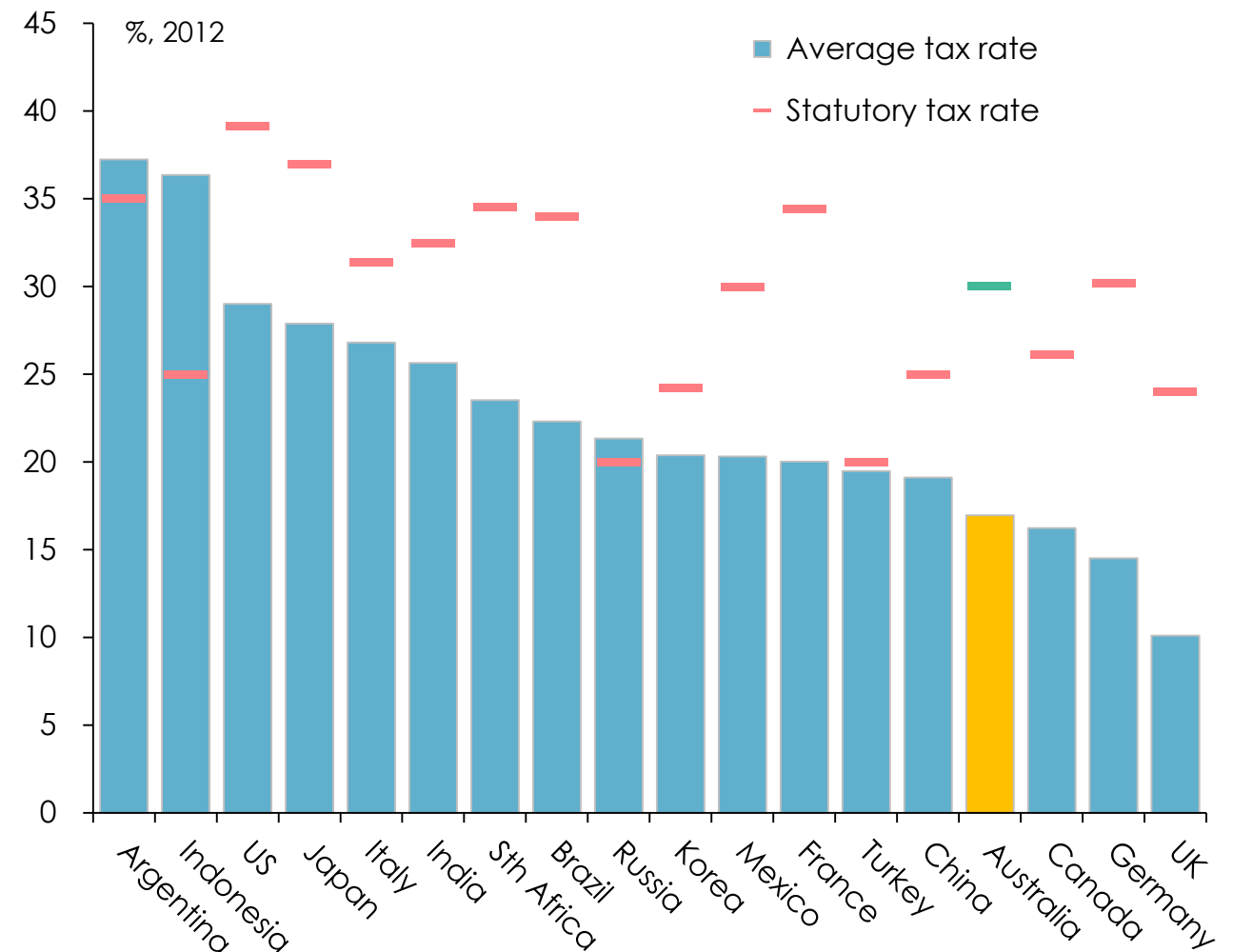
Sources: OECD.Stat, Revenue Statistics – OECD Member Countries and Economic Outlook database.

Australia's corporate tax rate is one of the highest in the 'developed world' – but companies don't necessarily pay the statutory tax rate

Corporate tax rates, selected 'advanced' economies, 2000-2018



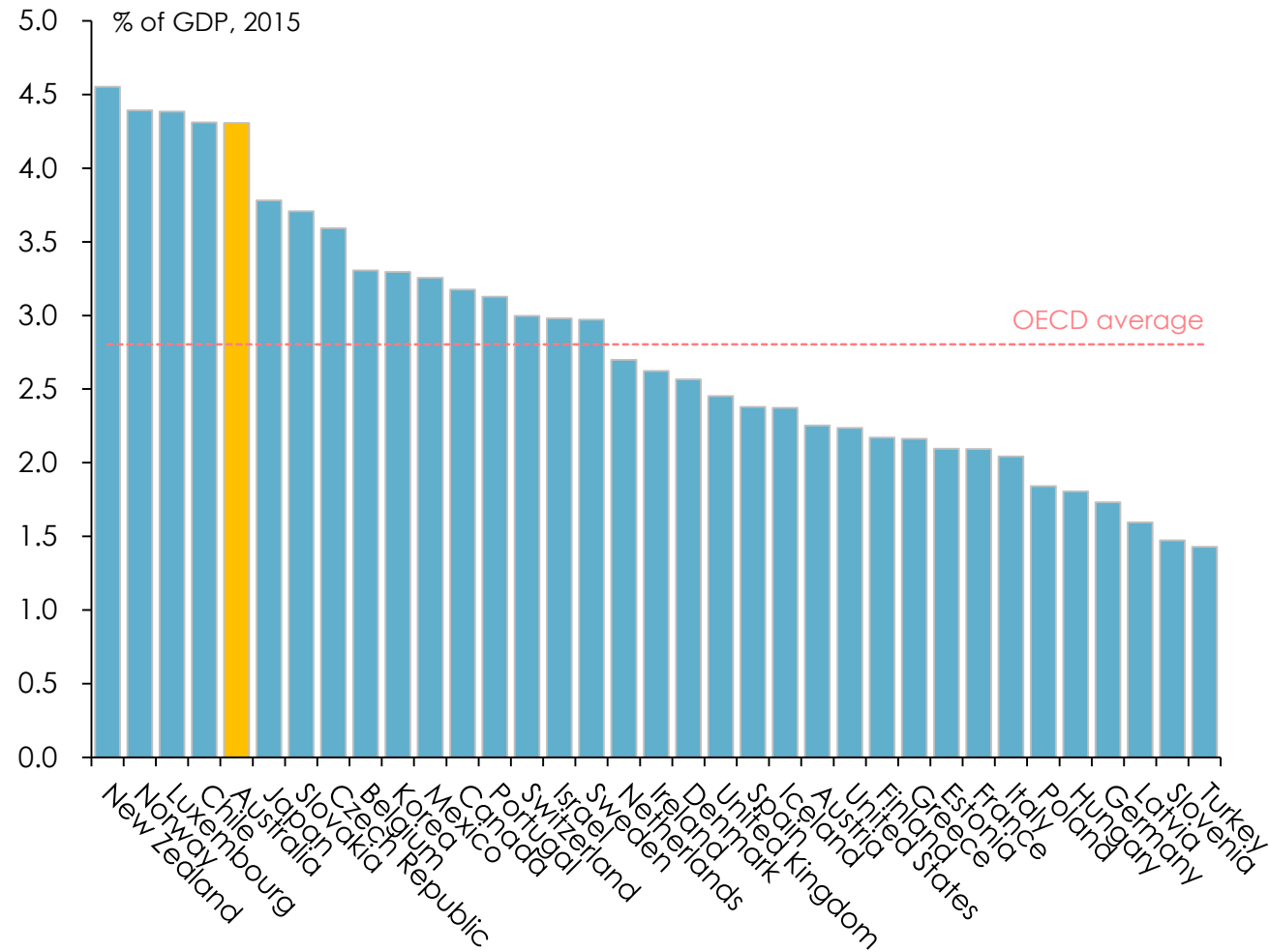
Statutory vs average corporate tax rates, G20 economies, 2012



