

Research Insights

Have tax-transfer policy reforms increased inequality?

Despite unprecedented economic expansion in Australia since the mid-1990s, fiscal reform has created a less progressive tax-transfer system, contributing to rising income inequality.

The polarising effects of tax-transfer reforms in Australia

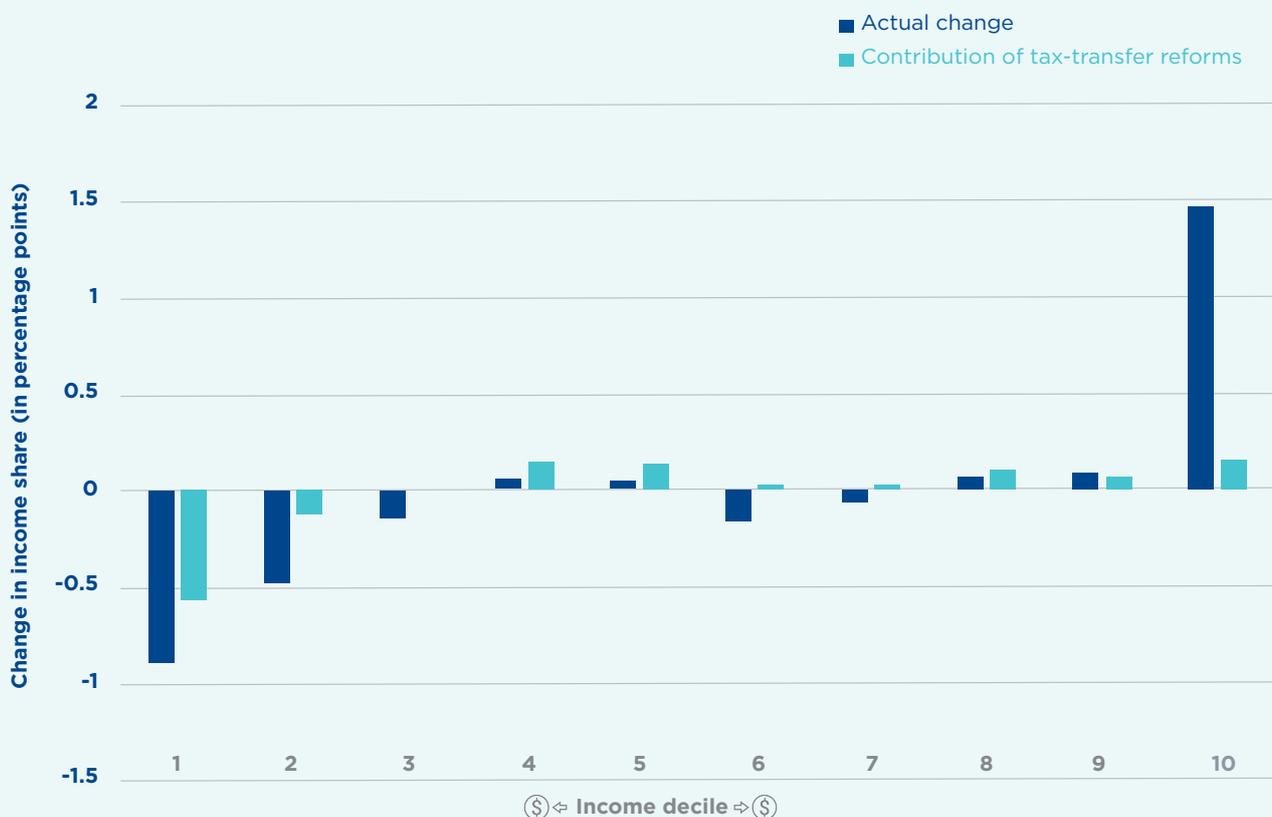
Australia has experienced 28 years of uninterrupted annual economic growth. Since reaching a peak of 11 per cent in 1993, the unemployment rate declined sharply and has been below 6 per cent for most of the period since mid-2003.

Despite these great economic achievements, research indicates that income inequality has increased since the mid-1990s and no substantial reduction in poverty has been achieved (ACOSS, 2016, 2018, Wilkins 2015, Hérault and Azpitarte 2015). During this period substantial fiscal reforms were implemented, so a legitimate question is whether, and how, these reforms added to or mitigated these inequality trends.

