Australia's reliance on income tax

A comparison with other OECD nations

Compared to other developed (OECD) countries, Australia is a low tax country that is not overly reliant on personal income tax when social security contributions are included. Australia is the 9th lowest tax country out of 38 OECD nations and 7th lowest for its reliance on income tax.

Discussion paper

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Summary

One of the most common misconceptions about Australia's tax system is that it is over-reliant on income tax. Despite repeated claims by business groups that Australia needs to reduce its reliance on income tax, the reality is that Australia is not only a low tax country when compared with other developed (OECD) countries but is also one of the least reliant on income taxes. Of the 38 developed nations Australia is the 9th lowest for all taxes and 7th lowest for income taxes including Social Security Contributions (SSCs).

The argument that Australia is over-reliant on income tax relies on narrowly defining income tax that mistakenly excludes SSCs. These social security contributions are levied by almost all developed countries to assist in the funding of a wide range of social benefits which can include unemployment benefits, accident, injury and sickness benefits, old age, and disability pensions, as well as the provision of various hospital and medical services. Importantly they act similar to income tax, in being levelled as a percentage of income earned (often just on employment earnings). SSCs are categorised as taxes on labour income by the OECD.

Claims that Australia is over-reliant on income tax do not stand up to scrutiny. Australia sits well below the OECD average when it comes to both income taxes and the amount of tax collected overall.

Introduction

One of the more commonly stated points about Australia's income tax system is that it is over-reliant on income tax. Such claims are often made by business groups such as Innes Willox, the Chief Executive of the Australian Industry Group who recently stated:

> We're amongst the highest, most reliant countries in the world on income tax to fund government coffers. I think we run only second to Denmark of developed countries in our reliance on income tax.[1]

This claim has been stated so often with little rebuttal that many in the media repeat it as though it is an uncontested fact, such as in a recent report on ABC Online which stated, "In short: Australia relies heavily on income tax to support everyday services".[2]

This claim is not only incorrect it is asserted to push a highly political argument. The idea that a large reliance on income tax reduces the incentive to work and thus income tax should be lowered.[3] This argument is often stated as if it were uncontested. In reality it is the subject of vigorous debate and research.[4]

The purpose of this paper however will focus only on the central claim that Australia is over-reliant on income tax compared other developed (OECD) nations. It will look at OECD data comparing developed countries and how much they tax as a proportion of Gross Domestic Product (GDP). Tax to GDP ratios is the most well accepted method of comparing different countries.

[1] Willox (2024) *Stage 3 tax cuts: Do changes make economic sense?*, ABC Radio National Breakfast, 24 January, https://www.abc.net.au/listen/programs/radionational-breakfast/stage-3-tax-cuts-does-a-redesign-make-economic-sense-/103382482

[2] Ziffer, (2024) *'It's not just unfair but immoral': Why experts say Australia's tax system is broken and what can be done to fix it,* https://www.abc.net.au/news/2024-02-12/tax-reform-unavoidable-income-tax-workers-ageing-population/103445138.

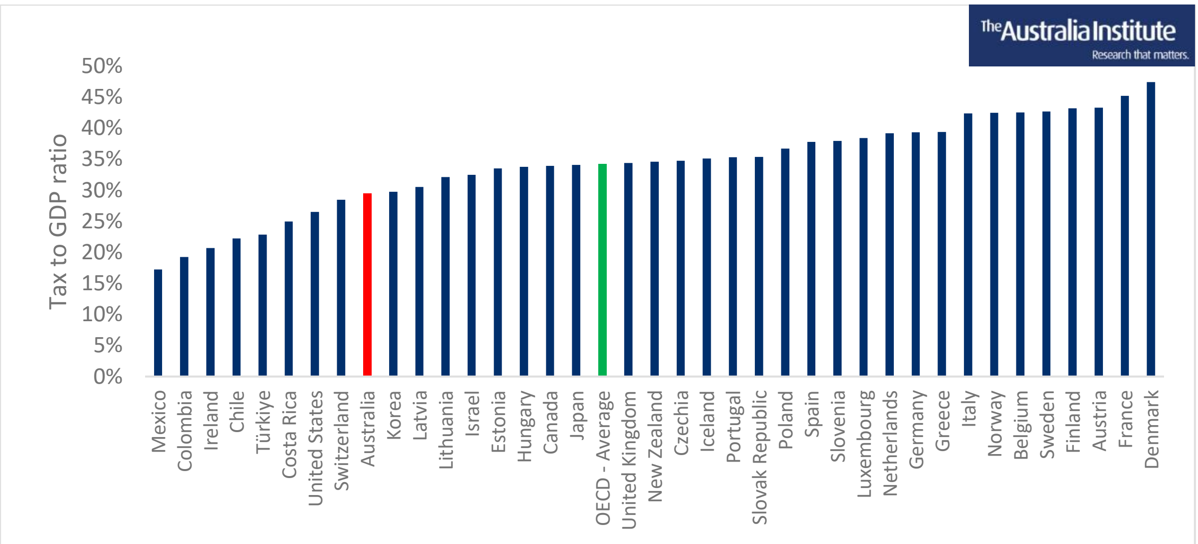
[3] Oliver (2024) *Oliver's insights*, https://www.amp.com.au/insights-hub/blog/investing/olivers-insights-australias-tax-system