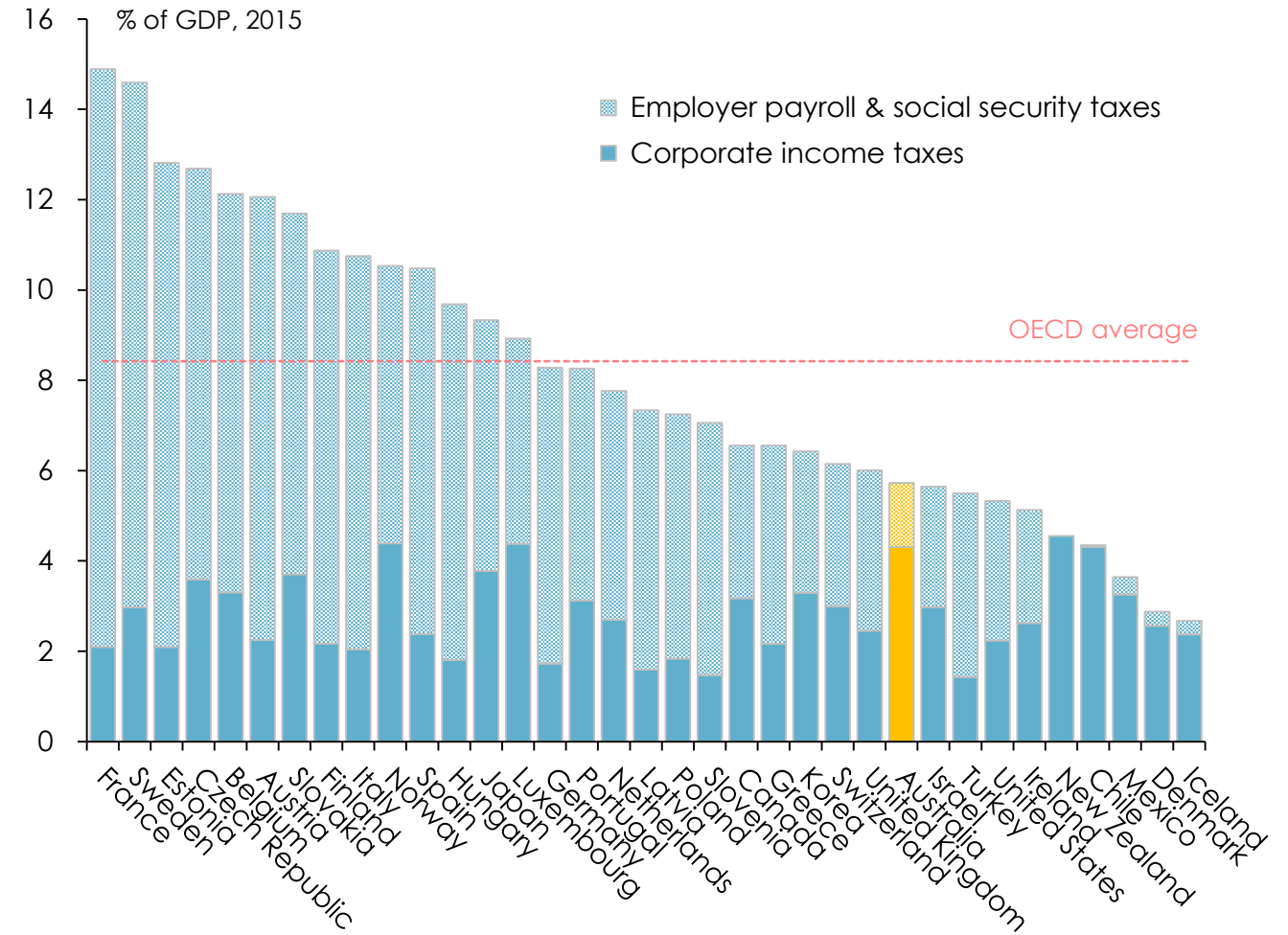
Sources: OECD.Stat, Revenue Statistics – OECD Member Countries; KPMG, Corporate Tax Rates table; US Congressional Budget Office, International Comparisons of Corporate Income Tax Rates, March 2017. Note: Average corporate tax rates are calculated as corporate taxes paid as a percentage of total income, as reported by US-owned companies operating in non-US jurisdictions, and foreign companies operating in the US.

