

Revenue Summit 2023

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“Stage 3 Better”

Greg Jericho

Chief Economist, The Australia Institute

Today I pay my respects to elders past president emerging, especially in this tough time.

Well, here we are. We've got just over nine months to go before the Stage 3 tax cuts come into effect. And would you believe it's been over five years since they were first announced by the then Treasurer Scott Morrison way back in May 2018. It's been so long, you might think, why are we still bothering? I mean, surely at this late stage the fight is lost. Why keep fighting?

Well, we at the Australia Institute and many of the speakers here today, and I think all of you here agree that fighting over taxation is important. We know that tax matters. There's only one reason, for example, that the two most popular cars in Australia today are the Toyota Hilux and the Ford Ranger. It's because they get an instant tax write-off and no other cars do.

Taxation - who we tax, how we tax it - matters. And never is this more clear than with the Stage 3 tax cuts, which effectively bring a flat tax arrangement into our income tax system.

Now. I first wrote about flat taxes over a decade ago, back in April 2013, when there was a bit of a debate over superannuation tax, much along the same lines we've already heard this morning. And there were a number of very pointed articles in The Australian pointing out that wealthy people already shoulder too much of the burden of taxation. And actually, a fairer way to go about it would be a flat tax.

My column for the ABC Drum website Rest in Peace was titled, quote, 'Unless you're wealthy, you're not going to like flat taxes'. And I ended up writing, quote, 'The superannuation debate was just the start. The flat income tax war comes when it does remember what the fight is really about: the wealthiest paying a lot less tax and a lot fewer services for everyone else.'

I think we always need to remember that Stage 3 is not just about fiddling with the tax rates and has no broader implications beyond that. Just realise they are expected to cost in their first year next year, around \$20 billion.

Now that is essentially on par with how much the government is expecting to spend on the disability support pension. It's about \$2 billion more than they'll spend on the PBS. It's 8 billion more, can you believe it, than they plan to spend on Jobseeker. \$11 billion more than they expect to give the states to fund public schools? And it's about three-quarters of the entire amount that the government will spend funding public hospitals.

Believing that losing that much revenue is not going to have an impact on ongoing government services and funding is incredibly naive. Of course, Stage 3 tax cuts themselves were not costed, not funded. I mean, how could they be? They weren't set to come in for another six years well beyond the budget papers. But don't worry, Scott Morrison told us in the 2018 budget papers that quote, "By growing our economy, the government can fund this plan and deliver a stronger budget." I always enjoy a government projecting strong growth just two years before a global pandemic that I'm sure didn't disrupt those figures one bit. But we know with how the government, sorry, with how political debate and coverage goes that if the Albanese government was to somehow start spending more than the Liberal Party had announced it was going to, or start spending on services that are actually needed, that we will get massive cries of "Oh, you're blowing the budget, you're increasing government debt", and we'd have debt and deficit on the front pages of newspapers.

But this actually, I think, is the secret weapon of the Stage 3 tax cuts for this government. Over. Forget the \$21 billion. Over the first ten years, the most recent sort of figures from the Parliamentary Budget Office of the Stage 3 tax cuts are going to cost in the first ten years, \$320 billion. Now, just think of that. Never before has any Labor government, any government ever, but certainly any Labor government had the opportunity to stand up and say we're going to spend \$320 billion on anything we like and no one can accuse them of blowing the budget, increasing government debt because it's all locked in that spending is agreed to.

This is why I think the Stage 3 tax cuts should not be seen as a millstone for the government, but just a once-in-a-generation opportunity. Now, before I get to what I think the government should do with the \$320 billion and I've got a few ideas, let's just set the scene about the whole Stage 3 tax cuts.

Now, they were notionally, notionally intended to do one thing that was cure us of bracket creep. You go back and read the Hansard. Malcolm Turnbull, Scott Morrison, Josh Frydenberg. It was all about ridding us of the evils of bracket creep. Now bracket creep and I won't get too much into the weeds here, essentially occurs when your wage rises in line with inflation, so your real wages stay flat, so that you don't get any better, no better living standards, but your wages are keeping pace with inflation. But because the tax system is a nominal tax system, you pay more tax.

