Impact of the Revised Tax Package on Australian Households

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Overview

Background

A year ago, the Government and the Australian Democrats negotiated the New Tax System (ANTS) package that will come into affect from July 2000. The package includes the GST, abolition of Wholesale Sales Tax, income tax cuts, changes to family assistance and compensation for social security recipients. ACOSS released a general analysis of the package in June 1999[1]. This new information paper provides more detail on one aspect of that analysis – its effect on the living standards of Australian households.

The data used for this paper is drawn from modelling commissioned by The Weekend Australian (published 27 May 2000) and conducted by the National Centre for Social and Economic Modelling (NATSEM) from Canberra University in conjunction with Professor Warren from the University of NSW. This modelling estimates the *average* impact of the package on a range of household groups *in its second year* of implementation.

Winners and losers

Our key conclusion is that some households who the modelling shows fall within the "at risk" zone of receiving very small average increases of up to 1% in household disposable income will actually be worse off as result of the new tax system.

This is because the modelling has a number of limitations principally related to the way in which data for household groups has been averaged (see details on page 4).

Taking into account these limitations, our analysis of the modelling data indicated the following broad conclusions:

- **Practically all of the top 20% of households** (those with incomes above $60,000) will gain substantially from the package, mainly due to their very generous income tax cuts (of $62 per week for individuals on $60,000 and above).
  - Some *high income families* will also gain substantially from the increases in family assistance for single income families with a child under 5 years, and from the easing of the income test for family assistance in respect of high income-earners.
- **Most middle income households** (those with incomes between $30,000 and $60,000) will make modest gains.

[1] See ACOSS: "Analysis of the Government-Democrat tax package" ACOSS Info no 106

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However, the following middle-income households are at risk of being worse off:

- *couples without children on a single full-time wage of about $30,000 or two low wages*[2] — due to the small size of the tax cuts they receive;

- *some families with children whose incomes change through the year* — due to changes in the operation of the income test for family assistance.

On the other hand, the following middle-income households will gain substantially:

- *single income families, including sole parents, with a child under 5 years* — due to increases in their family assistance payments;

- *families with children on incomes between about $30,000 and $40,000* — due to the easing of the income tests for family assistance.

- **The vast majority of low-income households** (those with incomes below $30,000) will tread water financially as a result of the package, neither making major gains nor losing.

However, some low-income households will be worse off since they belong to groups whose *average* gains are very small, and the impact of the GST on their budgets is greater than average [3]. The groups most at risk are:

- *unemployed single people or couples without children who have little or no private income* — due to their particular saving and spending patterns[4];

- *single full-time workers without children on a wage of around $20,000 to $30,000* — due to the small size of their tax cuts;

- *households on very low incomes who are not eligible for social security payments, including new migrants and self-employed households without children.*

- *some age and disability pensioners with little or no private income* — due to the small size of their average gains and the very large numbers in these groups.[5]

- *residents in caravan parks, boarding houses, and similar institutions* — because their landlords have the option to charge a special 5% GST on rents.

On the other hand, the following low-income households are likely to gain substantially:

- *single-income families with children (including sole parents) who have a child under 5 years old* — due to increases in their family assistance payments;

- *part-pensioners with private incomes above $10,000* — due to the easing of the pension income test.

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[2] With household income between $30,000 and $50,000, that is split between them roughly in the ratio 67:33

[3] See discussion of "limitations of the modelling" below

[4] Their saving and spending patterns are not fully captured in the modelling (the impact of the package on unemployed people was not separately modelled) and as a result ACOSS believes the impact of the GST on this group was under-estimated.

[5] There are approximately 700,000 maximum rate age pensioner households. Note, however, that pensioners benefited significantly from the removal of basic food from the GST, and improvements in their compensation package.

The following tables summarise the strongest outcomes of the modelling.[6]

The main winners	
Household groups	**Main reason**
High income households generally (the top 20% on incomes over $60,000)	They receive $6 billion in income tax cuts.
Single income families with a child under 5 years (including sole parents)	They receive a large increase in their family assistance payments.
Part-pensioners (those [7][8]with private incomes above $10,000)	They benefit from the easing of the pension income test.
Families with children with incomes between $30,000 and $40,000	They benefit from the easing of the family assistance income test.

The groups most at risk of being worse off	
Household groups	**Main reason**
Unemployed people without children	They are especially disadvantaged by the GST, due to their particular saving and spending patterns.
Single people without children on a low full-time wage (around $20,000 - $30,000)	Their income tax cuts barely compensate for the GST.
Dual income couples without children with one low full-time wage and one part-time wage (with household incomes between $30,000 - $50,000)	Their income tax cuts barely compensate for the GST.
Low-income households living in caravan parks or boarding houses	Their landlords can charge a special 5% GST on their rents, which is not adequately compensated for by increases in Rent Assistance.
Low-income households outside the social security system (eg new migrants, and self employed people without children)	The tax cuts alone will not fully compensate them for the GST, and the proposed $120 safety net payment for this group is inadequate.

The end result – increasing inequality

The package will increase inequality of living standards in Australia. It will increase the disposable incomes of high-income households more than those of low-income households.

The main elements of the package that are responsible for increasing inequality are:

- The $12 billion income tax cuts, of which half ($6 billion) go to high-income households on $60,000 and above.
- The $6 billion net increase in taxes on consumption, which raises the overall cost of living for Australian households.[9]

[6] A more detailed listing of winners and potential losers is provided in the body of this paper.

[7] Approximately one third of pensioners have incomes above the income test free thresholds, which are around $2,500 per annum for singles and $5,000 for couples.

[8]

- This affects low-income households more than high-income households because low-income households usually have to spend all of their income (no household saving) in order to survive.

In effect, $6 billion more is being raised each year from regressive taxes on consumption to pay for income tax cuts for high income households.

This is mitigated to some extent by the progressive measures in the package:

- the $2 billion compensation package for social security recipients; and
- the $2.5 billion family assistance package.

However, the effects of the income tax cuts and the large hike in taxes on consumption overwhelm these progressive measures.

Data Limitations

It is important to note the limitations of the modelling:

- It models the average impact on groups of households, not the actual effects on each household within a group. This means that some households within each group will be better off and some will be worse off than indicated. This limitation of the modelling is especially important for those groups that are estimated to receive very small increases in household disposable income. Some households within these groups will inevitably be worse off.