Australia does collect a lot of revenue from company tax – but the total tax burden on business is not high by ‘advanced’ economy standards

Company income tax revenue as a pc of GDP, OECD countries, 2015



Company income and other employer taxes as a pc of GDP, OECD countries, 2015

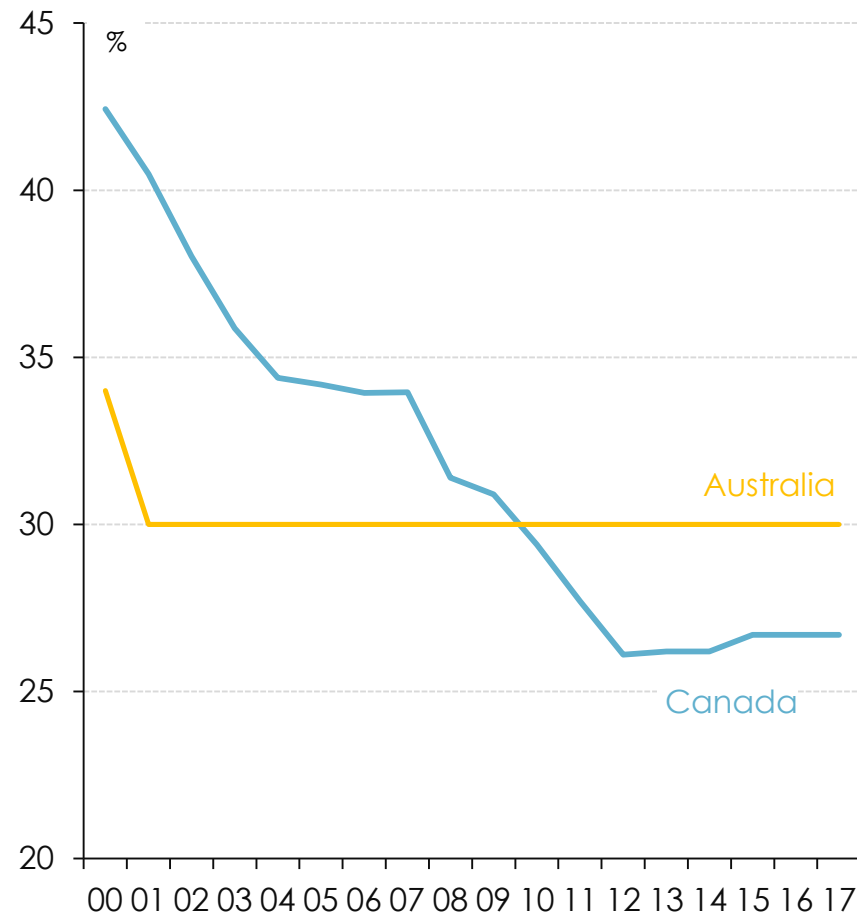


Sources: OECD.Stat, Revenue Statistics – OECD Member Countries.

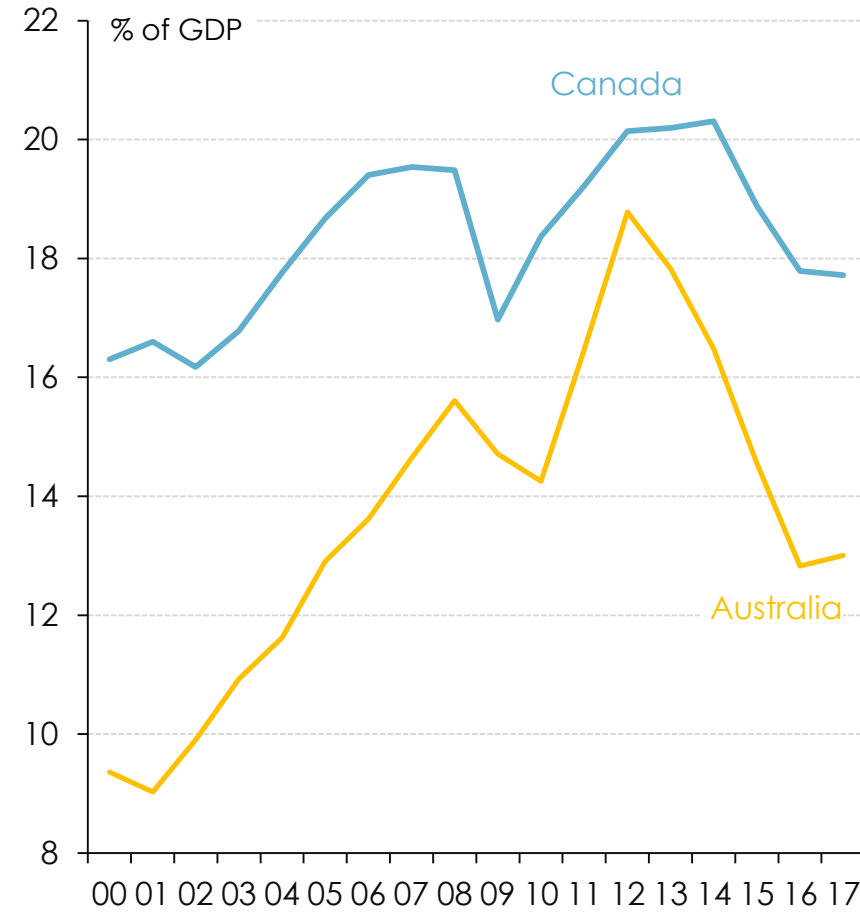
Canada has cut its corporate tax rate by three times as much as the proposed in Australia – without any obvious lift in investment or wages

