# Senate Inquiry into the Tax Laws Amendment (Personal Income Tax Reduction) Bill 2008

Paul Howes – National Secretary
The Australian Workers' Union

Level 10, 377-383 Sussex Street, Sydney NSW 2000
Phone: 02 8005 3333 Fax: 02 8005 3300
Website: http://www.awu.net.au/ Email: members@awu.net.au

# Introduction

The AWU represents working Australians from all walks of life – with the majority of its members outside the big capital cities.

Our union covers working people operating in some of Australia's most economic sectors – gas, oil, metalliferous mining, energy, aluminium, manufacturing, public sector and the steelworks. We have members who work in a wide range of industries, - from hairdressers to rabbit trappers. Our members build railways, they mill paper and build highways. They also farm fish and grow tobacco.

The AWU's history is as rich and complex as the industries we represent.

The Australian Workers' Union is a national union made up of state, regional and industry-based branches.

It represents more than 130,000 members across Australia. It is Australia's oldest general union and largest blue-collar union.

The AWU was formed in 1886 as the Amalgamated Shearers Union, and quickly grew to represent shearers across New South Wales, Victoria and South Australia. The Queensland Shearers Union formed in 1887.

By 1894 the Australian Workers' Union was formed, and struggled to cope with the conditions of the 1890s. Gradually, the AWU grew as the colonies recovered.

Federation in 1901 brought a Commonwealth industrial relations system. The AWU was the first union to secure a federal award under the new conciliation and arbitration system – the Pastoral Industry Award. With this award, the AWU was able to ensure that workers, not just bosses, had a say in settling pay rates and workplace conditions.

In 1994, the AWU underwent its most significant amalgamation with FIMEE, itself an amalgamated union of the Federated Ironworkers' Association of Australia (FIA) and the Australasian Society of Engineers (ASE).

Today the AWU believes it will grow even further as Australians take up more opportunities available in the spreading resources industry.

## Protecting the financial security of working families in the financial environment of 2008

As Australia's oldest union we know from our history how hard it is to maintain the standard of living of Australian working families - and how seemingly small changes to the economy can be ravage our members' lives.

The Rudd Government is correctly facing the issue of inflation head-on and has opened up the community debate about how we deliver our fair-go values in these economic times.

The AWU wants to enter this community debate in the interest of our 130,000 members and their families with our own National Discussion Paper.

If there is one economic lesson the electorate has learned in the aftermath of the federal election campaign it is that interest rate hikes cancel the value of a tax cut. Australia witnessed the futility of tax cuts promised by the Howard Government during the election campaign. The promised Howard tax cut was estimated to be worth around $90 a month for a household with a mortgage on median income. But just two interest rate increases – estimated to add around $80-$100 to the average monthly mortgage repayments – threaten to wipe out these cuts.

Something has to give to break this cycle of taking back with one hand what is given with the other. And there is simply no point in applying the fiscal policy accelerator to the economy through tax cuts if the Reserve Bank puts on the monetary policy brakes.

We needed to be reminded of the comments of Treasury Secretary Ken Henry on the criteria for assessing the merits of the policies of the parties during an election.

"In an economy operating at, or close to, full employment … expansionary fiscal policy tends to 'crowd out' private activity: it puts upward pressure on prices which …puts upward pressure on interest rates." (Address to Treasury staff, 14 March 2007)[i].

And higher interest rates will keep pressure on the exchange rate already buoyant as a consequence of the commodities boom – keeping them higher for longer – already the highest in the developed world. This adds to adjustment pressure on business looking to invest to compete on quality in addition to price.

The Australian dollar is regularly touching record levels and this is based on anticipated rises in our interest rates in addition to strong commodity prices. Up to two quarter-percentage point increases in rates are expected over the next 6-12 months, increasing the attractiveness of the dollar but delivering another blow to Australian's exporters and industry.

Dr Henry's observations regarding the threat posed by inflation with an economy running close to full capacity demand more by way of policy response than simply granting another tax cut. The Reserve Bank Governor has recently confirmed his concern about the outlook for inflation and the need for cautious approach to policy in the face of persistent demand.[ii] The AWU takes this advice seriously.

