

Briefing Paper:
Needle in a Haystack:
Searching for the Impact of Tax Cuts
on Consumer Spending and Economic Growth

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Summary

- New economic data confirm Australia's economy has slowed to almost a standstill. Growth in the September quarter fell to 0.4%, held back by declines in business and dwelling investment, and near-zero growth in consumer spending.
- Consumer spending growth was the weakest since December 2008 – when Australians were grappling with the worst moments of the Global Financial Crisis.
- Consumer spending stagnated despite expensive tax cuts provided by the newly-reelected Coalition government. Income taxes paid by Australians declined by over \$4 billion in the quarter. But fearing future recession, Australians socked away those savings: personal savings grew by \$6 billion in the quarter, more than taxes fell.
- Because of the sharp increase in the saving rate, **none** of the aggregate tax savings showed up in new consumer spending. The propensity of Australians to consume from their **pre-tax** income actually declined in the quarter. In other words, the effect of the tax cut had **zero measurable impact** on aggregate consumer spending.
- Wage growth slowed further in the September quarter – with the Wage Price Index increasing by just 2.2% over year-ago levels. With slowing wage growth and higher-than-expected unemployment, Australian consumers simply cannot afford to boost their spending, despite the tax cuts.
- One-time tax cuts have an insignificant effect on disposable incomes, compared to the benefits of restoring normal wage growth in Australia. In just one year, a restoration of normal wage growth would boost incomes by \$12 billion – 3 times the value of the tax cuts. Compounded over just 3 years, normal wage increases would lift incomes by a cumulative total of \$75 billion, and consumer spending by \$50 billion. Restoring wage growth, not cutting taxes, is the key to turning around Australia's flagging economy.

Introduction

Economic data for the September quarter confirm that Australia's economy continues to barely inch along. Expansion in GDP slowed to 0.4% during the quarter. Continuing weakness was evident in falling business investment and dwelling construction. Consumer spending flagged to its slowest pace since December 2008 – eking out just a 0.1% increase in the quarter. Modest increases in government activity (both current services and capital investment) partly offset private sector weakness. A \$1 billion improvement in the quarterly trade balance was the only bright light in an otherwise pessimistic GDP report. But even that was a mixed blessing: the larger trade surplus reflected both higher exports and lower imports – the latter being another sign of weak domestic spending.

Household consumer spending accounts for 55% of total GDP. So while injections of business investment, government activity, and export demand critically shape the direction of the economy, the willingness and ability of working families to re-inject their earnings into the economy through consumer spending is essential to any sustainable economic expansion. Thus the stark slowdown in consumer spending in the September quarter is an especially ominous sign of things to come: it reflects profound weakness in consumer incomes and confidence today, and presages further stagnation in the future.

The deceleration of consumer spending in the September quarter occurred despite the advent of much-advertised personal income tax cuts introduced by the Commonwealth government to stimulate spending and economic activity. The tax cuts were passed by Parliament on 4 July, fulfilling the signature promise that the Coalition took to Australians in the May 2019 election. The government claimed that by allowing “hard-working Australians” to keep “more of their own money,” the tax cuts would stimulate spending, labour force participation, and even wage growth.