[4] Dalamagas & Kotsios (2008) *Personal Income Tax: Incentive or Disincentive to Work Effort?*, https://www.cairn.info/revue-economique-2008-4-page-777.htm

Australia is a low tax country

Australia is one of the lowest taxing countries among developed (OECD) nations. When comparing taxation levels in different countries, the most common method is to look at the amount of tax collected as a proportion of Gross Domestic Product (GDP), also known as the tax to GDP ratio. Australia's tax to GDP ratio is the 9th lowest out of 38 developed countries, as shown in Figure 1.

Figure 1: OECD countries ranked by tax revenue to GDP ratios in 2021



Source: OECD (2023) Global Revenue Statistics Database, OECD.Stat

In 2021 Australia's tax to GDP ratio was 29.5%, while the average for OECD countries was 34.2%. If Australia collected the average rate of tax for the OECD, then it would collect an additional $105 billion in tax each year.

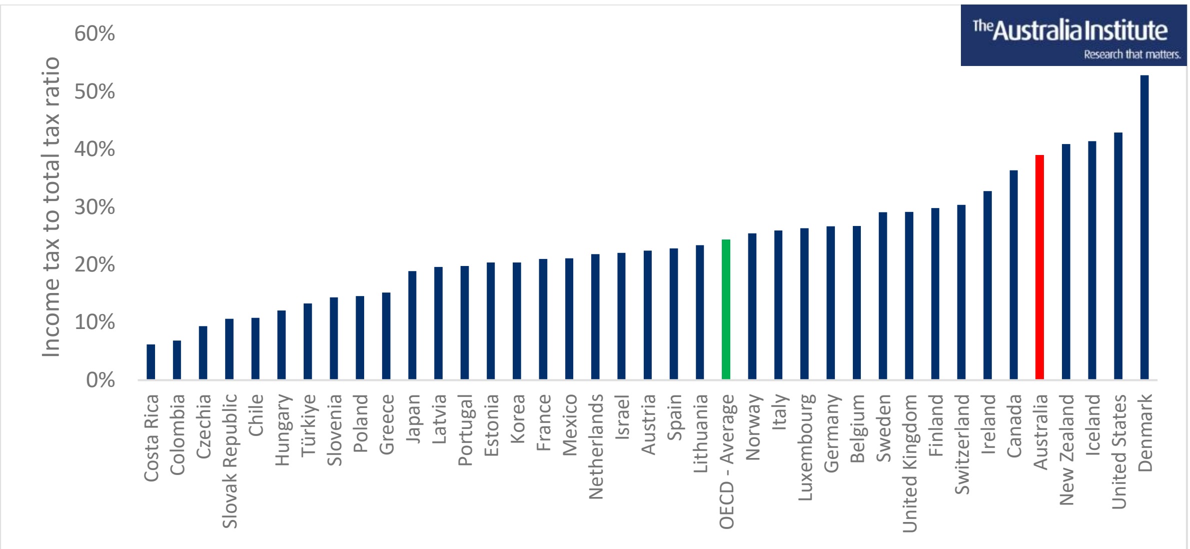
IS AUSTRALIA OVER-RELIANT ON INCOME TAX?

