The Australia Institute

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Tax Laws Amendment (Temporary Budget Repair Levy) Bill 2014 and related bills

Submission to the Senate Economics Legislation Committee

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TAI

Submission

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Submission

Thank you for the opportunity to make a submission to the Senate Economics Legislation Committee on the *Tax Laws Amendment (Temporary Budget Repair Levy) Bill 2014 and related bills.*

This levy has the effect of increasing the marginal tax rate from 45 to 47 per cent on incomes over $180,000. Inclusive of the Medicare Levy and the DisabilityCare Australia levy the marginal rate increases from 47 to 49 per cent. According to the explanatory memorandum and the budget papers the measure will raise $3.1 billion over the years it applies; 2014-15 to 2016-17.[1]

We note the legislation protects from the levy such items as employment termination payments and superannuation lump sum payments that would presently be protected. The two per cent levy also applies to other incomes that are equivalent to personal income such as relevant trustees, non-complying super funds and so on. Likewise the fringe benefits tax is also increased by two per cent.

The proposal to increase the tax on the top of the income distribution needs to be seen in the context of the increasing international concern about the level of inequality in the world. The huge international reaction to a work on inequality by French economist Thomas Piketty[2] is testimony to the growing concern about inequality. Piketty's book has been number one best seller and in late May is still number three on the Amazon best seller list.

There is evidence that inequality in Australia is bad and getting worse. For example the latest household income survey[3] shows that since 1994-95 the top ten per cent of income earners have increased their share of national income from 37.8 per cent to 39.5 per cent. Meanwhile the share received by the low income group (the ABS uses the second to third bottom deciles) fell from 10.8 to 10.4 per cent while the middle quintile went from 17.7 per cent down to 17.3 per cent. The ratio of the income at the top of the ninth decile to the income at the top of the bottom decile increased from 3.78 to 4.10.

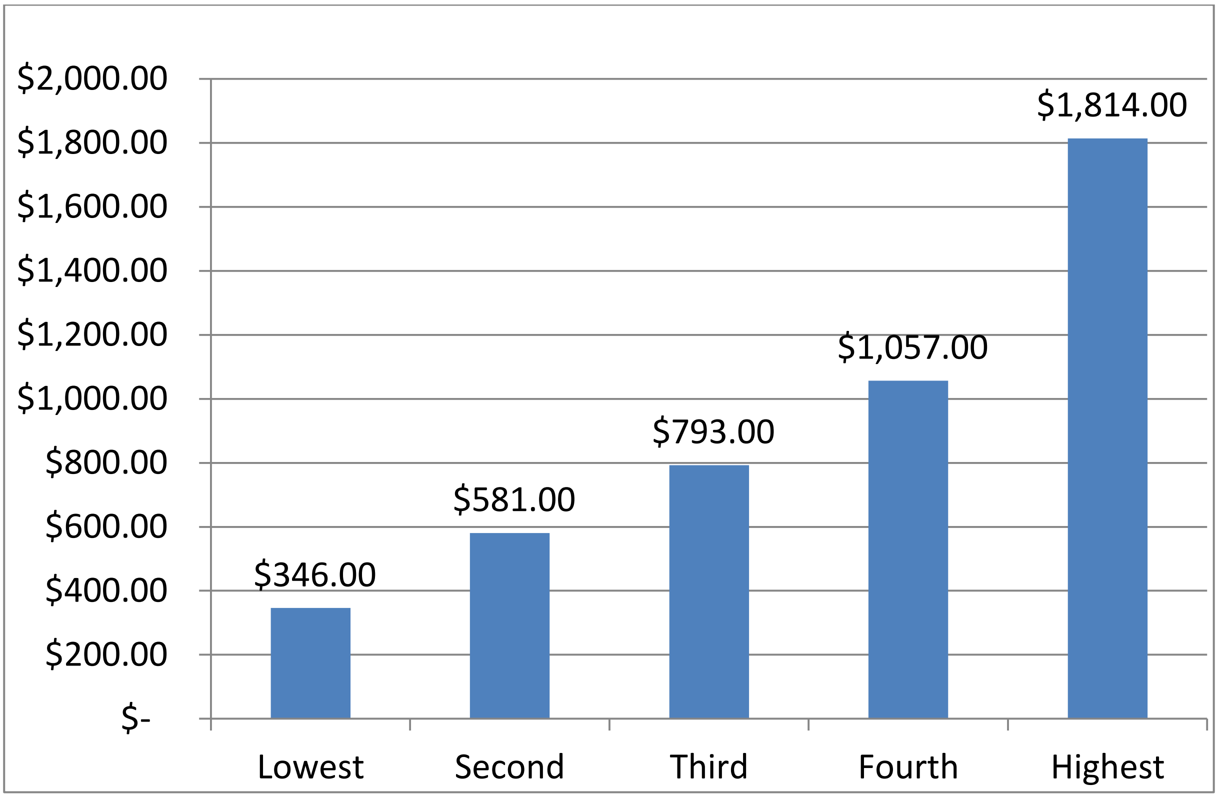
The latest income distribution figures by quintile are summarised in Figure 1 with the vertical bars representing the average incomes of those households in the bottom, second, third, fourth and top quintiles.