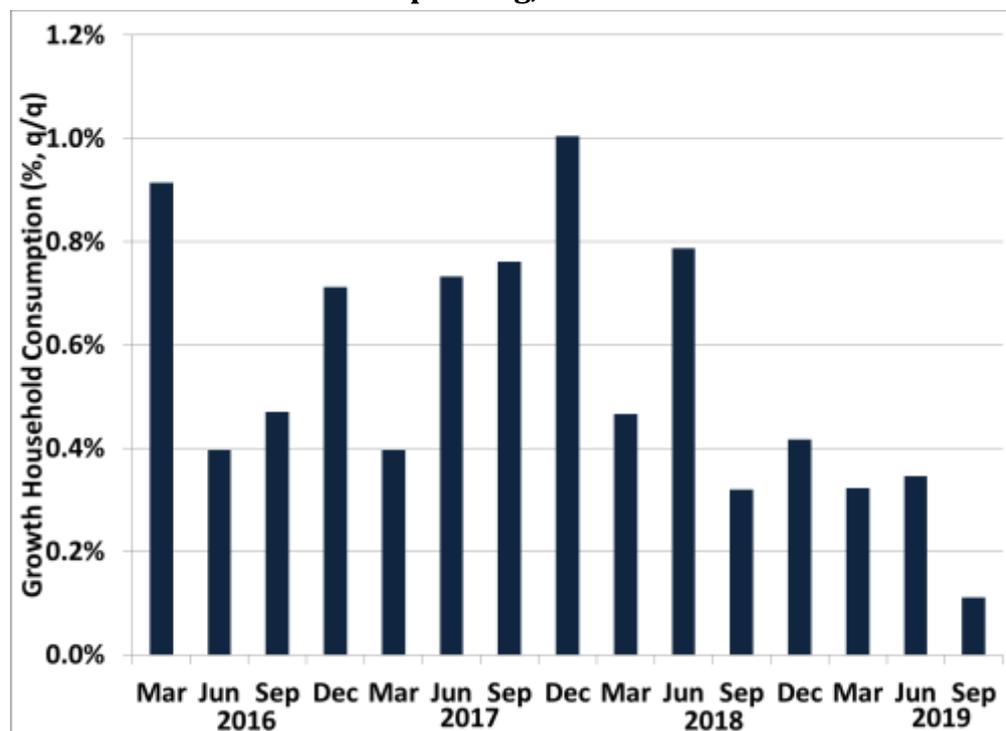
The first part of the government's 10-year tax cut program involves an expanded non-refundable tax offset, offered in varying amounts to individual taxpayers with incomes up to \$126,000 per year. The offset delivers up to \$1080 in tax savings for individual taxpayers (with the maximum received by those earning between \$48,000 and \$90,000 per year). But since the offset is non-refundable, it has little or no value to individuals with very low incomes (who pay little or no income tax in the first place). The government claimed that 4.5 million Australians would receive the full benefit of the expanded offset, while another 5.6 million would receive partial benefits. The government estimates that the expansion of this measure (compared to a smaller offset already included in its 2018-19 budget) will reduce federal revenues by \$15 billion over 4 years (or close to \$4 billion per year).

Even though the measure was not passed by Parliament until early in the 2019-20 financial year, individuals could receive the offset as soon as they filed their 2018-19 income tax return. By front-loading these savings, the government hoped that an immediate stimulus would be provided to Australian consumers: fast-acting medicine for a worsening economic slowdown. Publicity generated by the new measure sparked great interest among Australians (AAP, 2019). Within days of Parliament passing the package, the ATO was flooded with phone calls inquiring as to how Australians could access their refunds (Khadem, 2019). Government leaders boasted that almost twice as many Australians filed their tax returns in the first weeks of July, lured by the promise of the offset (Bagshaw, 2019; Clench, 2019).

Given the stated rationale for this policy, and the seemingly intense interest it generated among Australian tax-filers, did the tax cut have any measurable impact on consumer spending? The release of economic data for the first quarter of the new financial year provides an opportunity to measure the impact of this strategy for stimulating spending and job-creation. The evidence is overwhelming that ***the tax cut had zero incremental impact on consumer spending***. In aggregate, ***consumers saved the full value of their tax savings*** – and then some. Consumer spending declined in the quarter even relative to ***pre-tax*** incomes. The average household savings rate jumped dramatically, at exactly the point in time when the economy needs more spending, not more saving.