It has been claimed by some that while Australia might be a low tax country its 'heavy reliance' on income tax is, nonetheless, a problem.[5] They justify this claim by arguing that Australia raises more income tax as a proportion of total tax than almost all OECD nations. Figure 2 is a chart that is often used as evidence to support this proposition. It shows the tax on income, profits, and capital gains for individuals as a proportion of all taxes collected for each OECD nation. Australia is the 5th highest of the OECD countries. It is very important to

[5] Ziffer, (2024) *'It's not just unfair but immoral': Why experts say Australia's tax system is broken and what can be done to fix it,* https://www.abc.net.au/news/2024-02-12/tax-reform-unavoidable-income-tax-workers-ageing-population/103445138.

note that Figure 2 is the proportion of income tax to total tax collected, not a ratio of income tax to GDP as is more commonly used when comparing different nations.

Figure 2: OECD countries ranked by tax on income, profits, and capital gains for individuals as a proportion of all taxes in 2021



Source: OECD (2023) Global Revenue Statistics Database, OECD.Stat

Measuring a countries reliance on income tax as a proportion of all tax rather than as a proportion of GDP is problematic. This is because a low tax country and a high tax country might collect a similar amount of income tax as a proportion of GDP, but the low tax country will look more reliant on income tax as a proportion of total tax simply because it collects less tax overall. An example that highlights this a comparison of Australia and Belgium. As Figure 1 above shows, Australia is a low tax country (9th lowest), while Belgium is a high tax country (6th highest).

Table 1 below shows that tax on income, profits, and capital gains for individuals as a proportion of GDP for Australia and Belgium are almost identical. Australia is 11.5% and Belgium at 11.3%. But if we calculate tax on income, profits, and capital gains for individuals as a proportion of total tax (rather than as a proportion of GDP), Australia looks more reliant by more than 12 percentage points, at 39% compared to Belgium on 26.7%.

Table 1: Australia and Belgium total tax and tax on income, profits, and capital gains for individuals as a proportion of GDP and total tax in 2021

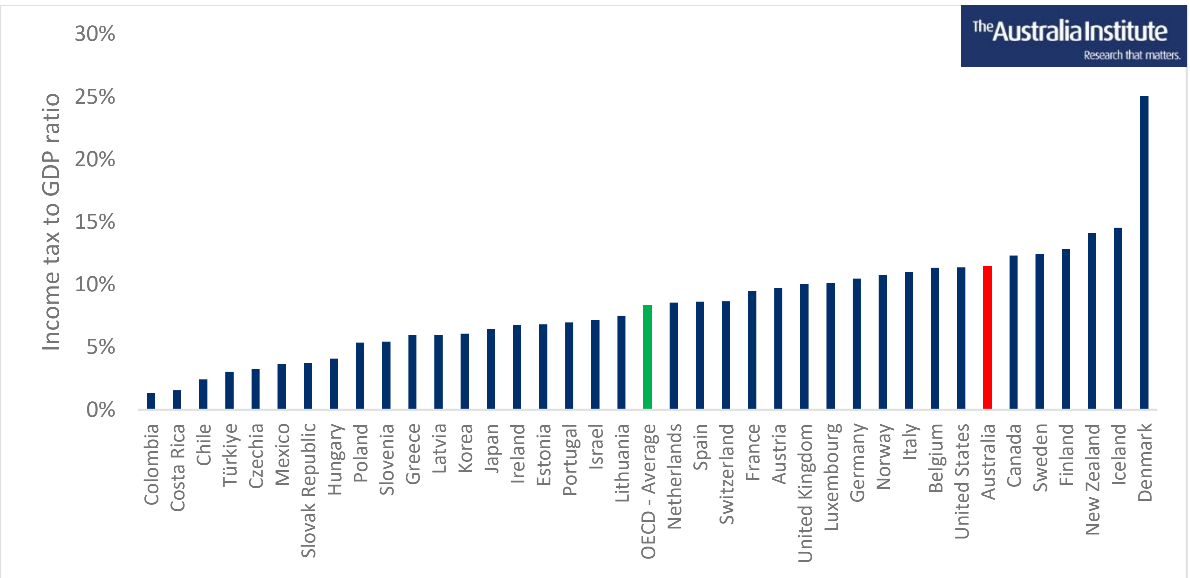
Country	Total tax (%GDP)	Individual income tax (%GDP)	Individual income tax (%total tax)
Australia	29.5%	11.5%	39.0%
Belgium	42.5%	11.3%	26.7%

