The Australia Institute
Research that matters.

Submission to Senate Inquiry into the extent of income inequality in Australia

August 2014

The Australia Institute

TAI

Submission

The Australia Institute
Research that matters.

About TAI

The Australia Institute is an independent public policy think tank based in Canberra. It is funded by donations from philanthropic trusts and individuals and commissioned research. Since its launch in 1994, the Institute has carried out highly influential research on a broad range of economic, social and environmental issues.

Our philosophy

As we begin the 21st century, new dilemmas confront our society and our planet. Unprecedented levels of consumption co-exist with extreme poverty. Through new technology we are more connected than we have ever been, yet civic engagement is declining. Environmental neglect continues despite heightened ecological awareness. A better balance is urgently needed.

The Australia Institute's directors, staff and supporters represent a broad range of views and priorities. What unites us is a belief that through a combination of research and creativity we can promote new solutions and ways of thinking.

Our purpose—'Research that matters'

The Institute aims to foster informed debate about our culture, our economy and our environment and bring greater accountability to the democratic process. Our goal is to gather, interpret and communicate evidence in order to both diagnose the problems we face and propose new solutions to tackle them.

The Institute is wholly independent and not affiliated with any other organisation. As an Approved Research Institute, donations to its Research Fund are tax deductible for the donor. Anyone wishing to donate can do so via the website at https://www.tai.org.au or by calling the Institute on 02 6130 0530. Our secure and user-friendly website allows donors to make either one-off or regular monthly donations and we encourage everyone who can to donate in this way as it assists our research in the most significant manner.

Unit 1, Level 5, 131 City Walk
Canberra City, ACT 2601
Tel: (02) 6130 0530

Website: www.tai.org.au

TAI

Introduction

The Senate referred the terms of reference for the Inquiry into the extent of income inequality in Australia to the Community Affairs References Committee on 18 June 2014. The Committee is to report by 26 November 2014.

The Australia Institutes is pleased to have the opportunity to make a submission to the committee. The submission is an edited volume of three research paper released in 2014. They are:

1. *Income and wealth inequality in Australia*, July 2014,
2. *Auditing the auditors*, May 2014, and
3. *Sustaining us all in retirement: the case for a universal pension*, April 2014.

The Australia Institute would welcome the opportunity to expand on the research presented in this submission should the Committee have any questions.

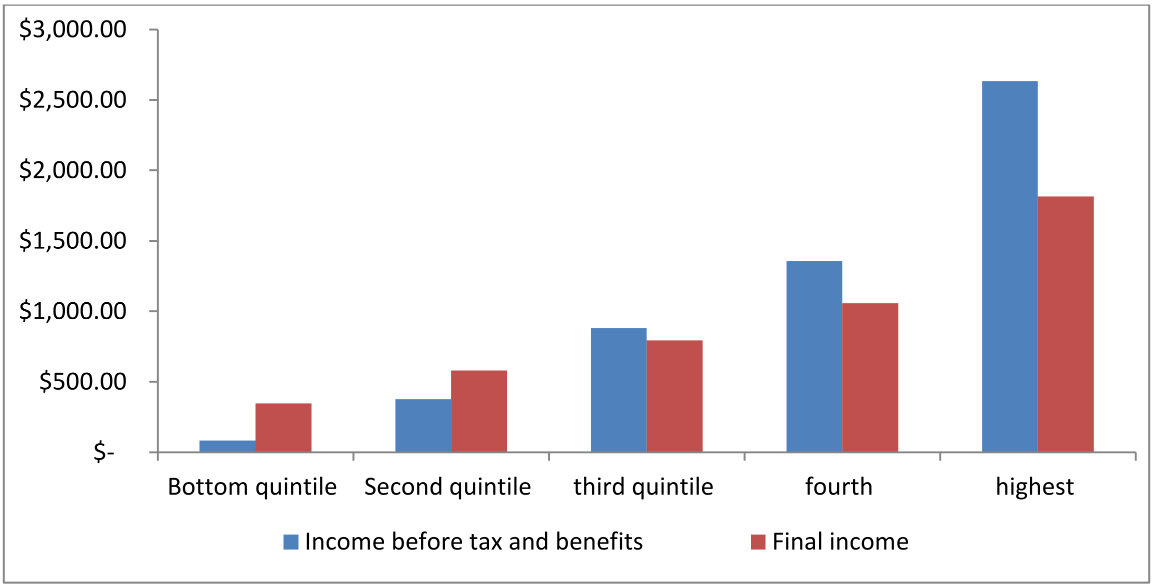
Income and wealth inequality in Australia

Inequality between those with the most and those with the least is rising in Australia. Australia is one of the wealthiest countries in the world, but there are many people in our society who are falling behind. For instance, the minimum wage and unemployment benefits have failed to keep pace with the rise in average earnings, resulting in a divergence between low-income earners and the average employed Australian. A divergence has also occurred between the average Australian and those at the top. Senior executive pay is now 150 times greater than average weekly earnings.

While income distribution is unequal, the distribution of wealth is even more so. The top 20 per cent of people have five times more income than the bottom 20 per cent, and hold 71 times more wealth. Perhaps the gap between those with the most and those with the least is most starkly highlighted by the fact that the richest seven individuals in Australia hold more wealth than 1.73 million households in the bottom 20 per cent.

The tax-and-transfer system has the capacity to redistribute income effectively to reduce inequality. The figure below illustrates how existing policies boost the incomes of those with the least, while only slightly reducing the incomes of the wealthy. This redistribution has always been the objective of Australia’s progressive tax system.

Figure 1: Income distribution before and after the tax and transfer system



Source: ABS (2013) *Household income and income distribution, Australia, 2011-12*.

Despite consistent public support for reducing inequality, the Abbott government is currently seeking to reduce income support. In fact, in recent months the Abbott government has begun to argue that inequality is not just unavoidable, but also beneficial. Rather than use the welfare system to redistribute income, the government is seeking to ensure that welfare payments grow at a significantly slower rate than wages. The result will inevitably be an even bigger gap between those with the most and those with the least.

The nature and extent of inequality is the choice of policy makers. We have the capacity to either reduce inequality or to exacerbate it. Successive governments have done little to reduce inequality and have unwound both welfare provisions and the progressive nature of our tax system. Tackling inequality is a political choice, not an economic problem.

Perceptions of income inequality

This section presents the results of a recent survey conducted by The Australia Institute into the attitudes of Australians towards inequality. Significantly, previous surveys have found that Australians tend to believe that the income distribution in Australia is much more equal than it really is.[1] Such results suggest that people use their own circumstances as the reference point and tend to think that most other people are either just above or just below that reference point.

The Australia Institute's recent polling showed that the majority of people believe their own circumstances fall roughly within the middle of the income distribution. Put simply, nearly all Australians think that average incomes are similar to their own personal incomes. For example, 58 per cent of those earning $20–$40,000 per year think that the average Australian earns between $20,000 and $40,000 per year. Similarly, 51 per cent of people who earn between $100,000 and $150,000 per year think that the average Australian earns between $100,000 and $150,000.

Table 1 clearly show how beliefs about income in Australia strongly reflect the respondents' own circumstances. More than 80 per cent of people in the low- and middle-income groups

[1] Neal D et al (2011) *Australian attitudes towards wealth inequality and the minimum wages*

(up to $100,000) think that the average household income is either in their band or the one just next to it. The number falls of substantially though for those whose household income is $100,000 or more. Many of these people are aware that they are unusual in terms of income distribution.

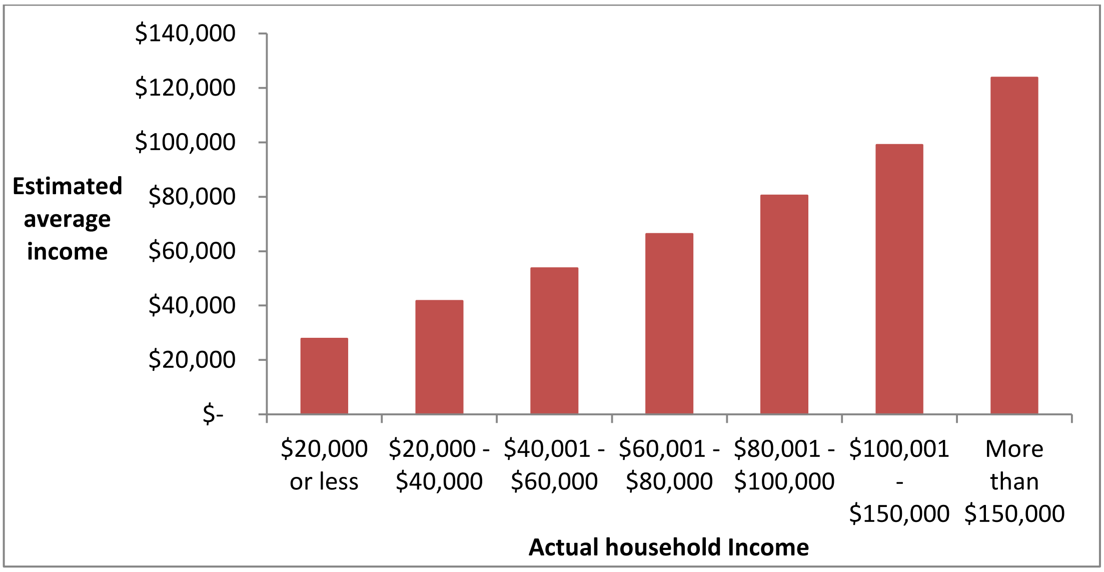
Table 1: Beliefs about average income by income groups

	Annual household income								All
	$20,000 or less	$20,000 - $40,000	$40,001 - $60,000	$60,001 - $80,000	$80,001 - $100,000	$100,001 - $150,000	More than $150,000	Not sure/rather not say	
$20,000 or less	69%	5%	0%	1%	2%	0%	0%	15%	11%
$20,000 - $40,000	13%	58%	6%	1%	3%	1%	0%	12%	15%
$40,001 - $60,000	10%	21%	71%	25%	13%	8%	13%	23%	25%
$60,001 - $80,000	5%	13%	17%	61%	25%	25%	19%	28%	24%
$80,001 - $100,000	2%	3%	5%	9%	55%	15%	20%	13%	13%
$100,001 - $150,000	1%	1%	0%	2%	3%	51%	16%	7%	9%
More than $150,000	1%	0%	0%	0%	1%	0%	33%	3%	2%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Number	167	262	218	173	159	173	70	184	1406
Proportion who believe the average is their income range or one above or below	82%	84%	94%	85%	83%	66%	49%	na	

Source: TAI polling.

Figure 2 uses the data presented in Table 1 to show how the estimate of average income rises with actual income. While people earning less than $20,000 per year think an average Australian earns around $23,000 per year, people earning more than $150,000 per year think that an average Australian earns more than $120,000 per year.

Figure 2: Estimated average household income by reported household income



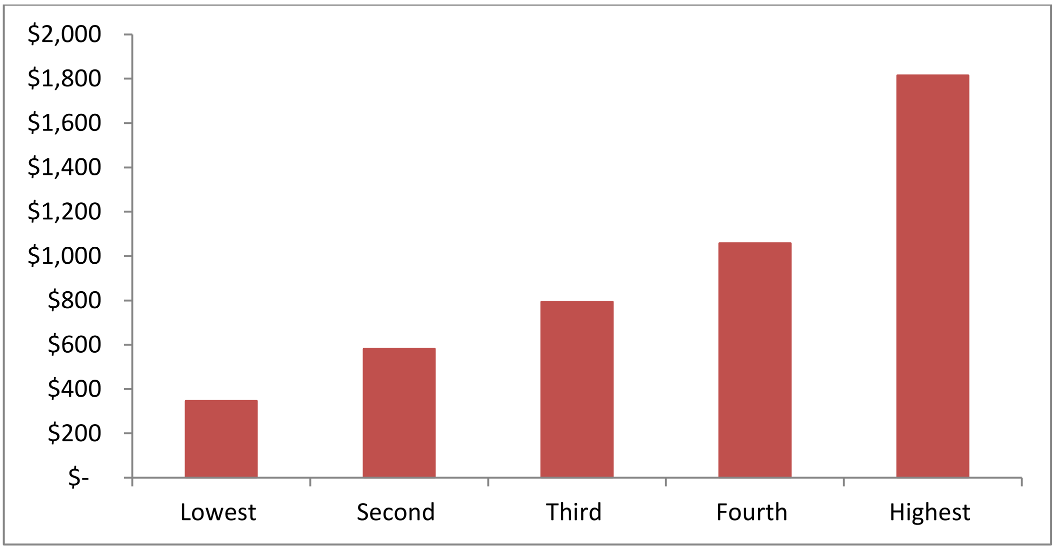
Source: TAI polling.

In contrast to the survey results presented above, Australian Bureau of Statistics (ABS) figures show that in 2011-12 household average incomes were $918 per week or $47,736 per annum, while median incomes were $790 per week or $41,080 per annum.[2] Incomes would not have changed significantly between the date of the ABS estimate and the survey.

Actual income inequality

The latest ABS data on income distribution figures by quintile are summarised in Figure 3 – the vertical bars represent the average incomes of those households in the bottom, second, third, fourth and top quintiles.

Figure 3: Australian income inequality $ per week, by quintile



Source: ABS (2013) *Household income and income distribution, Australia, 2011-12*

[2] ABS (2011) *Household expenditure survey, Australia: Summary of results, 2009-10*, Cat no 6530.0, 6 September.

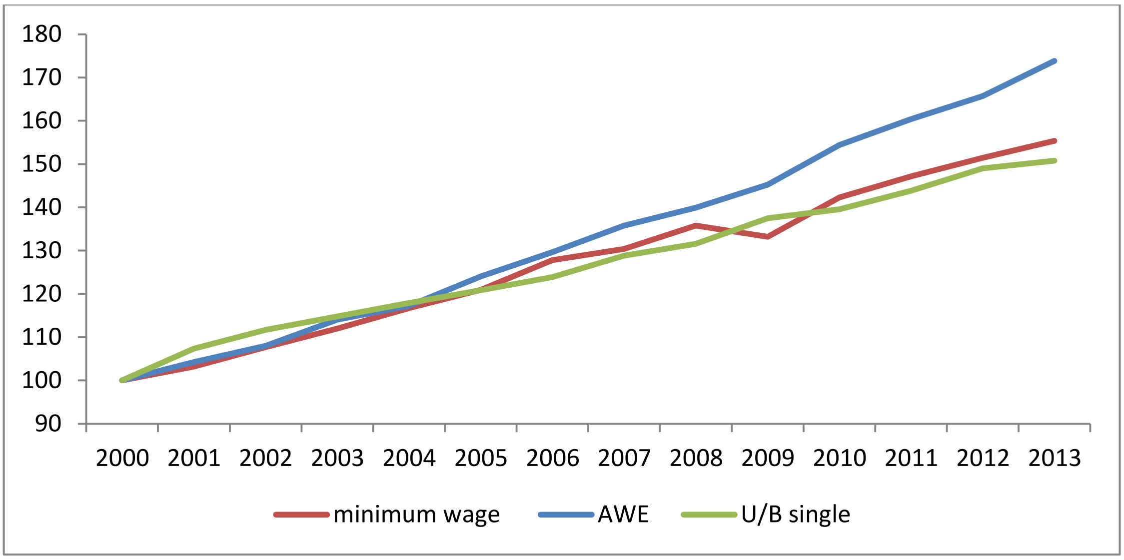
Figure 3 shows the degree of inequality among income groups after tax and after any transfers from the government such as the age pension, veterans' pensions[3] and unemployment benefits. Without these taxes and government transfers, income distribution would look much worse than suggested by Figure 3.