- It doesn't fully take account of differences in saving and spending patterns among households of the same type (e.g. single people) at different income levels (e.g. it assumes that an unemployed single person has the same spending patterns as a single person earning $100,000). This means that the impact of the GST on many low-income households is understated, while its impact on high-income households is overstated.

- It assumes that all households on very low incomes are entitled to the relevant social security payments. However, many low-income households, including new migrants who have not resided in Australia for more than two years, and self employed households with no children, are excluded from the social security system.

- It models the impact of the package in the medium term (around 2001-02) and does not take account of the higher price increases arising from the GST in the first year (especially in the September quarter, 2000).

- It does not model the effects of measures to close loopholes in the income tax system such as the abuse of trusts to avoid tax. These measures are likely to mainly disadvantage high-income households.

Research findings

The graphs below are drawn from modelling[10] conducted exclusively for The Weekend Australian newspaper by the National Centre for Social and Economic Modelling (NATSEM) at Canberra University in conjunction with Professor Warren from the University of NSW, and published 27

[9] If the GST was merely designed to replace existing taxes on consumption like the Wholesale Sales Tax (instead of raising extra revenue to fund income tax cuts) , its impact on inflation would have been much lower.

[10] Although the data were obtained from this study, any errors in the graphs or their interpretation are our responsibility.

May 2000. This modelling estimates the *average* impact of the package *in its second year* of implementation on a range of household groups.

The graphs show the estimated impact of the package on eight household groups:

(1) single person households of workforce age

(2) single income couples with no children

(3) dual income couples (67:33 split) with no children

(4) single age pensioners

(5) age pensioner couples

(6) sole parents with two children (one 5 years, one 5-12 years)

(7) single income couples with two children (both 5-12 years)

(8) dual income couples (67:33 split) with two children (both 5-12 years).

There are approximately 2.5 million households falling within these eight categories — that is, they represent around one third of all Australian households. Clearly, many groups of households with unique saving and spending patterns have been omitted from this list. However, we have attempted to strike a balance between simplicity and comprehensiveness. The graphs show the estimated net increase in household disposable income for each household group (broken down into income brackets) arising from the package in its second year. This is expressed as a proportion of household disposable income prior to the changes.

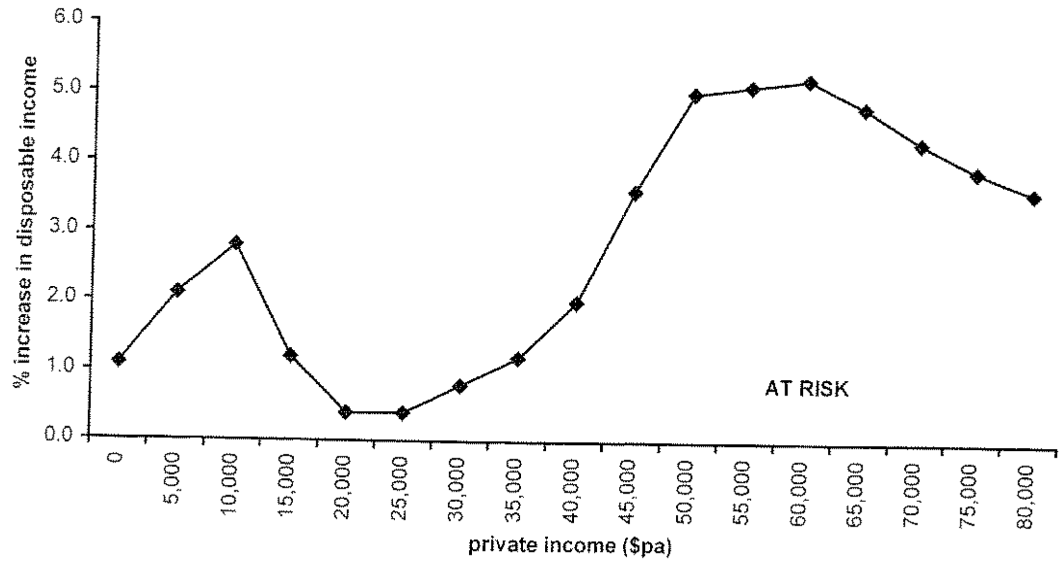
Important caveats

There will be many exceptions to the trends we describe below, both among groups of households and among individual households within each group. This means that it would be inaccurate to say that the data shows that all households gain from the package. For example:

- The impact of the GST on unemployed households without children has not been separately modelled. This is a group at risk of becoming worse off.
- In cases where the *average* gains are very low (eg less than 1%) it is inevitable that a significant number of households within that group will lose.
- The modelling incorrectly assumes that all low-income households on very low incomes receive social security payments.

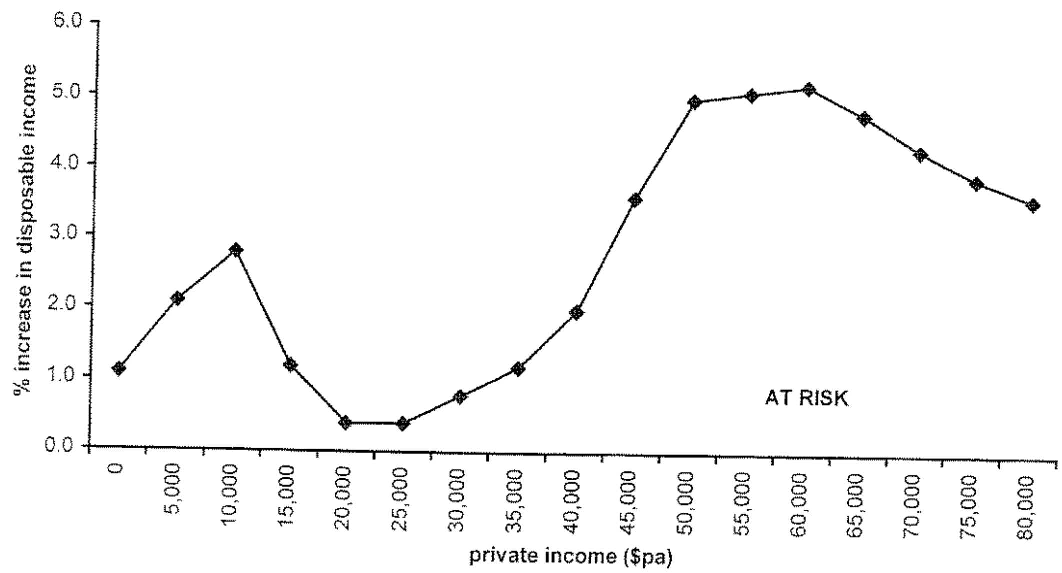
GRAPH 1 — 780,000 Households

Effect of Revised ANTS Tax Package on single workforce age people with no children



