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Progressivity in the tax transfer system: changes in family support from Whitlam to Howard and beyond

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Abstract

Since the 1970s personal income tax rates have become less progressive throughout the OECD. During this period inequality has also increased This is also true of Australia, where over the same period transfer payments have been more closely targeted to those in need. Accordingly over this time the Australian tax-transfer system has shifted from a system with highly progressive tax rates coupled with universal benefits in respect of children and pensioners to a system of flatter tax rates and transfer payments that are recognised as among the most targeted in the OECD. In this paper I will explore the relationship between personal income tax rates and means tested transfer payments in developing a progressive tax-transfer system since the 1970s, in the context of support for families.

Keywords: Tax-transfer; Family Tax benefit; Universal benefits; Progressive tax rates

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UHJDUGOHVV RI D SHUVRQ¶V PHDQV EXW WKRVH GHH take a higher contribution to the state. Further, if the benefit is also included in taxable income, a proportion of the benefit is clawed back which effectively applies a means test to that benefit. In contrast Australia is usually classified as a liberal welfare regime, in which the state and private enterprise work together: the state will subsidise the private sector in the provision of goods and services that are social goods, but does not usually extent that payments in respect of dependants are included in these benefit entitlements.

The benefits may be available as a tax concession, resulting in a reduction of personal income tax that would otherwise be payable by the taxpayer, or as a transfer payment paid directly to the claimants, but direct provision of services and consumption taxes are not discussed in this article.

2 THE 1970S: THE WHITLAM ERA

In the 1970s the Australian tax and transfer systems were not integrated, with family benefits within both systems. The predominant policy rationale was based on horizontal equity in order to recognise that families with children, compared with people without children at the same income levels, had greater calls on their available income. Hence family payments recognised this and increased the disposable income of all families with children. Vertical equity was delivered through a highly progressive tax system with personal tax rates ranging from 0.3% to 66.7% in 1972.

)DPLO\ EHQHILWV FRQVLVWHG RI WD[GHGXFWLRQV I spouse and children; additional pension or benefit payments for parents on income support; and Child Endowment. Child Endowment was a universal payment, payable to all families with children, and based on the number of children in the family. It was intended to complement the minimum wage as the basis of ensuring that families received an adequate income; however, evidence was emerging that certain groups in the community, including low income families, large families and sole parents, were at a high risk of poverty.

Child Endowment was paid to the primary carer while tax deductions or additional income support payments were paid through the pay packet to the breadwinner. Taxpayers could claim concessional deductions through the tax system[12] concurrently with the universal Child Endowment for taxpayers. Families receiving pensions or benefits through the transfer system received additional payments for children, added

Table 1 Change in Personal Marginal Tax Rates Following RATS

1983–84: Before RATS Reforms		1987–88: After RATS Reforms	
Annual Income	Marginal Rates	Annual Income	Marginal Rates
1 –$4,594	Nil	$1 –$5,100	Nil
$4,595 –$19,499	30%	$5,101 –$12,600	

- a supplement for low income families, with additional supplements for families in specified circumstances;
- indexation of child related payments;
- income payments to sole parent families, which are particularly vulnerable;
- income testing of dependant spouse rebates;
- positive steps to assist parents returning to the labour force;
- ensuring that the primary carer receives income support through directing payments to the carer; and
- retention of the universal family allowance as a base level of payment.

The Review also examined the option of income testing or taxing family allowances, but rejected that proposal. It highlighted the issues faced by families who were outside the paid labour force, or in low-paid employment.[23] In particular, it noted that the lack of indexation had eroded the increases that had been achieved in 1977 by about 30%.[24] It recommended the retention of a universal benefit with the addition of a means-tested layer to assist families in need.

The Cass Review heralded the introduction of reforms that targeted the Family Allowance to those families in most need, specifically low income families regardless of their work status. However, in implementing this targeted system the government

reducing the tax paid by families.[26] However, although the tax payable by low income families may have reduced, the taper rates resulted in increased EMTRs over this period.

From 2000 the FTB could be claimed either as a tax benefit or a transfer payment, although it was clearly linked to the tax system by the government and promoted as reducing the effective tax rates paid by families.[27] However, from its inception over 90% of FTB payments were claimed by instalments as a transfer payment, not as an annual lump sum through the tax system. Income support recipients, who represented about 25% of FTB recipients in 2007, were required to claim the benefit on a fortnightly basis.

