Effects of changes in the treatment of earners and families with children in the Australian tax-benefit system

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DRAFT – PLEASE CONTACT AUTHORS BEFORE CITING OR QUOTING
Research Question

Has reform of the Australian tax-transfer system since the 1980s resulted in gains for children that have come at the expense of equity between men and partnered mothers?

A number of views:

- Increased generosity of family payments → reduced child poverty (Harding, 1998; Redmond and Whiteford, 2011)

- Tax-benefit reform has resulted in an unfair and inefficient family tax system, with second earners (usually women) in couple families with children the biggest losers (Apps & Rees)

**Question:** what impact would a move back towards an individualised system have on family incomes and gender equity?
Overview

- Brief Introduction to ‘Supporting Families’
- Australian Tax-Benefit System in 1986 and 2009-10
- Microsimulation Model
- Modeling alternative systems of family support
- Conclusions
Supporting Families
Supporting Families

- Australian Research Council Linkage Project
- Australian ‘industry’ partners:
  - Australian Government (FaHCSIA)
  - Australian Council of Social Service
  - Australian Institute of Family Studies

- International academic partners
  - David Rea (Victoria University, NZ)
  - Michael Mendelson (Caledon Institute, Canada)
  - Brian Nolan (University College Dublin, Ireland)
  - Michael Wiseman (George Washington University, US)
  - Holly Sutherland (University of Essex, UK)
Supporting Families

Aims of the project:

- Examine reforms to the Australian tax-benefit system since the early 1970s
- Explore the impact of tax-benefit reforms on treatment of different groups of working age people and families
- Develop comparisons with other rich English-speaking countries

Methods
- model family calculations
- analysis of the Australian Income Distribution Surveys 1982 to 2009-10
- Develop a historical microsimulation & internationally comparable model of the Australian tax-benefit system as if impacts on working age people
  → Australian Tax-benefit Model (ATM) – based on EUROMOD

Timelines – September 2010 to December 2013
Evolution of the Australian Tax Benefit System
Evolution of the Australian Tax Benefit System 1980s to 2009-10

1982 system
- Largely individual tax system (some offsets for dependent spouses, etc.)
- Modest universal family allowance
- Family based means tested payments (unemployment, single parenthood, etc., all with additions for dependents)

Reforms from 1980s
Incorporating taxes → Individual → Family
Transfer payments → Family → Individual

Main aims of reforms:
- pay for a universal health care system (Hawke)
- reduce child poverty (Hawke)
- improve incentives to work for all (Keating)
- decrease incentives to work for mothers (Howard)
- restrict entitlement among high income families (Rudd/Gillard)
Evolution of the Australian Tax Benefit System 1980s to 2009-10

**Universal health care system (1983)**
First 1% then 1.5% medicare levy (+ 1% surcharge from late 1990s)
Exemptions based on *family* income

**Reduce child poverty (1983)**
Universal Family Allowance from 1976 (not indexed until 1983)
Family Income Supplement (for families with employment income) from 1983
Means testing of FA from 1987 (but at the top – 80% families eligible)
Large increases to FA + dependant additions for unemployment payments and pensions early 1990s
Evolution of the Australian Tax Benefit System 1980s to 2009-10

**Improve incentives to work (1994)**
(Partial) individualisation of unemployment payments and pensions
- Newstart Allowance for unemployed people
- Parenting Payment for carers of children
- Single FA system for all families and beneficiaries

**Decrease incentives to work for mothers (1996)**
Family Tax Benefit Part A (FTB-A continuation of Family Allowance) supplemented with FTB-B (Dependent Spouse Tax Rebate cashed in):
- Paid to single parents and second earners with dep children
- Means tested on second earner income only (until 2008)
- Low income threshold
- Large increases to FTB early 2000s to compensate for introduction of GST
- By early 2000s, FTB-A and FTB-B among the most generous in OECD
- Most families qualified
Restrict entitlement among high earning families (from 2008)
- Restriction of FTB-B to families where main earner earns less than $150,000
- Indexation of FTB by prices (rather than earnings)
- (forthcoming) means testing of health insurance rebate
Evolution of the Australian Tax Benefit System 1986 to 2009-10

Income Taxes
 Mostly individual, some family features (eg., Medicare, Dependent Spouse Rebate until 1997); but means-testing of FTB also brings in elements of family taxation

Allowances, thresholds and offsets not indexed (Bracket creep)