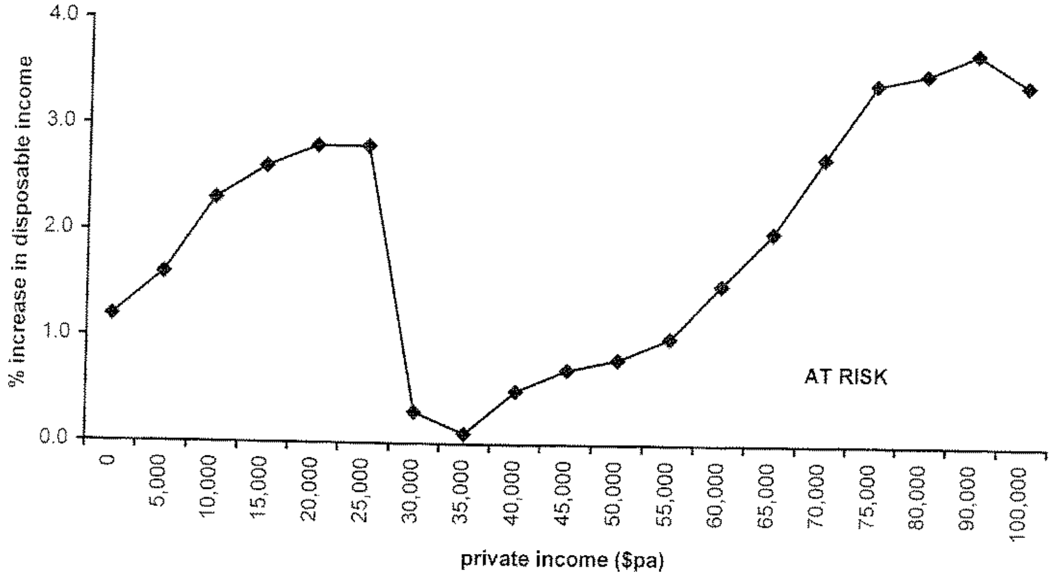
GRAPH 2 — 300,000 Households

Effect of Revised ANTS Tax Package on single income workforce age couples with no children



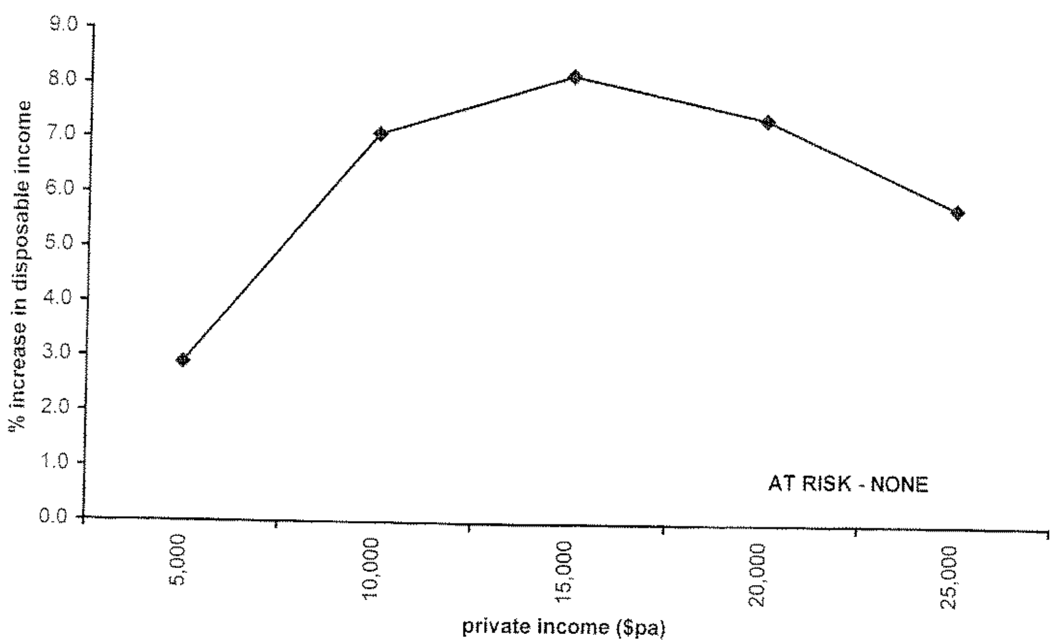
GRAPH 3 — 160,000 Households

Effect of Revised ANTS Tax Package on dual income (split 67:33) workforce age couples with no children