There has been an increase in the degree of inequality in Australia in recent years. The President of Fair Work Australia, Iain Ross, presenting the 2014 minimum wage decision, said:

> *While real earnings have generally increased over the past decade, earnings inequality is increasing. Over the past five years, the rate of growth in average earnings and bargained rates of pay have outstripped the growth in minimum wages for award-reliant workers. This has reduced the relative living standards of award-reliant workers and reduced the capacity of the low-paid to meet their needs.*[4]

The distribution of incomes within the wages and salary system is very important to explain a good deal of the inequality in countries like Australia. Figure 4 shows how average weekly earnings, the minimum wage and the unemployment benefit rate for a single adult have diverged over time. Each series is set at an index of 100 for the year 2000, allowing us to follow how those incomes have moved over time.

Figure 4: Minimum wages, average weekly earnings and the single unemployment benefit (indices: 2000=100)



Source: ABS (2014) *Average weekly earnings, Australia, Nov 2013*; O'Neill (2005) *National wage and safety net claims and outcomes 1991-2005*; Australian Government (2014) *Guide to Social Security Law*.

The data in Figure 4 show a divergence of average earnings and the minimum wage by about 20 index points over a short 13-year period – this is fairly substantial movement. Such a divergence would explain a good deal of the increasing inequality that took place because low-income earners were slipping behind average standards. That would also have dragged down the relative wages of people whose wages are set at a margin above the minimum wage. Incidentally the national wage decision increased the minimum wage by three per cent, which is insufficient to close the gap between the average and minimum wages that occurred over the relatively brief period shown in Figure 4. Addressing the gap in Figure 4

[3] References to the age pension in the rest of this paper should be read as including the veterans' pension.

[4] ABC (2014) *Minimum wage decision fails to please business or unions*

would require a one-off 12 per cent increase in the minimum wage as well as indexation to average weekly earnings thereafter.

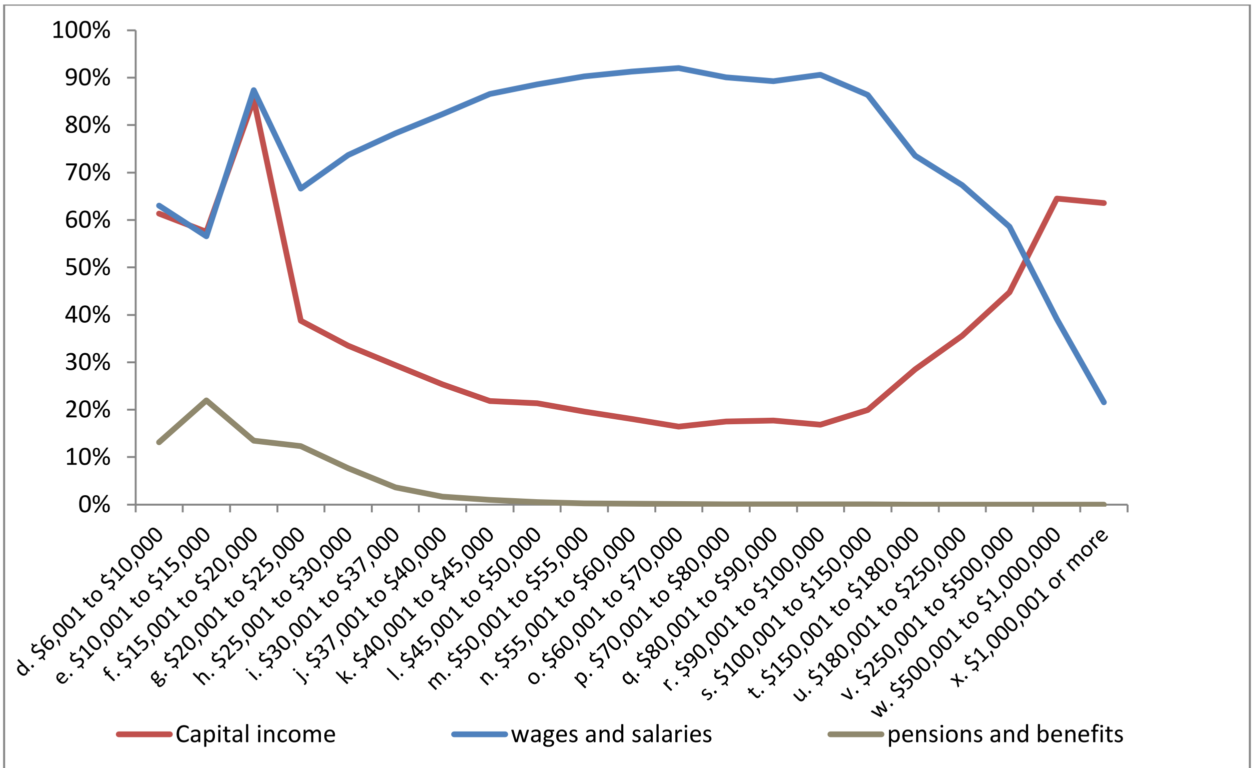
Also shown in Figure 4 is the unemployment benefit, which is indexed against inflation but nevertheless over time has moved well below both the other series by the year 2013. Over this relatively short period the unemployment benefit has failed to keep up with even the minimum wage.

Income sources and inequality

So far we have not sought to ask about the sources of income at various points in the income distribution. The ATO figures allow us to divide income into wages, benefits and pensions and capital income. The latter is defined to include private business income, dividends, interest income and similar receipts. Figure 5 is based on ATO data that gives the sources of income for each percentile in the income distribution – that is, going from the bottom one per cent of taxpayers by income through to the top one per cent of taxpayers.

Figure 5 clearly shows that, for low-income groups, payments from the government are an important source of taxable income. As we move up the income scale wages become a dominant source of income, accounting for 90 per cent or more of incomes in the middle-to-upper income ranges, from about $50,000 to almost $100,000 per annum. However, wages and salaries fade away beyond that range and account for only a bit over 20 per cent of incomes for the top one per cent of the income distribution.

Figure 5: Contribution to personal income from capital, wages and salaries, pensions and benefits as share of total income, 2011-12.



Source: ATO (2014) *Taxation statistics*

The capital income data in Figure 5 shows that capital income begins to dominate as we move higher up the income distribution. The interesting thing is that capital income is also prominent at some very low income levels – but the figures for income are those given to the ATO, so it is quite possible that there is undeclared income or income offset by prior-year losses and other deductions.

Low income earners by electorate

In a previous study, The Australia Institute examined the incidence of low-income earners by electorate in order to highlight the fact that low-income earners are not dispersed evenly across the continent but rather are concentrated in some regions. This has particular relevance when analysing policies that impact on low-income earners such as the Low Income Superannuation Contribution (LISC).

The LISC assists low-income earners by boosting their superannuation contribution. The payments are made on behalf of people on incomes up to $37,000. That data gives a good indicator of the incidence of low-income earners by region and electorate.

Table 2 below sets out the 10 electorates with the highest proportion of low-income earners, with the proportion of employees affected from highest, at the top of the table, to lowest.

Table 2: Top 10 – Number and proportion of low-income employees

Commonwealth Electoral Divisions	number of employees affected	Proportion of employees affected	Party
Cowper, NSW	23,093	46.5	National
Page, NSW	23,392	46.0	National
Mallee, Vic	24,674	45.4	National
Lyne, NSW	20,843	44.8	National
Richmond, NSW	23,762	44.5	ALP
Wide Bay, Qld	22,947	44.4	National
Lyons, Tas	17,796	44.3	Liberal
Murray, Vic	24,199	44.1	Liberal
Barker, SA	29,219	44.0	Liberal
Wannon, Vic	24,986	43.8	Liberal

Source: ABS Census data and TAI calculations.

Table 3 shows the ten electorates that would be least impacted by the removal of the LISC.

Table 3: Bottom 10 – Number and proportion of low-income employees.

Commonwealth Electoral Divisions	number of employees affected	Proportion of employees affected %	Party
Wentworth, NSW	15,216	18.1	Liberal
North Sydney, NSW	15,322	19.6	Liberal
Solomon, NT	10,911	20.4	CLP
Melbourne Ports, Vic	18,131	20.9	ALP
Canberra, ACT	19,987	21.7	ALP
Warringah, NSW	16,685	21.9	Liberal
Sydney, NSW	21,092	22.0	ALP
Fraser, ACT	23,563	23.1	ALP
Higgins, Vic	16,800	24.1	Liberal
Brisbane, Qld	20,266	24.3	Liberal

Source: ABS Census data and TAI calculations.

Table 3 shows that the electorates with the lowest proportions of low-income employees tend to be inner-city electorates and are held by the Liberal Party and the ALP. The clear exception is Solomon in the NT.

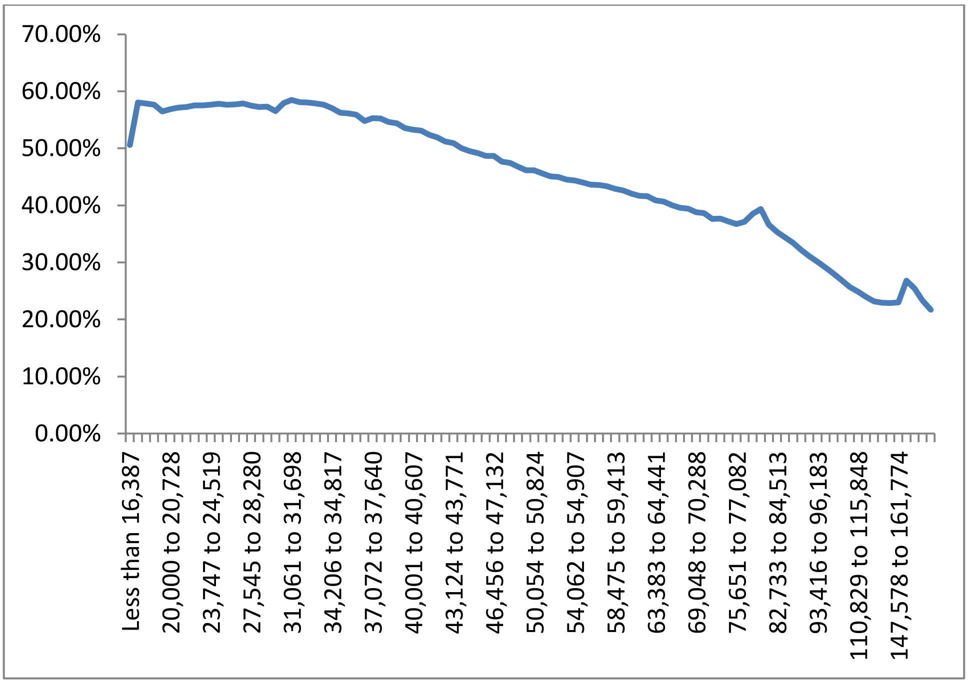
Just as tax and spending policies have significantly different impacts on men and women, changes to government grants have disproportionate effects on different regions around Australia. Such gender and geographical differences are often overlooked in national debates about 'the role of government' and the need for 'fiscal consolidation'.

Gender inequality

Inequality is not evenly distributed. Some demographic and geographic groups experience much higher levels of absolute and relative inequality. Similarly, policies to reduce inequality will deliver greater benefits to some groups and come at a higher cost to others. For example, as women are over-represented among low-income earners and are underrepresented among high-income earners they, as a group, tend to benefit from redistributive policies and fare poorly when governments cut taxes and benefits.

The ABS figures for income and wealth are generally silent on the gender balance except for wages and salaries. For information about the gender distribution of income we have to rely on ATO statistics, which show that women comprise 45 per cent of all taxpayers. Figure 6 shows the proportion of women at the various income points, ranging from the first one per cent of taxpayers by income to the top one per cent.

Figure 6: Proportion of women by percentiles in the income distribution



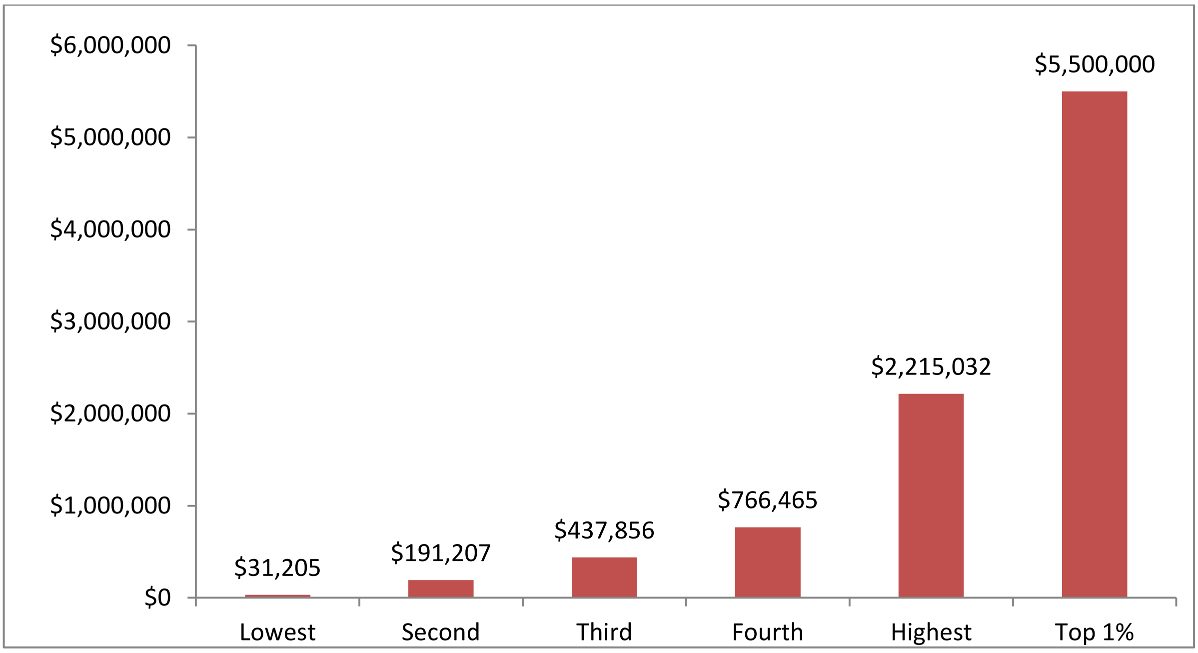
Source: Australian Taxation Office (2014) *Australian taxation statistics, 2011-12*.