Top tax rates gradually reduced from 1980s
- 1985-86: 25 – 60% (+ 1.12% Medicare Levy)
- 2009-10: 15-45% (+ 1.5-2.5% Medicare Levy)

Tax free income range partially expanded by a Low Income Tax Offset

Some Payments, Allowances and Pensions taxable, but Beneficiary Offset ensures that most are not taxed in practice
Evolution of the Australian Tax Benefit System 1986 to 2009-10

Patricia Apps (2006) The Australian tax system is unfair and inefficient

**Unfair:** “A young family in which both parents work full time to earn, say $70,000 pa, does not have the same standard of living as another in which one parent alone earns $70,000 while the other works full time at home. A family tax system that imposes equal burdens on these families is unfair. When the work choices of parents vary in this way, a progressive individual income tax system is required for fairness in the treatment of families with the same standard of living, and of those with varying living standards, that is, for horizontal and vertical equity.”

**Inefficient:** “[In comparison with high earning men] low wage earners, and married women in particular, tend to exhibit much more responsive labour supplies. High effective tax rates on their earnings can therefore be expected to reduce significantly the hours they work and the efficiency of the economy.”
Evolution of the Australian Tax Benefit System 1986 to 2009-10

Patricia Apps & Ray Rees (2010) Inefficiencies in the Australian tax system

All income tax systems comprise a lump sum and a marginal rate

Optimal tax theory → progressive taxation – those with higher incomes pay the highest tax rates
EMTR on family income for primary earner with non-earning partner and 2 children, 1986
EMTR on family income for second earner with 2 children, primary earner earns $30,000, 1986
EMTRs for primary earners with non-earning partner and 2 children, 2009-10

Tax 0.3 + FTB-A 0.2

Tax 0.38 + FTB-A 0.3
EMTRs for second earners and 2 children (partner earns $50,000), 2009-10

Tax 0.15 + FTB-A 0.2 + FTB-B 0.2

Tax 0.3 + FTB-A 0.3
Average effective tax rates, Australia, Ireland, UK, late 2000s

Average effective tax rates by percentiles of average earnings, single earner couple with 2 kids, Australia, Ireland and UK, 2008

Average Tax Rate for Income level
Market earnings (percentile of Average Wage)
AUS
IRE
UK

Average effective tax rates by percentiles of average earnings, single earner couple with 2 kids, Australia, Ireland and UK, 2008
Evolution of the Australian Tax Benefit System 1986 to 2009-10

Apps & Rees (2010) on the Australian tax system

“...Australia’s progressive individual income tax has been transformed into a system with strong elements of joint taxation and a rate scale that is no longer progressive...”

- Inverted ‘U’ shape to effective marginal tax rates
- Inequitable tax treatment of second earners (mostly women)

- Apps and Rees’ central policy proposal: “...reintroduction of a progressive individual based income tax combined with universal family payments...”

- Our question: who would gain, and who would lose from such a system?
What happened to employment of parents?
Trends in joblessness among parents (per cent) 1982 - 2009

- Partnered fathers not employed
- Partnered Mothers not employed
- Lone mothers not employed
What happened to child poverty?

Trends in child poverty, Australia 1982 to 2009-10 (per cent)
Microsimulation Model
The EUROMOD Microsimulation Model

• EUROMOD is a static tax-benefit microsimulation model developed by researchers at the University of Essex (Sutherland, et al) that enables the calculation of:
  – the effects of taxes and benefits on household incomes
  – work incentives for the population of each country
  – for the EU as a whole
  
  http://www.iser.essex.ac.uk/euromod

• As well as calculating the effects of actual policies it is also used to evaluate the effects of tax-benefit policy reforms and other changes on poverty, inequality, incentives and government budgets

• Our aim – to model Australian Tax and Transfer system to work within the EUROMOD framework
An Australian version of EUROMOD
ATM – Australian Tax-transfer Model

• What ATM adds in the Australian context...