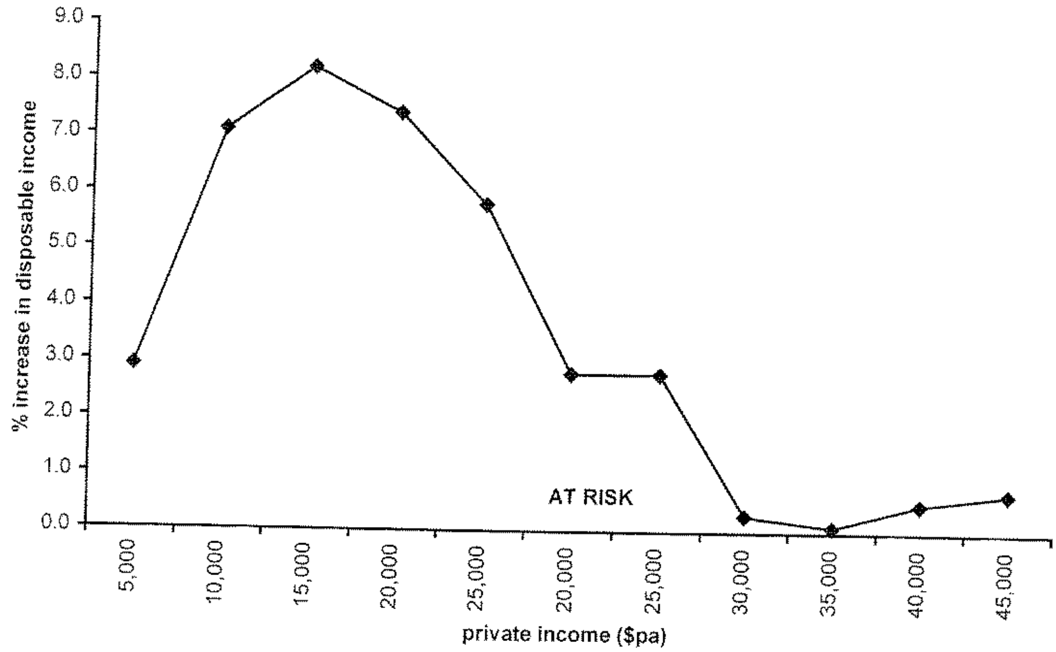
GRAPH 4 — 590,000 Households

Effect of Revised ANTS Tax Package single age pensioners



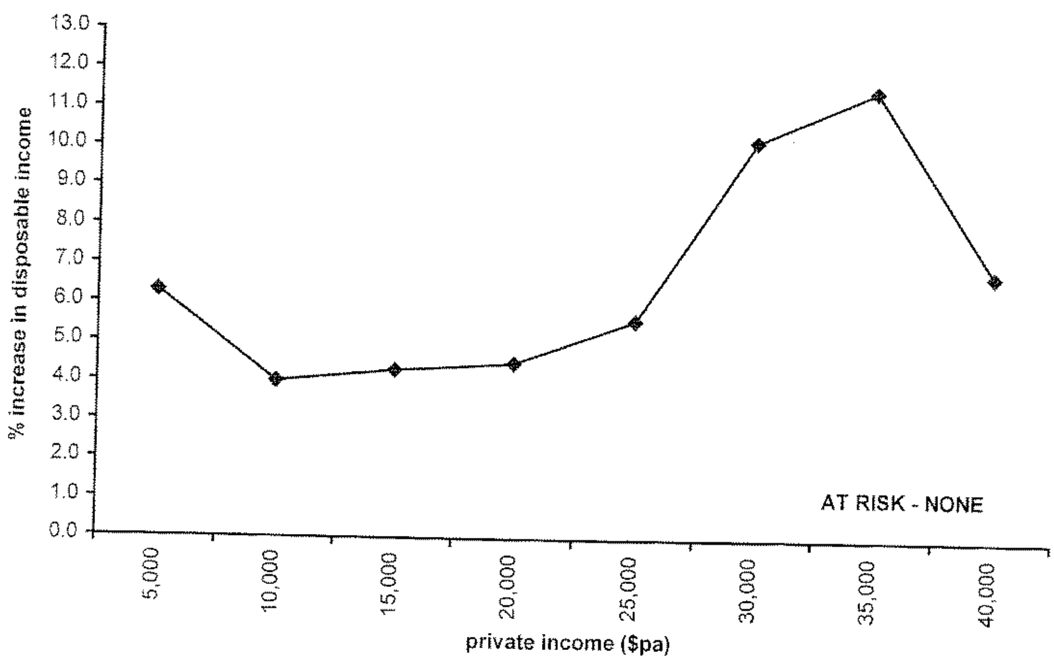
GRAPH 5 – 470,000 Households

Effect of Revised ANTS Tax Package age pensioner couples



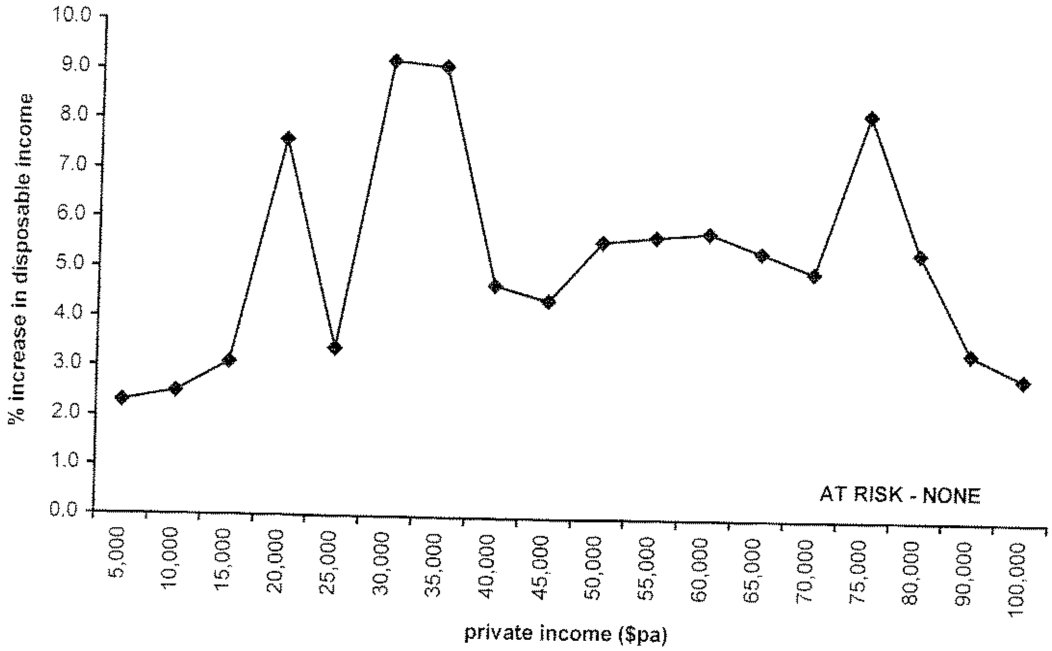
GRAPH 5 – 40,000 Households

Effect of Revised ANTS Tax Package on sole parents with 2 children (1 under 5)