Now, what this really means, though, is that bracket creep mostly affects people on low and middle incomes. Why? Because more of their income is either untaxed or taxed at the low rate. Right? So when it goes up a bit, the impact is much greater than for those on very high incomes who already are getting massively taxed. So if you actually care about bracket creep like Scott Morrison, Malcolm Turnbull, Josh Frydenberg said they were, you would devise a tax cut that was targeted to low and middle incomes and not so much to high incomes.

But what we know. Is that the statutory tax cuts do the complete opposite. This from the Parliamentary Budget Office, and they rather nicely for us worked out the impact of the statutory tax cuts and bracket creep, and they found that everyone earning less than \$120,000, so that's about 80% of us all. Are going to lose more income over the next ten years from bracket creep than they will get back from either Stage 1, Stage 2, let alone just Stage 3.

So, okay, the Stage 3 tax cuts, it falls at the first hurdle. It doesn't even do what it says it does on the box: curing bracket creep. Now that, to be honest, might be enough of a reason for the government to say not this is not a promise worth keeping. But the problem is the government actually did make that promise. They promised to keep the Stage 3 tax cuts. And politically, dumping a promise on tax cuts is really hard to get away with, and you'd need a bit more of a reason than "It was a stupid promise", which let's be honest, it was a stupid promise.

They need another reason. So let's I think let's help them. Let's help. Jim Chalmers. Back when he first announced that the ALP were going to keep the Stage 3 tax cuts, it was back in July 2021. Now let's consider. Back then the cash rate was 0.1%. And the Reserve Bank that month was still saying it would not raise interest rates until 2024. So in three months time, we should get our first interest rate rise. Obviously what happened, we're at 4.1%. Interest rates have gone up faster than they have in over 30 years.

What else was the case back then? Inflation was just 3%, not 5.4% like it is now. Certainly didn't get up to the nowhere near the 7.8% that it reached at the end of last year. Another kind of important thing and it doesn't seem important, but it actually is - I'll explain why - at that point the cost of constructing roads and bridges had been growing around 2.8% annually. You could almost back that in, and it hadn't grown faster - those costs hadn't grown faster than 7.8% since way back in 2008. And I use that figure because they haven't grown slower than that for the past 18 months.

Now, why that's important and the Financial Review is actually quite a help here because a month or so ago they leaked a bit of a report that found the government infrastructure costs for the next ten years have blown out by around \$33 billion purely because of those increase in material costs. So what that means is suddenly the government has a real need for more revenue that it could not have anticipated back when Jim Chalmers was promising to keep Stage 3 or even during the election campaign.

So clearly there are economic reasons to ditch Stage 3. They don't do what they said they do. And economic situations have changed, changed massively.

But. Obviously that still leaves the politics.

The problem with dumping the Stage 3 tax cuts is even though they massively are skewed to the wealthy, as you can see here, \$9,075 going to someone on \$200,000, as Anthony Albanese has

been want to say a little bit too often for my liking. They do come in at \$45,000, so that means someone on \$46,000 without getting \$25 bucks. Now, sure, that's pathetic. But the reality of the state's three tax cuts in the political term is if you dump them, it does leave the government open to claims and they were actually correct was pointless as they might be, open to claims that everyone earning more than \$45,000 would be have been better off if you had voted for the Liberal Party and they'd delivered the Stage 3 than if you'd stuck with Labor and they dumped it.

Being able to go around to an electorate and say, say a nurse or a teacher on 80,000 would be \$875 a year better off had Stage 3 come into place rather than the ALP dumping it is a pretty tough political argument to counter.

The good news, though, is that the Stage 3 tax cuts are not just economically out of date, economically stupid. They're also politically terrible because one of the weird things about the Stage 3 tax cuts, as I say, we're five years into this debate where they're being prominent, discussed, debated. We're nine months away from them coming into effect and most people don't like them. And in fact, more people don't even know about them.

