

Submission

on

**The Structure and Distributive Effects
of the Australian Taxation System**

to

The Secretary
Senate Economics References Committee
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by

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1. Introduction

The Senate Economics References Committee has called for submissions on the structure and distributive effects of the current Australian taxation system.

Festival of Light welcomes this opportunity to comment on the impact of the current system on families and the flow-on effects this impact has on society. We will be responding to items a, b, c, and d contained in the terms of reference as they relate to the Australian family.

The family unit has been called “the basic building block of the nation”. A nation is constructed of a vast number of individual family units. The strength and vitality of that nation is determined by the intensity and durability of the relationships that exist within and between family units. In effect, a nation is simply a larger version of the extended family.

The purpose of government is to legislate in order to maintain the peace and good order of society. Therefore, it is not only in the best interests of the various levels of government to strengthen and support the family, it is also their fundamental obligation.

The essential question being addressed by this submission is that of where lies the responsibility for the support of the family – with the family itself through its economic endeavours, or with the government through its various social assistance plans.

2. Distribution and impact of the current tax burden

It is clear that the bias of the taxation system since the early 1980s has been unfavourable to families. When the government of the day abandoned the “ability to pay” principle with the concept of so-called “social justice”, it created an inequity in which the tax burden was shifted from single taxpayers to families.

The shift from a form of “horizontal equity” which compensated for the number of individuals being supported by a single income to “vertical equity” has had numerous, negative social side effects. These include the creation of a new economic underclass known as the “working poor”, the forcing of large numbers of married women into the workforce with the consequent increase in the need for daycare facilities, a change in people’s perceptions about the desirability of children and childbearing, the increasing tendency to institutionalize aging family members rather than caring for them within the bosom of the family unit, and even in an extreme shortage of individuals available to man the large number of volunteer agencies necessary to maintain our society.

In economic terms, these changes in people’s attitudes and behaviour have resulted in a significant transfer of costs from the private to the public sector.

The current system provides numerous disincentives to the formation, preservation, and support of the traditional family.

2.1 Disincentive to marriage

Marriage requires a significant long-term commitment, both to an individual and also to an increased level of economic expenditure. Two simply cannot live as cheaply as one. But the current tax system, by making no allowances for the number of people being supported by that income, assumes that they can. Thus, some people will be motivated to delay marriage until their incomes increase, others, already married, will be motivated to separate from their partners in order to benefit from the treatment accorded to single parents.

These single-parent benefits also act as deterrents to marriage. We know of two single parents, who lived together for many years yet were unable to marry until the children of one of them grew up and left home. They were prevented from marrying because they simply could not afford the loss of benefits that it would entail.

In many cases, the availability of single-parent benefits also acts as an incentive for women, particularly unmarried women, to bear children ‘out of wedlock’¹. Although all authorities agree that this is a guaranteed route to poverty and disadvantages the resulting children greatly, the system establishes single parenting as an alternative both to employment and to marriage. Thus, the burden for providing for mother and child has been shifted from the father to the overburdened taxpayer.

The interaction of the tax and welfare systems has a built-in anti-marriage and anti-family bias. Benefits that are not available to families, even those in financial difficulties, are granted readily to parents (usually women) once they have separated from their husbands. Since money problems are cited most frequently as the root cause of family breakdown and divorce, the current tax system acts to aggravate the problem, not alleviate it. Separation and divorce have the same effect as single-parent allowances – they ultimately transfer the burden of supporting a family to society at large. Once parents have separated, the burden of the support of children usually falls unequally on the shoulders of the custodial parent, in the majority of cases, the mother. Since many single mothers find it impossible to earn sufficient income to support their families, particularly in view of the additional burden of childcare, they and their children frequently find themselves dependent on public support for their livelihood.

Not only is this demeaning to those individuals forced to turn to the government for support, it is also detrimental to their children. Although the current welfare system ensures that children of single-parent families are adequately provided for financially, it has been identified as the cause of many undesirable side effects such as increased incidence of teen-age pregnancy, poor school performance, early school leaving, and high unemployment rates. The impact of welfare dependence on children thus seems to be more on their attitudes than on their actual physical welfare. Clearly, welfare dependency has a negative impact on people’s self-esteem.

