

# Australia, we need to talk about revenue

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*Tax is the price we pay for living in a civilised society. Australia needs to have a real tax reform debate about how much revenue to raise and the most efficient and fair way to raise it.*

Discussion paper

**Matt Grudnoff & David Richardson**

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Level 1, Endeavour House, 1 Franklin St  
Canberra, ACT 2601  
Tel: (02) 61300530  
Email: [mail@tai.org.au](mailto:mail@tai.org.au)  
Website: [www.tai.org.au](http://www.tai.org.au)  
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## Introduction

The debate in Australia about the Federal Government’s Budget has too often focused on what spending will get cut to fund what tax cuts. Australia has also obsessed which Treasurer will deliver a budget surplus in which year. What has been lost in this simplistic debate is that tax is the price we pay for living in a civilised society. Rather than constantly debating how big the next income tax cut needs to be or how large the surplus should be, we need to have a discussion about revenue.

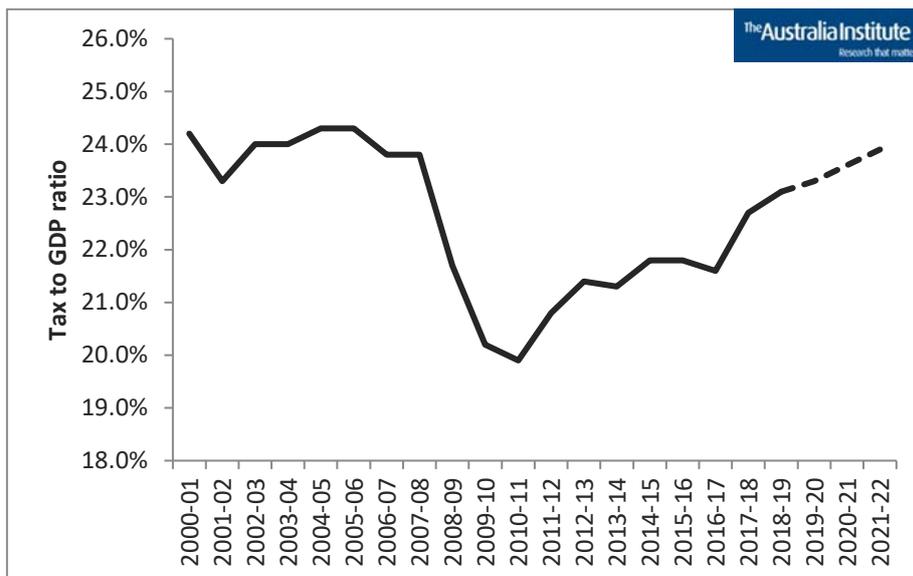
At a time when wages are stagnant and inequality is getting worse, the general public is increasingly interested in a debate on how much revenue needs to be collected and what kind of services the public expects from their Government. The public are keen for a debate about tax reform where tax reform doesn’t simply mean lower taxes.

This paper will look at what has happened to government revenue in the last 20 years, the state of government revenue today and how we can reform our tax system to make it more efficient and equitable.

## Recent history of government revenue

Federal Government budget revenue has spent the last 10 years recovering from the Global Financial Crisis (GFC). Post GFC, budget revenue fell dramatically. Revenue has taken a considerable period of time to recover. This is shown in Figure 1.

**Figure 1 – Government revenue as a proportion of GDP from 2001 to 2018, projections from 2019 to 2022**



Source: Australian Government (2018) 'Statement 11: Historical Australian Government Data', *Budget Strategy and Outlook, Budget Paper no 1, 2018-19*, available at <https://www.budget.gov.au/2018-19/content/bp1/index.html>

The slow recovery since the GFC is in part because of the substantial income tax cuts that the Howard Government made during the mining boom, just prior to the GFC.<sup>1</sup> The Howard Government took some of the temporary revenue gain from the mining boom and gave it out as permanent income tax cuts. The booming economy inflated government revenue which hid the underlying structural weakness in the Budget.