Evidence from the September Quarter

Figure 1
Growth of Real Consumer Spending, 2016-2019

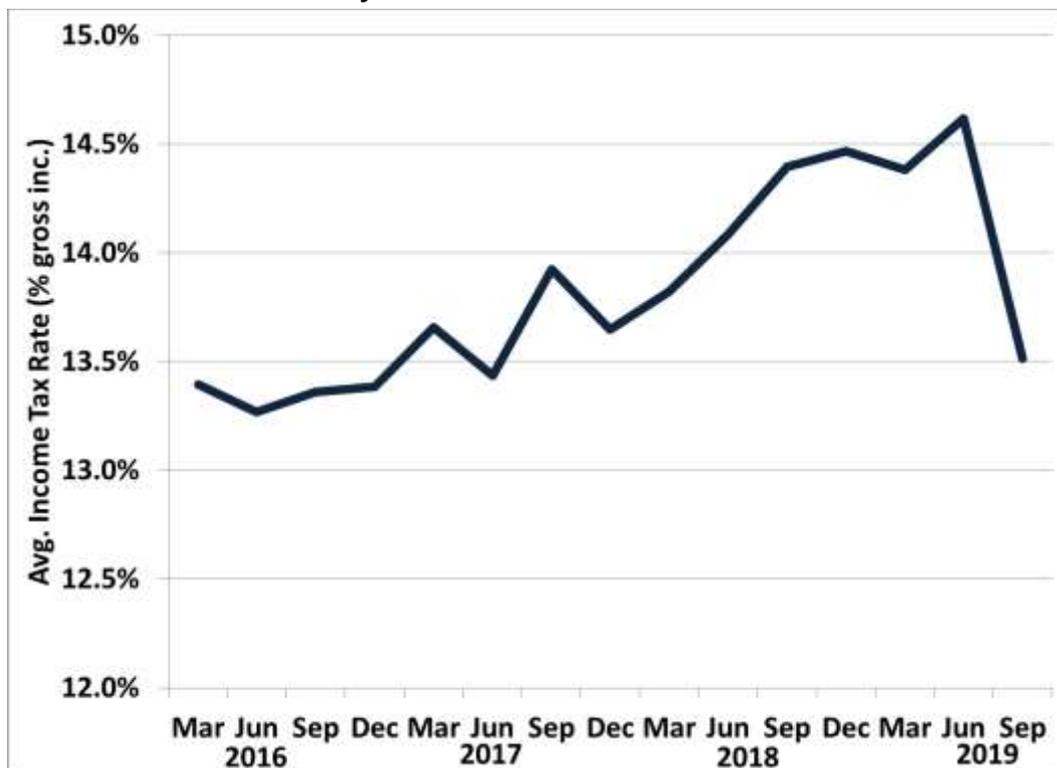


Source: Author's calculations from ABS Catalogue 5206.0, Table 2, s.a.

Consumer spending slowed significantly in the September quarter, from the already weak pace demonstrated in the first months of 2019. Figure 1 illustrates the quarterly expansion in real (inflation-adjusted) consumer spending over the 2016-2019 period. The boost to consumer spending in this quarter (just 0.1%) was very weak, even relative to the slow pace of spending growth earlier in the year. In fact, September constituted the weakest performance for consumer spending since December 2008 – when shell-shocked Australian consumers sat on their wallets in the wake of dramatic headlines about the escalating global financial crisis.

The tax cuts did reduce income tax payments by Australians in the September quarter. Income tax payments by households declined by over \$4 billion compared to the June quarter, and by over \$1.5 billion compared to the previous September quarter.¹ As indicated in Figure 2, the average tax rate (expressed as a share of gross pre-tax income) declined by over a full percentage point. It should be noted that this reduction in average tax incidence for the quarter partly reflects the normal payout of year-end rebates, and will likely be partially reversed in coming months.