• ATM focuses on long term historical changes (the purpose of the ARC grant)
• ATM will be open-access – available to other bona fide Australian researchers and policy analysts
• ATM facilitates policy comparisons with other countries, especially EU countries
Microsimulation Model: Data

- Survey of Income and Housing (SIH)
- Survey information is collected between July and June for the 2009-10 SIH data
- Collects information on sources of income, amounts received, housing characteristics, household characteristics and personal characteristics
- Income is collected on both a current and financial year basis
- The principal objective is to facilitate the analysis and monitoring trends in social and economic welfare
- Currently being conducted biennially
- The collection period is based in the previous financial year and on a current basis at the time of the interview
- We use current weekly where possible
Microsimulation Model: Australian version of EUROMOD - ATM

• We take micro data from the ABS Survey of Income and Housing
• At the moment ATM simulates the following
  – Income Taxes, major rebates & offsets
  – Medicare Levy
  – Parenting Payment (Partnered/Single)
  – Family Tax Benefit Part A (FTB A)
  – Family Tax Benefit Part B (FTB B)
  – Newstart Allowance
  – Rent Assistance
• We have (so far) developed the model for 1986, 2005-6 and 2009-10
## Microsimulation Model: Recipient Numbers 2009-10

<table>
<thead>
<tr>
<th>Taxes and Transfers</th>
<th>External Sources</th>
<th>SIH: Reported 2009</th>
<th>Simulated 2009</th>
<th>Ratio Simulated/External</th>
<th>Ratio Simulated/SIH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parenting Payment Total</td>
<td>473,461</td>
<td>419,559</td>
<td>420,007</td>
<td>0.89</td>
<td>1.001</td>
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<tr>
<td>Newstart</td>
<td>520,194</td>
<td>475,896</td>
<td>544,706</td>
<td>1.05</td>
<td>1.145</td>
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<tr>
<td>Family Tax Benefit A</td>
<td>1,772,797</td>
<td>-</td>
<td>1,768,697</td>
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<tr>
<td>Family Tax Benefit B</td>
<td>1,365,475</td>
<td>-</td>
<td>1,539,128</td>
<td>1.13</td>
<td>-</td>
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<tr>
<td>Total Family Tax Benefit</td>
<td>-</td>
<td>1,707,842</td>
<td>1,908,473</td>
<td>-</td>
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<tr>
<td>Income Taxes</td>
<td>-</td>
<td>-</td>
<td>10,348,390</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Medicare</td>
<td></td>
<td></td>
<td>7,009,170</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Income Taxes + Medicare</td>
<td>-</td>
<td>9,325,755</td>
<td>10,396,195</td>
<td>-</td>
<td>1.115</td>
</tr>
</tbody>
</table>
# Microsimulation Model: Expenditure on Taxes and Transfers 2009-10

<table>
<thead>
<tr>
<th>Taxes and Transfers</th>
<th>External Sources</th>
<th>SIH: Reported 2009</th>
<th>Simulated 2009</th>
<th>Ratio Simulated/External</th>
<th>Ratio Simulated/SIH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parenting Payment Total</td>
<td>-</td>
<td>4,536,177,268</td>
<td>4,374,493,652</td>
<td>-</td>
<td>0.964</td>
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<tr>
<td>Newstart Allowance</td>
<td>-</td>
<td>4,784,964,071</td>
<td>4,652,276,563</td>
<td>-</td>
<td>0.972</td>
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<tr>
<td>Family Tax Benefit A</td>
<td>-</td>
<td>-</td>
<td>11,696,402,974</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Family Tax Benefit B</td>
<td>-</td>
<td>-</td>
<td>4,619,784,649</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Total Family Tax Benefit</td>
<td>-</td>
<td>15,084,794,520</td>
<td>16,316,187,623</td>
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<td>Income Taxes</td>
<td>-</td>
<td>-</td>
<td>128,248,215,693</td>
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<td>-</td>
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<tr>
<td>Medicare</td>
<td>-</td>
<td>-</td>
<td>10,271,425,901</td>
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<tr>
<td>Income Taxes + Medicare</td>
<td>-</td>
<td>113,215,047,592</td>
<td>138,519,641,594</td>
<td>-</td>
<td>1.224</td>
</tr>
</tbody>
</table>
Distribution of Disposable Income: Simulated & SIH 2009-10

Net Family Income

Deciles of family market (pretax, pre-transfer) income

$ per year

Simulated
Reported

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Social Policy Research Centre
Distribution of Family Tax Benefit: Simulated & SIH 2009-10

Family Tax Benefit

$ per year

Deciles of family market (pretax, pre-transfer) income

- Simulated
- Reported

Flinders University

SPRC Social Policy Research Centre
Distribution of Parenting Payment: Simulated & SIH 2009-10

Parenting Payment

Deciles of family market (pretax, pre-transfer) income

$ per year

Simulated
Reported
Distribution of Income Tax: Simulated & SIH (both imputed!) 2009-10

Income Tax & Medicare

Simulated
Reported

Deciles of family market (pretax, pre-transfer) income

$ per year

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Modeling alternative systems of family support
Seven alternative systems of universal child benefit

Abolish FTB-A & B and LITO for people with dep. Children, and then.....