Figure 6 clearly shows that women are disproportionately represented at lower incomes and do not reach 45 per cent, their overall share, until the fifty-third percentile and the income range $51,606 to $52,407. After that women are disproportionately under-represented. For example, in the top percentile women are only 21.7 per cent of taxpayers and they peak at 58.5 per cent of taxpayers in the twenty-first percentile with an income range of $31,061 to $31,698. The taxation statistics also show that, while women were 45 per cent of taxpayers, they earned 37 per cent of the income. In addition, while the average male income was $78,407, for women the figure was $56,527. That is a discrepancy of $21,880 – or put differently, women earn 28 per cent less than men on those figures. As mentioned, ABS figures give wages and salaries by gender and they show women earn 17 per cent less than men.

Wealth distribution in Australia

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 7, which shows the average level of wealth by quintiles. This figure also provides an average level for the top one per cent of wealth-holders, which is represented in the column on the far right.

Figure 7: Australian wealth inequality



Source: ABS (2013) *Household wealth and wealth distribution, Australia, 2011-12*.

Comparing the graphs for income and wealth distribution, 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 important, as the accumulation of income from inherited wealth that drives much of the increasing inequality in modern economic systems.

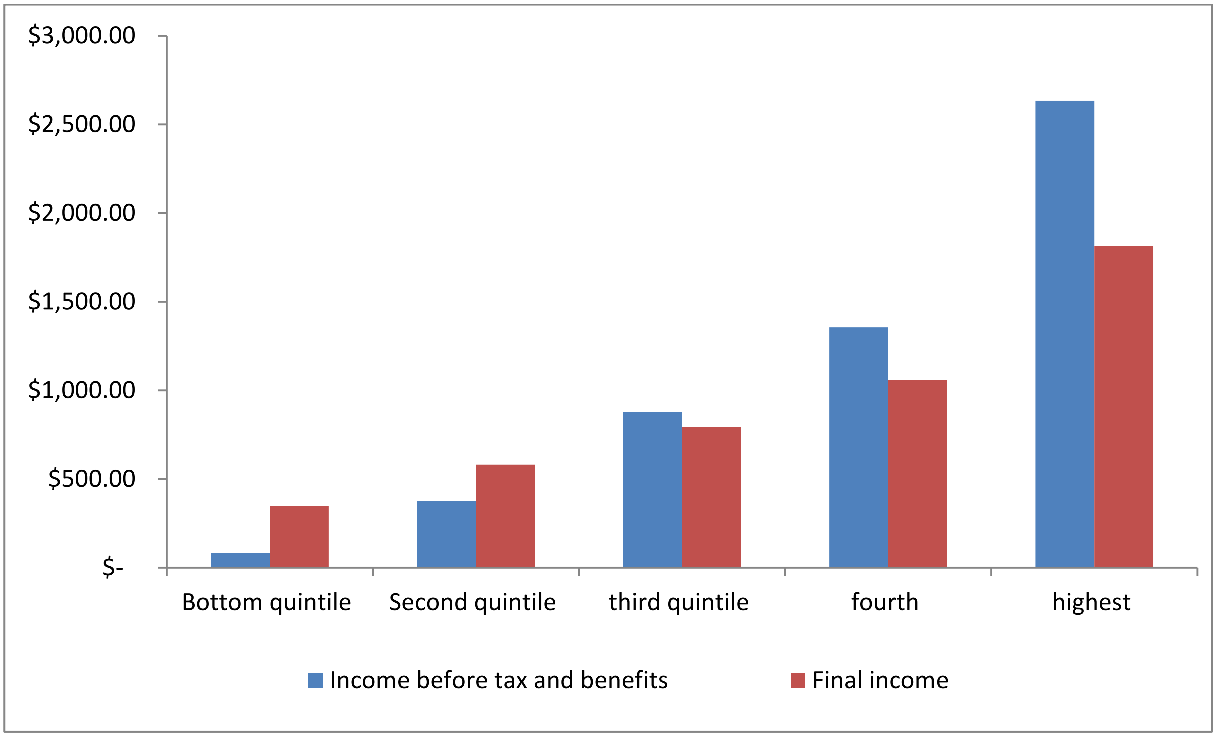
It is also interesting to observe that those among the bottom quintile, comprising 1.73 million households, have less wealth than the ten wealthiest families in Australia as reported by the Business Review Weekly's rich 200 list.[5] At the top of that list is Gina Rinehart who is estimated to have a personal wealth of $22 billion. Gina Rinehart's estimated wealth along with that of the other top ten wealth-holders who, together, hold more than $66 billion in wealth.

Redistributive role of the state

ABS data allow us to make some estimates about the extent to which Australia's tax and welfare system redistributes income. Those estimates are summarised in Figure 8, which shows the income quintiles before and after the effects of taxation and government pensions and allowances.

[5] Business Review Weekly (2013) 'BRW rich 200'

Figure 8: Income distribution before and after the tax and transfer system



Source: ABS (2013) *Household income and income distribution, Australia, 2011-12*.

Figure 8 clearly shows that income after the tax and transfer system is so much 'flatter' than it is prior to redistribution. Low incomes are dramatically higher, while high incomes are significantly reduced. The interpretation of Figure 8 is likely to be determined by an individual's desired role of the state. Figure 8 provides clear evidence that our progressive tax-and-transfer system is working as designed, and it also provides clear evidence that high-income earners pay significantly more tax than low-income earners. Whether this is a 'problem' or not depends entirely on the objective of government policy.

Leaving aside the disagreement about what governments 'should' do about income redistribution, there is little doubt about what governments have done – governments have over time sought to reduce the degree of redistribution implied by the fiscal arrangements. Recall that the top marginal personal income tax rate in the Menzies years was never below 67 per cent – whereas it is now 47 per cent with the Medicare levy, increasing to 49 per cent with the temporary levy due to apply between July 2014 and June 2017.

It is also important to highlight that the present top marginal tax rate takes effect at $180,000 or 2.4 times average weekly earnings, whereas in 2002-03 the top rate kicked in at $60,000 or 1.3 times average weekly earnings.[6] The large increases in the top thresholds were part of the favourable treatment for high-income earners under the Howard government. The Howard government also intended to reduce the top marginal tax rate (from 45 to 42 per cent) but this cut was deferred indefinitely by the Rudd government. The distribution of the tax cuts between 2005-06 and 2011-12 is shown in Table 4.

[6] TAI calculations. Note that in 2008-09 when the top threshold was increased to $180,000 it represented 3.0 times average weekly ordinary time earnings.

Table 4: Share of income tax cuts ($million)

Deciles	Share (%)	Share ($m)
1	0.0%	53
2	0.3%	454
3	0.7%	1,241
4	2.6%	4,314
5	5.4%	9,120
6	6.5%	11,035
7	8.6%	14,456
8	13.7%	23,130
9	20.0%	33,790
10	42.2%	71,286
Total	**100%**	**168,878**

Source: Grudnoff M (2013) 'Tax cuts that broke the budget', The Australia Institute.

Public support for redistributive policies

While it is impossible to say with certainty what Australians 'really want', surveys of community opinion have consistently shown that Australians support the provision of a wide range of income supports and universal services and are willing to pay the taxes necessary to fund such services. Indeed, as shown in Table 4 below, the majority of Australians support increasing the tax paid by high-income earners and spending more money on services. Table 5 suggests that only nine per cent of Australians want to pay less tax and receive fewer government services.

Table 5: Proportion who agreed with the following statements

Statement	Proportion
Provide more social services by collecting more tax from everyone	5%
Provide more social services by collecting more tax, especially from big business and higher income earners	55%
Provide the same level of social services as we do now	21%
Collect less tax from everyone and provide fewer social services	9%
Collect less tax from big business and higher income earners and provide fewer social services.	1%
Don't know	9%
Total	**100%**

Source: TAI polling.

These results are interesting and suggest that an overwhelming 81 per cent of people want the level of social services to either remain as they are or to be increased, even if increases mean additional taxation – especially from big business and high-income earners.

The ABC's 'vote compass' confirms that voters tend to have a more pro-government services position than the elected governments tend to have. For example, voters favour same-sex marriage and want to see dentistry included on Medicare.[7] TAI polling referred to in Table 5 clearly shows that the Australian population includes a large proportion of people who favour universal healthcare (92 per cent), education (82 per cent) and age pensions (76 per cent). Australian politics may well support the Pontusson and Rueda view that with rising inequality right-wing parties become more opposed to redistribution. The Coalition government's rhetoric about entitlements bears this out – for example, the Treasurer's 2014-15 budget speech in which he said that the "age of entitlement is over".[8]

Government income support, indexation and poverty

There have been many calls for increases in the payments going to the unemployed in Australia, including from the Business Council of Australia.[9] Families that rely on the unemployment benefit (Newstart) are among the poorest in Australia. Policy is fundamentally important when it comes to inequality – the experience of those who rely on the unemployment benefit is a very good example. Public policy affecting those who cannot fend for themselves is the main determinant of the numbers who are in poverty.

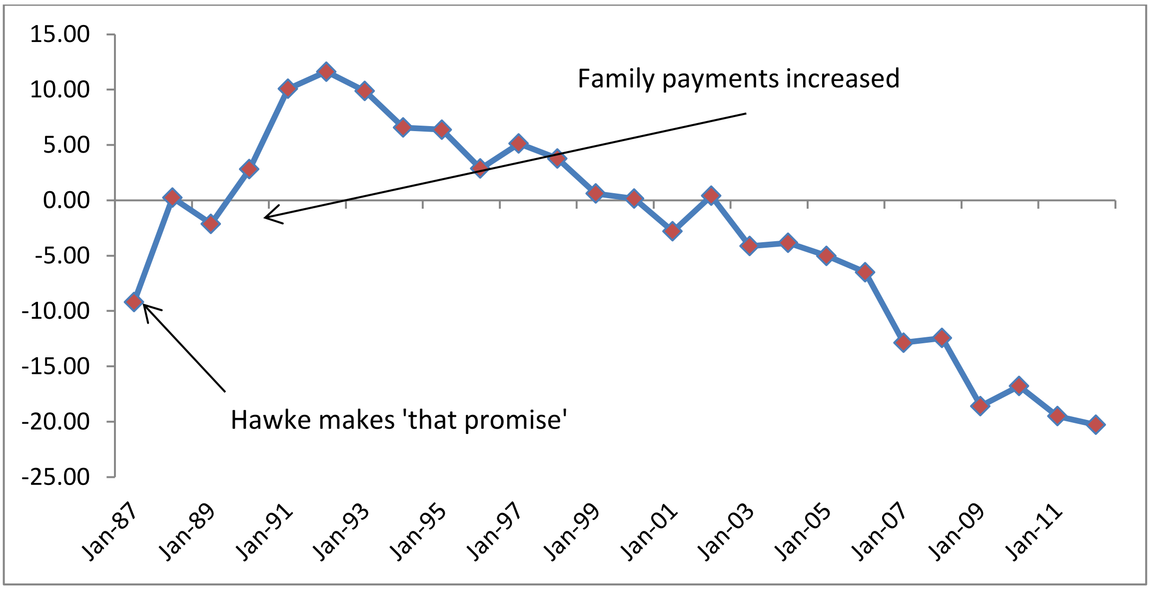
In the campaign leading up to the 1987 election the then Prime Minister Bob Hawke made the famous promise that "by 1990 no Australian child will live in poverty". That promise has been ridiculed ever since by cynics, but few people have looked at the facts. Around that time there were enormous changes introduced under the then Minister for Social Security, Brian Howe. Increases in income support and family payments significantly increased incomes and the impact is best illustrated by taking the example of an unemployed family of four, two adults and two children, and examining how their income moved relative to the Henderson poverty line. This is represented in Figure 9, which begins in 1987 when the promise was first made. At the time, payments for that family were almost 10 per cent below the poverty line. Where the graph line touches zero, payments for this family are the exact amount needed to be *at* the poverty line. Where the graph line is below it, the family is living below the poverty line. The axis shows the percentage by which the family is above or below the poverty line.

[7] ABC (2013) Vote compass explorer: What Australians think about the big political issues

[8] Hockey J (2014) 'Budget speech 2014-15', *Budget 2014-15*.

[9] See Denniss R and Baker D (2012) *Are unemployment benefits adequate in Australia?*

Figure 9: Unemployment benefit relative to the poverty line (%)



Source: Calculations by The Australia Institute based on Melbourne Institute of Applied Economic and Social Research, Poverty Lines: Australia (various issues), and Australian Government (2014) *Guide to Social Security Law*.

After Hawke made 'that promise', this family had indeed moved above the poverty line. By the early 1990s their income had peaked at just a bit more than 10 per cent above the poverty line. The movement relative to the poverty line has been downward ever since. By the early 2000s this family was back at the poverty line. By June 2012 the family was 20 per cent below it – much worse off than when Hawke made his original promise. Of course poverty is relative and the Henderson poverty line was deliberately designed so that it would keep up relative to the rest of society. Even though payments have been indexed ever since the early 1990s, such a long period of time has elapsed that the payments continue to fall further behind community standards.

Over that time the pension too has increased relative to Newstart – because the former is indexed to the higher of the Consumer Price Index (CPI), the Pensioner and Beneficiary Living Cost Index or Male Total Average Weekly Earnings. Usually, and over the long term, the average weekly earnings series published by the ABS outperforms the CPI and keeps up to date with community standards.[10]

Currently the age pension for someone who rents privately is $468.70 per week, or $671.40 for couples, which is above the poverty lines of $408.44 and $578.55 respectively. Those figures and the relevant figures for those with their own homes are included in Table 6..

[10] While this is true of Australia it is not universally true as the experience of the US demonstrates.

Table 6: Pensioners, payments and poverty lines per week

	Single age pensioner			Couple age pensioners		
	Payment $	Poverty line $	% above poverty line	Payment $	Poverty line $	% above the poverty line
Home-owners	406.00	243.72	66.58	613.10	397.46	54.25
Renters	468.70	408.44	14.75	671.40	578.55	16.05

Source: Melbourne Institute of Applied Economic and Social Research (2014) *Poverty lines: Australia, December quarter 2013*.

Table 6 shows that age pensioners are well above the poverty line if they own their own home. They are still 15 or 16 per cent above if they rent privately. However, a buffer of 15 to 16 per cent does not keep people above the poverty line for long if payments fail to keep pace with community standards. If community standards are increasing at 1.5 per cent above the inflation rate, the buffer will be eliminated in 10 years as a result of switching indexation away from average weekly earnings to just the CPI – which is exactly what is likely to happen in the future if present plans are followed through.

On budget night 2014 the Treasurer Joe Hockey announced that, as of September 2017, the age pension would be indexed only against the CPI and would no longer be indexed against the higher of that or the Pensioner and Beneficiary Living Cost Index or Male Total Average Weekly Earnings. The Pensioner and Beneficiary Living Cost Index is a series similar to the CPI but concentrates on the goods and services likely to be consumed by people on income support. Male Total Average Weekly Earnings is a separate series published by the ABS that comes out with the average weekly earnings series.