After the GFC, when economic growth returned to more normal levels, growth in revenue was slower than expected because the Budget was no longer able to generate the same amounts of revenue that it had before the income tax cuts were introduced. 10 years later, revenue levels have still not returned to pre-GFC levels.

## Revenue, spending and surpluses

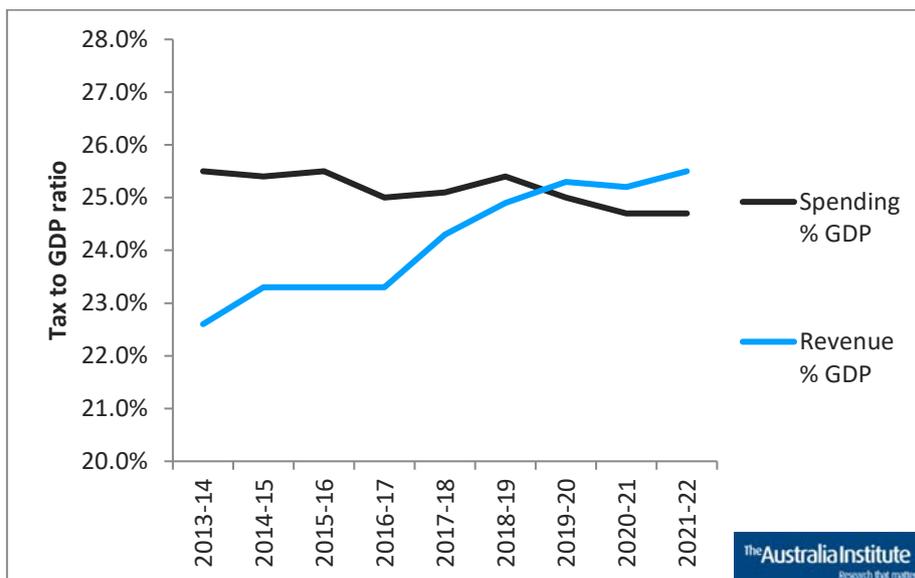
The Abbott, Turnbull and Morrison Governments have focused most of their attention on the spending side of the Budget, blaming an increase in spending for the budget deficit and continually promising to cut spending to return the Budget to surplus. Despite these promises, total spending has remained relatively stable at about 25 per cent of GDP for term of this Government. It is expected to remain at a relatively stable level over the forward estimates, dipping just below 25 per cent of GDP in 2020-21 and 2021-22.

Revenue is expected to continue to recover from its post-GFC lows. As government revenue increases the Budget is predicted to return to surplus. As Figure 2 shows, the surplus is mostly the result of the recovery of government revenue rather than cuts to spending.

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<sup>1</sup> Grudnoff M (2013) *Tax cuts that broke the budget*, The Australia Institute, 14 May, available at <http://www.tai.org.au/content/tax-cuts-broke-budget>

**Figure 2 – Spending and taxing as a proportion of GDP**



Source: Australian Government (2018) 'Statement 11: Historical Australian Government Data', *Budget Strategy and Outlook, Budget Paper no 1, 2018-19*, available at <https://www.budget.gov.au/2018-19/content/bp1/index.html>

A considerable risk to the continuing recovery of revenue is the Government engaging in further rounds of tax cuts. This has already begun with the Government's partial company tax cut and also from its seven year plan to cut income taxes, the largest part of the cut just beyond the forward estimates.

The Government's seven year income tax plan is the largest single tax cut ever legislated. While the tax cuts over the forward estimates (the next four years) are modest and mainly targeted at low and middle income taxpayers, the final three years of the tax plan are far larger and targeted at high income taxpayers.<sup>2</sup> This pattern of tax cuts has many similarities to the Howard era income tax cuts.

