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“Stage 3, inequality, and the gender pay gap”

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Richard Denniss (Standing in for Professor Patricia Apps: Thanks, Eb. I am definitely not Professor Patricia Apps, but I definitely am one of the leaders of the Patricia Apps Fan Club. It's a real pity she can't be here today. She's not well, but she sends her wishes to those of us who want to spend Friday afternoons talking about why we should pay more tax. That's right. That's the group that you're in. So, what I'm going to do is I'm going to speak through some of Patricia's slides. To be honest, and I've said this to her yesterday, that I reckon she was always going to struggle to get through them in the time available. I'm going to flick over a few of them, but hopefully I can do justice to her key points, because her key points are incredibly important.

What we've heard today from Greg and others of his about includes the enormous cost, the enormous cost of the Stage 3 tax cuts and the enormous inequity of those Stage 3 tax cuts. What Patricia's research shows is not just how expensive they are and how unfair they are, but how they're actually going to distort the economy in ways that will lower labour force participation, will harm women in particular, and actually have adverse economic benefits. So, it's a really important presentation that Patricia has written. And for those of you who haven't heard me speak before, I often make the observation that I think power corrupts and PowerPoint corrupts absolutely. I am about to, hopefully not give you death by PowerPoint, but it's not my happy place. So, if I stumble, stick with me. Okay.

So, what we're going to talk about now, again, this is Patricia's talk, not mine, ‘How Stage 3 will increase overall inequality and the gender pay gap with negative effects on productivity and the fertility rate.’ What a great idea. Quick, let's do that! And to be clear, I 100% support both the method and the conclusions of Patricia Apps’ analysis here. I'd go further, I'd say you would really be struggling to find an academic economist who would make the case that Stage 3 tax cuts will be good for productivity or good for labour force participation. I would go so far as to say I think it's unambiguous that this is the likely result.

Okay, so some definitions first. So, tax rates, there's personal income tax, that's what we're talking about here, how much tax you pay on your personal income. We're not talking about corporate taxes, we ae talking about personal income taxes. So big difference, which I assume most people in here are familiar with, but it's going to be important in this talk to distinguish between the average tax rate you pay and the marginal tax rate that you face. So, in Australia, we've got a tax free threshold of around $19,000. So, if you earn $18,000, your marginal tax rate is zero. Your average tax is zero. If you earn $20,000, you're over that. You're over that threshold. You pay some tax on that first thousand dollars, but you're still not paying any tax on that first $19,000. So, it's going to be a big difference between the marginal tax rate we face. That's the tax bracket we're in. And the average amount of tax that we pay will come back to that.

And then there's the effective marginal tax rate. The effective marginal tax rate refers to the interaction between the personal income tax scales and other benefits that the government might offer. Because what happens with a whole range of benefits, including Newstart, including Family Tax Benefit, and including something we're going to talk a bit about today, the low-income tax offset, as your income rises, you get less, you lose, some of these other welfare and transfer payments. So low-income earners don't just when they earn an extra dollar, they don't just lose some money to tax, they lose some money to less benefits or they lose some money to less offsets. So, what economists call their effective marginal tax rate is actually higher than just their marginal tax rate. So, we're basically saying if you get an extra dollar, how much of it do you get to hang onto? Well, if getting an extra dollar means you have to pay some more tax and you lose some family tax benefit or you lose a low-income tax offset, your effective marginal tax rate will be high.

Labour supply - we're simply referring to how much labour people are willing to supply under certain circumstances, particularly wage and tax rates. The low-income tax offset is a $700 payment that's given to low income earners. But then we have a taper, you lose some of that low income tax offset as you go forward.

Productivity refers to the amount of output per unit of input that that that is produced. So, if I work in a cafe, how many coffees I can make per hour would be a measure of my productivity. There are some definitions.

