Tax truth lies below the surface

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In this month's budget, the political parties face a prominent dilemma as a federal election closes in. How shall they deal with a hefty budget surplus? Should excess revenue be handed back to taxpayers via income tax cuts? Or should it fund additional so-called social programs — health, education, childcare etc? It is a question that average Australians should ponder too.

Cutting income tax rates has become a mantra for aspiring politicians, here and overseas. Any overt suggestion of increased spending — especially by an Opposition seeking office — has been tantamount to a suicide note. For nothing more effectively renders a contender unelectable than the description 'big-spending'. So it is that in Australia the big push now is for more tax cuts. Few dare to argue with the received wisdom that tax rates are too high. The government — keen to assert its low-tax credentials — has already made clear its intention to offer further cuts this year, to follow those of last year's budget.

Against this continual assertion of tax reductions as good public policy, it would seem reasonable to assume that recent governments have actually lowered taxes. After all, there have been several apparent tax cuts. And nominal rates have not increased for many years. Sadly, we would be well wide of the mark if we thought it was that simple. For a truer picture, we need to factor in the number of tax rates and the location of employees within that framework. Thirty years ago, there were twenty-nine different tax brackets in Australia. The top rate was 68 per cent, vastly higher than today's equivalent of 47 per cent [48.5 per cent, when the Medicare levy is included]. But — and here is the catch — a mere 0.05 per cent of Australians paid income tax at this level. In other words, just one in every two thousand workers was taxed at the highest rate. Now we have just four tax brackets. In 1960, the top tax rate cut in at fifteen times average earnings; in 1970 at nine times. By 2002/03 it caught tax payers on just 1.3 times average earnings.

In short, only the very wealthy paid tax at the highest rate then. Now most skilled employees do. The technical term for this is 'bracket creep'. Failure to modify its effect by indexing tax brackets has massively increased the proportion of their income that Australian workers lose to tax. This is well demonstrated by the fact that, had the top tax rate been indexed against the consumer price index over the past thirty years, it would now cut in at $268 647 per annum, rather than $62 500. Put another way, just nine per cent of total income tax was paid thirty years ago by people in the top tax bracket. Now top-rate tax-payers are contributing over half the total income tax take. In this environment, small cuts to nominal tax rates have very little lasting effect on most employees' disposable income, as these data make clear. And it should not be forgotten that these comparisons are between direct income taxes. They do not include the impact of the Good and Services Tax [GST] introduced three years ago. Nothing better illustrates the pernicious effects of bracket creep than the fact that the superficially sizeable tax cuts to compensate for the GST have all but disappeared in that short period, destroyed for most people by their movement into higher tax brackets. Most are now paying more income tax *and* the GST.

A similar gulf between tax rhetoric and reality extends to the impression of high and low taxing governments. Despite endless assertions of modern governments' low-tax, expenditure-reduction philosophies, they actually take more tax than predecssors branded routinely as high-tax, big-spending failures. The Thatcher governments in Great Britain provide a good example. Notwithstanding claims to the contrary, they spent more than their predecessors. In Australia, the Whitlam governments of the 1970s are routinely assessed as extravagant, despite grudging acknowledgment of their policy boldness. But, Australian Bureau of Statistics data [reproduced in the *Australian Financial Review*, 2 April 2004] suggest this characterisation is dubious, relative to their successors. The federal tax take in 1973/4 and 1974/5 was 19.8 per cent of gross domestic product [GDP]. This figure increased steadily though the 1980s and 1990s under governments of both persuasions. By 2000, the Howard government was taking 24.4 per cent [a record] *before* the GST. If it is included now, the tax take rises to 25.8 per cent. And, in passing, it is worth noting that in its short period of operation, GST revenue has already increased by sixteen per cent.

What is the message from all this? That Australians workers are paying more tax than they used to. That governments have steadily increased their take, often at the same time cutting services. That any tax statement by politicians excluding the word 'indexation' should be regarded with the utmost scepticism, especially when the word 'cuts' is included. And that better community value for money might perhaps come from a focus on the latter element of cost/benefit analysis, rather than total preoccupation with the former.

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NB. I am indebted to the Parliamentary Library for much of the statistical data discussed in this column.