Australia and Canada compared

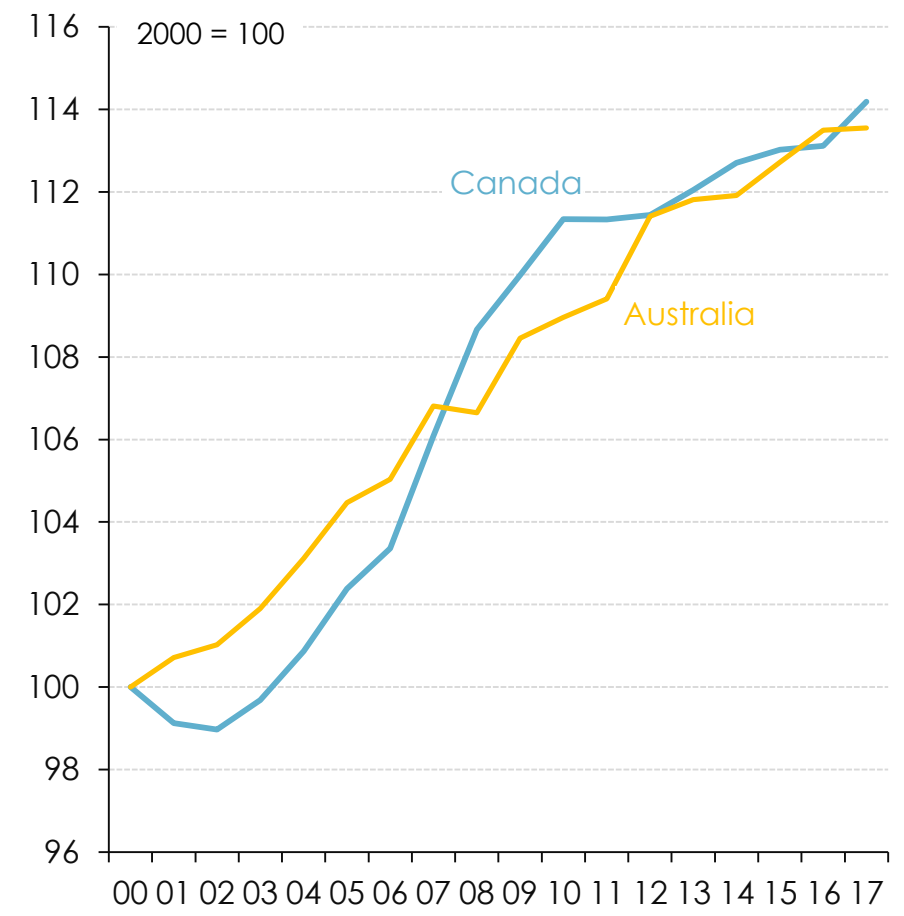
Company tax rate



Business investment



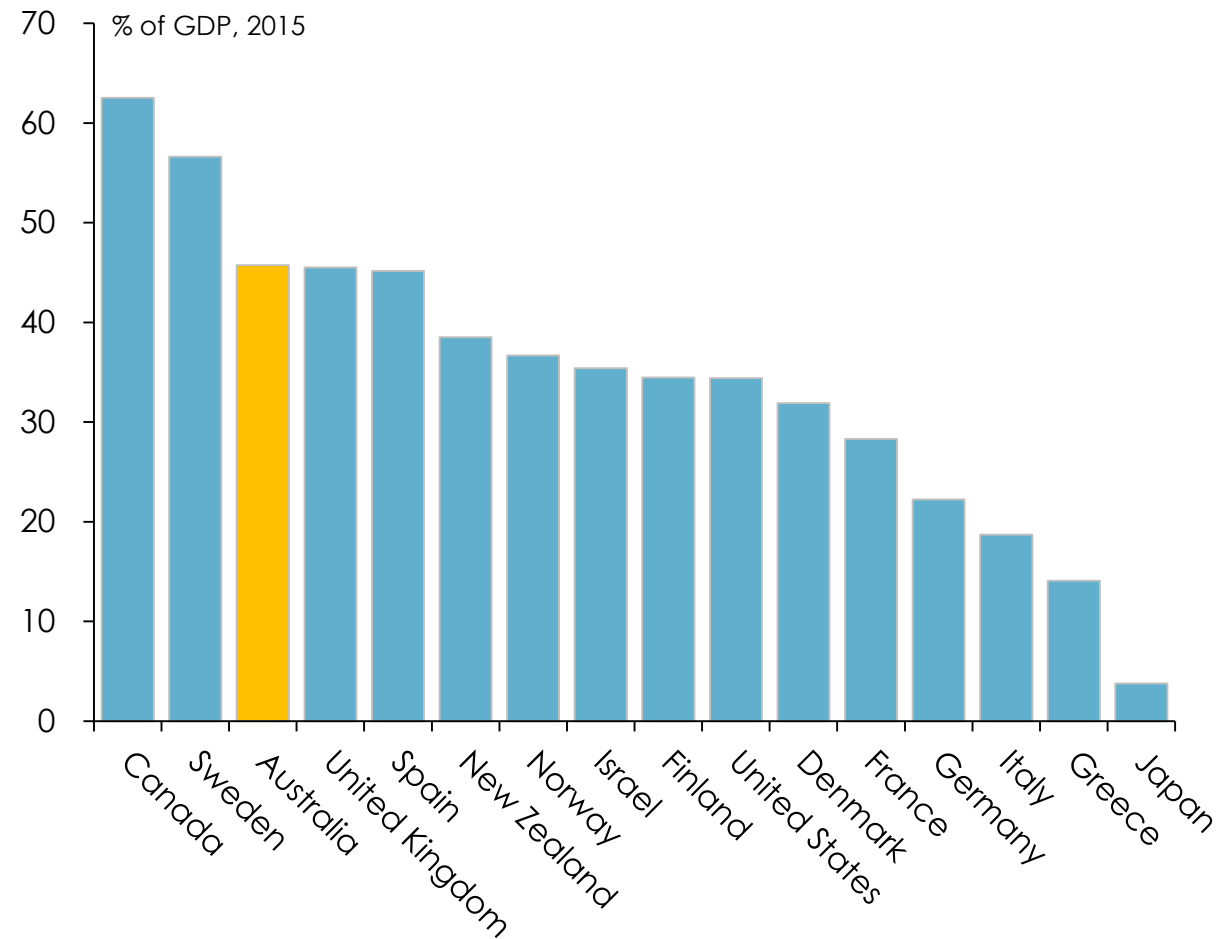
Real wages



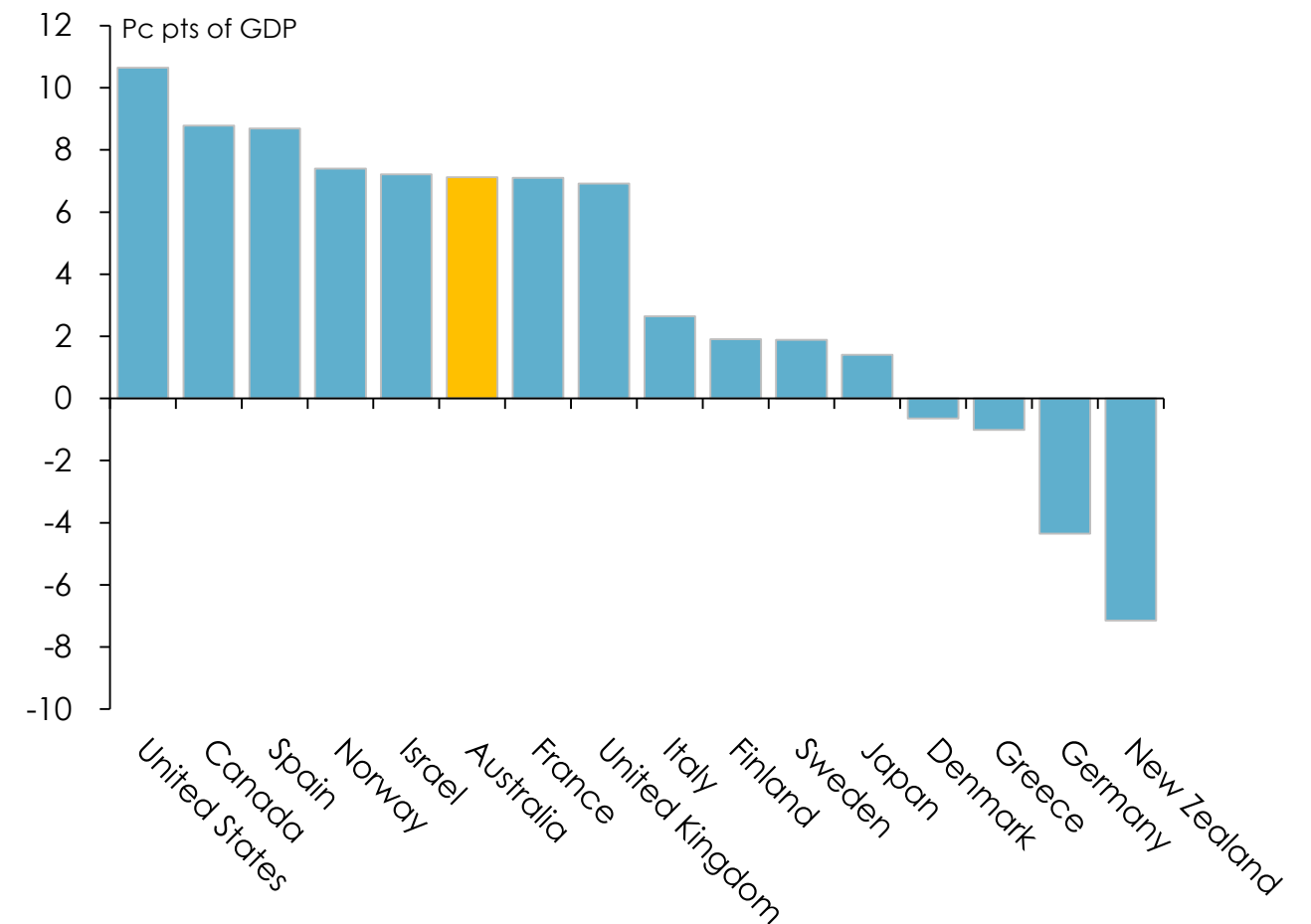
Sources: OECD; ABS; Statistics Canada.