Okay. So personal income tax, average tax, I'll skip over some of this because I've already mentioned it. Here are our tax scales at the moment, not to $18,000, no tax payable, $18,000 - $245,000, you pay that $0.19 for every dollar over that and so on, up we go. They are our marginal tax rates. But the effective marginal tax rate, the effective marginal tax rate includes the withdrawal of other benefits as our income rises. Again, we're going to focus on this low-income tax offset.

Okay, So the low-income tax offset was increased as part of the Stage 2 - we've talked a lot about Stage 3 tax cuts - this $700 payment came in as part of the Stage 2 tax cut. It's a maximum of $700. And you get the maximum if you earn less than $37 500. But once your income is over that, you start to lose some of this low-income tax offset. And by the time you earn $66,667, that's the income of the beast, you don't get any lower income tax offset any more. Now the low-income tax offset, plus the Stage 3 tax cuts interact with each other. That's what we're going to talk about in a minute. And this is the key point. The low-income tax offset, plus the Stage 3 tax cuts, mean that some low-income groups are going to be paying higher marginal tax rates than higher income groups. All right, I'll put up the numbers in a sec. But this is really important. The combination of the design of the low-income tax offset and the Stage 3 tax cut scales mean that we're going to have low-income earners facing higher marginal tax rates than higher income earners. That's the exact opposite of a progressive income tax system. That's a regressive tax system, actually making the system literally regressive. I'll talk about the consequences of that in a minute.

Okay, so there's those Stage 3 tax rates again. Key graph is, is what we do is we combine the Stage 3 tax thresholds and the low-income tax offset, when we add them together, what we've now got is what we call our effective marginal tax rates for a person who's eligible for the low income tax offset. At the moment, we're ignoring all the other benefits, we're ignoring all the other benefits which we shouldn't do. But just for simplicity, we're going to show how dumb this all is. So, for someone, when we combine these two things, people earning up to $21,884 won't pay any tax. Right, now $21,884? That's more than the $18,000 we're talking about a second ago, it's because that $700 tax offset offsets the small amount of tax that someone earning $20,000 would pay. Then we say that between $21,885 and $37 500, the effective marginal tax rate is 19%. For $437 500 to $45000, it's 24%. And then it jumps quite a bit, at $45,000. And for people earning between $45,000 and the number of the beast, $666,666, notice their effective marginal tax rate is 31.5%. That is, for every extra dollar someone earning, say, $50,000 earned, they'll lose 31.5 cents in the dollar.

Now, the key number here is 31.5%. You following me? So, what we've got here is really quite low income earners. Like full time workers between $44 and $66,000. that's the bottom of the full time income distribution, they're facing higher effective marginal tax rates than people earning up to $200,000 per year. Now there's a lot more slides to get through. I'm not going to get through them all. I'm going to pause here to make the key point. The key point is: when economists or more often business leaders and politicians talk about why we need to cut taxes, why we need to cut income taxes, we need to give people incentive. We need to give people incentive because if we don't give them incentive, they won't work hard. We have to cut taxes so that people can hang on to more cents in the dollar so that there's more reward. Reward for work, not burden of tax. The whole idea that cutting taxes will drive economic growth is a theoretical assertion that if we cut the after tax, if we lower the effective marginal tax rate, people have more incentive to work. And because they'll work more, they'll produce more and GDP will grow. And so, the fairy tale story goes. Because we all know that every time there is a tax cut, we go to our boss and say, “look, I've just calculated my effective marginal tax rate and I'd now like to work an extra 1.7 hours.” Or are you one of the 1.9 hour people? Because different people have different elasticities of labour supply, we understand that. Like you've all been in the room when this has happened, haven't you? Every time wage rates change and tax rates change, we all rush to our boss and renegotiate our hours of work, don't we? Anyone that thinks I'm an idiot right now is realising how ridiculous a lot of economic theory is. Because the theory of labour supply that all this stuff is based on, all the tax cuts is good stuff, is based on, is that humans primarily determine the labour supply based on the wage rate and the effective marginal tax rate. And most people who work full time don't actually give it a second thought.