Ideology and inequality

Governments are not supposed to run like businesses. They provide services because the citizens demand them, not because delivering them is profitable. They collect taxes from citizens – they don't charge prices to customers. While a business has a legal responsibility to maximise the dividends it pays its shareholders, it makes no sense for a government to generate a surplus from its own citizens.

The Commission focuses on the need for the government to sustain public finances but barely discusses the role of government in sustaining the health of Australia's citizens, its communities and its environment. There is no doubt that governments must make sustainable long-run decisions about tax and expenditure. Nor is there any question that the decisions it makes about how to improve the sustainability of our finances can have significant impacts on the sustainability of the broader systems on which our economy is built. But the auditors have failed to present evidence to support their premise that Australia has high levels of debt, taxes or public spending. Indeed, a wide range of international evidence suggests that the exact opposite is true.

There is more to intergenerational inheritance than the money. Australia only has one chance to educate a child, one chance to care for those in need, and one chance to protect the natural environment before it is destroyed. The auditors have chosen to focus on a very narrow range of threats to future generations.

While the potential 'burden of public debt' left by one generation to another is much discussed, the economic and social burdens of failing to address climate change, invest in high-quality education or support families through times of stress and ill-health are virtually ignored. Children in Tasmania, whose educational outcomes are the poorest in Australia, and Indigenous children, who are suffering from preventable and treatable diseases, will experience a far greater burden as a result of our failure to support them than they will from slight variations in levels of public debt.

Much is also made of the repeated claim that Australia's ageing population will place significant pressure on current levels of spending – levels that are low by international and historical standards – when, in fact, the increase in spending is the result of population growth, something the Commission assumes will continue. The Commission does not talk about what assumptions it has made about the growing Australian population, but the Australian Bureau of Statistics assumes there will be 48.3 million people in Australia by 2061. Despite population expansion being the largest single driver of spending growth, the Commission does not reveal its assumed rate of growth in the report's section on 'key demographic assumptions'.

In outlining the case for a co-payment to reduce demand for GP services, the Commission is silent on the fact that people living outside of major capital cities make fewer visits to the GP. If the Commission's recommendation on a co-payment is accepted, the groups that are most likely to reduce their number of visits to the doctor are the groups that are already the most likely to be currently underserviced. Similarly, the Commission ignores demographic reasons for disparities in demand for GP services, for example, the requirement of women to see a GP to obtain a repeat prescription for the contraceptive pill.

The auditors accept uncritically the notion that privatisation and deregulation lead to increased efficiency and lower costs to consumers. By failing to consider examples of when privatisation and deregulation have failed to deliver expected benefits, the Commission of Audit has provided no clear guidance to the government about better and worse classes of assets to privatise or better and worse ways of managing such a process.

Awareness among the auditors of the political nature of their report is highlighted by their silence on the likely efficiency and effectiveness of the Abbott government's Direct Action and Green Army programs. The Commission of Audit is highly critical of the Commonwealth's ability to efficiently administer grant-based funding programs – but despite these concerns, and the overwhelming evidence that a carbon price is a more efficient mechanism to drive emission reductions than direct funding, the Commission has been silent on the merits of this large area of new government expenditure.

There is also a question about the interests of the auditors. Many of the major recommendations of the Commission of Audit would deliver significant benefits to members of the Business Council of Australia, of which Shepherd is the former president. Despite the lack of independence between the auditors and the beneficiaries of the audit, the report includes no statements about the auditors' independence, no declarations of their own personal investments, and no description of any process by which they sought to exempt themselves from decisions that could be seen to affect their personal or organisational interests. Put simply, in no way can the 'auditors' be seen as independent.

The report of the Commission ignores two important drains on available funds for Commonwealth programs. These are superannuation tax concessions and the increasing minimisation of the top marginal tax bracket.

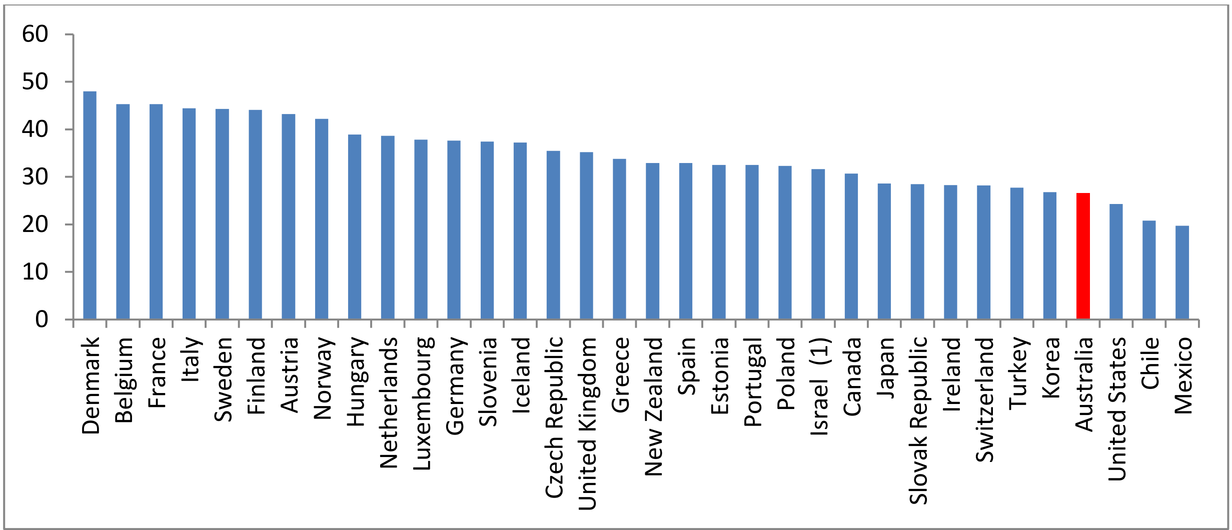
The annual cost of tax concessions for superannuation will exceed the annual cost of the age pension in 2016-17, and while the cost of the age pension is growing at around six per cent per annum, the costs of tax concessions for superannuation are growing at 12 per cent per annum. Treasurer Joe Hockey has admitted that, despite the $35 billion annual cost of tax concessions in 2013-14, the proportion of people receiving the age pension will be no lower in 2050 than it is today. The Commission of Audit makes no recommendations about the need to reform these tax concessions.

Since 2001 the income threshold for the top tax bracket has increased threefold from $60,000 to $180,000 and, in turn, the proportion of taxpayers in the top tax bracket has fallen from 13 per cent to three per cent. Over the same period the top tax rate has fallen from 47 cents in the dollar to 45 cents in the dollar. Rather than draw attention to the enormous loss of revenue associated with tax cuts in the last decade, or highlight how the top ten per cent of income earners has received more benefit from recent tax cuts than the bottom 80 per cent combined, the Commission of Audit focused instead on the potential downsides of ‘bracket creep’ associated with a growing number of people entering the next tax bracket.

Is Australia is a high taxing country?

Like public debt, political and business figures often claim that Australia is a high-taxing country. Such claims are not supported by international evidence. Figure 10 shows tax-to-GDP ratios and compares Australia with other developed economies. With tax at just 26.5 per cent of GDP – which combines Commonwealth and state taxes – Australia *is the fourth lowest taxed country*. In 2012, total Commonwealth tax was just 22.6 percent of GDP. Most OECD countries have tax to GDP ratios of 30 per cent or more.

Figure 10: Tax as share of GDP in OECD countries (%)



Source: OECD Database.
Note: In most cases the latest figure applies to the calendar year 2012 but in Australia’s case 2011 is used.

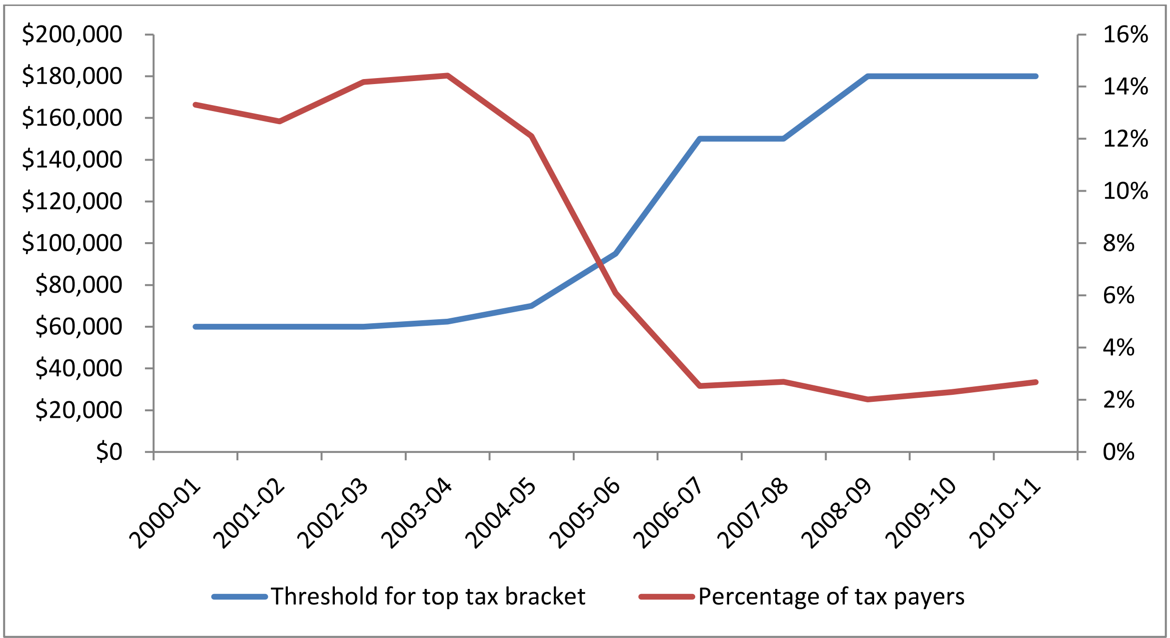
Despite having a comparatively low tax rate, Australian governments have actually made tax cuts over the past decade. The last budget of the Howard government and the 2007 election promises from both major parties resulted in large income tax cuts under the ALP governments (2007–13). In fact, The Australia Institute has estimated that the cumulative cost of the tax cuts introduced since 2005 are about $170 billion, with the top ten per cent of income earners receiving more of that $170 billion than the bottom 80 per cent combined.[11]

The Commission of Audit has argued that inflation is steadily pushing people into higher tax brackets and that this is a significant problem best solved by annual tax cuts. But as Figure 11 shows, such ‘bracket creep’ is a small problem compared to the ‘bracket slashing’ that has occurred in recent years. For example, since 2001 the top tax bracket has been

[11] Grudnoff M (2013) *Tax cuts that broke the budget*

increased from $60,000 to $180,000. Over the same period the proportion of taxpayers in the top tax bracket has fallen from 13 per cent to three per cent and the top tax rate itself has been cut from 47 to 45 per cent. The Commission of Audit provides no evidence to support its stated concern about the more recent increase in the proportion of people in the top tax bracket in the past couple of years.

Figure 11: Decline in relevance of the top tax bracket



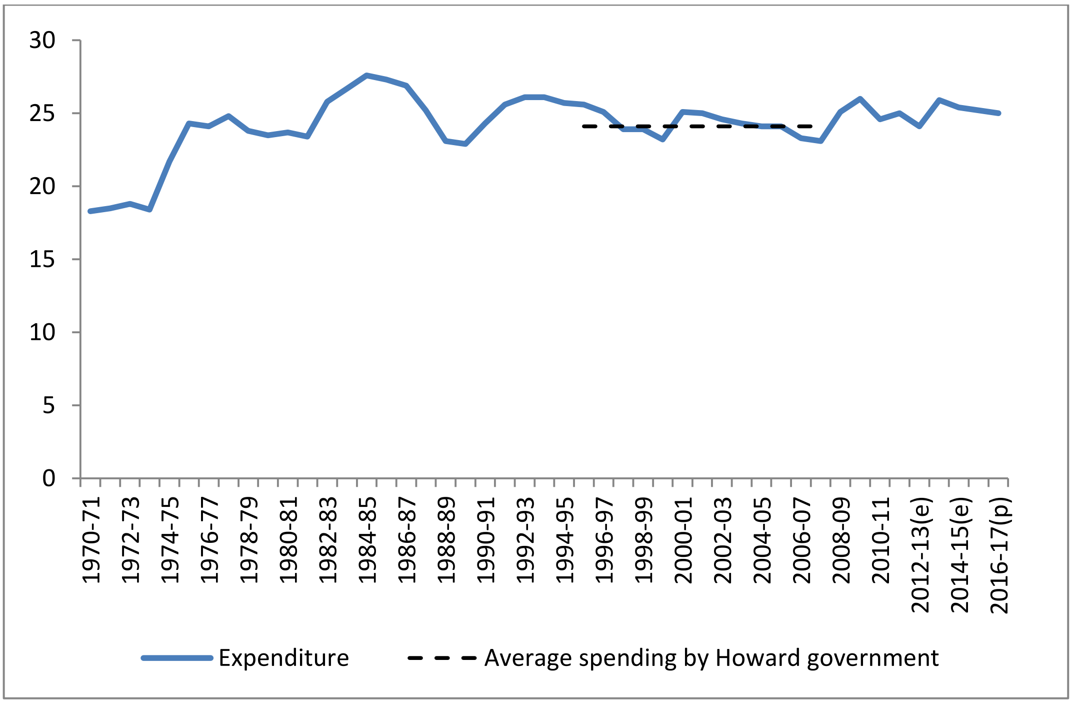
Source: Australian Taxation Office.

It is clear from the evidence above that problems like underfunded schools and TAFE colleges, crowded hospitals, poverty and poor public transport could be quickly and equitably solved by restoring the tax rates that existed during the long period of economic growth leading up to the tax cuts – and by limiting access to rapidly growing tax concessions for superannuation and capital gains, which chiefly benefit a small minority of high income people.

Does Australia have big-spending governments?

The myth that Australian government spending is 'out of control' is widespread in public commentary from political and business figures and is implied in the NCA Terms of Reference. Yet the idea that Australian governments spend a lot of money in ever-increasing amounts is not supported by historical evidence. Figure 5 shows government spending as a share of GDP since 1970-1.