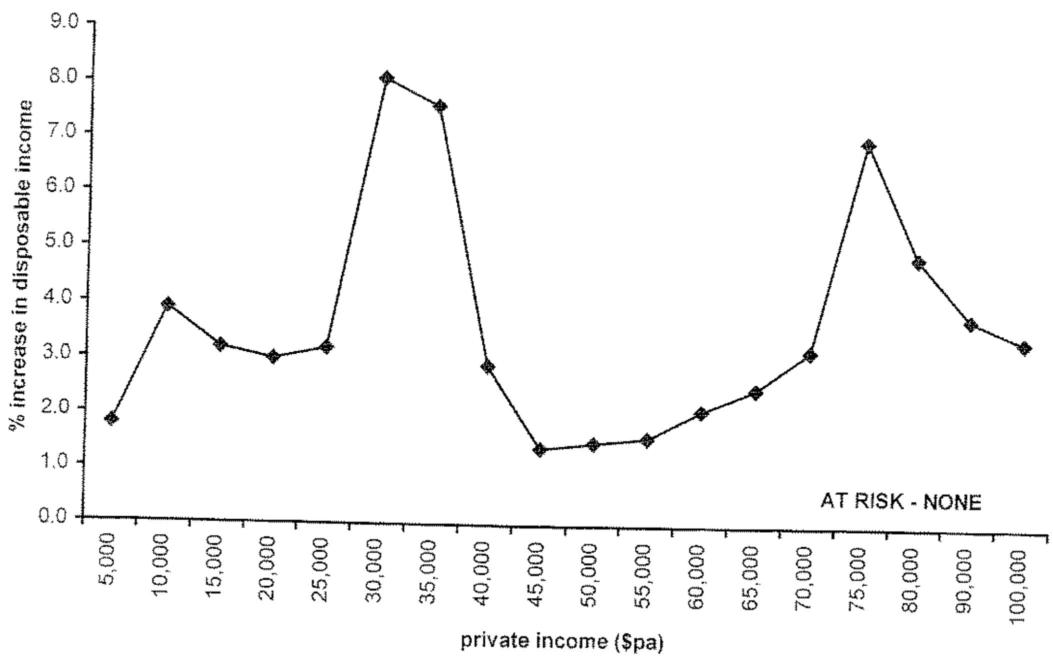
GRAPH 5 — 70,000 Households

Effect of Revised ANTS Tax Package on single income couples with 2 children (5 yrs & 12 yrs)



GRAPH 5 — 70,000 Households

Effect of Revised ANTS Tax Package on dual income couples (67:33 split) with 2 children (5 yrs & 12 yrs)



Impact on income inequality

A conventional method to assess the impact of tax changes on income inequality is to calculate the net increase (or reduction) in household disposable incomes for different income groups.

- If the package is *progressive* (reducing income inequality), then average increases in household disposable incomes will be greater for lower-income households than for those on higher incomes. That is, the line in the graphs will slope *downwards*.

- If the package is *regressive* (increasing income inequality) then average increases in household disposable incomes will be greater for higher-income households than for those on lower incomes. That is, the line in the graphs will slope *upwards*.

The graphs above do not give a comprehensive view of the impact of the package on inequality. This is because many household groups are excluded (for example, families with one child), and no information is available on the number of households that fall within each income bracket. This is a major deficiency of the "cameo" approach to modelling the impact of the package. It only deals with hypothetical families, not the actual spread of households of different types and income levels across the community.[11]

Nevertheless, the graphs tell a clear story, which is consistent with the results of the modelling results for other household groups. The basic facts are:

- The package is clearly regressive in overall terms.

- The income tax cuts, in combination with the consumption tax changes, have a strongly regressive impact, which can be clearly seen in graph 1 (single person households).

  - The gains are therefore smallest (in proportion to income) for single individuals in the $20,000 to $30,000 private income range, and largest in the $50,000 to $70,000 income range.

- The Family Assistance Package has a progressive impact that offsets this to some extent, as shown in graphs 6 to 8 (dealing with families with children).

  - The progressive impact of the increased family assistance payments can be observed by comparing graph 2 (single income couples with no children) and graph 7 (single income couples, 2 children); and graph 3 (dual income couples without children) and graph 8 (dual income couples with 2 children).

  - The easing of family assistance income tests also has a progressive impact on the distribution of income among families with children. This is evident in the large "peaks" on the left of graphs 7 and 8. Note however, that the peaks on the right hand side represent the benefits of the easing of the family assistance income test for some high-income families.

  - The Family Assistance Package substantially boosts average incomes for low-income sole parents, as shown in graph 6. The vast majority of these households are living on low incomes (below $30,000).

- However, the majority of age pensioners, who have less than $5,000 in private income, receive only small average gains from the package, in contrast to the large gains (often above 4%) for high income single and couple households shown in graphs 1 to 3.

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[11] We have provided estimates of the numbers of households represented within each graph, but it should be noted that households are not evenly distributed across the income brackets within each graph. For example, the vast majority of pensioners and sole parents are clustered in the left hand (low income) side of graphs 4 to 6, whereas most dual income families are around the middle of graph 8.

- This category of low-income pensioners is a large group, comprising the clear majority of all retirees.

- On the other hand, the smaller population of part-pensioners with incomes above $5,000 gain substantially from the easing of the pension income test (see graphs 4 & 5)

Groups receiving the largest gains

We have identified below those groups who are estimated to receive an increase in their household disposable incomes of 4% or more. It should be noted that other groups of households apart from those modelled by NATSEM may also gain more than 4%, but the overall pattern of winners is clear from the table below.

Groups receiving the largest gains
- at least a 4% increase in disposable income

Household type	Household private income range [12]
Singles without children, workforce age	$50,000 - $70,000
Single (part) age pensioners	$10,000 - $25,000
Single Non-pensioner retirees	$50,000 - $70,000
Single income couples without children, workforce age	$50,000 - $70,000
Dual income couples without children, workforce age	$100,000 - $150,000[13]
Age and Disability (part) pensioner couples without children	$10,000 - $40,000
Single income couples with children (esp. those with a child under 5 years)	$30,000 - $80,000 $20,000 - $30,000 (with a child under 5)
Dual income couples with children	$30,000 - $35,000 $75,000 - $90,000[14] $75,000 - $125,000[15]
Sole parent families with a child under 5 years) [16]	0 - $40,000

Source: ACOSS analysis of NATSEM modelling of revised tax package

[12] Private income ranges within which most gain at least 4% in disposable income
[13] only where income is split 50:50
[14] 67:33 split
[15] 50:50 split
[16] There are no estimates provided for the 50% or so of sole parents with no child under 5 years. Their average gains will be smaller. Note that very few sole parents have incomes above $40,000

Groups receiving the smallest gains

We have identified below those groups who receive an increase in their household disposable incomes of 1.0% or less, which would therefore inevitably include households that are worse off. We have included three groups whose circumstances are not accurately captured in the modelling:

- unemployed households without children with little or no private income, because their estimated average gains are small and it is likely that the modelling significantly understates the increase in their cost of living due to the GST[17];
- low-income residents of caravan parks and boarding houses, because their increases in Rent Assistance are unlikely to effectively compensate them for the 5% GST which their landlords can choose to levy on their rents.[18];
- low-income households outside the social security system, because the modelling assumes that all households on very low incomes receive compensation through the social security system, but many groups such as new migrants and self employed households with no children are not eligible for these payments.