[1] Parliament of the Commonwealth of Australia (2013-14) 'Explanatory memorandum', *Tax Laws Amendment (Temporary Budget Repair Levy) Bill 2014*.

[2] Piketty T (2014) *Capital in the twenty-first century*, Cambridge and London.

[3] ABS (2013) *Household income and income distribution, Australia, 2011-12*, Cat no 6523.0, 16 August.

Figure 1: Australian income inequality

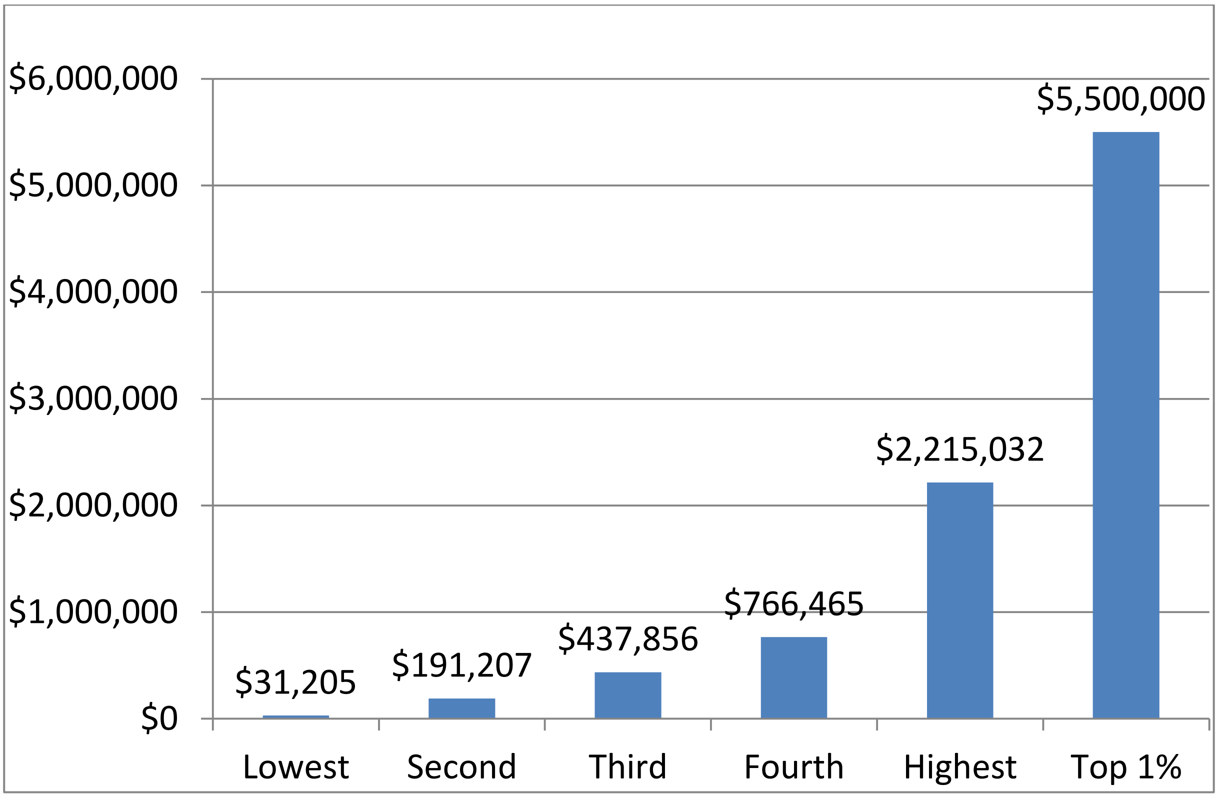


Source: ABS (2013) *Household income and income distribution, Australia, 2011-12*, Cat no 6523.0, 16 August

Figure 1 shows the degree of inequality among incomes in after tax and after any transfers from the government such as the age pension and unemployment benefits. Without the taxes and government transfers the income distribution would look much worse than suggested by Figure 1.

The distribution of income has implications for the distribution of wealth and vice versa. High incomes enable the accumulation of large wealth holdings on the one hand while large wealth holdings generate high incomes. Wealth inequality is illustrated in Figure 2 which shows the average level of wealth for those in the bottom, second, third, fourth and top quintiles. For wealth we also have a figure for the top one per cent which is represented in the most right hand bar in Figure 2. Again the height of the bar represents the average wealth in each of the quintiles.

Figure 2: Australian wealth inequality



Source: ABS (2013) *Household wealth and wealth distribution, Australia, 2011-12*, Cat no 6554.0, 21 August.

Comparing the graphs it is clear that the distribution of wealth is much more unequal than the distribution of income. For example the top income quintile has just over five times the income of the bottom quintile but by wealth the top quintile has 71 times the wealth of the bottom quintile. The distribution of wealth is very important, as Piketty shows, since the accumulation of income from inherited wealth drives the increasing inequality in modern economic systems.

It is also interesting to observe that those among the bottom quintile comprising 1.73 million households have less wealth than the top 10 people and families as reported in the Business Review Weekly's rich 200 list.[4] Top of that list is Gina Rinehart who is estimated to have a personal wealth of $22 billion.

