WHY WE NEED TO SPLIT THE TAX BILL

The twin dangers we face: a slow-down in economic growth and threats to funding for essential services

With wages and consumer spending stagnant and unemployment increasing, public concern is growing around the future of jobs and economic opportunities. The Government’s main ‘solution’ – large tax cuts locked in over the next five years – raises risks of its own around the future of essential services.

Just this week, the GDP figures came out, showing that economic growth slowed to 1.8% over the year to March 2019, and the RBA cut interest rates for the first time in three years. The hope is that the rate cut will ease pressures on people with large mortgages, so they open their wallets and spend a little more. Together with the easing of credit restrictions by APRA, this may also bring an end to the decline in house prices by the end of this year, though at the expense of housing affordability.

With interest rates at 50-year lows, there’s not much more the RBA can do through monetary policy to support stronger economic activity. As the Governor urged again on Tuesday, fiscal policy must also play its part. The Government must also act.

In fact, government spending is already holding the economy above water. Public consumption (services such as the rollout of the NDIS) grew by 5.1% over the year to March, while household consumption increased by just 1.8%. But over the next four years, real growth in Commonwealth expenditure is slated to fall to its lowest level in 50 years.

Tax cuts: solution or problem?

The only major policy the Coalition Government took to this Federal Election was a large scale income tax cut package. It wants to pass $8 billion in modest tax cuts for middle income-earners as soon as possible, a policy that has bipartisan support. Again, the hope is that at least some of this tax rebate will be spent, not saved – despite record household debt.

However, the Government wants to go further and take a big gamble. It wants to lock in an extra $160 billion of tax cuts over the next decade, on top of the $150 billion already on the books. The largest cuts, most of which go to individuals earning $90,000 or more, don’t kick in until 2022 and 2024 – three to five years away.

By 2022, the Government is betting that the budget surplus will be large enough ($9 billion after the tax cuts) to absorb the additional $16 billion price tag for ‘Stage 2’ of the tax cuts slated for that year.

By 2024, when ‘Stage 3’ is implemented, another $18 billion will be added to the cost. The cumulative cost of all three stages in 2024 is around $35 billion.

The 2019 budget painted a rosy picture of the future economy

Yet no one knows what the economy, or the budget, will look like in three years’ time.

To meet the Federal Budget projected surplus, we will need the economy to be growing by 3% a year in 2022, wages growing by 3.5%, inflation back up to 2.5%, and unemployment holding at 5%. These projections are in the budget, but they are not the Treasury’s best estimates. Because they are so far in the future, these kinds of budget projections are made on autopilot, based on what the economy would look like in an ideal world of ‘full employment’. 
But things are changing quickly. The RBA’s growth forecasts for the next few years are already lower than those in the 2019 Budget. While the budget is predicated on wages growing by 2.75% in 2019-20 and 3.25% the following year, the RBA now predicts wages will rise by 2.5% next year and by just 2.6% in 2020-21.

What happens next?

We need to plan for a few different scenarios – none of which we are actually predicting because, along with other commentators, we don’t really know.

One scenario is that the economy slows more sharply this year, unemployment rises, and the Government decides to spend more (or cuts taxes more) to boost growth. Under those conditions, the budget surplus will quickly shrink – as it should. By 2022, instead of a $9 billion surplus, the budget could be in deficit – as the last Labor government found five years after the GFC.

Another scenario is that the economy limps along and the Government sticks rigidly to its budget settings, demanding a surplus at all costs.

The trouble with this second scenario is what it’s built on. The 2019 budget takes for granted that growth in funding for payments and services (after inflation) can be held at 50-year lows. The Government’s ‘back in black’ already requires us to cut real growth in health funding to 0.7% a year over the next four years, despite growing demands for medical services and aged care. The Government also expects growth in social security and welfare spending to fall to 2.8% a year, despite the NDIS.

Indeed, the budget papers predict that real Commonwealth expenditure per capita (adjusting for inflation and population growth) will be flat over the next four years.

If these projections on budget spending don’t hold, the community will have to pay for those locked-in tax cuts one way or another, whether through higher public debt or reduced payments and services – as it did after the 2014 budget. So often these cuts most impact those who can least cope. Single parents and their children come to mind. People with disabilities. People who are unemployed. Recipients of overseas aid.

What should be done now?

Instead of locking in tax cuts in three-to-five years’ time, our priority right now should be to strengthen growth in jobs and economic opportunities. The first round of the tax cuts (which are modest, and targeted to middle income-earners) may help, along with lower interest rates and the easing of restrictions on home loan credit.

More should be done, and the Government should have an eye to the long-term benefits – as well as the short-term impacts – of a range of economic stimulus measures.

Income tax cuts are not the most effective measure to lift consumer spending. At a time when middle and high income-earners are heavily in debt, the temptation will be to pay down the mortgage and credit card. The lowest 40% of households by income – who really have little choice but to spend every extra dollar they receive, will get little benefit from tax cuts, as their incomes are too low to tax. We also need to use the social security system to target people who need income relief the most – and who are also the most likely to spend extra dollars quickly and regularly.
Increase Newstart Allowance

The first obvious step is the long-overdue increase in the Newstart Allowance. The benefits of this necessary structural reform would flow immediately into local shops and services in regions most affected by unemployment. For example, modelling by Deloitte Access Economics found that a $75 a week increase in Newstart and related income support payments for single people and sole parents would lift disposable incomes by $288 million in South Australia and by $96 million in Tasmania.

Lift public investment, including in social housing

Well-targeted public infrastructure investment is another way to grow the economy now while improving its future productivity. The Government has already committed to substantial ‘congestion-busting’ transport infrastructure, but that has long lead times. There are other options. For example, a boost to investment in social housing would ease rental stress and homelessness and provide jobs in low-income regions at the same time.

A package that increased Newstart and invested in large-scale social housing growth and other well-chosen public infrastructure would be great for the economy. At today’s super-low interest rates, the Government could afford to do this. Indeed, Australia is better placed from a public budget point of view to do this than most other wealthy nations.

It will also mean some of the three million people in poverty might be able to feed themselves properly and get a better roof over their head. Surely this would be a better fiscal lever than delivering large-scale tax cuts to people on the highest incomes? People on $200,000 and over are slated to gain an eye-watering $11,000 in annual tax cuts if Stages 2 and 3 are implemented.

Governments are prone to lecturing us about the need to live within our means. If there was ever a case in point, it’s the choice about which fiscal policy levers we use right now or lock in for an unknown future.