"AT RISK" Groups	
Household type	**Household private income range [19]**
*Single unemployed people without children	$0
*Singles without children on a low full-time wage	$20,000 - $30,000
Single age (full) pensioners	$0
*Unemployed couples without children	$0
*Single-income couples without children on an average wage	$30,000 - $35,000
Dual income couples without children, workforce age	$30,000 - $60,000
Age and disability (full) pensioner couples	$0 - $5,000
Single non-pensioner retirees	$30,000 - $35,000
Non-pensioner retiree couples	$45,000 - $75,000
Dual income couples with children	$35,000 - $60,000
Households outside the social security system, such as new migrants and self employed households without children	on very low incomes (less than around $20,000)
Households living in caravan parks and boarding houses	on low incomes (less than around $30,000)

Source: ACOSS analysis of NATSEM modelling of revised tax package

[17] This is because their particular saving and spending patterns have not been separately modelled. These unemployed households are likely to spend more their current income, and they spend a relatively high proportion of their budgets on items such as rents and power and public transport.

[18] No GST applies directly to long-term rents for houses and flats, but the Government has estimated that these rents will rise by 2.3% over the medium term as a result of the higher input costs faced by landlords. The Rent Assistance increases for low-income households that are included in the compensation package are premised on these lower average rent increases for houses and flats. Although Rent Assistance increases by 7%, it only covers a minority of the cost of rents (around 20-30%, depending on location). Some of the most disadvantaged groups in the Australian community live in boarding houses and caravan parks.

[19] average increase in disposable income is estimated to be less than 1% (except in the three special cases above)

Analysis

What is the effect of the consumption tax reforms on household living standards?

They key changes are:

- the introduction of a 10% GST, excluding "basic" foods and a range of public and community services;
- the abolition of Wholesale Sales Tax and Financial Institutions Duty;
- adjustments to excises on fuels, tobacco and alcohol, including an effective cut in diesel excise in rural and regional areas;
- an overall increase in taxes on consumption of $6 billion per annum, to help pay for the income tax cuts.

These changes affect household incomes in two ways:

- First, these tax changes *increase inflation*, especially in the immediate aftermath of the introduction of the GST in the September quarter of 2000.
  - The Federal Treasury estimates that the package will increase the Consumer Price Index (CPI) by 3.75% in that quarter, by 2.75% over 2000-01, and by 2.25% over the long-term[20].
  - This increase in inflation is strongly regressive; that is, it affects low-income households more, in proportion to their incomes, than high income-earners. This is because low-income households usually have to spend all of their income to survive[21] (or more, if they are living off savings or borrowing), while high-income households are usually able to save part of their income (and their savings are not affected by inflation as long as they are invested at a rate of return greater than the CPI[22]).
  - The main reason for this increase in inflation is the $6 billion net increase in taxes on consumption, although changes in the structure and coverage of consumption taxes are also mildly inflationary[23].
  - This means that much of the inflationary impact of the package, and much of the risk for low income households, could have been averted by maintaining existing levels of taxation on consumption[24].

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[20] Federal Budget Paper No1 (2000-01)

[21] These trends are not fully picked up in the modelling used in this paper. For example, it is assumed that high income households spend all of their income. Household saving and dis-saving rates are difficult to model, given limitations in the available data on household incomes and spending.

[22] However, retirees who are living off their savings are worse off, due to the decline in the value of those savings.

[23] The effect on inflation of replacing business input taxes like the WST with a tax on consumers such as the GST depends substantially on whether the initial boost to international competitiveness from removal of input taxes is offset by an increase in the value of the Australian dollar (which drives inflation down because it reduces the cost of imports). This is an important factor in modelling the effect of the package on households.

- Second, these tax changes shift the *relative* prices of different goods and services, so that household groups are affected in different ways, according to their particular spending patterns.
  - For example, services such as motels, haircuts and household power bills will generally increase in price while some goods such as cars should fall in price.
  - This means that the CPI (a population-wide index) is not a reliable indicator of the impact of the changes on different groups.[25]
  - It is not clear whether these relative price changes are progressive or regressive, but since "basic" food has been removed from the GST any impact either way is likely to be modest.
  - However, some low income groups will be adversely affected by these relative price changes, especially those (such as unemployed single people) who spend relatively little on food and much more on expenses such as rent, household power and public transport.

Is the compensation package adequate?

The compensation package includes:

- the income tax cuts, especially an increase in the tax free threshold from $5,400 to $6,000 and a reduction in the bottom rate from 20% to 17%;[26]
- a 4% increase in social security pensions and allowances, including a 2% "buffer" that is maintained above and beyond any future CPI-based increases in rates of payment;
- increases in family assistance payments for each dependent child;
- increases in income test thresholds;
- savings bonuses to compensate retirees for the loss in future spending power of their investment assets;
- a special safety net scheme (a flat $120 once-only payment[27]) for people on low incomes who are not eligible for social security payments.

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[24] For example, by broadening the GST food exemption, abolishing state financial taxes sooner, properly compensating the states for this, and protecting the federal budget surplus by reducing the tax cuts for high income earners. See ACOSS: "Negotiating for fairness" ACOSS Info No 105 (May 1999)

[25] The modelling below captures these differences in respect of different household types (eg single people without children) but does not take account of differences in spending patterns among people with different incomes within each household type (eg between an unemployed single person and one earning $100,000 per annum).

[26] The tax cuts higher up the scale are largely unnecessary for compensation purposes, since all tax-payers benefit from these changes at the bottom of the scale.