Figure 2
Personal Income Tax Payments as Share of Gross Income

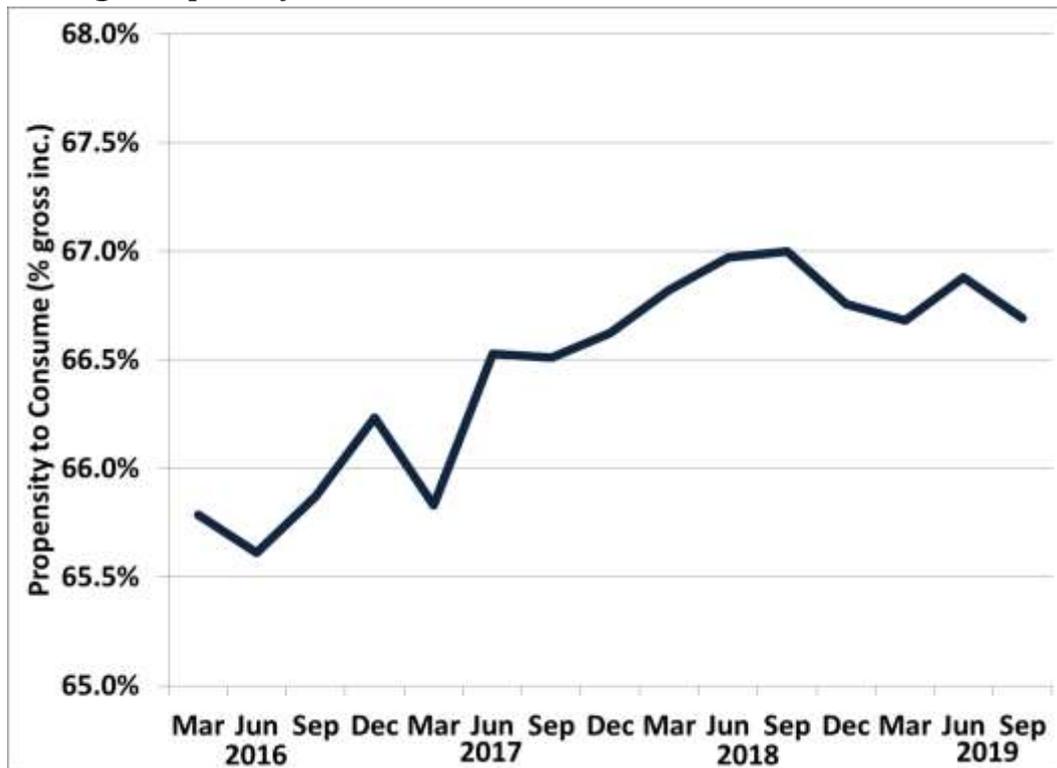


Source: Author's calculations from ABS Catalogue 5206.0, Table 20, s.a.

¹ Since the timing of income tax payments fluctuates over the year, year-over-year comparisons are more reliable than quarterly changes.

However, **this reduction in tax payments did not translate into any visible increase in the willingness of consumers to spend.** In fact, measured as a share of their total pre-tax income, consumer spending **declined** slightly in the September quarter. In other words, not only did consumers save all of their tax savings – they actually reduced their aggregate spending propensity relative to levels before the tax cut was implemented. As shown in Figure 3, the average propensity of Australian households to spend out of pre-tax income declined in the September quarter, and remains well within the bounds of recent patterns. By this measure, the tax cut is completely invisible.

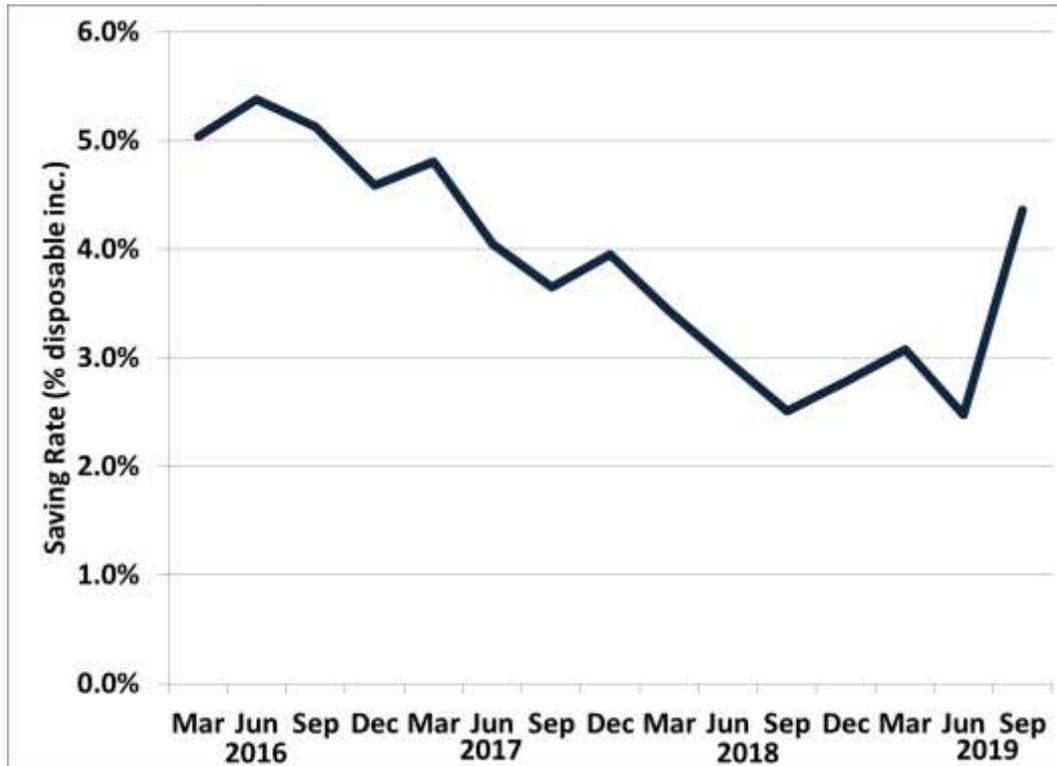
Figure 3
Average Propensity to Consume, 2016-2019