Figure 12: Government expenditure (% GDP)



Source: Australian Government (2013) *Midyear Economic and Fiscal Outlook.*

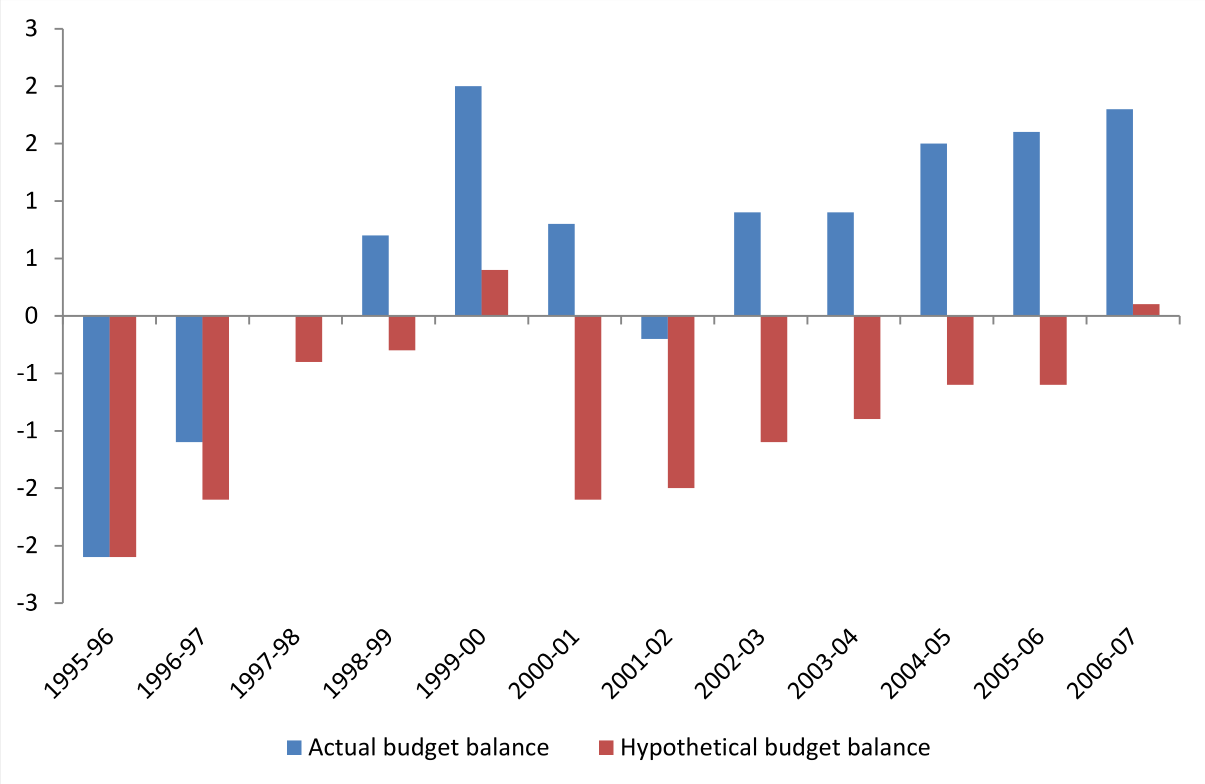
Figure 12 suggests that government spending increased substantially as a share of GDP under the Whitlam government and in the early years of the Hawke government, when these governments were taking on major new responsibilities in health, education and income support. Since then, however, government spending has tended to hover around 25 per cent of GDP. Clearly the view that government spending is out of control and increasing rapidly is not supported by the facts. The increase in spending in the 1970s, which has continued since then, is best interpreted as reflecting the view of the Australian electorate that the government needed to increase its funding of sectors such as health and education.

A variant of this particular myth is that welfare spending is out of control and will get worse. Treasurer Joe Hockey, for example, has announced that, "we still have a major demographic bulge confronting our economy and budget".[12] Health and the age pension are usually singled out as being vulnerable to pressure from an ageing population. Health and education are addressed further in the discussion below.

The easiest way to highlight that Australia's current budget deficit is a result of tax cuts and not spending increases is to answer the question: 'what would the deficit have been under John Howard if he had relied on the current level of revenue collection?' Figure 6 shows that if John Howard had overseen budgets with revenue of only 23.5 per cent of GDP his governments would have been in deficit for 10 of the 12 years for which he was prime minister.

12 Kehoe J (2014) *Hockey signals pension age rise.*

Figure 13: Actual and hypothetical Budget balances (assuming revenue of 23.5% of GDP)



Source: Australian Government (2013) 2013-14 Budget Papers

Policy prescriptions of the National Commission of Audit

The National Commission of Audit (NCA) set out a raft of recommendations designed to undermine the foundations of Australian society. This review considers recommended changes to key policy areas of welfare, health, education and the environment.

Welfare

The Treasurer Joe Hockey has stated that:

> *The age of entitlement is over. The age of personal responsibility has begun.*[13]

The NCA has responded by delivering recommendations to cut a wide range of income support programs. While the term 'welfare' is often used pejoratively to demean people on income support payments, the actual breadth of the payments captured by the term is highlighted in Table 7.

If we think of 'welfare' as including social security, health, education, housing and community amenities, then 'welfare' makes up 62 per cent of Commonwealth government outlays. These are big programs that a lot of people depend upon for leading long, healthy, meaningful lives, satisfying caring relationships and access to the amenities of life. The threat of not being able to support an ageing population is used as a pretext for withdrawing these services.

[13] Read more: Ireland J (2014) *Treasurer Joe Hockey says 'age of personal responsibility has begun*

Table 7: Expenses by function

	$million	Share of total (%)
Social security and welfare	138,145	34.7
Other purposes	73,560	18.5
Health	64,636	16.2
Education	29,742	7.5
General public services	23,023	5.8
Defence	22,045	5.5
Other economic affairs	11,283	2.8
Housing and community amenities	8,775	2.2
Fuel and energy	7,586	1.9
Transport and communication	6,453	1.6
Public order and safety	4,272	1.1
Recreation and culture	3,696	0.9
Agriculture, forestry and fishing	2,654	0.7
Mining, manufacturing and construction	2,431	0.6
Total	398,301	100.0

Source: Australian Government (2013) *Mid-year Economic and Fiscal Outlook*. Note 'Other purposes' is mainly general-purpose payments to the states and territories and public debt interest.

It is true that the population is ageing, but it will be a gradual process. At June 2014 the share of over-65s in the population is expected to be 14.7 per cent. That will increase to 17.1 per cent in 2024, and then 19.2 in 2034, 20.2 in 2044 and so on in smaller and smaller steps.[14] A recent report by the Productivity Commission showed that there will indeed be some increase in age pension spending, but that this too will be gradual and will eventually settle down as a stable share of GDP.[15] In the meantime, the intergenerational report predicts that, over the next 40 years, Australia's GDP per capita will grow by 1.5 per cent per annum,[16] which means that in 40 years we will all be 'richer' by 81 per cent. We can easily afford a modest increase in the age pension.

According to the latest estimates by the University of Melbourne, age pensioners are now substantially above the Henderson poverty lines compared with those on the Newstart allowance, which is positioned below the poverty line. The National Commission of Audit has recommended that indexation of the age pension be switched from male average weekly earnings to either the CPI or the Pensioner and Beneficiary Living Cost Index until 2027-28. Such a change will see the pension rate decline over this period to 28 per cent of average weekly earnings.

[14] These figures come from ABS (2013) *Population projections, Australia*.
[15] Productivity Commission (2013) *An ageing Australia: Preparing for the future*.
[16] Australian Government (2010) *Australia to 2050: Future challenges*.

The Mid-year Economic and Fiscal Outlook published in December projects that real wages and real GDP per capita will grow by 1.5 per cent into the future. In this scenario, under the NCA's recommendations the age pension would fall below the Henderson poverty line in early 2023 for both singles and couples. This is well before the time when the pension will again be indexed to a wage measure. By the middle of 2027-28 under these arrangements the age pension would be seven and six per cent below the poverty line for singles and couples respectively. The NCA recommendations would have the effect of keeping the age pension permanently below the poverty line. Judging by the NCA's diagram, it appears that the aim is essentially to cut pensions by 20 per cent below what they would otherwise have been.

The Commission of Audit sees the problem very differently. It believes that the ageing population should be seen as a burden which makes spending on welfare unsustainable. The Commission says:

This Audit identifies actions that can be taken now to ensure that Commonwealth spending is placed on a more sustainable long-term footing. It recognises the unfairness of saddling today's children with our debts. With an ageing population there will be fewer people of working age to look after the retired. They should not inherit our debt as well as the burden of looking after us.

Accordingly it has recommended savage cuts to welfare spending, including reducing the real value of pensions, unemployment benefits, disability and carers payments over the next 15 years. This would then cap these payments at lower levels. The Commission also recommends increasing the eligibility age for the pension and transitioning it to 77 per cent of life expectancy at age 65.

Young unemployed people have come in for particularly harsh treatment, with single 22- to 30-year-olds being threatened with having their support payments cut off if they are unwilling to move to an area with better employment prospects. With strict asset tests, those on unemployment benefits first have to run down their savings, then, after a year on benefits, are supposed to be able to find the funds to move.

Health

The Minister for Health has described the health system as 'unsustainable'. Treasurer Hockey has gone further, arguing that expenditure on health has been 'growing exponentially'.[17] Comments such as these seem to have been more frequent as the budget approaches and seem designed to suggest the inevitability of cuts in areas valued by the community. Figure 14 plots the change in health spending as a share of GDP.

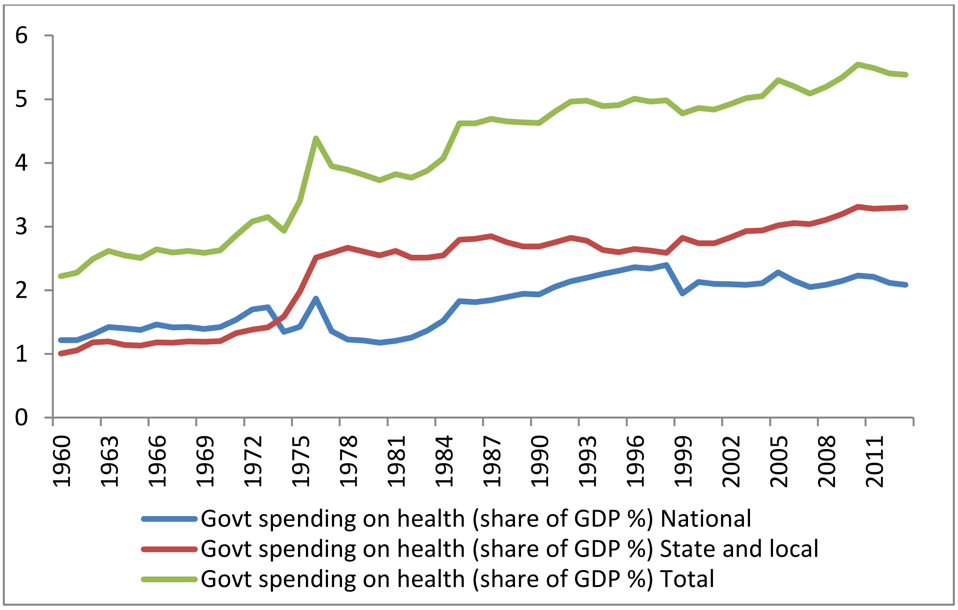
There is indeed an upward trend, but it is comparatively slight – over the last two decades, total spending on health increased from around 4.9 per cent of GDP to 5.4 per cent while Commonwealth spending has been pretty constant at just over two per cent. If the government cuts spending on health it will either reduce the existing availability of health care or increase the out-of-pocket costs people have to pay.

Australia's Medicare system is based on some fundamental principles that are now at risk. As Anthony Harris, Director of the Centre for Health Economics at Monash University, put it:

[17] Martin P (2014) *Health, welfare and education: Tough choices loom for Treasurer Joe Hockey*.

> *… a fundamental principle of Medicare is that we want the poor to have the same high-quality care and attention as the rich, paid for in a fair way. Health is not like other insurance markets because the poor need the same insurance against health risks as the rich, and the amount they need is not related to their income.*[18]

Figure 14: Trends in health spending (% share of GDP)



Source: ABS (2013) *Australian system of national accounts.*

Significantly, while the Commission of Audit suggests that people are visiting the doctor too often, it does not take account of regional circumstances. A wide range of evidence suggests that, compared to people who live in urban areas, those who live in rural areas visit the doctor less regularly, have reduced access to GPs and have poorer health outcomes as a result – refer to Figures 15 and 16.[19] Yet despite the underservicing of health in rural areas, the Commission does not recommend any discount to the suggested $15 co-payment, or make any recommendations about other ways to address underservicing of people in non-metropolitan areas.

[18] Harris A (2014) *On being treated well: Reforming Medicare after 30 years*.

[19] Steering Committee for the Review of Government Service Provision (2014) Report on Government Services 2014.

Figure 15: Mean annual number of GP visits per head of population by region

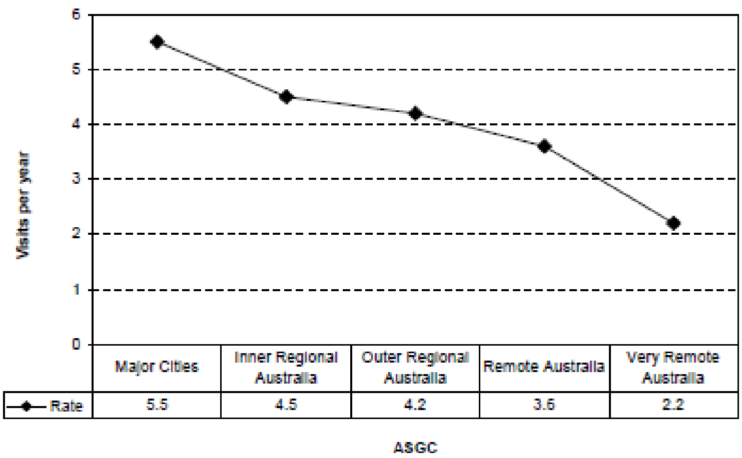
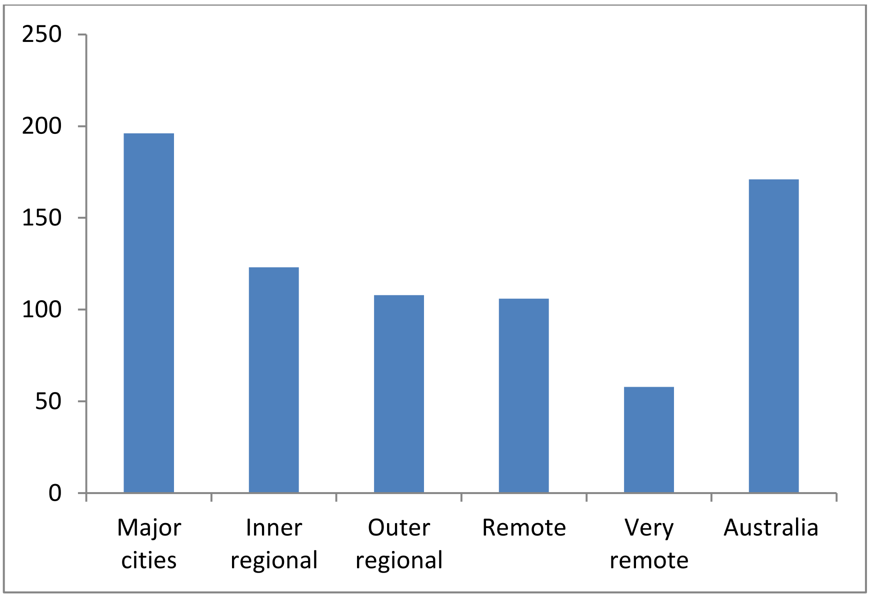


Figure 1.4: Mean annual number of GP visits per head of population by ASGC Remoteness, 2001 (MBS A1 and A2 item claims)

Source: AIHW, *Locality matters: The influence of geography on general practice activity in Australia 1998–2004*.