We actually did a poll that was released this week where we just asked people, would you support or oppose the ALP dumping the Stage 3 cuts? We didn't explain what Stage 3 cuts are, we just said that. 37% said they would support them being dumped, compared to just 24% saying they support them. So just on that head-to-head basis, more people were supporting getting rid of them completely.

But for me the real crucial thing was that 39% of voters didn't really have an opinion, had no clue, didn't know. This is on a policy that's been around for five years and apparently was so important the ALP needed to commit to it to win an election. 40% basically no idea. Even if we look at Coalition voters, 63% supported either dumping them or they had no opinion on them whatsoever.

Now to me, that's an extraordinary lack of support for such a high-profile policy. And the really good news for the government, if they think that's not good enough, is that when we actually explain the Stage 3 tax cuts to people, explained how much it cost and who benefits the most from it, which is high-income earners, which is not question whatsoever, the ambivalence turns to outright hatred.

The don't know, go from 39% to 14%. I mean, there's always going to be about 14, 15% of people who don't know about tax. And, you know, that's perfectly understandable. The percent wanting to keep them now falls to just 17%, 17% of the electorate saying keep them that see it. A quarter of voters still want them dumped completely, but 44% want them changed to give low to middle income earners a greater share of those tax cuts. Even 77% so three quarters of Coalition voters say dump them, change them or I don't know.

Now, to me, that is just screaming political opportunity. But then we actually get to the hard nosed electoral maths. We know from the recent voice referendum that the teal seats have not embraced Peter Dutton at all. And we also know from all reports from insider accounts and everything that the Liberal Party basically given up on the teal seats, they're not going to win him back. And to be honest, you've got Peter Dutton as leader, you're not going to win him back.

So that means they've decided the way to winning the election is through the outer suburbs. Now the Labor Party is obviously, the Labor government, they know they're not going to win the teal seats either. They would never Labor seats in the first place. And that's just as well because actually when you look at who is in the teal seats, they are actually the ones who benefit the most from Stage 3. And they actually don't even like the Stage 3 taxes.

Remember all the way back in 2019 when Bill Shorten went into the election, the promise was we're going to dump the Stage 3 taxes. Back then they weren't the teal seats yet. But all those seats that became teal seats actually swung to Labor. The rest of the country swung away from Bill Shorten. The teal seats swung to Labor. They do not like the Stage 3 tax cuts, even though they are the most beneficiaries.

So what that means is the next election's really going to be fought in the outer suburbs. So what do we know about those seats? Well, we know for one thing, they have a higher number of low and middle income households. So right now, the two major parties have a bipartisan position to support Stage 3, that benefits the teal seats, which neither of them care about winning and delivers little to the seats in outer suburbia that are both desperate to either hold or take back.

Now, again, to me, that just screams advantage, screams opportunity, a first mover advantage. Be the first party to show that you care about these seats. You care about low and middle income earners. That's going to be the party that gets all the marbles. And know this as well. When the statutory tax cuts come into place. From then on all the way up to the election, the Liberal Party is going to be able to turn to the Labor Party that has delivered this wonderful Stage 3 cut and say you've done nothing for low to middle income earners, you've done nothing for these seats and they'll be right because the Stage 3 tax cuts don't do anything for low and middle income earners.

So if you're the government, you know that you're going to get this attack. Why not get in first and actually deliver something?

So what to do? We've got poor economics, poor politics. But there's still this problem that if the government just dumps them, these outer suburban seats are going to be bombarded with adverts and pamphlets saying this nurse on \$80,000 is \$875 worse off under Labor, vote for Liberal. That's something they're going to want to avoid. So what to do?

The great thing is the Stage 3 tax cuts cost so much, are so badly directed, that it really is actually, in my view, the biggest political gift ever given a government. It's a \$320 billion gift to deliver better tax cuts, tax cuts that actually go to low to middle income earners. Those who have suffered the suffer the most from bracket creep, those who have suffered the most from cost of living crisis, Another thing that has occurred in the time since Jim Chalmers announced we're supporting the Stage 3.