It's not as if Australia has had any great difficulty attracting foreign direct investment, despite its relatively high corporate tax rate

Stock of inward FDI as a pc of GDP, selected 'advanced' economies, 2016



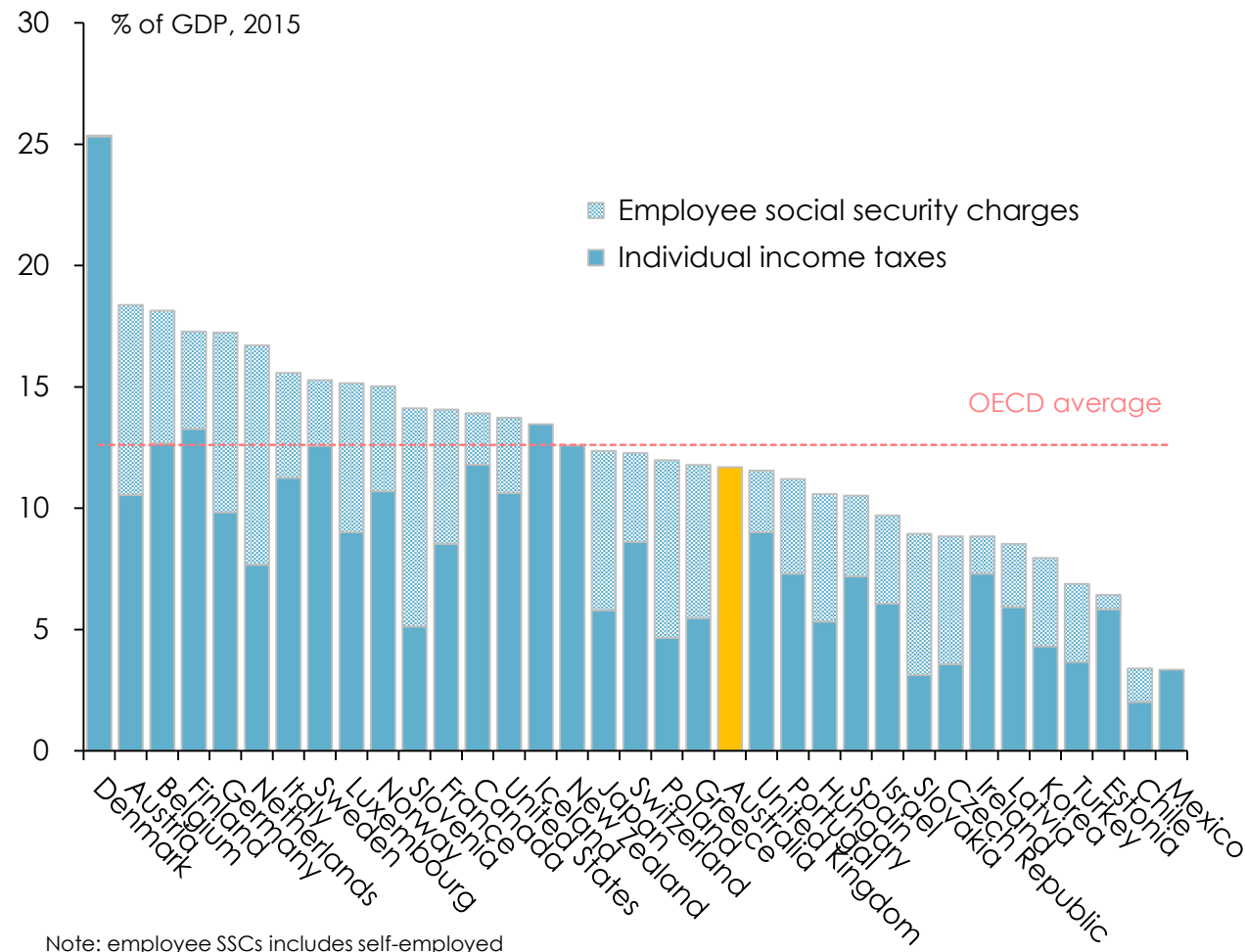
Change in stock of inward FDI as a pc of GDP, 2006-2016