Reform 1  Taxable Child Benefit $5000 per child + additional $3000 for sole parent
Reform 2  Taxable Child Benefit $6000 per child + additional $5000 for sole parent, higher tax rates
Reform 3  Non taxable Universal Child Benefit ($5,000/$3,000), 2009-10 tax rates
Reform 4  Non taxable Universal Child Benefit ($5,000/$3,000), all tax rates increased by 2%
Reform 5  Non taxable Universal Child Benefit ($6,000/$5,000), lower tax rates increased by 2% + new upper band
Reform 6  Non taxable Universal Child Benefit ($6,000/$5,000), new upper tax band
Reform 7  Non taxable Universal Child Benefit ($6,000/$5,000), means tested at a high level, new upper tax band
## Seven alternative systems of universal child benefit

<table>
<thead>
<tr>
<th>Child benefit</th>
<th>2009-10 system</th>
<th>Taxable Child Benefit $5000 per child + additional $5000 for sole parent</th>
<th>Taxable Child Benefit $6000 per child + additional 3000 for sole parent, higher tax rates</th>
<th>Non taxable Universal Child Benefit, 2009-10 tax rates</th>
<th>Non taxable Universal Child Benefit, all tax rates increased by 2%</th>
<th>Non taxable Universal Child Benefit, lower tax rates increased by 2% + new upper band</th>
<th>Non taxable Universal Child Benefit, means tested at a high level, new upper tax band</th>
<th>Non taxable Universal Child Benefit, new upper tax band</th>
</tr>
</thead>
<tbody>
<tr>
<td>Per child</td>
<td>$5,000</td>
<td>$6,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$6,000</td>
<td>$6,000</td>
</tr>
<tr>
<td>Per lone parent</td>
<td>$3,000</td>
<td>$5,000</td>
<td>$3,000</td>
<td>$3,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>CB is taxable?</td>
<td>yes</td>
<td>yes</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
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<tr>
<td>Tax schedule</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>rate 1</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
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<tr>
<td>threshold 1</td>
<td>$6,000</td>
<td>$6,000</td>
<td>$6,000</td>
<td>$6,000</td>
<td>$6,000</td>
<td>$6,000</td>
<td>$6,000</td>
<td>$6,000</td>
</tr>
<tr>
<td>rate 2</td>
<td>0.15</td>
<td>0.15</td>
<td>0.15</td>
<td>0.15</td>
<td>0.17</td>
<td>0.17</td>
<td>0.15</td>
<td>0.15</td>
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<tr>
<td>threshold 2</td>
<td>$35,000</td>
<td>$35,000</td>
<td>$35,000</td>
<td>$35,000</td>
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<td>$35,000</td>
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<td>rate 3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.32</td>
<td>0.32</td>
<td>0.3</td>
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<tr>
<td>threshold 3</td>
<td>$80,000</td>
<td>$80,000</td>
<td>$80,000</td>
<td>$80,000</td>
<td>$80,000</td>
<td>$80,000</td>
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<tr>
<td>rate 4</td>
<td>0.38</td>
<td>0.38</td>
<td>0.38</td>
<td>0.38</td>
<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
</tr>
<tr>
<td>threshold 4</td>
<td>$180,000</td>
<td>$180,000</td>
<td>$130,000</td>
<td>$180,000</td>
<td>$180,000</td>
<td>$130,000</td>
<td>$130,000</td>
<td>$130,000</td>
</tr>
<tr>
<td>rate 5</td>
<td>0.45</td>
<td>0.45</td>
<td>0.45</td>
<td>0.45</td>
<td>0.47</td>
<td>0.47</td>
<td>0.47</td>
<td>0.47</td>
</tr>
<tr>
<td>threshold 5</td>
<td></td>
<td>$180,000</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
</tr>
</tbody>
</table>

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**Flinders University**

**Social Policy Research Centre (SPRC)**
Seven alternative systems of universal child benefit

Costs of FTB / universal child benefit ($ billion per year)