Inequality data tends to be complicated so it is appreciated that the ABS data may not necessarily give an intuitive feel for what is going on. However, ABS results suggest the rich are getting richer and the poor are getting poorer, especially in relative terms. Note in that context that many low income earners have their payments indexed to the consumer price index (CPI) alone and over time they will slip behind as the rest of the population enjoys gradually rising living standards. The latest budget announced that as of 2017 the pension will also be indexed to the CPI alone.

Australia has tended to have a government sector that was one of the best in the OECD in terms of redistributing income towards the lower income groups and so producing a more

[4] Business Review Weekly at http://www.brw.com.au/lists/rich-200/2013/;jsessionid=31260E5A7278F08BD3E465C3BE5D2A5D

equal society.[5] While some measures in the budget considerably weaken its redistributive impact, the temporary levy redresses that, at least in relation to the top end of the income distribution. To that extent the levy does go some way, albeit only a little, towards addressing rising inequality in Australia.

There are other arguments in favour of higher taxes on very high income earners. For example, Piketty argues that very high taxes on high incomes such as the 80 per cent or higher rates in the US and UK in the decades after world war two had a very important consequence. There was no point in corporate executives bargaining for very high incomes and it was only when the tax rates were reduced that it became worthwhile for the CEOs to capture some of the economic rents being generated by large companies. Australia had top tax rates of 67 per cent or more during the Menzies years which would also have moderated high incomes. The objection would be that high marginal taxes reduce incentives and so harm economic growth. Australia's superior economic record over the early post war period suggests there is not much merit in such arguments.

This submission suggests that the levy be supported, but furthermore there is a strong argument in favour of making the levy permanent, incorporating it into the regular income tax scales and perhaps increasing the top marginal rate over time to somewhere near the rates under the Menzies Government.

[5] OECD (2008) Growing unequal? Income distribution and poverty in OECD countries, Paris: OECD.

References

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