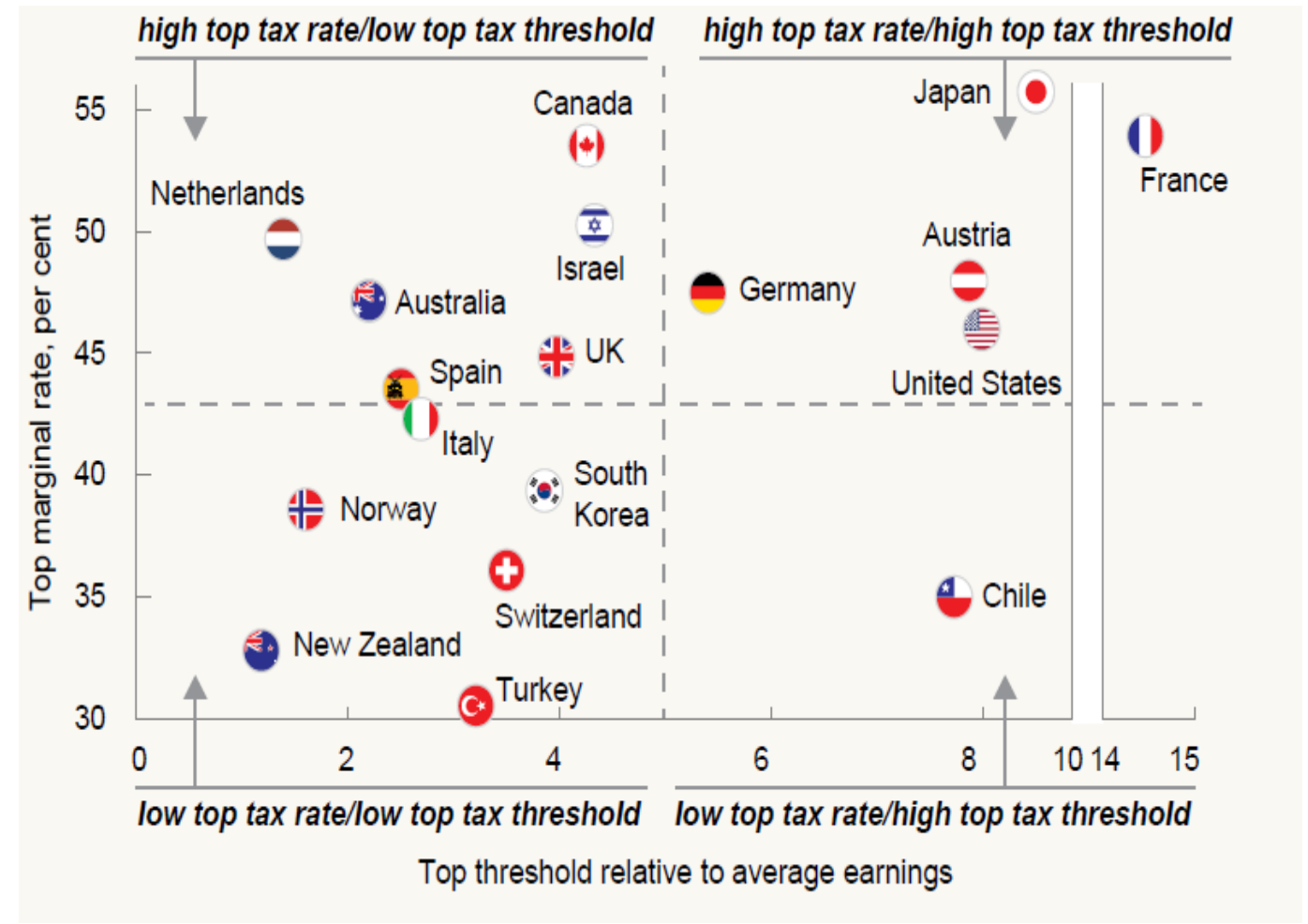
Note: Not shown are Ireland (Inward FDI stock 286% of GDP in 2016), Switzerland (120%), Netherlands (120%) and Belgium (102%).
 Source: United Nations Conference on Trade and Development (UNCTAD), World Investment Report 2016..

Australia's personal income tax system is quite steeply progressive by OECD standards, especially if social security taxes are included

Income tax and individual social security charges as a pc of GDP, 2015



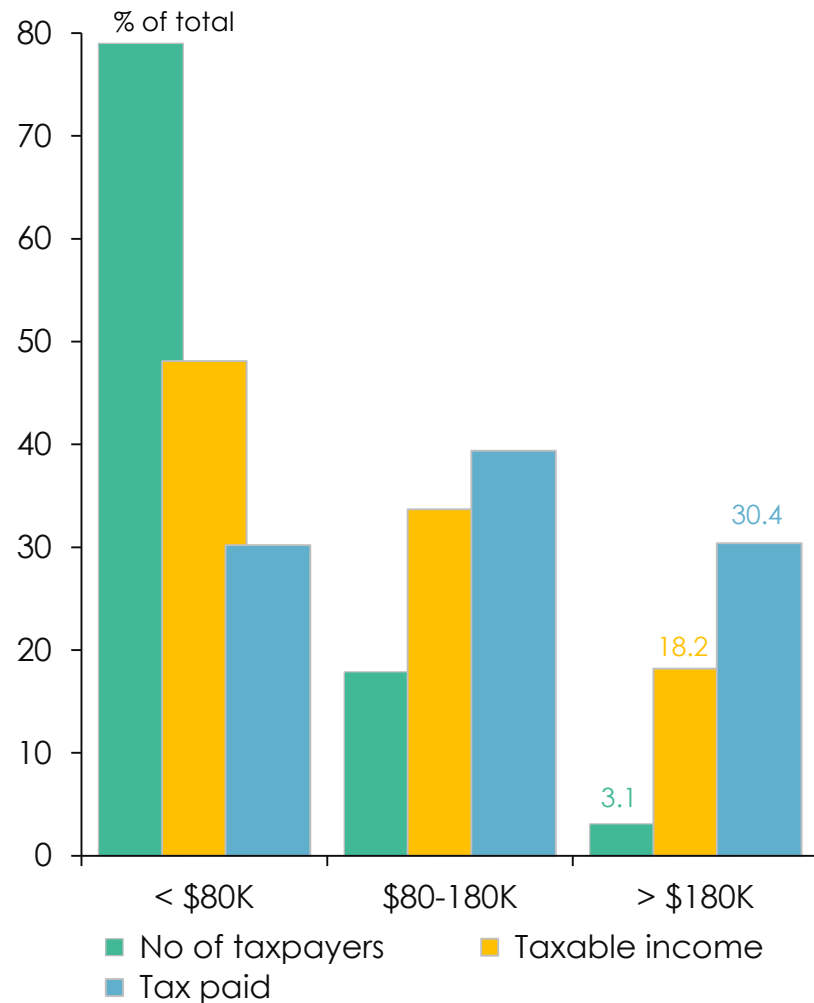
Top marginal tax rates and top thresholds relative to average full-time earnings, 2017