Source: Author’s calculations from ABS Catalogue 5206.0, Table 20, s.a.

Because the reduction in taxes increased consumers’ disposable income (relative to what would have been generated at previous tax settings), but consumer spending did not respond accordingly, the observed propensity to save of Australian consumers increased sharply in the quarter. Household saving increased by over \$6 billion in the quarter – half-again more than the value of households’ income tax savings. As indicated in Figure 4, the household saving rate (relative to disposable income) jumped by almost 2 full percentage points in the September quarter.

Figure 4
Household Saving Rate, 2016-2019



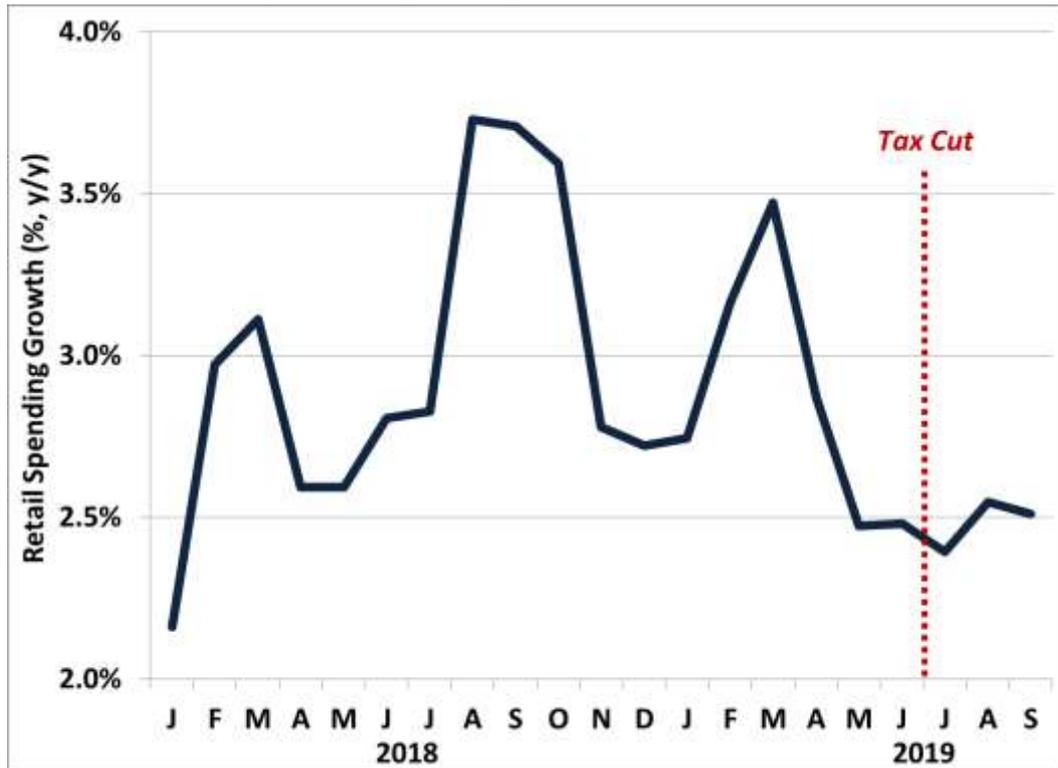
Source: Author's calculations from ABS Catalogue 5206.0, Table 20, s.a.