[27] This was announced in this year's federal Budget

Social security recipients in the short term

All social security payments will rise by 4% from July 2000 to compensate recipients for the expected impact of the GST. From March 2001, payments will be further adjusted to take account of the impact of the GST on inflation. Given that the Treasury estimates that the CPI will rise by 4.5% in the September quarter 2000 as a result of the GST and ordinary price rises, and no further increase is paid until March 2001, it is likely that many social security recipients will be worse off over the first nine months from the introduction of the GST (from July 2000 to March 2001).

Social security recipients over the medium term

The Government argues that social security recipients will be better off over the medium term (beyond one year) because any increase in the CPI due to the tax reform package will be reflected in automatic adjustments to rates of payment, and because a 2% "buffer" (above and beyond future CPI based increases) has been introduced to provide a margin for error.

The key issue here is whether the 2% buffer provides *enough* "margin for error": that is, whether it compensates those households whose price increases are not fully captured in the CPI. Although the Government argues that the CPI is an acceptable and well-established measure of inflation for social security purposes, the reality is that it will not capture the diverse effects on different groups of a major change in the rates of tax on different goods and services.

On the face of it, the modelling used in this paper indicates that social security recipients will make small gains, on average, in the medium term. However, in our view the modelling also points to the probability that some social security recipients will lose, for two reasons:

- The estimated gains are *averages* for each group of households. Every household *within* each group will have its own pattern of spending and saving, so that most will either gain more then average or less than average. Where the average gain is very small, it is inevitable that there will be losers.
- The modelling under-estimates the price increases faced by some low-income groups, such as single unemployed people. This is because it does not fully capture the differences in saving and spending patterns between households on different income levels within each household type, such as single people without children.

AT RISK groups

The following groups of social security recipients appear to be at risk, either because the modelling indicates that their average gains are very small (less than 1% of income) or because the estimated gains are small and the modelling probably overstates them.

- *Unemployed people without children* are at risk of being under-compensated because they spend a very high proportion of their budgets on essential items that increase significantly in price with the GST (such as rents, power and public transport), and often spend more than their income (either by drawing down savings or by borrowing) until they find a job. This means that the price increases they face are likely to be significantly higher than increases in the CPI, and the 2% buffer may not provide sufficient protection for this group.
  - The modelling indicates that a single unemployed person with no private income will be $1.89 per week (1.1% of income) better off, and an unemployed couple with no private income will be $3.47 per week (1.1% of income) better off. However, these projected average gains are small, and will not be achieved by all in the group. Moreover, the modelling does not accurately take account of the above factors.
- *Some age pensioners on the maximum rate of pension* are also at risk because their average gains are very small and this group is very large in number (around 700,000

households). On the other hand, pensioners particularly benefit from exemption of "basic" food from the GST.

- Single pensioners with no private income are estimated to gain just $1.74 per week (0.9% of income) on average while pensioner couples are estimated to gain $2.63 per week (0.8% of income).

- *Disability Support pensioners with small amounts of private income* appear to be at risk because their average gains are also very low.
  - A couple on DSP with private income of $5,000 is estimated to gain just $2.69 per week (0.7% of income).

Are the income tax cuts and $120 payment enough to compensate those *outside* the social security system?

Low-income households outside the social security system include *low wage-earners and self employed people without children*, and *new migrants* (who are not entitled to social security payment for their first two years of residence).

The answers to two questions will determine whether they will be better or worse off:

- are the tax cuts on their own sufficient to compensate these households;
- is the proposed safety net one-off $120 payment scheme together with tax cuts adequate to compensate these low income households outside the social security system?

Tax cuts alone

It is clear that the income tax cuts provide more than enough compensation for individual tax-payers and couples without children who have high incomes.

However, the following groups of households without children are at risk of being worse off if their only form of compensation is the income tax cuts:

- *Single person households with incomes around $20,000*:
  - Their average net gain from the package is estimated to be just $1.39 per week (0.4% of income).
- *Single-income couples without children with incomes around $30,000*:
  - Their average net gain from the package is estimated to be just $3.69 per week (0.8% of income).
- *Dual income couples without children on middle incomes* ($30,000 to $50,000):
  - For example, the average net gain for such a household on $35,000 is just $0.66 per week (0.1% of income).

Safety net payment, together with the tax cuts

It is clear that a once-off $120 payment will not provide the *ongoing* compensation these groups need (since prices *remain* higher after the GST than they otherwise would have been). At best, it will only compensate them for one year's price increases and even this is doubtful.

This payment on its own will provide less compensation, for the vast majority of the target group, than that which is on offer to social security recipients (a 4% increase in disposable income). For example, $120 only exceeds 4% of income only where a single person earns less than $3,000.

Therefore, it is unlikely to adequately compensate those low-income households who do not pay income tax in a given year, such as many low-income *self employed people*.

On the other hand, if the payment is combined with the tax cuts, they will together increase the disposable incomes of most low-income single person households without children on about $10,000 or more by approximately 4%.[28]

However, the payment may not adequately protect low-income couples and families with children. It is not clear at the time or writing whether couples would receive two payments of $120. Regrettably, it does not appear that any allowance has been made for the increased costs of raising children, to address in cases where the family is not entitled to family assistance. This is particularly important for *new migrant families*.

It is also unclear whether the payment will extend to groups who have been deliberately excluded from the social security system, such as *new migrants* (in their first two years of residence) and *self employed people without children*. This is very important since these are the very groups who need a safety net scheme the most. It is one thing to deny people social security payment because they are not considered needy (which ACOSS strongly disputes in the case of new migrants). However, it is another matter entirely to deny them compensation for policy decisions (the GST) that reduce their living standards.

AT RISK groups

The key "at risk" groups outside the social security system are:

- single people on around $20,000;
- couples without children on around $30,000;
- self employed households without children on very low incomes;
- new migrants generally.

Necessary safety net improvements

These groups need a robust and well-targeted safety net payment to protect them from a fall in their living standards. The proposed $120 once-only payment is grossly inadequate to meet this need. It should be paid on an annual basis, and it should be paid at higher rates in cases where:

- the recipient household is not entitled to any income tax cuts; or
- the recipient has dependents.

It is crucial that this payment extend to groups who have been denied access to the social security system, including new migrants and self employed people.

[28] So low full-time wage earners who receive this payment may be protected from sustaining a loss in at least the first year of the package.