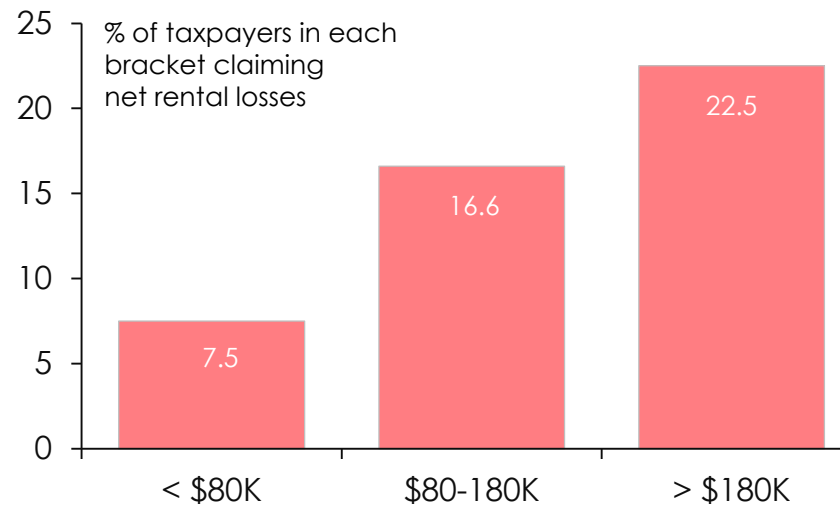
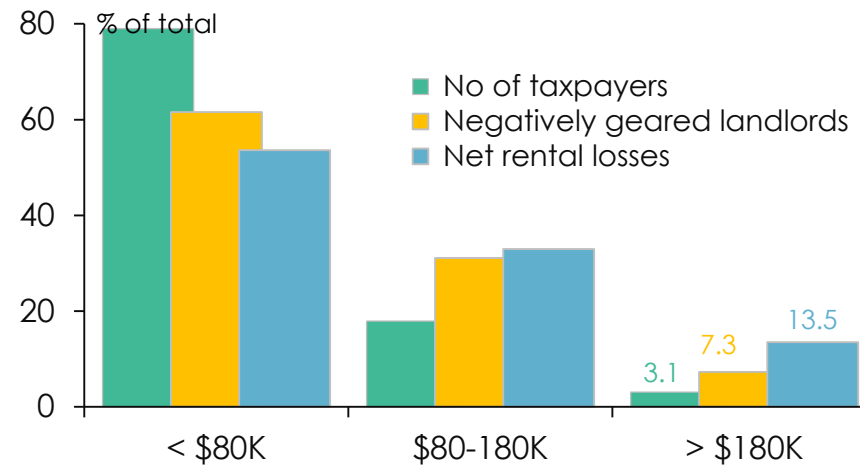
Sources: OECD.Stat, Revenue Statistics – OECD Member Countries ; Australian Government, 2018-19 Budget Paper No. 1, Statement 1.

3% of taxpayers pay 30% of all personal income tax – but a lot of income earned by high-income earners which isn't taxed at the top rate

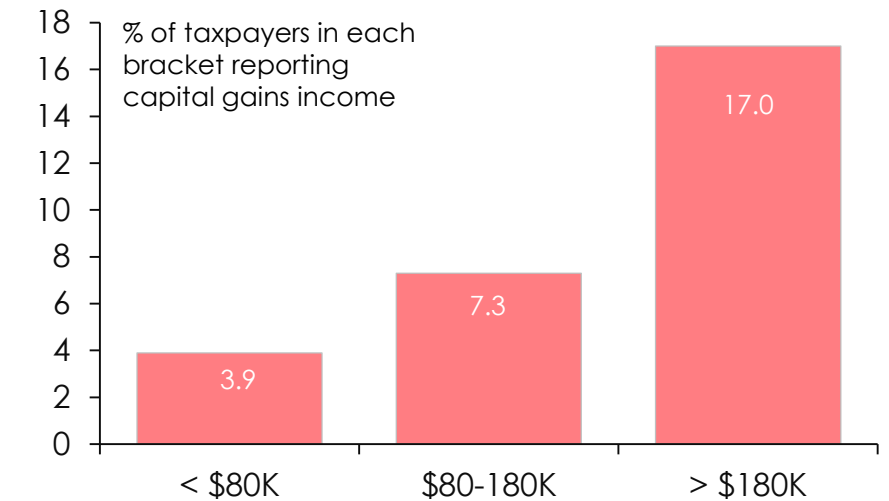
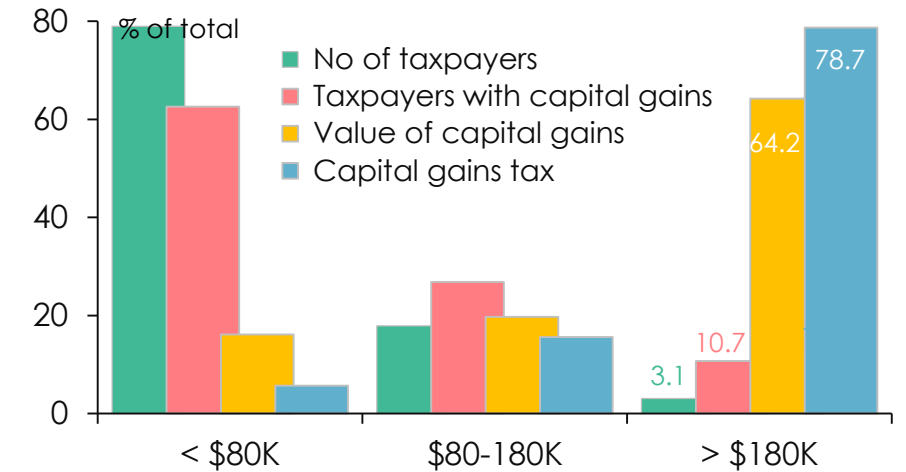
Taxpayers, income and tax paid by tax bracket, 2015-16