## Low tax country

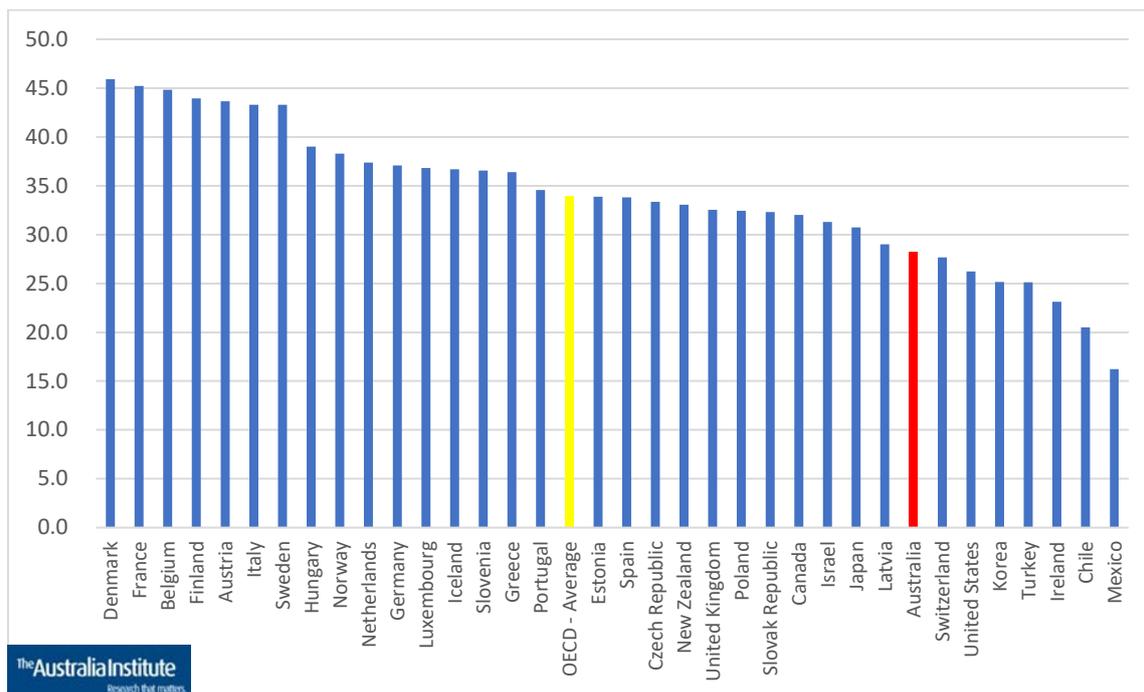
Australia is a low-taxing country. Tax debates in Australia tend to focus on tax rates, with endless comparisons of different countries' rates of different taxes. But this ignores tax exemptions and the different economic activities and assets that different countries tax. A better comparison is to look at the total tax take as a proportion of

<sup>2</sup> Grudnoff M (2018) *High income earners the big winners from scrapping 37% tax bracket*, The Australia Institute, 29 May, available at <http://www.tai.org.au/content/high-income-earners-big-winners-scrapping-37-tax-bracket>

GDP. When this comparison is made it shows that Australia raises far less tax revenue than most developed countries.<sup>3</sup>

The Organisation for Economic Cooperation and Development (OECD), an organisation of mostly high-income countries that share data and analysis, shows that Australia’s revenue collection is among the lowest relative to Gross Domestic Product (GDP) of OECD members. A comparison of OECD nation’s tax to GDP ratios is shown in Figure 3.

**Figure 3 – Total tax revenue as a percentage of GDP**



Source: OECD.Stat available at <<https://stats.oecd.org/>>

There is no right or wrong level of taxation. But the public debate around taxation is usually ignores the fact that Australia is a low tax nation. It instead assumes that Australia has high rates of tax with an emphasis on these supposed high rates of tax making Australia internationally uncompetitive. When you start from that mistaken assumption, tax cuts look more desirable than they actually are.