In addition to ignoring regional disparities in the provision of health services, the Commission is also silent on demographic differences in the demand for GP visits. For example, women seeking a prescription for the contraceptive pill are required to see a GP in Australia, whereas in other countries repeat prescriptions can be obtained by seeing a nurse.

Figure 16: Number of GPs per 100,000 population by region



Source: Australian Institute of Health and Welfare, Health and Community Services Workforce 2006, 2009

The Commission of Audit report saw health care as a major fiscal challenge, despite the reality that federal health spending as a percentage of GDP is relatively stable. The Commission of Audit said:

> *Health care spending represents the Commonwealth's single largest long-term fiscal challenge, with expenditure on all major health programmes expected to grow strongly to 2023-24 and beyond. Putting health care on a sustainable footing will require fundamental changes to all the components of the health system.*

Choosing to ignore that real incomes and GDP are expected to grow rapidly, and that, by world standards, Australian spending on health is quite modest, the Commission of Audit recommended large changes to the way health is both provided and rationed in Australia.

The most radical is a shift to an Obama-style system with compulsory private health insurance, which will effectively end Medicare – or universal health care – as we know it. The Commission has also suggested introducing a co-payment of $15 to visit the doctor.

There are two reasons for taxing something – because you want to discourage it or you want to raise revenue. Introducing a co-payment for GP visits is likely to make lower income groups less inclined to visit the doctor, with obvious consequences that have been observed when services have been cut under European-style austerity programs.[1] There is evidence that people put off early intervention, with the consequence that much more expensive care is required in the future.[1] The modest savings are therefore, at best, temporary and likely to be problematic in the future – a 'poor health debt' on future generations.

The second reason to implement a tax is to raise revenue. Using sickness as a revenue base is very strange. There are far better bases to raise revenue from – including personal income, wealth and profits.

Education

The Coalition went to the 2013 election promising to implement the Gonski reforms, which address the needs of children with learning difficulties or low incomes. Prime Minister Abbott has said this commitment was only for four years, after which education spending can be reduced.

The head of the International Monetary Fund (IMF), Ms Christine Lagarde, made it crystal clear that education is a social investment, saying:

… making sure there are equal opportunities for all is something where public money is needed. It's not a question of … entitlement.[20]

The evidence confirms that education contributes to growth in national income. One study cited by the OECD came to the conclusion that an extra year of average education has in the past raised output per capita by around four to seven per cent across OECD countries in the long run.[21]

A functioning system of education also meets our need for a rich cultural diet of ideas to think with and play with.[22]

[20] Kwek G (2014) *IMF chief Lagarde backs quotas*.
[21] Bassanini and Scarpetta, 2001 cited in de Serres A, *Structural Policies and Growth: A Non-Technical Overview*.
[22] OECD (2003) The Sources of Economic Growth in OECD Countries.

The Commission of Audit has a different view, particularly of higher education:

> *The Commission considers that a rebalancing of the public and private contributions to higher education is warranted, reflecting the substantial private benefits that arise from higher education.*

The Commission proposed that students pay more for their degrees, increasing student contributions to 55 per cent while reducing the government's contribution to 45 per cent. It also called for the deregulation of fees for bachelor degrees, allowing universities to increase fees. It proposes increasing interest rates on HELP debts as well as requiring payment to commence at the minimum wage.

It recommends the removal of all Commonwealth funding of vocational education and training including support for apprentices.

All these proposed changes push Australian education towards a US-style user pays system. There are already user pays provisions in the Australian education system but Australians rightly believe that education should be based on merit and open to all people regardless of the wealth of their parents. These changes would help limit education to the wealthy and prevent social mobility. Over the long term they would make Australia a less equitable country.

Environment

While international agencies such as the World Bank, IMF and OECD are all very concerned about the economic, social and environmental consequences of climate change, the Commission of Audit clearly was not. The long-term state of the federal budget and its potential impact on future generations drives the apparent concerns of the auditors, but the state of the environment appears to be of far less concern, despite the likely negative impacts on the economy.

The Commission of Audit agreed with the government's attempts to abolish the Clean Energy Finance Corporation, the Climate Change Authority and Low Carbon Australia Limited. While the Commission of Audit talked extensively about the sustainability of the budget it seemed unconcerned about the sustainability of the planet.

Surprisingly, the Commission of Audit was entirely silent on the cost-effectiveness of the Coalition's Direct Action scheme and the near-consensus view of the economics profession that a carbon price would be a more efficient and equitable way to fund greenhouse gas emission reductions than taxes raised from the population more generally.

Other areas

The Commission of Audit recommended that the Commonwealth government hand over all responsibility for home affordability and homelessness to the states except for the payment of rent assistance. It also recommended that the Commonwealth government should offer to pay rent assistance to those in state public housing only if the states charge commercial rents on those properties.

Indigenous affairs were also targeted, with the Commission recommending that the 150 Commonwealth Indigenous programs be consolidated into no more than seven programs. It also recommended an education voucher system requiring Indigenous people to navigate a voucher system in order to access education. This would add extra complexity for a disadvantaged group that already has low levels of attachment to the education sector. Voucher systems require people to be well-informed about all possible options, and are therefore unlikely to offer better educational outcomes for Indigenous Australians, especially in remote areas.

Defence funding was left largely untouched except for calls to reduce the number of civilian public servants in Canberra. While the Commission called on the government to review its commitment to increase defence spending by two per cent of GDP (approximately $10 billion) it stopped short of saying that such an idea should not occur.

The poorest people of the world were not so lucky, with the Commission recommending that all foreign aid targets be linked to GDP, and that the millennium development goals be abandoned.

The almost $6 billion subsidy to industry, in the form of the fuel tax credit scheme, was left untouched, while reductions to some industry specific grants were recommended. Business and superannuation tax concessions were not even considered by the Commission of Audit. In the case of superannuation tax concessions this is strange, since the Commission paid keen attention to other retirement policies such as the aged pension.

Inequality in retirement

As Australia's population ages, government policies that assist retirement will become even more essential. Superannuation tax concessions and the age pension are the two key government policies that assist the ageing, but they are becoming increasingly expensive. Increasing costs have prompted the Treasurer, Mr Joe Hockey to suggest the pension age be increased to 70. This suggestion is part of an austerity narrative being used by the government to justify broader spending cuts to health, education and welfare support. This paper shows super tax concessions, most of which are being claimed by people able to afford early retirements if they choose, will soon cost more than the age pension.

The age pension currently costs $39 billion and superannuation tax concessions will cost the budget around $35 billion in 2013-14. These concessions are projected to rise to $50.7 billion in 2016-17, an increase of around 12 per cent per annum. By this time superannuation tax concessions will be the single largest area of government expenditure. The overwhelming majority of this assistance flows to high income earners. Low income earners receive virtually no benefit. The combined cost of these two policies will be $74 billion in 2014 alone. With an ageing population the dual pension/superannuation system will become increasingly expensive. The government's own projections are that the cost of super tax concessions as a share of GDP will exceed that of the age pension by 2016-17.

The following section presents an overview of an alternative model that could produce a fairer, more adequate and more sustainable retirement system. It proposes that we abolish tax concessions for superannuation and create a universal (non-means-tested) age pension. This proposed system is similar to the approach taken in New Zealand where labour force participation among older people is higher than in Australia. A subsequent paper will outline how the proposed universal age pension model could be implemented.

A universal age pension would be particularly beneficial to those groups whose superannuation balances are low, such as low income, seasonal or intermittent workers, the self-employed or those who have long periods of time out of the workforce (e.g. predominately women who care for children/ageing parents). A universal pension would create a level playing field amongst income groups and reduce the inequality in Australia's retirement system. Superannuation could then act as a top-up for those who can afford it.

It is suggested that the single pension be lifted from 30 per cent of male total average weekly earnings to 37.5 per cent, with a consequent lift in the partnered rate. This would raise the pension rate for singles from $21,018 per annum to $26,273 per annum and the pension rate for couples from $31,689 per annum to $39,611 per annum. This system would cost $52 billion a year, almost 30 per cent less than we currently spend on both the pension and superannuation tax concessions.

The proposal outlined herein uses a 15 to 25 years phase-in period for illustrative purposes only; the precise phase-in method can be varied to suit policy objectives. The proposed transition options mean that the immediate cost of the new scheme is a lot less than the immediate revenues flowing from abolition of tax concessions. Revenues are brought forward whereas costs flow on many years down the track. This produces the interesting result that, whereas the scheme is revenue neutral in the long term, it produces a large net saving to the government in the short term. This must be of some interest to governments facing budget stringency caused by the slowing of the mining boom.

Such an increase in the pension rate would help to alleviate poverty among the aged. Additionally, government assistance by income class would become more progressive than it currently is. Whereas the present system of tax concessions of superannuation contributions favours high income earners the new system would more closely reflect the existing taxation rates applicable at each income level.

Although the cost of a universal age pension will rise over time, the cost of the existing combination of age pension and superannuation tax concessions will cost more. On that basis the policy proposed in this paper is more sustainable.

The cost of superannuation tax concessions

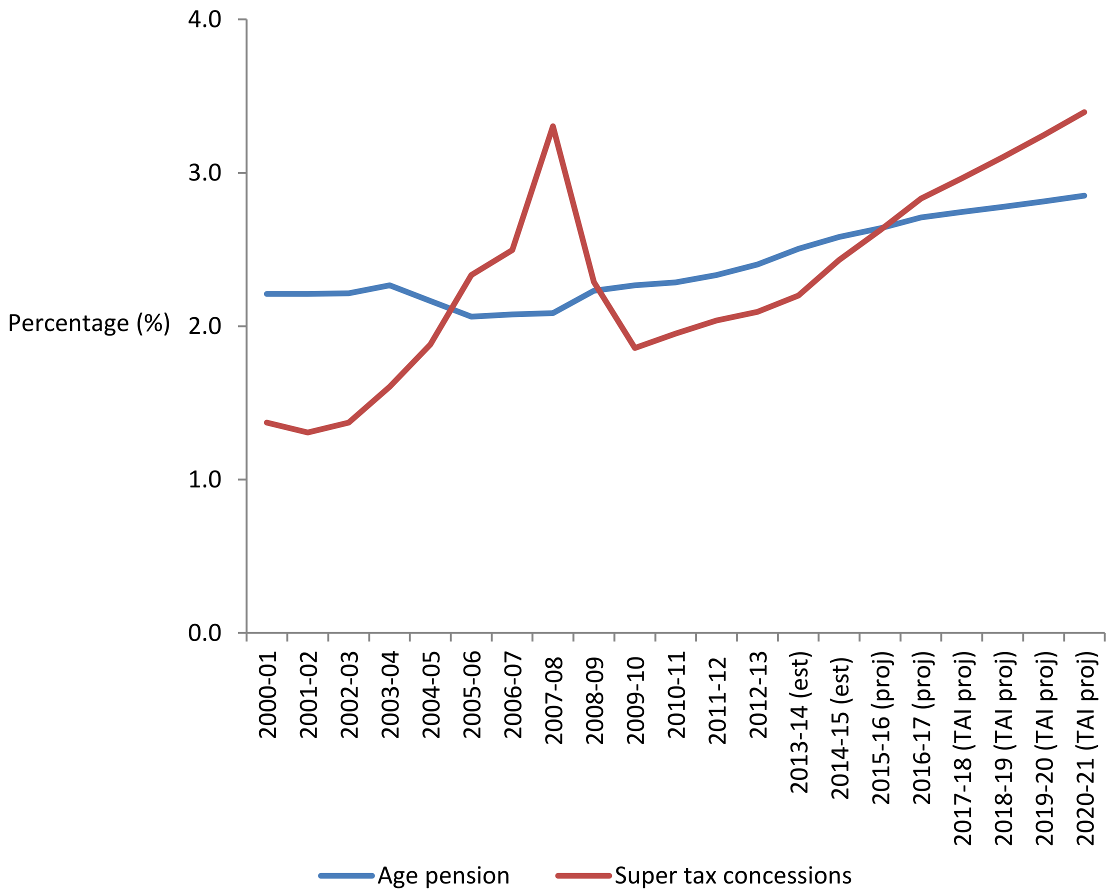
The cost of superannuation tax concessions in 2013-14 is projected to be $35.6 billion. This is projected to rise to $39.6 billion in 2014-15; $44.8 billion in 2015-16 and $50.7 billion in 2016-17.[23] These are staggering rises, of approximately 12 per cent per annum, reflecting the impact of the compounding of member balances and the phasing in of higher rates of the superannuation guarantee (SG). The SG will rise from 9 to 12 per cent over a 12-year period starting in July 2013[24]. The current tax concession cost is slightly less than spending on the age pension at $39 billion,[25] but these costs are projected to cross over in 2016-17 since the cost escalation is greater on the tax side. Figure 17 shows that the cost of super tax concessions as a share of GDP is increasing faster than the age pension.

[23] Treasury 2013b Budget paper No 1 and Treasury 2013a Tax Expenditure Statement 2012

[24] This will become 14 years under the Coalition.

[25] Treasury 2013b Budget paper No 1 2013-14 Statement 6 table 9.1

Figure 17: Cost as a share of GDP (%)



Source: Australian Government (various years) Budget Paper No 1; Australian Government (2013) Mid-year economic and fiscal outlook, 2013-14; and TAI calculations and projections.

The bulk of these tax expenditures relate to two items – concessional taxation of superannuation entity earnings – $19.1 billion – and concessional taxation of employee contributions – $14.1 billion – in 2013-14. These concessions reflect the impact of taxing super at a flat rate of 15 per cent – and zero per cent for some – rather than the income tax rates applicable to members. Both items are growing strongly; the latter in relation to nominal wage growth and the former compounding in relation to the total sums invested in super. Such assets, currently around $1.5 trillion, are expected to reach almost $9 trillion in 2041[26].

The Treasury has noted criticisms of the tax expenditure (TE) concept, notably that the revenue from closing down the tax expenditure would not be nearly so great as estimated because of behavioural changes – that is, that voluntary savings outside the superannuation guarantee (now 9.25 per cent of salary) would virtually cease. Accordingly, they have provided new estimates of *revenue gain* (RG) which are “a way of producing tax expenditure estimates that are more comparable to budget revenue estimates”.[27] These estimates relate to the two principal components of the super tax concessions noted above.