At a moment of economic weakness, when both business and consumer attitudes are shifting negatively, there is an enormous risk that pessimistic expectations can become self-fulfilling. If consumers and businesses respond to uncertainty by reducing their own expenditures, and socking away money for a feared downturn, they can hasten the arrival of the downturn that they fear. Perversely, the federal government has actually encouraged this counter-productive reaction, with both the size of its tax cut, and its design. By arranging the tax reduction in the form of a one-time end-of-year offset, the government has actually encouraged consumers to set it aside. ***Not a single dollar of the tax cut is visible, in aggregate, in new consumer spending.***

Even before to the release of the September GDP statistics, other evidence was already pointing to continued stagnation in consumer spending, despite the promised boost that the tax cut was to have provided. For example, Figure 5 illustrates the year-over-year growth in retail spending, reported on a monthly basis by the ABS.² Since May of this year, retail sales have been growing (in nominal year-over-year terms) at around 2.5%. That's the weakest sustained pace of retail spending growth since 2011. And there is no sign at all of an acceleration of spending after the federal election, nor after the tax cuts were passed and the offsets began to be paid out.

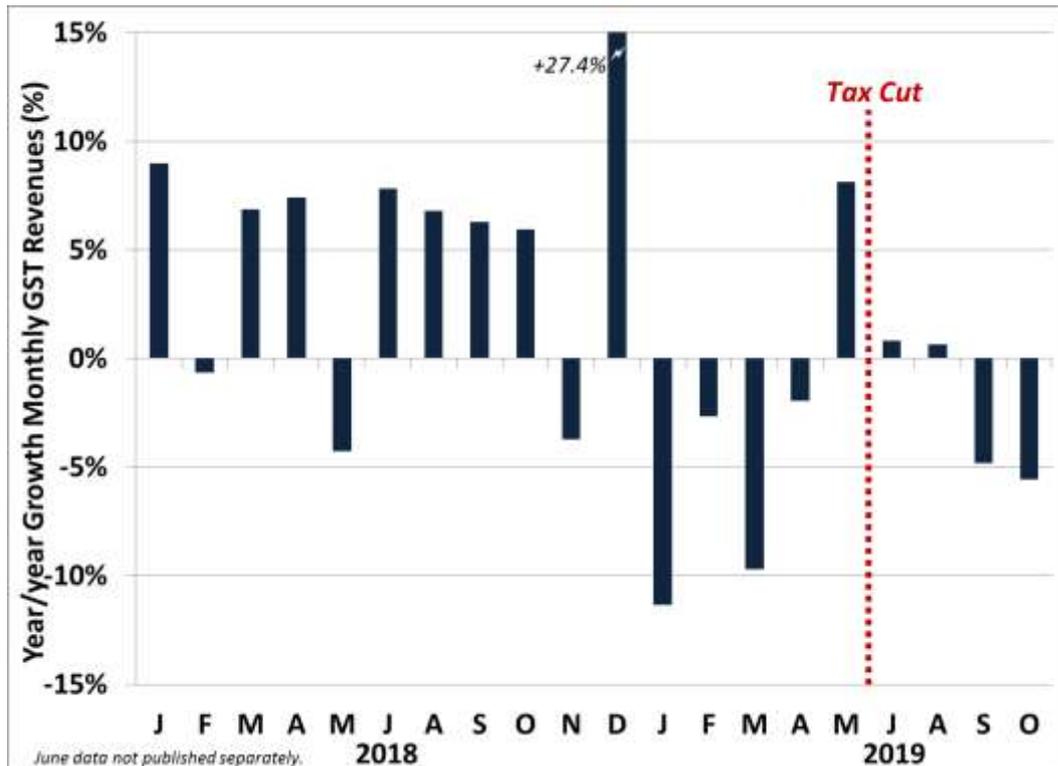
² Retail spending is a smaller category than the consumer spending reported in quarterly GDP statistics, because it excludes most services.

Figure 5
Growth in Monthly Retail Spending, 2018-19



Source: Author's calculations from ABS Catalogue 8501.0, s.a.

Figure 6
Growth in Commonwealth GST Collections, 2018-2019



Source: Author's calculations from Commonwealth Monthly Financial Statements.