Source: OECD (2023) Global Revenue Statistics Database, OECD.Stat

Comparing countries as a proportion of total taxation changes the figures depending on whether the country is a low tax or high tax country. A way to remove that distortion is to use the more common method of comparison as a proportion of GDP. If the concern about over-reliance on income tax is that it creates a disincentive to work, then the size of non-income taxes should not be important. That is, the comparison should be as a proportion of GDP.

Tax on income, profits and capital gains as a proportion of GDP is shown in Figure 3. We can see that Australia is still near the top but has fallen from fifth highest (in Figure 2) to seventh highest.

Figure 3: OECD countries ranked by tax on income, profits, and capital gains for individuals as a proportion of GDP in 2021



Source: OECD (2023) Global Revenue Statistics Database, OECD.Stat

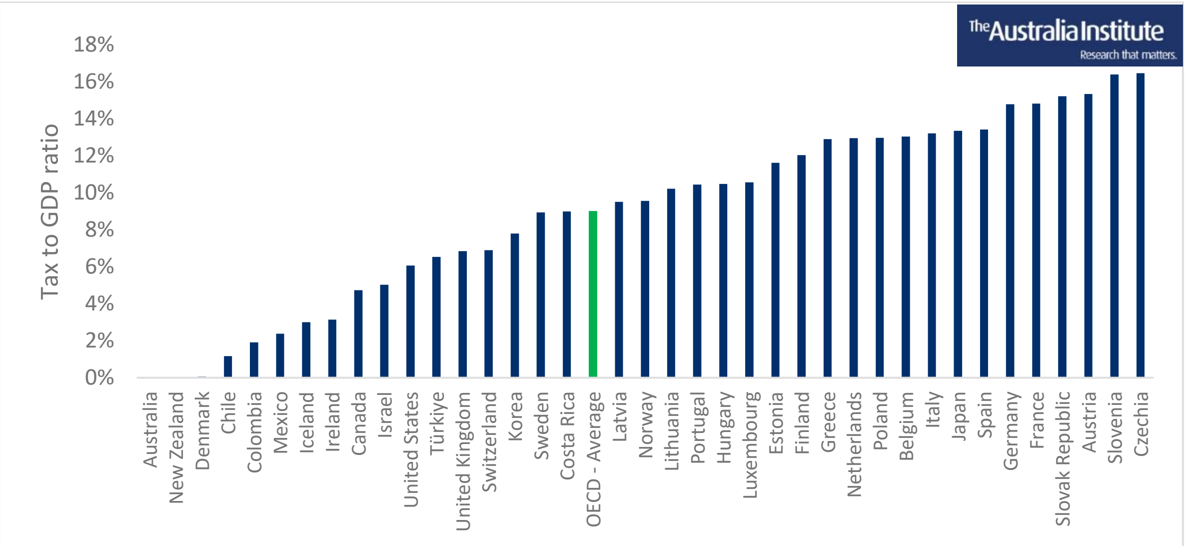
The data in Figure 2 and 3 suffers from an additional problem. This measure of reliance on income tax uses a narrow definition of income tax that excludes revenue raised in most of the rest of the OECD but not in Australia.

SOCIAL SECURITY CONTRIBUTIONS ARE A TAX ON INCOME AND SHOULD BE TREATED AS INCOME TAX

The data presented in Figure 3 above excludes social security contributions (SSCs) which are collected in all OECD nations, except for Australia and New Zealand. SSCs are taxes levied on employment income used to support the provision of a wide range of social benefits which can include unemployment benefits, accident, injury and sickness benefits, old age, and disability pensions, as well as the provision of various hospital and medical services.