Negatively geared landlords by tax bracket, 2015-16



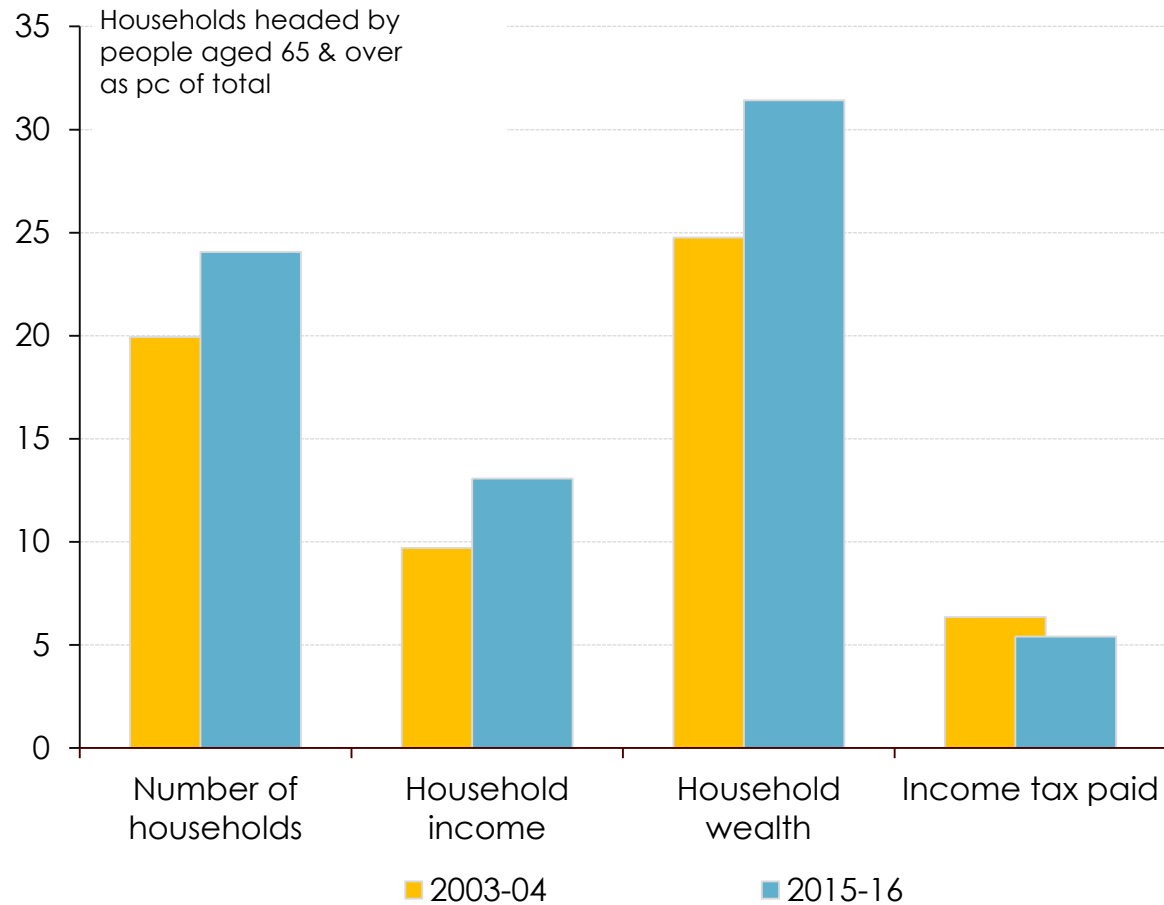
Capital gains taxpayers, by tax bracket



Source: Australian Taxation Office, Taxation Statistics 2015-16.

Older households have increased their share of household income and wealth over the past 15 years, but are paying a smaller share of tax

'Senior' households share of income, wealth and tax



Income tax paid as a pc of gross income, by age group



Source: ABS, Household Income and Wealth 2003-04 and 2015-16 (6523.0)

The dumbest tax policy decisions of the past two decades

1. The exemption from personal income tax of superannuation payments to people over 60 (2006-07 Budget) (partially reversed in the 2016-17 Budget)
2. Replacing the 1985 capital gains tax regime (tax on real gains at full marginal rates) with one in which nominal gains are taxed at half marginal rates (September 1999 in response to the Ralph Report)
3. Abolition of indexation of petroleum products excise (2001-02 Budget) (re-introduced in 2014 Budget)
4. The Senior Australians Tax Offset (SATO, now SAPTO) (2001-02 Budget), which allows people aged 65 and over to pay less tax on a given amount of income than people aged under 65, just for being 65 or over
5. First Home Owner Grants for purchasers of established homes (part of the GST introduced in 'Australia's New Tax System' in 2000) (abolished by most state governments after 2013)
6. Entrepreneurs' Tax Offset (25% discount on tax liabilities of small businesses with turnover of less than \$50K, phasing out at turnover of \$75K) (2004-05 MYEFO, abolished in 2011-12 Budget, but re-introduced in the 2015-16 Budget)
7. Introduction of a lower company tax rate for small corporations and 5% tax discount (up to \$1000) for unincorporated small businesses (2015-16 Budget)
8. Allowing pre-tax contributions to super of up to \$1 million in the 2006-07 financial year (2006-07 Budget)
9. Allowing self-managed super funds (SMSFs) to borrow in order to purchase assets (2007, residential property from 2010)
10. Raising the tax free threshold from \$6000 to \$18000 (and raising the bottom marginal rate from 15% to 19% to pay for it) (2012-13 Budget)

So what should tax reform be about?

- ❑ 'Tax reform' is not simply about cutting taxes
 - “merely cutting or raising taxes in isolation, no matter how beneficial, is not the same as whole of system reform. Nor is it politically palatable”
 - Australian Institute of Company Directors, *Governance of the Nation*, April 2018
- ❑ The starting point for tax reform needs to be the answers to two questions –
 - how much do we want governments to spend on our behalf, on things that we cannot provide for ourselves individually?
 - how can we raise this amount fairly (as between taxpayers in similar *and* different positions), with the least unintended impact on individual or business decision-making, and at the lowest possible compliance cost?
- ❑ The answers to these questions are at least as more a matter of value judgements and political preferences than the result of economic analysis
 - which is why it is appropriate that they are the subject of political debate
- ❑ But most economists would say that tax reform should entail
 - broadening the base of whatever taxes are imposed – that is, reducing or eliminating exemptions, concessions, and preferences which privilege particular groups of taxpayers, types of income or expenditure, forms of business organization or categories of saving over others
 - and imposing the lowest possible rates consistent with raising the required amount of revenue, and with widely-shared notions of fairness and equity