## Current revenue collections

Total Commonwealth revenue in 2018-19 is budgeted to be \$473,745 million with taxation of various forms amounting to \$440,480 million and non-tax receipts of \$33,265 million.<sup>4</sup> This brief concentrates on the taxation items.<sup>5</sup>

<sup>3</sup> Campbell R & Murray C (2018) *Australia – the low tax country*, The Australia Institute, 17 April, available <<http://www.tai.org.au/content/australia-%E2%80%93-low-tax-country>>

Taxation is classified as either ‘income taxation’ or ‘indirect taxation’ in the budget papers. ‘Income taxation’ or ‘direct taxation’ is the taxation of various forms of income as the name suggests and it includes taxes on personal income and property income received by individuals, companies and the various other entities liable to pay tax. Indirect taxes are those associated with the production or sale of goods and services such as the GST. Table 1 gives the budget estimates for collections of direct and indirect taxation for 2018-19.

**Table 1 - Income and indirect taxation estimated for 2018-19**

 Estimated collection	Share of total	
	\$m	%
<b>Income taxation receipts</b>	322,980	73
<b>Indirect taxation receipts</b>	117,500	27
<b>Taxation receipts</b>	<b>440,480</b>	<b>100</b>

Table 1 clearly shows that tax collections are roughly 3 to 1 in favour of income taxation.

Income taxation can be further broken down into its components which are shown in Table 2. Table 2 is based on the classification in the budget papers. Gross income tax withholding refers to items such as the pay-as-you-go tax collections from wage and salary earners. Other individuals includes non-wage incomes as well as incomes received by trusts, partnerships and similar entities. Refunds due to taxpayers at the end of the year are recorded separately and that is deducted from the first two items to give the total for individuals and similar. The other items in table 2 are self-explanatory.

**Table 2 - Components of income taxation 2018-19 estimate**

 Estimated collection	Share of total	
	\$m	%
<b>Gross income tax withholding</b>	201,800	62.5
<b>Gross other individuals</b>	46,700	14.5
<b>less: Refunds</b>	30,500	9.4
<b>Total individuals and other withholding tax</b>	218,000	67.5

<sup>4</sup> All figures are taken from Australian Government (2018) *Statement 5: Revenue*, Budget Strategy and Outlook, Budget Paper *no 1, 2018-19*, available at <<https://www.budget.gov.au/2018-19/content/bp1/index.html>>

<sup>5</sup> Non-tax receipts include sales of goods and services of \$14,551 million, interest and dividends of \$8,227 million and sundry other items worth \$10,487 million.

<b>Fringe benefits tax</b>	4,220	1.3
<b>Company tax (plus petroleum resource rent tax)</b>	90,450	28.0
<b>Superannuation fund taxes</b>	10,310	3.2
<b>Total income taxation receipts</b>	<b>322,980</b>	<b>100.0</b>

The contributions of the different types of income tax are evident from Table 2 but are highlighted in Figure 4 which gives the distribution of income tax collections between individuals and the other categories.