Figure 4 shows SSCs by OECD country as a proportion of GDP. It highlights how important SSCs are for most OECD nations. It is also interesting to note that excluding SSCs does not just exaggerate the importance of income tax for Australia. Of the six countries that rank higher than Australia in Figure 3, all but one of them collects SSCs as a proportion of GDP below the OECD average. This includes New Zealand, which like Australia does not collect SSCs. It also includes Denmark which collects the third lowest proportion of SSCS at just 0.1% of GDP.

Figure 4: OECD countries ranked by Social Security Contributions to GDP ratios in 2021



Source: OECD (2023) Global Revenue Statistics Database, OECD.Stat

Critically for our purposes of comparison, SSCs are levied in a similar way to income tax. They are collected by employers at payroll and forwarded to the government. In some cases, employers are also required to contribute. Importantly they reduce the take home pay of workers and if this reduces the incentive to work then SSCs would have the same impact as income tax. While SSCs are not called “income tax”, the OECD explicitly calls them a “tax on labour income”.[6]

SSCs vary in different countries. They can be set at a flat rate like the Medicare levy, or they can have different marginal rates across different income ranges. Some countries have a maximum annual contribution for SSCs. SSCs can also be levied on employees, employers, or both.

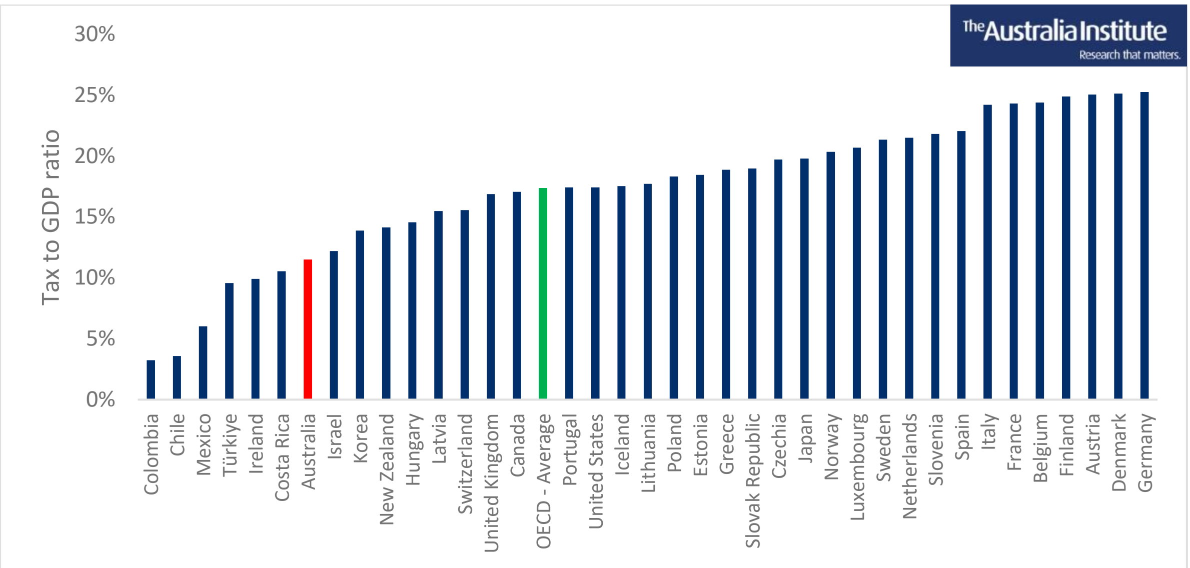
Counting SSCs as akin to income tax is not unprecedented. Professor Peter Whiteford of the Crawford School of Public Policy at ANU argued in 2022 that SSCs “are very similar to

[6] OCED (2023) *Taxing Wages – Australia*, https://www.oecd.org/tax/tax-policy/taxing-wages-australia.pdf

income taxes. They are generally collected the same way and counted as direct taxes on households or individuals in income surveys."[7]

Therefore, to get a more accurate comparison of how reliant Australia is on taxes on income, it is necessary to include SSCs. When including SSCs Australia raises the 7th lowest proportion of income tax out of 38 OECD nations for tax revenue levied on income, as seen in Figure 5.