Think of this in the last three years, wages have risen about nine and a half percent. In that time, the cost of necessities food, petrol prices, gas, electricity, rent, all the things you can't avoid paying. Not 9% - they've gone up 21% - more than double. But at the same time, the cost of luxuries, the things you can do without, the holidays and things like that, they've only risen 13%. And we know that low and middle income earners spend more of their income on those necessities. So again, they are the ones who have been hurt hardest from cost of living. So why not actually try and help them?

Now the opportunity really arises for the government because the statutory tax cuts are actually in three parts. The first part, this is it, cutting the 32.5% tax rate for earnings between \$45 and \$120,000 to 30%. Now, if that's all the Stage 3 was, yeah, we might quibble and say, Hey, you should have spent that on aged care, on renewables or on something else, but we'd have a pretty tough time defeating it on inequality grounds because it's it looks pretty fair, to be honest. Yeah, I'd like it fairer, but it's not that bad. But the great thing for the government is that's not where Stage 3 ends.

The next part is cutting the 37% rate for incomes between \$120 and \$180 grand to 30%, all the benefits go to people earning above \$120,000, which is about 20% of the electorate. And it doesn't stop there because the last part, perhaps the worst part ever seen in any income tax cuts, is cutting the 45% rate for incomes between \$180 and \$200,000 all the way to... I was going to say 15, don't give them ideas! ... 30% and you can see that's benefiting only people earning more than \$180,000. And if we're generous, we can say that's about the 5% of the electorate, closer to about three and a half.

So the great thing about this, though, is those orange and yellow bits, those last two parts cost around 53% of all the Stage 3 cost. That gives us about \$177 billion to play with. And let me tell you, it's fun playing with that. My colleague Matt Grudnoff and I decided we can do better than this. Let's come up with the least four alternatives to Stage 3. We set ourselves some parameters.

First one, we have to deliver bigger tax cuts to low and middle-income earners, and we kind of set \$120 grand as our sort of borderline, rough borderline. We thought if the government's going to dump Stage 3 and come up to some degree, it needs to do more than just saying, Oh, you won't be any worse off. They've got to actually promise you're going to be better off. So bigger tax cuts for low and middle-income earners because actually they are the ones who need it.

Secondly, we actually thought, well, look, we don't want to be accused of being communists here, God bless us. We don't want that. So let's at least give the high income earners around 1% because that's going to make it pretty politically sellable.

Thirdly, it needs to cost less than the Stage 3 tax cuts because we want the government to say, "look at us, we're great budget managers, great economic managers, we're keeping debt down, we're lowering inflationary pressures" and so on.

And then just to make things a little tougher, we wanted to do all those three things, but also at the same time be able to lift Jobseeker by \$250 a fortnight, which is essentially what ACOSS are campaigning for with the Raise The Rate campaign. Do all of those things and cost less than Stage 3.

Now I have to say I actually wish it was harder than it was. The Stage 3 tax cuts are so terrible, I'm telling you, forget, you know, monkeys at typewriters working for... you need one monkey just bashing on a typewriter and you're coming up with a better tax income cut than Stage 3. Okay, let's go through them.

Now, in this, the blue line is the old Stage 3. So these are tax cuts. Who gets them? You can see Stage 3, four and a half percent goes to \$200,000. The orange one in all these. These are our new alternatives.

So this is alternative one. What we do here, it's pretty straightforward. We just cut the 32.5% tax rate for incomes between \$45 and \$100 grand to 29%. So a bit more than that 30% cut. That's it. Under this one, everyone earning between \$45 and \$130,700 is better off than they would be if they just got Stage 3. That nurse, that teacher, that stereotypical person on \$80,000 who we always hear about they'd be \$350 better off under the alternative tax cut than they would be under Stage 3. So that's \$350 more. And this costs \$130 billion less than Stage 3. So that's kind of the minimal, the cheap option.