Another timely source of data on trends in consumer spending is provided by the Commonwealth government's monthly financial reports. Those reports list monthly GST collections by the government, which depend directly on the strength of consumer spending. As indicated in Figure 6, for the fiscal year to date (July through October), the government's GST collections have actually declined (by over 2%). While monthly GST figures can fluctuate greatly (due to irregularities in the timing of retailer GST payments to the government³), the sustained weakness of GST revenues so far in this financial year clearly confirms that consumer spending is in the doldrums – and has not been lifted by the tax cuts.

Explaining Weak Consumer Spending

Ultimately, the tax offset that featured so prominently in the 2019 election, and was implemented quickly by the Coalition government upon its return to power, is unlikely to have any sustained impact on consumer spending (and hence on economic growth and job-creation), for several reasons. A one-time end-of-year rebate will not generally alter consumers' regular spending patterns. And when future economic conditions seem uncertain (as is the case at present), many consumers will save any unexpected cash they receive – rather than re-spending it. Moreover, tax cuts cannot compound year after year, unlike annual wage increases (which have an escalating, compounding effect on income). They may facilitate a modest one-time adjustment in the ratio of disposable to total income. But arithmetically they cannot generate ongoing improvements in annual incomes; for that, Australian workers need to receive regular, normal wage increases.

Indeed, to understand the deeper factors behind the weakness in Australian consumer spending, one need look no further than the continuing unprecedented weakness in Australian wages. Since 2013, nominal wages have been growing at around 2% per year – the slowest sustained pace since the end of the Second World War. That has barely kept up with the rise in consumer prices; real wages (and hence real living standards) have stagnated for several years. Despite repeated official government predictions that wage growth would quickly accelerate back to normal rates (such as the forecasts contained in its 2019-20 budget documents), wages have remained in the doldrums. In fact, during the September quarter, wages decelerated – with wage growth falling to 2.2% on a year-over-year basis. Hence the government's official wage forecast for the 2019-20 financial year (an important factor in its own revenue projections) is already proving unrealistic.

Table 1 summarises the major assumptions made in the 2019-20 budget regarding consumer spending, and the labour market outcomes that are key influences on

³ The large year-over-year swings in GST revenues for December 2018 and January 2019 reflect such a timing irregularity, with earlier-than-normal receipts in December pushing up year-over-year growth – but then causing a year-over-year decline in the subsequent month.

consumer spending. Unemployment has been higher than the government projected, and wages (measured by the ABS's Wage Price Index) have been growing more slowly. There are not enough jobs for the unemployed and underemployed Australians who want to work – and incomes for those who have work are growing too slowly. Until these problems are resolved, consumer spending will remain very weak, and that will hold back the prospects for the overall economy.

Table 1
Assumptions and Reality
Commonwealth Budget Forecasts
 (% change, year over year)

	Budget Forecast	Sept. Quarter¹
Consumer Spending (real)	2.75%	1.20%
Consumer Spending (nominal)	4.75% ²	3.13%
Wage Price Index	2.75%	2.23%
Unemployment Rate	5.0%	5.3%

Source: Author's calculations from Dept. of Treasury (2019) and ABS Catalogues 5206.0, 6202.0, and 6345.0.

1. Year over year growth.
2. Consumer spending subject to GST.

To spend more on goods and services, Australian workers need to be receiving more income. Until wages start to grow at normal rates, one-time tax adjustments cannot possibly support the sustained spending power that the economy needs. To give a numerical example, Australian workers earn \$825 billion in wages and salaries each year. At present wages are growing about 1.5 percentage points more slowly than was typical prior to the 2013 slowdown.⁴ That 1.5% wage shortfall drains over \$12 billion from pre-tax incomes in a single year – 3 times the value of the government's tax cut (none of which translated into increased consumer spending, anyway). Worse yet, every year that weak growth persists, the loss of potential income compounds – since reduced wage increases are applied, each successive year, to a lower starting point. Over 3 years, for example, today's sub-par wage growth reduces pre-tax incomes by a cumulative total of over \$75 billion. At average spending propensities, that reduces consumer spending by over \$50 billion.

In that context, a one-time package of tax offsets is truly a needle in a haystack. Strengthening wages, to underpin a genuine and sustainable increase in consumer spending, requires urgent measures to address the wages crisis – not token tax cuts.

⁴ Wage growth averaged around 3.75% over the 2000-2013 period, compared to 2.25% at present.

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