2.2 Disincentive to having children

Children represent another long-term cost to the family budget. If one were to perform a cost/benefit analysis for having children, the costs, particularly the economic costs, would generally outweigh the benefits. As the economic commitment to the rearing of children increases, there is more and more pressure on the family either to delay the bearing of children, or to avoid it altogether. Clearly, financial considerations play a large part in a couple’s decision to have or not to have children.

Financial pressures force many women to choose employment rather than motherhood. Social pressures also cause many women to seek a career rather than merely a temporary source of income. Both of these forces militate against the bearing of children or cause women to wait until much later in life to have their children.

These delays in childbearing, however, often result in increased risk to mother and child. As the age of the mother increases, so does the risk of congenital illness or abnormality. In addition, the older the parents, the greater the chance that one or other will die or suffer ill health before the child reaches maturity. Older parents often lack the vitality and emotional flexibility needed to raise their children properly. Each of these situations represents a potential charge on the public purse.

For many women or families unable to handle the cost of a child, abortion is the most attractive option. Abortion not only represents a considerable charge to Medicare, it also presents many well-documented psychological and physical risks to the women who opt for it including, quite frequently, sterility. In many cases, the child the woman has aborted is the only one she will ever conceive. If, in later life she desires to have children, the only option available may well be expensive IVF treatments – another drain on the Medicare budget.

2.3 Disincentive to caring for one’s own children

One of the greatest ironies of a tax system that discriminates against single-income families where the mother chooses to remain at home and care for her children is that it establishes the principle that the best person to look after one’s children is a total stranger.

Parental childcare is based on grace and love. Parents nurture their children. Paid childcare, on the other hand, is based on a contractual agreement. Childcare workers do not nurture children. They are required only to provide them with a specified standard of care. Children grow best in an atmosphere of love and personal attention. Not only is this a philosophical truth, it is also a fact well known to social scientists.

Currently, the government provides subsidized day care to assist working mothers. The tax system, on the other hand, provides little or no relief for the mother who chooses to remain at home to look after her own children. However, studies show that the majority of people in Australia believe it more important for mothers of young children to remain at home with them than to be in the workforce. A report by M.R.D. Evans entitled 'Norms of Women's Employment over the Life Course Australia 1995', concluded that "a large majority of Australians in the mid-1990s feel that women ought to stay out of the work force when their children are young; about two thirds support full-time homemaking and only about one third support employment for mothers of young children".²

2.4 Disincentive to earning additional income

The common-sense solution to an inadequate family income is to work more. Theoretically, people who work more, who put in overtime, or who take on an additional job, should have more money to spend, but, given the current tax structure, this is not always the case.

If a low-income earner attempts to increase his family income by any of the above means, the combined effects of the tax and welfare systems often serve to negate his efforts. Firstly, as soon as he earns an additional dollar, it is immediately taxed at his highest personal rate of tax. If his income is in the relevant range, it will also reduce his Medicare exemption threshold, adding more to his tax bill. Since most welfare benefits are income tested, many of these may either be reduced, or, if the income has risen high enough, eliminated altogether. He may also become ineligible for concession rates on electricity, telephone, water, bus tickets and the like. Now, not only does the individual have to pay for lost benefits out of his own pocket, he must do it with after-tax dollars, thus increasing his costs even more. Depending on the income figures involved, it is often possible for an individual to discover that his disposable income has actually been decreased by the attempt to improve his family's circumstances by seeking additional income.

Instead of providing an incentive for individuals to attempt to increase their incomes and hence their standards of living, the current interaction between taxation and welfare systems often works to discourage initiative and self reliance.

2.5 Disincentive to the extended family

The lack of horizontal equity in the tax system is even a disincentive to the extended family and an additional burden on the aged-care system. Before the advent of the social welfare system, children were regarded as their parents' old age security system. It was once common for elderly parents to live with their children, to continue to participate in family activities and to act as grandchild minders and respite care givers in their children's homes. As the parents had looked after the children in their youth, so the children would now care for their parents in their old age. Not only was this better for all concerned, but it was a much kinder, more genteel and more cost-effective way of looking after the nation's elderly citizens.

Without horizontal equity, most families can no longer afford to keep elderly relatives in their homes, particularly when it requires two full-time salaries to maintain it. Thus the burden for elderly care has now fallen on the government and the cost per person for such care has increased tremendously.