**Figure 4 - Share of income tax collections by type 2018-19 estimate**

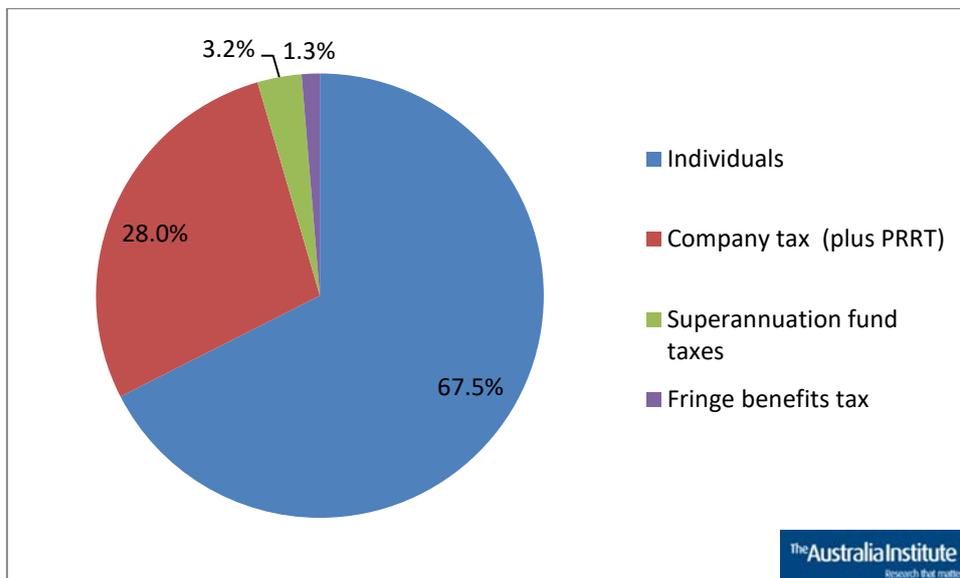


Table 2 and Figure 4 clearly show the relative income tax contributions by type of taxpayer with 67.5 per cent paid by individuals, 28 per cent by companies, 3.2 per cent by superannuation funds. The remainder, 1.3 per cent, is the fringe benefits tax.

That now leaves indirect taxation. Table 3 presents the main categories of indirect taxation.

**Table 3 - Components of indirect taxation (2018-19 estimate)**

	Estimated collection	Share of total
	\$m	%
<b>Goods and services tax</b>	67,527	57
<b>Total excise and customs duty</b>	39,390	34
<b>Other indirect taxes</b>	10,583	9
<b>Total indirect taxation</b>	<b>117,500</b>	<b>100</b>

Total indirect taxation in Table 3 is \$117,500 million. The goods and services tax is self-explanatory and brings in the bulk of the revenue. The customs and excise duties refer to a number of specific items on petrol, tobacco and so on as shown in Table 4.

**Table 4 - Customs and excise duties**

 Estimated collection	Share of total
\$m	%
Petrol, diesel and other fuels	50
Tobacco	32
Alcoholic beverages	15
Imports (cars, clothing etc)	5
Less refunds	1
<b>Total</b>	<b>100</b>

For completeness there are a number of minor indirect taxes not included in the above but are presented in Table 5. A big item in Table 5 is 'other' which includes a myriad of fees and charges – although most fee-for-service charges are presented as offsets to expenditures in the budget papers.

**Table 5 - Minor indirect taxes not elsewhere presented, 2018-19 estimate**

 Estimated collection	Share of total
\$m	%
<b>Wine equalisation tax</b>	<b>9</b>
<b>Luxury car tax</b>	<b>7</b>
<b>Major bank levy</b>	<b>15</b>
<b>Agricultural levies</b>	<b>5</b>
<b>Other taxes</b>	<b>63</b>
<b>Total minor indirect taxation</b>	<b>100</b>

The above exhausts the list of taxation revenues collected in Australia. However there are also a host of exemptions from tax as well as tax concessions that should also be mentioned. These are collectively known as 'tax expenditures' because they act like ordinary government expenditures but are delivered by collecting less tax from those who qualify for the tax expenditure in question.

Some of the listed tax expenditures are:

- Lower company tax rates for smaller companies (\$8.1 billion over the forward estimates)

- Concessional taxation of superannuation fund earnings (\$110 billion over the forward estimates)
- GST exemption for food (\$31 billion over the forward estimates)

A full list of tax expenditures is given in the annual *Tax Expenditure Statement* and the biggest of these is the exemption of the family home from capital gains tax with just the discount component of that valued at \$192 billion over the forward estimates.<sup>6</sup>

## Risks to revenue

The main risk to Federal Government's budget revenue is political. The risks centre on the Government's belief that its role is to cut taxes and then run a budget surplus by cutting spending to pay for the tax cuts.