The AWU therefore shares Labor's commitment to tax reform, and to all reforms that lift productivity and living standards.

A responsible tax policy needs to be able to sustain growth over the medium to longer term rather than returning bracket creep eaten up by lower wages, and higher household costs, including interest rates.[iii]

That means that more investment in education and skills and infrastructure is required in order to tackle the threat to living standards posed by inflation to our growing economy. The speed limit on the economy must be raised.

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By putting aside savings for the right type of investment in education and infrastructure, the means is at our disposal to raise productivity and living standards without risking higher interest rates from unsustainable domestic demand fueled by tax cuts.

The AWU will support the Rudd Government in reinvigorating the economy by, in particular, Raising private savings and incentives;

- Tackling the productivity challenge by addressing education, skills shortages, and training and lifting our workplace participation and the incentives to working hard;
- Beating inflation by investing in capacity in our roads, rails and ports' and
- Future proofing the economy against external shocks and risks such as the risk posed by a possible US recession by ensuring a stronger and diversified export performance across the economy in particular in value added manufacturing.

Despite the tax cut, Australia will be no better off unless we lift the speed limit currently restricting the performance of the Australian economy by also investing in education and skills, health, infrastructure investment and lifting our trade performance.

The risk that the Australian economy runs is that in order to keep a lid on inflation, other necessary and worthy spending by Government will need to be held in check in order to offset the tax cuts at a time when the economy is bumping up against serious capacity constraints. But the AWU does not agree with cancelling the tax cuts altogether.

That is why the AWU supports raising private savings by providing half of Labor's $31 billion tax cut as a contribution to a nominated taxpayer superannuation fund.[iv] This funding will be available to invest in productive investments aimed at building capacity and productivity growth.

Australia ranks 20th out of 25 OECD countries for its public investment in infrastructure as a proportion of GDP. That is reflected in our declining productivity performance as the economy confronts capacity constraints.[v]

We need to alleviate the capacity constraints at our ports, advance our telecommunications infrastructure and invest in the priority areas of water, energy and transport infrastructure. In partnership with industry, investing in infrastructure can increase GDP, business investments, housing investment, exports and living standards. There is also now evidence that increases in education attainment increases length of working life by delaying retirement and increased participation over an individuals working life.

Interest rates in Australia may stay higher for longer than they need to because of the delay by the Howard Government in addressing these structural issues and leaves us exposed to any further deterioration in global growth because of the US slowdown and relative fall in our competitiveness.

The AWU recognises that the Rudd Labor Government knows that tax cuts alone will do nothing to increase participation in the workforce or for people in the workforce to work harder without tax reform which addresses disincentives from the current high effective marginal tax rates (the sharp increase in the tax rate on the next dollar earned due to the combination of bracket creep and the loss of low income tax offsets and family tax payments). For example, raising the Low Income Tax Offset is an important initiative in this direction.

Increasing private savings by allocating half o the proposed tax cut to a taxpayer nominated superannuation fund will ensure these funds are invested effectively as part of the economy's future, rather than current, consumption. This is a much better deal ultimately for taxpayers because it will place positive downward pressure on interest rates by boosting savings and reduce the drag on the economy from interest rate increases at a time when the mining boom and investment by industry is already ensuring strong growth over the medium term. Government will be much freer position to identify and address capacity constraints immediately in the knowledge that national savings are increasing. It will also serve to build confidence in financial markets.

If the global credit squeeze continues, it could also make financing Australia's large current account deficit more expensive or difficult to accomplish. Building national savings in the form of superannuation is a useful way of taking pressure off the current account from excessive consumption spending, easing pressure on the current account deficit and with it the level of Australia's foreign debt.

Remember that in 1995 Mr Howard promised to reduce Australia's foreign debt. Instead during his term of office it trebled – in order to fund a trembling in the size of the average mortgage over this time - and, partly as a result, Australia's interest rates are among the highest in the developed world.

And our situation would be much worse had Labor not dramatically boosted national savings through the creation of compulsory superannuation.