3. Plight of the single wage-earner

"Couples living on a single income are the new poor."³ This is largely the result of the removal of horizontal equity in the tax system. The following account from a member of Festival of Light illustrates the problem:

In 1988, my wife and I built a new home on Housing Trust land. Every third house was privately owned, with the rest being occupied by Housing Trust tenants. With one exception (ourselves) all the privately owned homes were occupied by DINKs (Double Income No Kids). Similarly, all the Housing Trust homes but one housed single-parent families.

Very quickly, the two exceptions became evident to the world because they were the only two homes on the street without air conditioning and the only ones without a decent car parked in the driveway. The DINKs had enough income to afford all these amenities; the single-parent families were obviously receiving an effective income of similar value and purchasing power.

What made these two exceptional homes stand out was that they both contained single-income families. I was trying to pay off a 17% mortgage and my neighbour was just trying to get by. Eventually, I succeeded in paying off my mortgage and things started to get a bit easier for us, but my blue-collar neighbour just sank deeper and deeper into the mire as his family increased in size. His family was dressed (albeit cleanly and tidily) in thrift store merchandise, his furniture was all second hand, his car was held together in places with duct tape and his standard of living just kept on declining despite overtime and an eventual part-time job for his wife. Inflation and 'bracket creep' conspired to impoverish him, even though he worked long and hard to provide for his family.

Even those earning professional salaries (as I was) find it hard going to raise a family on a single income. This, however, was not the case prior to the abolition of horizontal equity and the concept of the ability to pay in our tax system. It also became very evident to me that if I, as a professional person, could barely afford the payments on a modest, starter home, that for single-income families on a lower salary home ownership had become an absolute impossibility. Thus, most couples desiring home ownership must obviously choose between a home and children. Interestingly enough, we were acquainted with an unmarried female, who was earning significantly less than I, who had no trouble in financing the purchase of a house similar to our own and still manage to live much better than we did.

The system's failure to compensate for the number of people being supported by a single income provides a powerful disincentive both to children and to marriage.

4. Economic and social costs of the current tax system

Generally speaking, the impoverishment of the single-income family due to the lack of horizontal equity in the tax system has and will continue to result in a gradual decline in our standards of living and an ever-greater reliance by an increasing number of people on social assistance.

High welfare expenditures are not effective in compensating for the lack of horizontal equity in the tax system. Instead, high levels of welfare spending simply create a state of welfare dependency and a demand for still greater levels of spending as people lose both the will and the ability to provide for their own economic needs. As the gap between welfare income and earned income levels diminishes, there is less and less incentive for people to provide for their families and to better their own circumstances.

High levels of so-called transfer payments are necessary to fund high welfare expenditures. Transfer payments place an increasing burden on wage earners. In addition to the needs of their own families, transfer payments make them also responsible for the support of numerous unrelated individuals such as the unemployed, unmarried, disabled and aged. This again is an unfair burden, particularly in view of the fact that most social assistance benefits do consider horizontal equity or need and increase with the size of the family involved.

At present the tax system provides disincentives to marriage, to children and to single-income families. It provides incentives for mothers to enter the workforce, for children to be placed in daycare instead of being raised at home and for women to delay childbearing and to seek abortions. All of these tend to increase the requirements for public assistance and to perpetuate the problems being faced by families.

5. Recommendations for change

Healthy marriages are the crucible in which strong families are forged. And strong families are essential for the continued growth of our society and for our survival as a nation. Therefore, it is imperative to moderate both the taxation and the welfare systems and to remove the built-in bias against the family, particularly the single-income family, caused by the interaction of the two.

Using the taxation system to support marriage is of supreme importance in these modern times when many of the old strictures of social support for marriage, such as the disapproval of illegitimacy, of divorce and of cohabitation, have disappeared and the legal barriers to divorce have been all but eliminated. Barring romantic considerations, marriage is generally regarded and evaluated by its participants according to its perceived costs and benefits. If the costs outweigh the benefits, then people will simply find illegitimate means of obtaining the benefits of marriage without having to pay the costs – which means that someone else, namely the taxpayer, will have to assume them.