For concessional taxation of superannuation entity earnings the revenue gain is $14.2 billion as compared with the TE of $19.1 billion, a reduction of $4.9 billion or 25.7 per cent. For

[26] Rothman and Tellis 2008 “Projecting the distributions of superannuation flows and assets”

[27] Treasury Tax Expenditure Statement (TES) 2013

concessional taxation of employee contributions the revenue gain is $10.8 billion as opposed to the TE of $14.1 billion, a reduction of $3.4 billion or 23.8 per cent. For the total the reduction is a massive $8.3 billion or 25 per cent. Since these two TEs account for some 95 per cent of the superannuation total, the 25 per cent figure can be regarded as the appropriate discount to apply in estimating revenue gain for the whole of the TE, which reduces from $35.6 billion to $26.7 billion.

It is no coincidence that around 30 per cent of total contributions to superannuation are voluntary; that is, over and above the SG. In effect the Treasury revenue gain methodology assumes that almost all voluntary contributions would be redirected into private savings. Some of these forms of private saving, like investment properties, are relatively lightly taxed. Others, such as bank savings accounts, are taxed heavily and might be expected to yield additional tax revenue.

The revenue gain method shows little revenue from taxing fund investment income during the pension phase, as many older people pay very little income tax because of the Senior Australians' and Pensioners Tax Offset (SAPTO). This raises the tax threshold to over $32,000 per annum for singles and $57,000 per annum for couples. A taxable non-means-tested age pension at a higher rate would substantially reduce the effective tax threshold for such people.[28]

The Treasury methodology might therefore be regarded as producing a lower limit to the total revenue gain from eliminating tax concessions. We use the RG figure not because we agree with it but because it provides a degree of robustness in our costings, with which it is not then possible for a reasonable person to disagree.

Mercer[29] disputes this cost of the tax concessions (TE), arguing that it takes no account of pension savings over the longer term, with the suggestion being that the tax concessions pay for themselves in pension savings. We refute this claim; however this issue is best dealt with when considering the incidence of tax concessions and total government support for retirement.

Incidence of tax concessions

Super tax concessions are extremely regressive, as described in Ingles, Denniss and Richardson and Denniss.[30] Ingles, on the basis of Treasury figures,[31] found that "tax concessions flow overwhelmingly towards the well-off". The Association of Superannuation Funds of Australia (ASFA) points out that government tightening of concessional contribution limits would by now have reduced this disparity; on its reckoning the top 20.4 per cent of wage earners receive 49 per cent of employer contributions,[32] but a higher percentage of the

[28] With the new pension rates the effective single tax threshold falls from $9,000 to $4,000 and the couple threshold from $31000 to $17,000, so there is considerable prospect of tax clawback. These effective thresholds can be calculated by subtracting the pension rate from the income levels at which tax is payable as outlined elsewhere in this paper. Indeed, we propose that with the means test abolished the tax thresholds for pensioners be aligned with the new maximum pension rates such that tax is payable from the first dollar of private income (Appendix 2); this would allow for a considerable claw-back especially at higher income levels.

[29] Mercer 2012 "Tax, super and the age pension: assessing the value of total government support" February

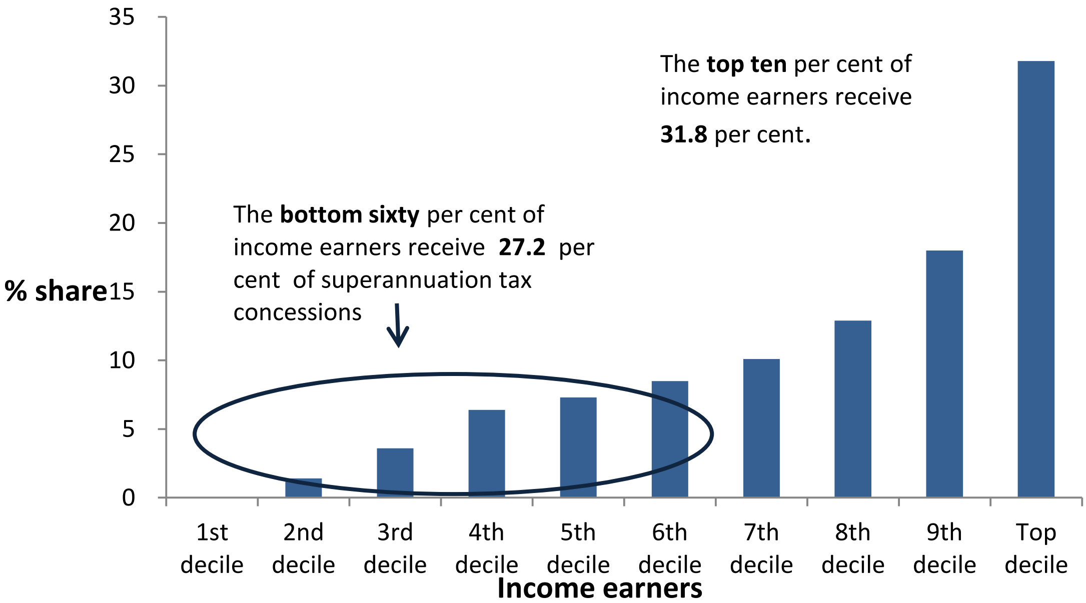
[30] D Ingles 2009a "The great superannuation tax concession rort" TAI Research Paper No 61, February, R Denniss and D Richardson 2012 "Can the taxpayer afford 'self-funded' retirement" TAI Policy Brief No 42; R Denniss 2013 "Super for some" TAI March

[31] (Henry Review) "AFTS Retirement incomes consultation paper" 2009 p22 ACOSS has also published figures which deal with the tax concessions going to those on the top marginal rates in its 2012-13 Budget Priority Statement and its paper "A fairer, more efficient tax and social security system" (2011)

[32] ASFA 2012 "The equity of government assistance for retirement income in Australia" Research Paper February table 2.1

total tax benefits. On Treasury numbers the top two deciles of income earners received 57.7 per cent of total concessions and the top decile 38.2 per cent of the total in 2009-10.[33] Denniss and Richardson[34] suggested that up to 61 per cent of a person's 'self-funded' retirement is actually attributable to the tax concessions provided by other taxpayers. Figure 18, from Denniss, illustrates the regressivity of the tax concessions on super contributions.

Figure 18: Distribution of tax concessions on superannuation contributions 2012-13



Source: Denniss 2013 p2

The regressivity of superannuation taxes derives from their flat-rate character, with the progressive income tax scale being replaced by, in effect, a proportional (15 per cent) tax system on all contributions and investment income (with investment income in the drawdown phase being tax free). This benefits high income earners who would otherwise pay up to 47 per cent on their income. It disadvantages low income earners who would normally be free of tax up to the tax threshold of $18,200. The introduction of a low income rebate of $500[35] temporarily mitigated the impact on low wage earners. The new Coalition government has since abolished this comparatively smaller superannuation policy, one of the few progressive elements in the system.

Knox[36] and other researchers have disputed the regressivity of the tax concessions, noting that they are offset by withdrawal of age pension under the means test. In this view what matters is the progressivity of the total retirement income system and not individual elements of it. On this question Knox finds that total government assistance for retirement income is pretty much flat across income classes, with only a slight peak for higher income earners. The Treasury has come to a similar conclusion.[37] Yet on the latest Treasury figures the jump

---

[33] Treasury 2012 "Distributional analysis of superannuation tax concessions", paper for Superannuation Round Table 23 April. This paper presents Treasury analysis on the distribution of superannuation taxation concessions as presented to the Superannuation Round Table of 23 April 2012

[34] Denniss and Richardson 2012 p6

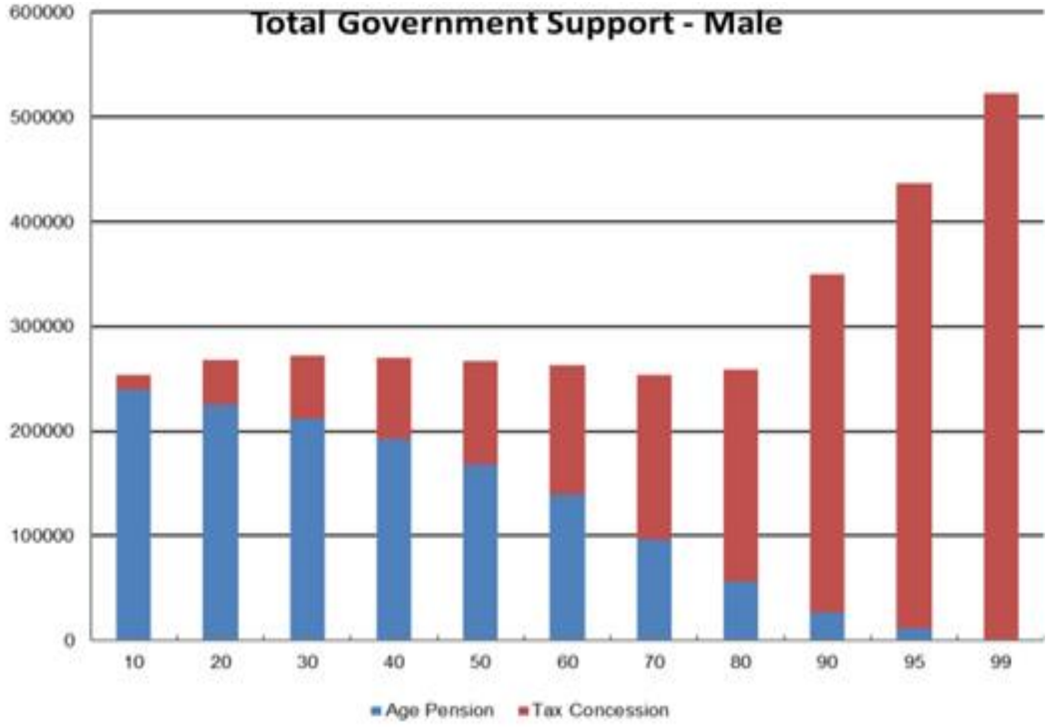
[35] The rebate is payable at 15 per cent of contributions up to an income limit of $37,000 per annum and broadly makes superannuation tax free for low income earners.

[36] Knox 2010 "*The fairness and future of Australia's retirement income system*" The Australian Economic Review 43(3) pp. 302-11

[37] Rothman G 2009 "Assessing the equity of Australia's retirement income system" RIMU Treasury, July Rothman found that 2 key measures in that years' Budget added to the equity of the retirement income system,

in assistance at the top decile is quite marked. While total average assistance for all other income groups is around $265,000, at the 90th percentile of male earners it jumps to $350,000; for the 95th percentile to $425,000 and for the 99th percentile to $515,000.[38]

Figure 19: Distribution of "total government support" (both superannuation tax concessions and age pension)



Source: Treasury (2012) Figure 2

The Treasury does not provide similar figures for women; presumably the distribution would be similar. But we note that women would be disproportionately represented in the lower deciles for the population as a whole, and greatly under-represented at the top. Kelly et al noted that women are a particularly vulnerable group in terms of superannuation because they are more likely than men to work part-time or part-year; they are more likely to have interrupted careers, and even when they work full time their earnings are lower than mens, at some 84 per cent.[39] In 1994 women spent 17 years on average in the paid labour force compared to 39 years for men; while this gap is narrowing it would still be very large. According to Kelly et al the average female superannuation assets will still be only 70 per cent of the average male assets by 2030.[40] Moreover women will represent two-thirds of the population in the over-85 age group, a group where superannuation assets are likely to be quite diminished.[41]

There are some problems with the Treasury/Knox total assistance analysis. For example, assumptions must be made about a wide variety of matters including how individuals invest

being first the increase in the base pension (and associated increase in the means test taper) and second the reduced caps on concessional contributions.

[38] Treasury 2012 “Distributional analysis of superannuation taxation concessions”. These figures are read off their graph, reproduced as Figure 19 here.

[39] Kelly S Percival R and Harding A 2002 Women and superannuation in the 21st century: poverty or plenty.

[40] Kelly et al 2002 p231

[41] Kelly et al 2002 p233

their lump sum and what returns they get. Knox attributes only part of the tax benefit from the low fund tax rate to individuals, on the grounds that they wouldn't pay much tax on investments outside of super. He also disregards the tax break on fund earnings during the payout phase on the grounds that the elderly don't pay much tax. Of course they don't – they have access to tax-free super. Further, the net benefits to individuals depend on how much they manipulate the system by 'double dipping', a particular issue with the current system.[42] Double dipping refers to the ability of savers to benefit from generous tax concessions but still get the age pension, for example by using super to pay off their house mortgage – the house is not an assessable asset in the pension asset test.

The bottom line is that if the distribution of net government benefits were truly flat by income class it would be equal to the value of the full-rate age pension at each income point, with the pension being a declining proportion of the total as income rose and the total cost of pension plus tax concessions not being greater than that of a universal age pension. This is not the case – the current system costs much more, even on a revenue gain basis. This feature makes the tax-pension trade-off proposed in this paper feasible and revenue-neutral or even revenue-enhancing.

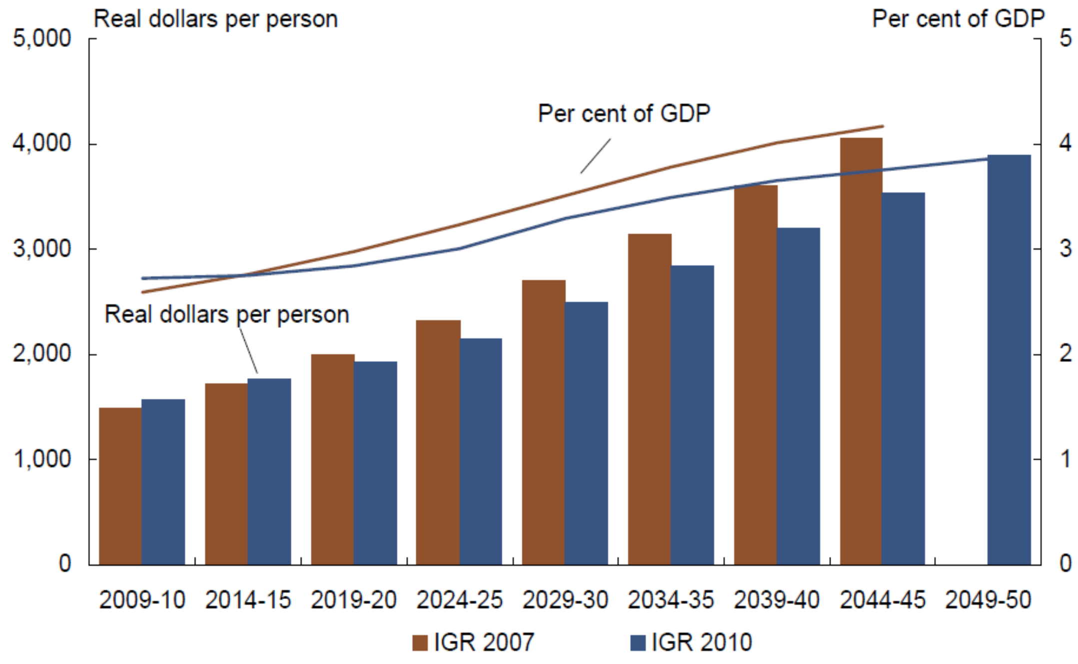
Superannuation tax concessions cannot be rationalised by pointing to saved expenditure on the age pension. The sums simply do not add up. And in terms of individuals, it is notable that even when the SG is fully mature, almost two-fifths of the aged will receive a full pension and another 40 per cent a part pension. Only 22 per cent are projected to receive no pension, a slight increase on 18 per cent currently.[43] Savings on pension spend are limited by the coverage of the SG (very low wage earners and self-employed are excluded), the generosity of the pension means test (for example, homes are excluded), and opportunities to take and run down lump sums ('double dipping'). Age pension expenditure is therefore expected to grow from 2.7 per cent of GDP in 2014-15 to almost four per cent in 2049-50[44], despite much larger superannuation balances as the SG matures.