So, what we've got here is clear evidence. So now let's back it up. The whole idea that we need to cut taxes is because if we lower people's effective marginal tax rates, they'll work harder. They'll work longer. This will boost GDP. But we've actually now got a system where these people earning between $45 and $66,000 are going to have higher effective marginal tax rates than higher income earners than them. That is, we're going to discourage those people from working. Now I've just mocked the idea that people spend a lot of time looking at their wage, right, looking at their tax rate, looking at the benefits they get, and doing some optimisation calculation for how many hours they work. I've just mocked the idea of that for most people, brackets, particularly blokes who work full time. But there is one cohort in Australia that is actually really responsive to this. There is one cohort in Australia whose labour supply decision is really responsive to the combination of their wage rate, the tax rate and the rate at which they lose other benefits. Does anyone want to have a guess at which cohort that is? That's you. And who the hell are you? “I'm women!” (audience) You're women. Your work matters. Thank you very much. And look, there's no homogenous group called blokes. There's no homogenous group called women. There's no homogenous group called women with kids. But I tell you what. If there's any cohort, if there's any cohort in the labour supply that behaves in the way that economists think we all behave, it's women with kids and it's because of these really high effective marginal tax rates combined with pretty low wages, combined with really expensive childcare. And it and that's why they're paying such close attention to these, because why would you go to work for $40 bucks an hour if you're going to pay a fair bit of tax, lose a fair bit of other benefits and pay a lot per hour for childcare. So, the one group that really seems to respond to the kind of economic rationalist economic man is actually economic woman. So that's the first problem. We've got a higher effective marginal tax rate for this group, which is bad because that's the opposite of a progressive income tax system. And it's also really bad because that's banging the cohort of people who are probably responsive to changes in labour supply.

So, the key point that I'll conclude on is, see, I told you Patricia was never going to get through all this, so have a look at that blue line there. The dark line at the top is basically blokes' hours of work over their lifecycle, and the blue line is women's. And in Australia, in Australia where we're crap at designing tax transfer and childcare policies, women in phase two of life, having a kid, have this big reduction in labour supply and it never really picks back up in Australia. Other places do exist. Some people might have heard of Norway or Denmark or Sweden or France or Germany or crappy little countries like that that we shouldn't pay any attention to. And their labour supply for women looks very similar to the labour supply for blokes. But here in Australia we've designed these really bad systems that load up all of these disincentives on women in the labour market, which have these really big consequences for labour supply. Again, Patricia was never getting through all this.

So to conclude. The one reason, the one reason to spend $300 billion - from an economist's point of view, if we only wanted to think about the economy - these would both be dangerous ways to make policy. Just think about economists and the economy. But if you had just a bunch of economists who only cared about GDP, the one reason that you might want to have big income tax cuts is because you wanted to lower people's effective marginal tax rates. Because you might induce them to work longer and that might lead to a bigger GDP. Except, remember all that stuff Greg showed you this morning about how high-income earners get all the benefits? We're not actually dropping the marginal tax rate for rich people. The top marginal tax rate isn't changing. So how much extra labour supply a rich bloke's going to contribute? None. Not a cent, not an hour, not a minute. U.S. But the people who are responsive to these things, the people who are sensitive to effective marginal tax rates, are particularly women with kids, and we're actually creating disincentives for them.

So not only are the Stage 3 cuts really expensive, really poorly timed, if we're worried about inflation, really inequitable, but they're actually going to have no impact, no impact on the people that are getting most of the tax cuts because the top tax rates are not changing. So, no change in their effective marginal tax rate and we're actually going to discourage labour supply amongst the one cohort of people that probably are responsive to these effective marginal tax rates. So, if you thought Greg's presentation made the Stage 3 tax cuts look dumb. All I can say is Patricia says they make them even dumber. Thank you very much.