Fiscal policy, including tax and transfer policy, is the main tool used by governments for redistributing income. Evidence from several OECD countries suggests that tax-transfer systems have become less effective at redistributing income due to the regressive nature of fiscal reforms implemented up until the 2000s (OECD 2011), a finding that applies to Australia too (Hérault and Azpitarte 2015, 2016).

The difficulty in identifying the impacts of fiscal reform is that it occurs alongside many other changes which affect economies. Hérault and Azpitarte (2016) developed a modelling framework which allowed for the identification of the specific impacts of tax-transfer policy reforms on income inequality. This Research Insight applies this methodology to the most recent Australian Survey of Income and Housing (SIH) data from the Australian Bureau of Statistics. This approach is based on simulated tax and transfer payments assuming full take-up of benefits and is, therefore, not affected by changes in benefit mis-reporting in survey data or to changes in benefit take-up rates.

Figure 1: Changes in income shares by income decile between 1994–95 and 2015–16



Notes: Post-tax post-transfer income adjusted for household size. The unit of analysis is the individual. The contribution of tax-transfer reforms includes labour supply responses to these reforms. Source: Authors' calculation based on the ABS Survey of Income and Housing and the Melbourne Institute Tax and Transfer Simulator.

Key Insights

1 Tax-transfer reforms widened the divide between low-income and high-income groups

Tax-transfer reforms in Australia between 1994–95 and 2015–16 contributed to a reduction in the income shares of the bottom two deciles of the population (Figure 1). Income is defined as household disposable income per adult equivalent, which means that it is adjusted for household size and composition. Tax-transfer reforms account for two-thirds of the decline in the income share of the bottom decile, which decreased from 4.5 per cent of total income in 1994–95 to just 3.6 per cent by 2015–16.

Our analysis shows that the Gini coefficient, the most commonly-used measure of income inequality, increased by almost 10 per cent between 1994–95 and 2015–16. This is a sizeable increase, one-third of which is attributable to tax-transfer reforms alone—a result in line with those reported earlier by Hérault and Azpitarte (2016). These reforms particularly affected the most disadvantaged households and are estimated to have pushed an additional 3.3 per cent of Australians below the poverty line over that period (when the poverty line is set at 50 per cent of median income).

If the poorest 20 per cent saw their share of the economic pie decrease, other people must have seen their shares increase. And indeed, the overall income share of the top income decile increased from 22.7 per cent to 24.2 per cent, though some of that increase was likely due to changes in the collection of ABS household income survey data (Wilkins 2014). Nevertheless, our results indicate that tax-transfer reforms contributed one-tenth of the actual increase.

2 The redistributive capacity of the system impeded by tax-transfer reforms

Progressive tax and transfer systems typically aim to create a fairer distribution of income by transferring income from high-income to low-income families. Some recent reforms in Australia have reduced the extent of redistribution. These reforms included cuts in top marginal tax rates and increases in the top tax thresholds which reduced the income range taxed at those higher rates. The top tax threshold doubled from \$90,000 to \$180,000 between 2005 and 2008, while the top tax rate decreased from 47 per cent to 45 per cent in 2006 and several successive tax cuts brought the second highest tax rate down from 43 per cent in 1995 to 37 per cent in 2011.

In addition, there has been a push to move many Australians off (higher) pension payments and on to the Newstart Allowance, for example, by decreasing the percentage of work capacity at which someone is still eligible for the Disability Support Pension; another example is the reduction in the age of the

youngest child at which the primary carer is still eligible for the Parenting Payment Single income support. This has occurred at a time when Newstart Allowance payment rates have been falling behind pension rates due to the former being indexed to the inflation rate while the latter are indexed to the faster growing wage cost index.

Taken together, all the transfer reforms enacted between 1995 and 2016 were responsible for one-fifth of the large reduction in the share of government cash transfers in total household income, from 15.5 per cent in 1994–95 to 10.6 per cent in 2015–16.