Unlike the GST component of the package, the changes to family benefits were evolutionary change, as the new system was based on the child related payments in place before 2000: child related payments remained means tested and affluence tested, with low income families being entitled to higher payments while high income earners lost entitlement. The dependant spouse rebate was removed from the tax system in relation to families with dependent children, being replaced by the FTB Part B. However, this development was also consistent with the Home Child Care Allowance that had been in place between 1994 and 1997, which had also paid the spouse related benefit to the primary carer.

A more significant development was the increased rates of child related payments payable to middle income families. This was a function of the increased payment rates and the lower withdrawal rates at both the upper and lower income thresholds that allowed more families to qualify for FTB, but the longer taper range meant that more families experienced increased EMTRs as FTB was withdrawn.

Analysis of the impact of the ANTS package on tax and benefits concluded that the package was, overall, redistributive towards lower income households.[28]

However there were later adjustments to personal income tax rates that clearly benefitted higher income earners. Between 2001 and 2006 the thresholds for the higher income tax rates were increased, culminating in a substantial lift in the year ended 30 June 2006.

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[26] Peter Costello, 'Costello Hands Down Ninth Budget' (2004) ABC Lateline 11/05/2004 <http://www.abc.net.au/lateline/content/2004/s1106256.htm>

[27] Australian Treasury, Not A New Tax: A New Tax System (AGPS, 1998) 52; Peter Costello, 'Meet the Press 30/04/2006' (2006) <http://legacy.ten.com.au/promo.aspx?currentpage=2&factSheetYear=2006&factSheetMonth=4&factShe

indexation of payments places financial pressure on low income families as the cost of living increases, while the freezing of the upper family income threshold for FTBA results in a form of bracket creep.

The FTB was within the terms of reference of the Henry Review,[30] which made a number of recommendations.[31] The report recommended changes to child-contingent pay

of the EMTR is the labour force participation impact. High income earners are more likely to be in receipt of investment income and are also more likely to be highly skilled and able to relocate to obtain or change employment. Accordingly, they are more likely to be responsive to changes in income tax rates at the highest marginal tax rates. The withdrawal rates for transfer payments are not likely to be a major consideration for high income earners because the application of the income test would limit any entitlement.

A further implication of the flattening of tax rates since the 1980s is that inequality in disposable income has increased, as high income earners retain more of those earnings as tax rates are reduced.[41] In this context the role of the transfer system as a means of redistribution is increased. A number of measures can be applied to assess changes in policy priorities over the period of this analysis, including the Gini coefficient. Trends in the Gini coefficient over the period of this study are shown in Figure 1 below:

Figure 1 Changes in Income Inequality: Gini Co-efficient: [42]

Inequality in Australia before taxes and transfer payments was fairly steady over this period at around 0.47. The effect of the tax-transfer system was to moderate the impact of the market, reducing inequality by redistributing income within the community, but due to changes over this period, inequality after taxes and transfers increased from 0.298 to 0.334, particularly over the period of the 1990s. However, the Gini coefficient only looks at the overall inequality within society, and does not look at the redistribution between particular groups within society, for example from taxpayers without children to families.

Figure 2 Couple Family Benefits in Australia 1984 – 1999, by Quintile $ per week 1999 prices[52]

The biggest distributional shift followed the reforms to Family Allowance from the late 1980s. Although the 1983 Family Income Supplement had assisted low income familes when introduced, the low rate eroded its effectiveness until the 1987 reforms directed increased Family Allowance and FAS to families in the lowest quintiles.

The effect of the 2000 reforms is not reflected in Figure 2 because data from the 2004 Housing and Income Survey are not directly comparable with data for the previous surveys due to changes in measurement. However, Harding et al[53]

was a trigger that signalled the need to address the redistributive effect of-the tax transfer system.

In contrast the second significant change, the application of means and affluence tests to target benefits to low income families, was a response to exogenous economic and political factors. The economic shocks of the 1970s were followed by structural change to the global economy that was reflected in the Australian economy from the 1980s, with an impact on poverty levels.

The political philosophy of the government affected the policy design: the Hawke Labor government in Australia used the transfer system in conjunction with the social wage as an income support strategy.

In the late 1990s the Howard Liberal government increased integration of the tax and transfer systems, providing compensation to low and middle income families for the impact of the GST. Although increases in rates were linked to the GST in Australia the increased integration of family benefits with the tax system was an endogenous change triggered by feedback within the system. It had become clear that the family tax transfer system was not effectively redistributing resources to needy families; accordingly the system was adjusted in an attempt to align the tax and transfer aspects of the system.[56]

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