This was a great example of what can be achieved when government, business and unions work cooperatively together. Labor's compulsory superannuation did more than just secure the financial future for many Australian families; it established a national savings pool and gave birth to a great national industry - the financial services industry.

Remember also that Mr Howard ultimately reneged on – what became 'non-core' – his promise to respect Mr Keating's May 1995 Budget allocation of a superannuation contribution to workers making up for the other half of the 1993 tax cut which was cancelled at that time.[vi]

The AWU Believes in building the national savings pool by making half the proposed tax cut a superannuation contribution at the same time as implementing the tax reforms already announced by Labor. The Governments Tax Laws Amendment (Personal Income Tax Reduction) Bill 2008[vii] sets a goal over six years, by 2013-14, for a personal income tax system with the following features:

- A reduction to three rates from the current four;
- A reduction of the current 45 per cent rate to 40 per cent; and
- A reduction of the current 40 per cent rate (which by 2010-11 would have been reduced to 37 per cent) to 30 per cent.
- Middle-income earners would be the major beneficiaries of Labor's six year tax goal – with only a 30 per cent marginal tax rate applying over the full income range from $37,000 to $180,000.

Alongside these reforms, the Government can develop strategies to assist in rebuilding the nation's skills, infrastructure, health services and trade performance.

Our superannuation funds and private sector have a major role to play. Financing these investments is key to achieving the positive benefits required for the economy in terms of increased productive capacity thereby reducing the pressure on inflation and interest rates.

Advice should be sought as a priority from the Treasury and the ATO on the optimal means of ensuring that taxpayers receive the superannuation contribution. Exploiting existing channels to superannuation for workers seems logical. However, there may be other options and which may have already have been modeled to some extent. The argument for doing this work is compelling.

Adding to national savings through a compulsory contribution to superannuation provides the opportunity to dampen inflation and interest rate pressures, boost confidence, and allow financial markets to borrow on more favourable terms conducive to local investors and industries and to locally sourced suppliers of goods and services.

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Endnotes

[i] Secretary's speech to staff, 14 March 2008, http://www.treasury.gov.au/contentitem.asp?Navid =008&ContentID=1249

[ii] Glenn Stevens, Governor, RBA, Economics Prospects in 2008: An Antipodean View, Address to Australian Business London – 18 January 2008. http://www.rba.gov.au/Speeches/2008/sp_gov_190108.html

[iii] In its World Economic Outlook released in October 2008, the IMF highlighted the risks involved in continually disbursing to households the revenue windfalls arising from the commodities boom and strong economic growth more broadly. Referring specifically to Australia (and New Zealand), the IMF notes that 'the main short-term policy challenge … continues to be to keep firm control on inflation in the face of strong domestic demand and tight labour markets', and encourages Governments to 'continue to exercise fiscal restraint in the period ahead' (page 83) More generally, the IMF argues that 'countries facing overheating pressures in the context of strong output growth and capital inflows would benefit from greater fiscal restraint, by saving a larger share of buoyant revenues, rather than allowing public spending to soar or prematurely cutting taxes' (p.30). Although the IMF then goes on to say that this advice is 'particularly relevant for counties in emerging Europe with large current account deficits', we share the views of the ANZ that it is also apposite in the Australian context. Saul Eslake, Chief Economist, ANZ – *Election 2007*.

[iv] The ATO may be best placed to administer the allocation of half of the tax cut during the processing of tax returns beginning in 2008-09. Existing PAYG wage earners may be able to receive half the tax cut as a contribution to their existing superannuation fund per pay fortnight. However, advice should be sought on the optimal means of implementing the policy from the Department of the Treasury and the ATO.

[v] Speech by Kevin Rudd to the Australian Industry Group Canberra, 27 February 2007:
PROSPERITY BEYOND THE MINING BOOM

[vi] George Megalogenis: *Just give or take a few billion*, OPINION The Australian *May 12, 2007*
http://www.theaustralian.news.com.au/story/0,20867,21714708-7583,00.html

[vii] Tax Laws Amendment (Personal Income Tax Reduction) Bill 2008

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