The proposed payment compares very unfavourably with the safety net scheme proposed by the Coalition Parties in the Fightback package in 1991. The GST tax credit proposed in that package was:

- an ongoing, indexed quarterly payment to people on very low incomes;
- based on the same percentage increase in incomes that was promised to pensioners;
- targeted towards an estimated 1 million primary income-earners [29];
- estimated to cost $300 million in 1991.

It also compares very unfavourably to the equivalent tax credit that was paid to low income households in New Zealand following the introduction of a GST there in 1986.

Improvements to the compensation package

The compensation arrangements need to be improved, especially to adequately compensate people for the short-term increases in prices arising from the GST, and to improve the safety net scheme for those outside the social security system.

However, it is regrettable that low-income households have to rely so heavily on a $2 billion compensation package in the first place. Fortunately, the need for compensation has been greatly reduced by the exclusion of "basic" food from the GST. However, consumption tax reform *could* have been implemented in a way that price rises would have been minimal, if consumption taxes had not been increased by $6 billion to help pay for the tax cuts. This would also have greatly eased concerns about the effects of the package on both households and the overall health of the economy.

For example, in May 1999 when the revised tax package was being negotiated between the Government and the Australian Democrats, ACOSS called for a broadening of the GST food exemption and earlier abolition of state financial taxes in order to reduce the inflationary impact of the package, together with proper compensation for the states and a reduction in the tax cuts for high income-earners (or further action to close income tax loopholes) to protect the federal budget surplus. See ACOSS: "Negotiating for fairness" ACOSS Info No 105 (May 1999)

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[29] The tax credit would also have been paid to around 1 million "second earners" within couple households.

What is the effect of the tax cuts on income inequality?

The income tax cuts are described in the table below.

Previous and revised income tax rates			
Present tax scale		Proposed tax scale	
Taxable income ($ p.a.)	Tax rate (%)	Taxable income ($ p.a.)	Tax rate (%)
0-5,400	0	0-6,000	0
5,401-20,700	20	6,001-20,000	17
20,701-38,000	34	20,001-50,000	30
38,001-50,000	43	50,001-60,000	42
50,001+	47	60,001+	47

It is not obvious from the table above that the tax cuts are strongly regressive. The top marginal tax rate is maintained, and the largest changes occur in the middle of the income tax scale, especially the 30% rate that applies from $20,000 to $50,000.

However, it is a tax-payer's *overall tax rate*, not their *marginal tax rate*, that matters from the standpoint of living standards. High-income tax-payers may still pay tax on *some* of their income at 47%, but they benefit from all of the tax cuts further down the scale. Moreover, only tax-payers earning $50,000 or more receive the *full* benefit of the lower 30% rate on incomes from $20,000 to $50,000. As the table shows, a tax-payer earning $30,000 only saves $8 per week from the new 30% rate, while a tax-payer on $60,000 saves $23 per week.

The table below shows the effect of the revised income tax cuts on individual tax-payers on different income levels. The increases in disposable income[30] peak at 5.2% at the level of $60,000 in household income, and then taper off at higher income levels. In absolute terms, the tax cuts also peak (at a flat $62 per week) for all tax-payers on $60,000 and above. Either way, high-income households register much larger gains than those on low and middle incomes.

It is clear that tax cuts that are so heavily skewed towards higher income earners will also increase inequality among households. For example, approximately half the total value of the tax cuts ($6 billion out of $12 billion) is paid to the top 20% of households on $60,000 or more[31]. While this is not an accurate indicator of effect of the tax cuts on the distribution of income, it does indicate how poorly targeted the tax cuts are from the point of view of household income inequality.

[30] expressed in proportion to gross household income

[31] ACOSS analysis using Stinmod 99, NATSEMs microsimulation model

Effects of tax cuts in the new package on individual disposable incomes				
Taxable income ($pa)	Tax-payers with income below these levels [32] (%)	Gain from proposed 30% rate only ($pw)	Total gain from tax cuts ($pw)	Gain as a % of income (%)
$20,000	25%	$0	$10	2.6%
$30,000	50%	$8	$16	2.8%
$60,000	85%	$23	$62	5.2%
$75,000	90%	$23	$62	4.3%
$100,000		$23	$62	3.2%

Source: federal Budget papers, Taxation Statistics

ACOSS has no objection in principle to the proposed tax cuts, including the new 30 per cent income tax rate. If these tax cuts were mainly paid for by closing income tax loopholes used by high-income earners, such a package might actually *reduce* income inequality. However, these tax cuts are mainly paid for by increasing taxes on consumption by $6 billion (to the detriment of low-income households generally) and by reducing the federal budget surplus by a similar amount. That means there is now less room in the federal budget to improve health, education and welfare services or social security payments, and this also disadvantages people on low and middle incomes.

What is the effect of the family package?

The key changes to family assistance include:

- simplification of Family Allowance and Family Tax Assistance and other payments, by combining them into two new payments: Family Tax Benefit, Part A and Family Tax Benefit, Part B;
- modest increases in the level of family assistance in respect of each dependent child;
- substantial increases in respect of single income (including sole parent) families with a child under 5 years;
- an easing of income tests for family assistance;
- modest increases in assistance with child care costs.

These changes lead to modest improvements in disposable incomes for most families with dependent children, and large increases for those who are:

- single income families with a child under 5 years, at all income levels; or
- in the two household income ranges ($25,000 to $30,000 and $70,000 to $80,000) where they derive the largest benefit from the easing of income tests.

The table below indicates that, with the exception of families with children aged 12 to 16 years, the increases in family assistance in the package are generally higher than the increases in social security payments for adults (that is, a 4% increase). The increases are substantial for single income families with at least one child under 5 years.

[32] In the year 2000-01

Comparative increases in family assistance		
Family Type	**$ per week increase in family assistance**	**% increase**
One child 5 years or over	2.68	5%
One child under 5, single income family	9.39	14.8%
Two children under 5, single income family	12.08	6.3%
Two children over 5 years	5.37	5%
One child over 12 years	2.68	3.9%
Two children, one under 5 and one over, single income family	12.08	6.3%

Source: Federal Treasurer: "A New Tax System" (1998)

In overall terms, the Family Assistance Package is strongly progressive, since it increases payments that are set at flat rates according to need. Moreover, these payments are generally income tested and this limits the benefits for high income-earners.

However, this positive effect is overshadowed by the regressive effect of the income tax cuts.