Figure 5: OECD countries ranked by tax on income, profits, and capital gains for individuals plus SSCs as a proportion of GDP in 2021



Source: OECD (2023) Global Revenue Statistics Database, OECD.Stat. This is calculated by adding taxes on income, profits and capital gains by individuals, plus social security contributions.

Excluding social security contributions from income tax might help to make it look like Australians pay a high amount of income tax relative to others in the OECD, but it is not an accurate way to compare countries. Social security contributions are levied on the gross wages of employees. The OECD specifically includes SSCs and income tax together when calculating the take home pay of workers. For example, in its most recent briefing on Taxing Wages, the OECD concluded that:

> In Australia, the average single worker faced a net average tax rate of 23.0% in 2022, compared with the OECD average of 24.6%. In other words, in Australia the take-home pay of an average single worker, after tax and benefits, was 77.0% of their gross wage, compared with the OECD average of 75.4%.[8]

[7] Whiteford (2022), "Do Australians pay too much income tax? 6 charts on how we rank against the rest of the world", *The Conversation*, https://theconversation.com/do-australians-pay-too-much-income-tax-6-charts-on-how-we-rank-against-the-rest-of-the-world-185223.

[8] OECD (2023) Taxing Wages: Australia, https://www.oecd.org/tax/tax-policy/taxing-wages-australia.pdf

By contrast for Germany the OECD concluded:

> In Germany, the average single worker faced a net average tax rate of 37.4% in 2022, compared with the OECD average of 24.6%. In other words, in Germany the take-home pay of an average single worker, after tax and benefits, was 62.6% of their gross wage, compared with the OECD average of 75.4%.[9]

Including social security contributions when calculating the amount of tax paid by workers on their income but then excluding them when calculating the amount of income tax levied by governments on workers, is not presenting an accurate or reasonable comparison.

An accurate and reasonable comparison shows Australia is a low tax country that is less reliant on taxes on personal income than most nations in the OECD.

COMPULSORY SUPERANNUATION CONTRIBUTIONS ARE NOT TAXES

The revenue from Figure 5 is from taxes levied on income. Some business groups in Australia also argue that compulsory superannuation contributions are a tax that is similar in nature to SSCs.

This is clearly wrong.

A tax is a compulsory unrequited payment to the government. Payments to Australia's compulsory superannuation system are not considered a tax as the money is paid into the worker's own private superannuation account and always remains their property. It can be used by the payee after retirement (and occasionally in other circumstances) and can be bequeathed to the payee's descendants.

Further, superannuation is not a tax that provides revenue to the government. Indeed, in Australia, the generous tax concessions linked to superannuation mean that funds flowing into superannuation actually lead to a significant reduction of funds flowing to the government. Superannuation is simply a form of forced, but tax-effective, saving whereby individual contributions are returned to the individual (or their descendants) with interest.

On the contrary, SSCs do not remain the property of the individual. For example, someone who does not get sick, or become unemployed will get little to no benefit from SSCs and unused SSCs are not refunded to dependents on retirement or death.

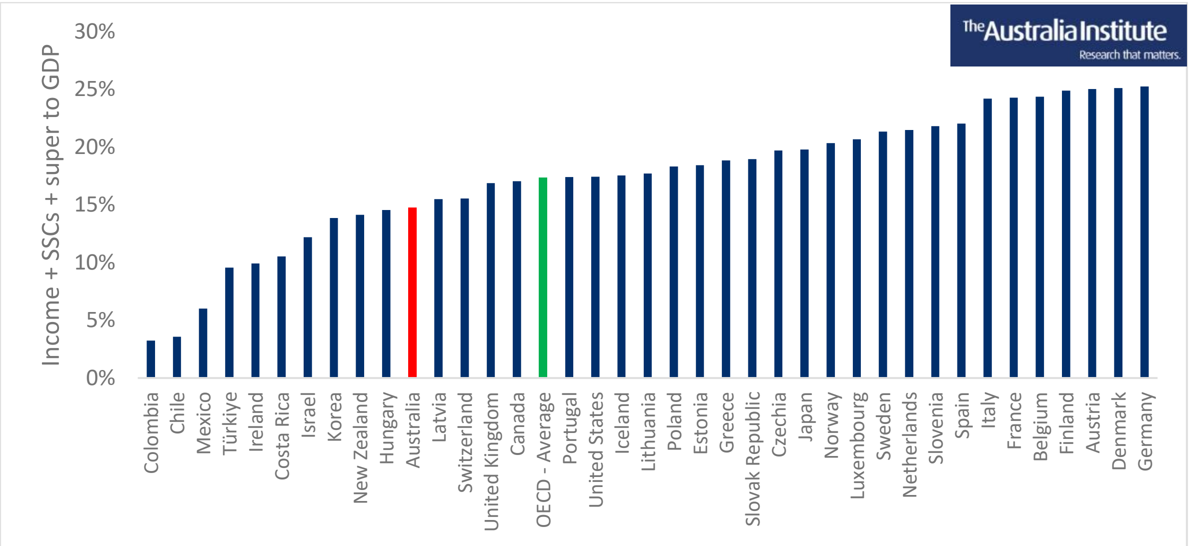
But this is where the business groups' argument is further undermined. *Even if* we were to treat compulsory superannuation payments as a tax (which they clearly are not as the