Restoring the redistributive capacity of the tax-transfer system

In the search for the drivers of rising inequality, tax-transfer reforms are not the only culprit. Global factors such as technological change and globalisation have certainly played a role too. However, instead of mitigating the effects of these global trends, Australia's tax-transfer reforms magnified them. The result is that two decades of fiscal reforms have made the tax-benefits system less progressive, leading to rising income inequality and no major reduction in poverty despite unprecedented economic expansion. At the same time, more and more evidence globally has been pointing to the negative effects of inequality on a wide range of socio-economic outcomes (e.g., Atkinson 2015, Stiglitz 2012), as well as to the lack of any strong evidence showing that redistributive policies harm economic growth (Ostry et al. 2014). These findings point to the need for more, not less, redistributive tax-transfer policies in Australia. Such policies should aim to boost the social safety net—starting with the level of the Newstart Allowance—and make the tax system more progressive.

Authors

Nicolas Hérault

Melbourne Institute: Applied Economic & Social Research,
The University of Melbourne

Guyonne Kalb

Melbourne Institute: Applied Economic & Social Research,
The University of Melbourne

Francisco Azpitarte

Loughborough University, United Kingdom

Further Information

Datasets:

This report is based on the Australian Survey of Income and Housing (SIH) for the period from 1994-95 to 2015-16. The SIH is a nationally representative survey designed by the Australian Bureau of Statistics to collect detailed household and household member information on income sources, income level, labour market status, hours worked and socioeconomic characteristics.

This Research Insight represents the opinions of the author(s) and is not intended to represent the views of Melbourne Institute. Whilst reasonable efforts have been made to ensure accuracy, the author is responsible for any remaining errors and omissions.

Research Insights produced by the Melbourne Institute provide a clear and practical understanding of contemporary economic and social issues in Australia.

Supported by high-quality academic analysis, each Research Insight aims to make sense of complex issues to enable evidence-based decision making for policy and practice.

melbourneinstitute.unimelb.edu.au

References:

ACOSS 2016. Poverty in Australia 2016, available at <https://www.acoss.org.au/wp-content/uploads/2016/10/Poverty-in-Australia-2016.pdf>.

ACOSS 2018. Inequality in Australia 2018, available at <http://www.acoss.org.au/wp-content/uploads/2018/07/Inequality-in-Australia-2018.pdf>.

Atkinson, A. B. 2015. *Inequality: What can be done?*, Harvard University Press, Cambridge.

Biddle, N., R. Breunig, F. Markham, and C. Wokker. 2019. "Data Survey Introducing the Longitudinal Multi - Agency Data Integration Project and Its Role in Understanding Income Dynamics in Australia." *The Australian Economic Review* 52(4):476-495.

Hérault, N. and Azpitarte, F. 2015. Recent Trends in Income Redistribution in Australia: Can Changes in the Tax-Benefit System Account for the Decline in Redistribution?, *The Economic Record*, 91(292), 38-53.

Hérault, N. and Azpitarte, F. 2016. Understanding Changes in the Distribution and Redistribution of Income: A Unifying Decomposition Framework, *Review of Income and Wealth*, 62(2), 266-282.

OECD (Organization for Economic Cooperation and Development) 2011. *Divided We Stand: Why Inequality Keeps Rising*, Paris.

Ostry, J.D., A. Berg, and C.G. Tsangarides. 2014. "Redistribution, Inequality, and Growth." IMF Staff Discussion Note 14-02.

Stiglitz, J. 2012. *The Price of Inequality: How Today's Divided Society Endangers Our Future*, W.W. Norton & Company.

Wilkins, R. 2014. "Evaluating the evidence on income inequality in Australia in the 2000s." *Economic Record* 90(288):63-89.

Wilkins, R. 2015. "Measuring income inequality in Australia." *The Australian Economic Review* 48(1): 93-102.



Minerva Access is the Institutional Repository of The University of Melbourne

Author/s:

Kalb, G; Herault, N; Azpitarte, F

Title:

Have tax-transfer policy reforms increased inequality?

Date:

2020-02-01

Citation:

Kalb, G., Herault, N. & Azpitarte, F. (2020). Have tax-transfer policy reforms increased inequality?. Melbourne Institute of Applied Economic and Social Research.

Persistent Link:

<http://hdl.handle.net/11343/258648>

File Description:

Published version