They have signalled this ongoing plan by introducing an arbitrary cap on how high the tax to GDP ratio will be allowed to go.<sup>7</sup> This cap is an arbitrary number and the Government has announced that if tax revenue looks like it will go above the cap the Government will reduce taxation through "tax relief" (tax cuts).

The Government have picked the average tax to GDP ratio between the introduction of the GST and the beginning of the GFC. At the time they chose this time period the average was 23.9 per cent. Since then, with revisions to the numbers, the average has increased to 24 per cent. The Government have not changed the cap.

Once the cap is reached it means the Government can't increase spending beyond growth in GDP. This means that if the people of Australia are in favour of a large new government program, like the NDIS, this can only come at the expense of existing Government spending.

While this might fit with the Coalition's stated philosophy of being a low taxing small government, it does not necessarily fit with what the majority of people expect from their government. The Coalition's major attempt to reduce spending in its 2014 Budget was very unpopular.

While the Coalition is focused on tax cuts and revenue caps, the general public is increasingly concerned about inequality. There is also an understanding that that

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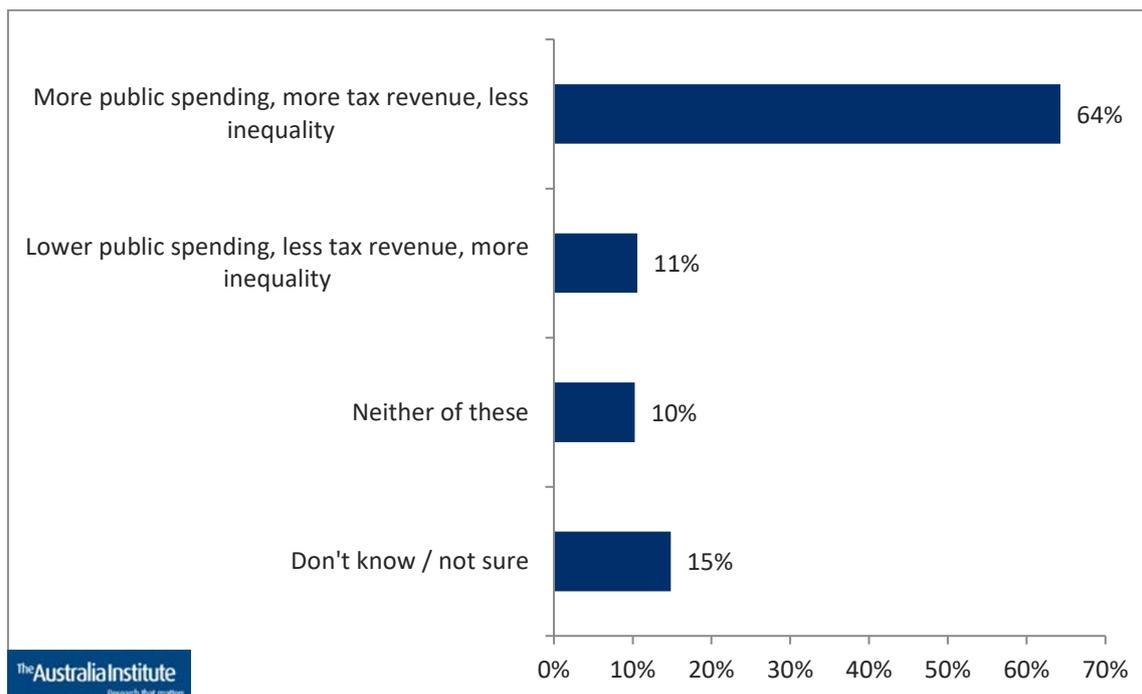
<sup>6</sup> Australian Government (2018) *Tax expenditure statement, 2017*, Canberra. While the family home is 100 per cent exempt that 100 per cent is split into a component reflecting the 50 per cent discount provided to disposals by individuals of all assets and a 'top up' component that brings the concession up to 100 per cent. The estimate here is the first component, the discount element.