[9] OECD (2023) Taxing Wages: Germany, https://www.oecd.org/tax/tax-policy/taxing-wages-germany.pdf

contributions always remain the property of the individual), it has little effect on Australia's position among OECD nations.

In 2021 superannuation guarantee contributions were $72,629 million.[10] GDP in that year was $2,237,695 million.[11] This means they make up 3.2% of GDP. Adding them to the numbers in Figure 5 gives us the numbers in Figure 6 which shows that Australia has moved up from 7th lowest to 11th lowest. This is still less than Canada, the United Kingdom, the United States, and Switzerland, and still falls in the bottom third of OECD countries.

Figure 6: OECD countries ranked by tax on income, profits, and capital gains for individuals plus SSCs to GDP ratios with compulsory super contributions added to only Australia in 2021



Source: OECD (2023) *Global Revenue Statistics Database*, OECD.Stat, ABS (2023) Australian System of National Accounts – 2022-23, APRA (2021) Quarterly superannuation performance statistics – June 2021, and authors calculations

It is important to note that compulsory superannuation contributions have only been added to Australia. Other OECD countries have schemes with compulsory contributions to private retirement savings. As each country is different it is not possible to add the compulsory contributions to each of their tax to GDP ratios. They have therefore only been included for Australia. This can be seen as a scenario in which compulsory superannuation contributions are having the largest possible effect on Australia's ranking.

[10] APRA (2021) *Quarterly superannuation performance statistics – June 2021*, https://www.apra.gov.au/quarterly-superannuation-statistics

[11] ABS (2023) *Australian System of National Accounts – 2022-23*, https://www.abs.gov.au/statistics/economy/national-accounts/australian-system-national-accounts/2022-23

Conclusion

Australia is unambiguously a low taxing nation. Australia raises the 9th lowest amount of tax revenue out of the 38 OECD nations. In 2021 Australia's taxation revenue was equal to just 29.5% of GDP – less than South Korea (29.8%) and Japan (34.1%) as well as Canada (33.9%) and New Zealand (34.6%) let alone European nations like Germany (39.3%) and Italy (42.4%) or the Scandinavian economies of Sweden (42.7%) and Denmark (47.4%).

Neither is Australia highly dependent upon income tax. When including social security contributions, Australia raises the 7th least of all the OECD nations. Claims that Australia is overly reliant on income tax rely on semantic tricks about what "income tax" is. This is designed to exclude SSCs.

While this paper has not sought to debate the economic impact of high-income tax, clearly any argument that an over reliance on income tax has negative economic effects must equally apply to workers paying SSCs. If higher income taxes do have a strong behavioral effect by reducing people's desire to work, then that effect would exist regardless of whether their marginal rate of tax was increased by income tax or SSCs.

Indeed, the figures presented in this paper suggest that Australia should raise more tax than it currently does. By increasing our level of tax merely to that of Japan or Canada – two nations not generally regarded as high taxing – the government would raise an extra $100 billion each year.

Claims that Australia is over-reliant on income tax do not stand up to scrutiny. Australia sits well below the OECD average when it comes to both income taxes and the amount of tax collected overall.