The negative, long-term effects of these illegitimate routes to ‘happiness’ such as single parenting, serial cohabitation, the avoidance of marriage, the devaluation of children and motherhood and welfare dependency are destructive both to society in general and to the individuals involved in such activities in particular. Therefore, it is highly appropriate that the government use the tax system to eliminate the bias against families and once again ‘tilt the balance’ in favour of families and children. To this end, we make the following specific recommendations

5.1 Restore horizontal equity

Our primary recommendation is that the concept of horizontal equity be restored to the taxation system. As in the past, the taxation system must be driven by the concept of the ability to pay, rather than by the desire for simplicity. The current marriage of tax and welfare systems has proven to be counterproductive. Therefore a mechanism must be established to recognize the financial need of taxpayers who are responsible for the support others.

If the taxation system recognizes the cost involved in supporting dependent individuals, then it follows that more taxpayers will be willing to accept these costs. Fewer wives will be forced to enter the job market merely to help balance the family budget thus fewer children will be placed in daycare centres easing the strain on government budgets. As children become less of a financial burden to parents, there should be less pressure on the Medicare budget both for abortions and for IVF treatment for infertility. As taxpayers are compensated for the costs associated with caring for elderly or infirm relatives, they will be better able to look after them in their own homes, which is much more cost-effective than putting them in institutions.

Finally, it should be noted here that there is a demographic argument in favour of allowing family after-tax incomes to be increased in proportion to the number of dependents. This is because Australia’s fertility rate has, for over a quarter of a century, been below the level necessary to maintain our population. Because of this, the ratio of employed to retired people has been decreasing, forcing Australia to rely on immigration to maintain its work force and placing great strain on its social services budgets. Increased fertility rates will lessen our reliance on immigration and help to redress the balance between those who are in and out of the workforce.

5.2 Enable people to support themselves

It is the primary responsibility of people to support themselves and to provide for their own needs. When people “pay their own way” instead of having to depend on perceived government ‘handouts’, it not only boosts their self-esteem and gives them a sense of pride in their own accomplishments, it also acts as an incentive to hard work and personal initiative.

To this end the taxation system needs to be overhauled to exempt at least the basic minimum necessary family income from taxation. It should once again become the guiding principle of the tax system that no

income should be taxed until the taxpayer has enough to provide a minimally acceptable standard of living for himself and his family. Only once his family's basic needs have been met does it become acceptable for the government to begin to tax the surplus.

At most moderate levels of income, people spend all their additional income almost immediately, thus providing not only increased employment to produce all the additional goods and services necessary, but also taxable income in the hands of the people and firms involved in providing those goods and services.

To adopt this approach would seem to be very much in accord with the policies of the current government. People should be encouraged to look first to their own resources to meet their needs before turning to the government. Thus, the tax system should foster attitudes of self-reliance rather than dependency on government handouts.

5.3 Provide benefits only for people in need

Once the family income has been increased by means of a more generous tax-free threshold and taxes made commensurate with the taxpayer's ability to pay, then it should prove possible for the government to eliminate many of the current social welfare programs. Benefits should only be provided to those in genuine need, or, in other words, those on full social assistance such as old age pensioners, the unemployed, the disabled and those acting as full-time caregivers.

This approach will save the government countless millions of dollars in benefits, while, at the same time, reducing the bureaucracy necessary to administer the current social services program.

5.4 Tax family units rather than individuals

We recommend that the Australian Taxation Office adopt the concept of family income tax and produce a family tax form rather than in individual tax form. Thus, all the family income would be reported on the single form.

The tax-free threshold would then be increased by a multiple determined by the number of dependent individuals in the family unit (for example, multiply the tax-free threshold by 2 for a married couple, 2.5 for a couple with one child, etc.) The size of each tax bracket would also be multiplied by the same factor. Thus, if the lowest rate of tax applied to the first \$10,000 of individual income, it would apply to the first \$20,000 of income for a husband and wife, the first \$25,000 for a family with one child and so forth.

The benefit to the government in the introduction of a family income tax form would be in the considerable reduction in the number of returns filed each year and the elimination of calculations that affect both husband's and wife's returns.

References

1. Swan, P. & Bernstam, M. (1988), 'The Political Economy of the Interaction between Labour Market Regulation and the Social Welfare System', *The Australian Journal of Management*, **13**(2), pp 177-201.
2. Evans, M.R.D. "Norms of Women's Employment over the Life Course, Australia 1995, 6 December 1995, Research School of Social Sciences, ANU, Volume 1995, 1106.
3. Institute of Applied Economics and Social Research, University of Melbourne, quoted in the *Sydney Morning Herald*, 4 November, 1988, p 3.