Second option. You can see starting to get a bit more here. This one, we reduce that 32.5 cent tax cut tax rate down to 30%, same as the Stage 3. But we also think hang on. Under Stage 3, no one under \$45,000 gets anything. Well, they've been smashed by cost of living. Let's give them a tax cut. And so what we do there is drop the 19% tax rate for income between \$18,245 grand from 19 to 17%.

Under this one. Everyone earning everyone earning up to \$127,600 is better off than under Stage 3. That's more than 80% of workers. That person on \$80,000 there now, \$536 better off. And I know that's a lot of money we must be spending now. We're saving \$111 billion on the state. I tried to spend more than Stage 3. It was bloody impossible. All right. Alternative three. I kind of like this one is probably my favourite, but, you know, they're all they're all good. It's similar states to the alternative to it. But what we do, is we lower the tax rate for the \$18200 to \$45 bracket from 19% to 15%. And then we cut, because that's fairly expensive, we only cut the 32 and a half per cent tax rate to 31. Which you might think, 'Oh God, we're we've forgotten middle incomes, we're going to get slaughtered'. Nup. Yes, under this alternative, the biggest tax cut goes to those on \$45,000, really hitting that spot of people and low incomes being smashed by cost of living and also really get hit by bracket creep. But under this one, everyone earning up to \$124,600, again, easily 80% of the electorate gets a bigger tax cut. The nurse on \$80,000. \$722 more than they would get under the Stage 3. \$720. That seems a pretty juicy thing to take to an electorate, especially when you can say we're saving \$92 billion in over ten years.

Think of what else they could promise to do with \$92 billion at the same time, like giving a bigger tax cut to more than 80% of people. Finally last one. And this is the most expensive one. We lower that 19% rate to 18%, which I admit's not generous. It was more generous in the other one. But we also this time play around with the thresholds that \$45,000 threshold with the 32 and a half per cent tax rate kicks in, we raise that to \$50,000. And then we lower that 32 and a half per cent tax rate to \$30,000, much like Stage 3 three, except under this one, everyone earning up to \$132,400 is better off than under Stage 3. That person on \$80,000. That lovely stereotypical nurse teacher, police officer, insert whatever you want. They're now \$868 better off than under Stage 3, almost double the tax cut that they get under Stage 3. Everyone up to \$132,400 better off, middle incomes double better off. You think 'Well, we've blown the budget there'. No, we're saving \$70 billion over ten years. More than enough, still with this massive tax cut, to be able to raise Jobseeker by \$250 a fortnight and still spend less than we would if we just brought in Stage 3 and did nothing else. Debt lower. Deficits lower.

Here's what the whole thing looks like. Key thing. Even the richest people here, even those on \$200,000, they're still getting a \$2,116 tax cut. And a little tidbit that's a bigger tax cut than anyone earning under \$125,000 is getting from Stage 3. So pretty hard to complain about that when you're not even giving that much to 80% of the populace population under Stage 3. Under these alternatives, the government saves money and gives a bigger tax cut to 80% of voters. I think that's a pretty juicy thing to take to an electorate, especially given all the changes to the economy.

But what I like most about it is it forces anyone who may still hold to Stage 3 like Peter Dutton, to actually go out and say, I want to spend more money to give 80% of people less. And I want to spend more money to give the richest 20% more. That's not a really winning political argument. You are basically wedging the hell out of him. Which is a nice thing for an ALP government to finally do rather than continually wedge themselves.

And so with nine months to go, the fight to rid us of this pathetic, terrible, badly constructed and badly promised Stage 3 goes on.

Now, these four alternatives, they're not the only ones who said you can do literally anything and you come up with a better one. But I think they show how Stage 3 is not a problem. It is an opportunity, a massive political, economic, \$320 billion election-winning opportunity. I mean, it's right. It's right there. Just grab it.

We need a better Stage 3. We need one that will leave Australia in a better place, both economically and socially. We here at the Australia Institute, we will keep the fight going on. And I thank you today for listening to me how we plan to do it and why. Thank you.