Year: 2009-10

- Reform 1: 25.31
- Reform 2: 31.13
- Reform 3: 25.31
- Reform 4: 25.31
- Reform 5: 31.13
- Reform 6: 31.13
- Reform 7: 27.79

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Social Policy Research Centre
Seven alternative systems of universal child benefit
Income tax raised under 2009-10 and reform systems ($ billion per year)
Seven alternative systems of universal child benefit
Net cost to Treasury of reform systems compared with 2009-10 system ($ billion per year)
Seven alternative systems of universal child benefit

Net annual gain/loss to families compared with 2009-10 system ($ per year)

- Reform 1: $5
- Reform 2: $596
- Reform 3: $-361
- Reform 4: $-171
- Reform 5: $435
- Reform 6: $446

Families gain
compared with 2009-10 system

Families lose
compared with 2009-10 system

Reform 1  Reform 2  Reform 3  Reform 4  Reform 5  Reform 6  Reform 7

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Social Policy Research Centre
Seven alternative systems of universal child benefit
Net annual gain/loss to families compared with 2009-10 system
($ per year)

<table>
<thead>
<tr>
<th>Reform</th>
<th>No dependent children</th>
<th>With dependent children</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reform 1</td>
<td>-224</td>
<td>-174</td>
</tr>
<tr>
<td>Reform 2</td>
<td>614</td>
<td>2,632</td>
</tr>
<tr>
<td>Reform 3</td>
<td>-785</td>
<td>1,085</td>
</tr>
<tr>
<td>Reform 4</td>
<td>-911</td>
<td>2,630</td>
</tr>
<tr>
<td>Reform 5</td>
<td>-483</td>
<td>3,569</td>
</tr>
<tr>
<td>Reform 6</td>
<td>-236</td>
<td>2,776</td>
</tr>
<tr>
<td>Reform 7</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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Seven alternative systems of universal child benefit
Net annual gain/loss to families compared with 2009-10 system ($ per year)
Seven alternative systems of universal child benefit
Net annual gain/loss to families with children compared with 2009-10 system, by decile group of family income ($ per year)
Seven alternative systems of universal child benefit
Net annual gain/loss to families with children compared with 2009-10 system, by decile group of family income ($ per year)

Deciles of disposable family income (2009-10 system)

Reform 5  Reform 6  Reform 7
Seven alternative systems of universal child benefit
Per cent families with children in poverty (equivalised incomes less than half median for all families)

<table>
<thead>
<tr>
<th></th>
<th>2009-10</th>
<th>Reform 1</th>
<th>Reform 2</th>
<th>Reform 3</th>
<th>Reform 4</th>
<th>Reform 5</th>
<th>Reform 6</th>
<th>Reform 7</th>
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<tbody>
<tr>
<td>Poverty</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lone parent families</td>
<td>12.6</td>
<td>16.7</td>
<td>6.4</td>
<td>11.8</td>
<td>11.0</td>
<td>4.1</td>
<td>4.2</td>
<td>5.6</td>
</tr>
<tr>
<td>Couple with children</td>
<td>5.2</td>
<td>6.5</td>
<td>6.1</td>
<td>6.0</td>
<td>6.0</td>
<td>4.2</td>
<td>5.5</td>
<td>5.6</td>
</tr>
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</table>
Seven alternative systems of universal child benefit
EMTRs for second earners and 2 children (partner earns $50,000),
Reform 6
Conclusions
Is an individual tax system with generous universal child transfers feasible?

• Giving *all* families a universal family payment may appear expensive, but that depends on what it replaces

• Work incentives would be improved

• A universal family payment would by definition go to better-off as well as poorer families, but this could be partially clawed back by making it taxable, or increasing tax rates on higher incomes

• A universal family payment would likely be popular among families with children, because they confer unconditional recognition of the importance to society of raising children

• A universal family payment could reduce the proportion of children living in poverty.

• A system with universal payments would be cheaper to administer than the current means tested system.
On the other hand….

• These alternative systems raise new questions about equity between taxpayers without children (who would pay for the reform, but gain nothing) and taxpayers with children.

• The biggest immediate (and maybe longer term) gainers would be families with children at the upper middle of the income distribution, not those at the bottom.

• Work incentives are important, but so is adequacy – would universal payments be adequate for families where parents could not work?

• Raising headline tax rates does not appear to be on the agenda at the moment (… but things change)
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