<sup>7</sup> Richardson D & Browne B (2018) *23.9 completely arbitrary*, The Australia Institute, 7 May, available at <<http://www.tai.org.au/content/239-completely-arbitrary>>

government spending and taxation is one of the most effective tools the Government has to fight against inequality.

Polling shows that people prefer less inequality through higher taxation and stronger government services.<sup>8</sup> A large national poll of 1,557 Australians found that 64 per cent of people wanted more public spending funded by tax revenue and less inequality.

**Figure 5 – Which of the following approaches to economic, social and tax policy would you prefer Australian governments to aim for?**



Source: The Australia Institute (2018) *Small government has small support – National poll*, 18 April, available at <<http://www.tai.org.au/content/small-government-has-small-support-national-poll>>

A majority of voters from all parties selected the more spending and more taxation option, including:

- 56 per cent of One Nation voters
- 60 per cent of Coalition voters
- 71 per cent of Labor voters
- 75 per cent of Greens voters

<sup>8</sup> The Australia Institute (2018) *Small government has small support – National poll*, 18 April, available at <<http://www.tai.org.au/content/small-government-has-small-support-national-poll>>

## Tax reform

Tax reform has often been code for cutting taxes. But real tax reform means taxes that are more efficient and fairer. There is considerable scope to do this in Australia. This can be best achieved through reform to tax concessions and tax loop holes. These are mainly used by high income earners which mean that reducing them will see more tax paid by those with high net wealth and high incomes. These tax concessions and tax loop holes also cause distortions in how people invest, and how they structure their economic affairs. Tax reform, if done well, can result in fewer distortions and higher efficiency.<sup>9</sup>

A good example of this is the large distortions in the residential property market that have encouraged over investment in rental property, which in turn has increased house prices and prevented potential home owners from entering the market. This over investment is driven in part by generous tax concessions which inflate the after tax earnings of these investments. Reform to negative gearing and the capital gains tax discount will not only raise billions in revenue but also reduce distortions in the property market.

Superannuation has seen some reform in recent years but it could still be reformed further. Examples of reform include (a) requiring compulsory super to be earmarked for genuine retirement income products and (b) further limiting the tax concession for those whose super balance are sufficiently large that they are unlikely to ever claim a government pension. Tax concessions should be limited to helping people fund a reasonable retirement. They shouldn't be mechanisms for tax avoidance or estate planning.

Australia's economy is becoming increasingly oligopolistic. It is made up of firms with considerable market power who are earning what economists call super profits – profits above what competitive firms could hope to earn. In these situations, the most efficient solution is to impose super profit taxes. They are among the most efficient taxes as they don't distort behaviour. There are a number of industries that could be considered for a super profits tax including banking, mining, and other industries that have been identified as having low rates of competition and high rates of profits.

Other possible tax reform ideas include:

- Reintroducing tax on estates and inheritances

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<sup>9</sup> For a wider discussion of revenue reform including costings for some proposals see Grudnoff M (2015) *It's the revenue stupid: Ideas for a brighter budget*, The Australia Institute, 3 May, available at <<http://www.tai.org.au/content/its-revenue-stupid-ideas-brighter-budget>>

- A larger role for land taxes
- Abolishing or partially abolishing dividend imputation
- Introducing a carbon tax
- Introducing a financial transactions tax

## Conclusion

Old simplistic paradigms of lower taxes and smaller government have not served Australia very well. The public not only expect their Governments to provide high quality relevant services but also maintain a stable economy and keep growing inequality in check. Rather than focus exclusively on lower taxes and running a budget surplus, we need to have a conversation about how much revenue we want our Governments to collect and how they're going to collect that revenue in the most efficient and fair way.

The lack of government action in this area means there are many real opportunities for reform. The ultimate purpose of government is not to get smaller but to improve the lives of its people. In Australia there are many areas where government tax reform would make a real difference in people's lives.