[42] Even when the SG is fully matured the percentage of the age not receiving any pension is expected to rise only slightly: see Henry 2008. Researchers such as Mercer conclude that the system works well, implicitly because the swings and roundabouts cancel out: see e.g. Mercer 2012 "Australia among the best in Global pension index".

[43] Henry 2008 "AFTS: Retirement Income consultation paper", December Chart 6.1

[44] Treasury 2010 "Intergenerational Report"

Figure 20: Projections of Australian government spending on age-related pensions



Source: Intergenerational Report 2010 Chart 4.13 p.63

We do not have similar long-range projections for tax expenditures but, given current growth rates, they could imply a total cost for retirement income support of 10 per cent of GDP by 2050.

Kelly[45] concludes that it is not unreasonable to consider the use of compulsory income streams in retirement as one way to address, inter alia, double dipping. Many other academics have called for this. But compulsion raises difficult issues. Australians are attached to their access to lump sums; half of all retirement benefits are taken in this form.[46] Compulsory annuitisation raises difficult questions of equity between the long-lived (that is, the well-off) and those with shorter life expectancies. And the age pension means test can make annuities very unattractive.

The policy option – abolish the tax concessions and the means test

There is a very simple way of ensuring that the incidence of total government assistance is progressive by income class: abolish the super tax concessions and abolish the pension means test. Since the pension is taxable, the income tax will claw back part of the universal pension from the well off. The sums involved – $26.7 billion in savings even on the Treasury's conservative revenue gain calculation compared with the $13 billion cost of means test abolition[47] – indicate that this option would produce a $13.7 billion saving to revenue, leaving a surplus which could be used to raise the base pension rate.

[45] S Kelly 2012 "Household savings and retirement: where has all my super gone" for CPA Australia and Kelly 2013 20 years of the superannuation guarantee, Report for CPA Australia

[46] APRA statistics indicate that in 2011-12 $35 billion was taken in lump sums and the same amount in pensions. Cited in Steketee 2013 "Unfair, inefficient and expensive: what went wrong with Australia's superannuation system" Inside story 18 February.

[47] It is difficult to find an up-to date figure for this cost. Clare 2008 suggests that it would be "a net cost well in excess of $6.5 billion a year" (p11), but this figure is not sourced. Dunsford and Wickham 2009 computed a cost of $10.6 billion in 2006-07 or one per cent of GDP. Rothman 1998 projected a 2010-11 cost of .75 per cent of GDP. My costing is as follows: since 18 per cent of the elderly receive no pension, the minimum gross

There would be additional savings because the universal age pension would be taxable; this means that net government assistance would actually decline by income class instead of rising as it now does.[48] For the highest income decile the net assistance would be approximately half that of the lowest, reflective of the effective 47 per cent top income tax rate.[49] Many would regard such a pattern of assistance as quite defensible in a public policy sense.

The logic of this policy is that the existing age pension means test discourages retirement savings and superannuation tax concessions encourage them. The net impact of these countervailing incentives is a wash, but the process creates distortions in saving and investment behaviour including people converting their lump sums into housing, which of course makes housing less affordable in general. The two current policies are in conflict, not harmony. This argument has been made in the past,[50] and by a number of researchers. Ross, for example, concluded that “fundamentally we have two complex systems (age pension/social security and superannuation) which have conflicting effects – the means test … discourages saving for retirement, while the superannuation system is designed to encourage it.”[51]

Thirty years ago Ingles et al, in one of the earliest comprehensive attempts to cost tax concessions for occupational superannuation, noted that the “presence of an income test is likely to work counter to the savings incentives promoted by the tax concessions”.[52] They went on to say that: “An alternative approach would involve reducing or eliminating the tax concessions themselves. This might be done in combination with easing or abolishing the income test on age pensions”.[53]

This was in a context where the means test for those aged over 75 had been abolished in 1973 and for those aged 70-74 in 1975. Since those days there has been a general move back towards increased targeting of the age pension, with the reintroduction of income tests and subsequent imposition of an assets test and deeming. There is now a general antipathy towards ‘middle class welfare’, though such antipathy does not appear to extend to welfare provided through the tax system. Stanton and Herscovitch suggest that: “If cutting so-called ‘middle class’ – and indeed, ‘upper-class’ – welfare is an important policy aim, restoring tax on superannuation for people 60 and over should be a priority”. [54]

For more detail see Ingles, D and Denniss, R (2014), Sustaining us all in retirement: The case for a universal age pension, Policy Brief No.60, The Australia Institute, Canberra, April.

---

cost is 20 per cent of current spending – i.e. $7.8 billion. There are additional costs from part pensioners which we here estimate at $5.2 billion; hence $13 billion in total or .85 per cent of GDP. Most pensioners – two thirds – receive the full rate. The cost is rising slowly as the SG matures and pensioners have greater assets, which why our figure is slightly higher than Rothman’s.

[48] Henry suggested that pensions should become tax free, which might make sense if there is a means test but not otherwise. Making the pension taxable reduces the net assistance to higher income earners and creates a measure of horizontal equity vis-à-vis those of workforce age. The NZ pension is fully taxable and, in fact, some tax is paid by NZS pensioners with no other income.

[49] That rate is actually 45 per cent, but the Medicare levy, now 1.5 per cent, will rise to two per cent to bring the total to 47 per cent.

[50] See Ingles 2001 and references therein and also Knox 1995.

[51] Ross J 1997 “The gap between objectives and policy outcomes in Australian retirement incomes” paper for eighth Annual Colloquium of Superannuation Researchers” University of New South Wales

[52] Ingles Jackson Podger and Raymond 1982, “Taxation expenditures” p25. The then-income test on age pensions was later modified to again become a means test.

[53] Ingles et al 1982 p26

[54] Stanton and Herscovitch 2013 “Social policy and programs: from principles to design” (p21)

Summary

This submission examines different aspects of income inequality in Australia. The submission briefly describes the existing income and wealth inequality present in Australia and points to how this is perceived and how it affects different groups within Australia differently.

There is also evidence of the wide spread public support for policies and programs that will address this inequality. The breadth of policy options is evident in the range of mechanisms available to through the tax and transfer system and in the example of a proposed universal pension.

The Committee has a great opportunity to address income inequality in Australia. The Australia Institute hopes the Committee finds this submission assists them in this task.

References

ABC (2013) Vote compass explorer: What Australians think about the big political issues at <http://www.abc.net.au/news/2013-11-11/vote-compass-full-data-explorer/5016244>

ABC (2014) 'Minimum wage decision fails to please business or unions' ABC PM, 4 June <http://www.abc.net.au/pm/content/2014/s4018802.htm>

ABS (2011) *Household expenditure survey, Australia: Summary of results, 2009-10*, Cat no 6530.0, 6 September.

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

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

ABS (2013) *Australian system of national accounts, 2012-13*, Cat no 5204.0, 1 November.

ABS (2013) *Population projections, Australia*, Cat no 3222.0, 26 November.

ABS (2014) *Average weekly earnings, Australia, Nov 2013*, Cat no 6302.0, 20 February.

ACOSS 2011 *"A fairer, more efficient tax and social security system*" Paper prepared for the national Tax Forum 2011"
http://acoss.org.au/images/uploads/A_fairer_more_efficient_tax_and_social_security_system_-_Sept_29_2011.pdf

ASFA 2012 "*The equity of government assistance for retirement income in Australia*" Research Paper February

Australian Government (2014) *Guide to Social Security Law*. <http://guidesacts.fahcsia.gov.au/guides_acts/>

Australian Government (2010) *Australia to 2050: Future challenges*, January.

Australian Government (2013) *2013-14 Budget Papers*.

Australian Government (2013) *Mid-year Economic and Fiscal Outlook*, December.

Australian Taxation Office (2014) *Australian taxation statistics, 2011-12* <https://data.gov.au/dataset/taxation-statistics-2011-12/resource/63fe43d4-e5e5-47d1-a187-34d761068c8c>

Bartels L (2009) *Unequal democracy: The political economy of the new gilded age*, Princeton University Press.

Business Review Weekly (2013) 'BRW rich 200' <http://www.brw.com.au/lists/rich-200/2013/;jsessionid=31260E5A7278F08BD3E465C3BE5D2A5D>

Clare R 2008 *The age pension, superannuation and Australian retirement incomes* ASFA Research and resource centre.

de Serres A, *Structural Policies and Growth: A Non-Technical Overview*, OECD Economics Department Working Paper, no 355, May 2003, p. 12.

Denniss R 2013 "*Super for some*" TAI March https://www.tai.org.au/index.php?q=node%2F19&pubid=1133&act=display

Denniss R and Richardson D 2012 "*Can the taxpayer afford 'self-funded retirement'*?" TAI Policy brief No 42, August https://www.tai.org.au/index.php?q=node%2F19&pubid=1034&act=display

Denniss R and Baker D (2012) *Are unemployment benefits adequate in Australia?*, The Australia Institute, April.

G Dunsford and D Wickham 2009 "*New ideas for age pension reform – discussion paper*" Journal of superannuation management vol 3 no 2 p13 http://s3.amazonaws.com/zanran_storage/www.actuaries.asn.au/ContentPages/19212964.pdf

Grudnoff M (2013) *Tax cuts that broke the budget*, The Australia Institute, May.

Harris A (2014) 'On being treated well: Reforming Medicare after 30 years', *The Conversation*, 27 February.

Henry K 2008 "AFTS - *Australia's future tax system: Retirement Income consultation Paper*" December http://www.taxreview.treasury.gov.au/content/downloads/retirement_income_consultation_summary/Retirement_Incomes_Consultation_Paper.pdf

Hockey J (2014) 'Budget speech 2014-15', *Budget 2014-15*.

Ingles 2009a "*The great superannuation tax concession rort*" TAI Research paper No 61, February http://www.taxreview.treasury.gov.au/content/submissions/retirement/Australia_Institute_20090227.pdf

Ingles 2001 "*Interaction of the age pension means test and the taxation of superannuation*" ANU Public Policy discussion paper No 84, July https://crawford.anu.edu.au/degrees/pogo/discussion_papers_previous/No84Ingles.pdf

Ingles D Jackson W Podger A and Raymond J 1982 "*Taxation expenditures*: Submission by the Department of Social Security to the Inquiry into tax expenditures by the Senate Standing Committee on expenditure" Research paper no 17, Development division Department of social Security, March

Ireland J (2014) 'Treasurer Joe Hockey says 'age of personal responsibility has begun'', *Sydney Morning Herald,* 3 February.

Kehoe J (2014) 'Hockey signals pension age rise', *The Australian Financial Review*, 10 April.

Kelly S Percival R and Harding A 2002 *Women and superannuation in the 21st century: poverty or plenty*. https://www.sprc.unsw.edu.au/media/SPRCFile/NSPC01_14_Kelly_Percival_Harding.pdf

Kelly S 2012 "*Household savings and retirement: where has all my super gone*" Report for CPA Australia

Knox 2010 "*The fairness and future of Australia's retirement income system*" The Australian Economic Review 43(3) pp. 302-11 http://www.wbaonline.co.uk/abstract.asp?id=54971&rev=

Knox 1995 "*The age pension: means tested or universal*" Australian Economic Review 3rd quarter pp107-110

Kwek G (2014) 'IMF chief Lagarde backs quotas', *Australian Financial Review*, 21 February.

Martin P (2014) 'Health, welfare and education: Tough choices loom for Treasurer Joe Hockey', *Sydney Morning Herald*, 22 February.

Melbourne Institute of Applied Economic and Social Research (2014) *Poverty Lines: Australia December quarter 2013,* 24 April

Neal D et al (2011) *Australian attitudes towards wealth inequality and the minimum wages*, Report prepared for the ACTU.

OECD (2003) *The Sources of Economic Growth in OECD Countries*, OECD.

OECD, *OECD Database*, accessed 19 February 2014 <http://stats.oecd.org/>

Pontusson J and Rueda D (2008) 'Inequality as a source of political polarization: A comparative analysis of twelve OECD countries', in Beramendi P and Anderson C*, Democracy, inequality, and representation: A comparative perspectiv*e, pp 312- 53.

Productivity Commission (2013) *An ageing Australia: Preparing for the future*, Productivity Commission research paper, November.

Ross J 1997 "*The gap between objectives and policy outcomes in Australian retirement incomes*" paper for eighth Annual Colloquium of Superannuation Researchers" University of New South Wales

Rothman G and Tellis P 2008 "*Projecting the distributions of superannuation flows and assets*" http://rim.treasury.gov.au/content/pdf/CP08_1.pdf

Rothman G 1998 "*Projections of key aggregates for Australia's aged*" Paper for the sixth colloquium of superannuation researchers, Conference Paper 98/2

Rothman G 2009 "*Assessing the equity of Australia's retirement income system*" RIMU Treasury, July
http://wwwdocs.fce.unsw.edu.au/fce/Research/ResearchMicrosites/CPS/2009/slides/Rothman.pdf

Schafer A (2012) 'Consequences of social inequality for democracy in Western Europe', *Zeitschrift für Vergleichende Politikwissenschaft*, Vol 6 (2 Supplement), pp 23–45.

Stanton and Herscovitch 2013 "*Social policy and programs: from principles to design*" Asia and the Pacific Policy Studies Working Paper Series 01/2013 April

Steering Committee for the Review of Government Service Provision (2014) *Report on Government Services 2014*, Productivity Commission, Canberra.

Steketee M 2013 "*Unfair, inefficient and expensive: what went wrong with Australia's superannuation system*" Inside story 18 February.

Stiglitz JE (2014) 'The Price of Inequality: Why inequality matters and what can be done about it', *Testimony to the United States Senate Budget Committee Hearing on Opportunity, Mobility, and Inequality in Today's Economy*, 1 April.

Treasury 2010 "*Intergenerational Report*"

Treasury 2013a *Tax Expenditure Statement* (TES)

Treasury 2013b *Budget Paper No.*1 2013-14

Treasury 2012 "*Distributional analysis of superannuation taxation concessions*" Treasury analysis on the distribution of superannuation taxation concessions as presented to the Superannuation roundtable of 23 April 2012.