

# History repeats on tax cuts and the Budget

4 June 2018



## Summary

The current debate over personal tax cuts and the Budget echoes a similar debate a decade ago, when just before the 2007 federal election, the Coalition government promised \$31 billion of income tax cuts.

The promised 2007 tax cuts were to be organised in three parts: the first going to middle income-earners (including an increase in the Low Income Tax Offset) and the later stages mainly targeting high income-earners. At that time, the economy was growing strongly and the budget was in surplus despite four years of income tax cuts.

That was **Step 1** in this short history of tax cuts and the budget.

In **Step 2**, the then Labor Opposition committed to implement most of the Coalition's tax cuts.

In **Step 3**, the newly elected Labor government was confronted with the Global Financial Crisis (GFC) and the budget quickly moved into deficit. The tax cuts left little room for the government to commit to new spending on social programs and restore the budget to surplus after the GFC.

**Step 4** was a decade of budget deficits, due in large part to the eight successive income tax cuts paid out when the economy was booming.

**Step 5** was the newly elected Coalition government's response to these budget challenges. In the 'horror' Budget of the 2014, benefits for people in poverty were cut, indexation of Medicare and hospitals funding was frozen or cut, and funding for schools, TAFE and higher education were cut. The Parliament rejected much of this package, but \$15 billion of social security cuts were passed, while others including a four week wait for payments for new migrants and abolition of the \$4-7pw Energy Supplement for new applicants, remain on the books.

**Step 6** was the 2018 Budget, which followed previous efforts to restore public revenue by clamping down on high-end super tax breaks and the announced increase in the Medicare Levy. The 2018 Budget announced a \$140 billion tax cut package to be implemented in stages over six years, starting with a modest tax reduction for middle income earners and building up to large tax cuts for high income-earners. This was justified by projections of strong growth in wages and income taxes.

So far, history has repeated. The proposed tax cuts are before the Senate, with Labor and the cross bench yet to decide whether they will bake them into legislation covering the next six years.<sup>1</sup>

We urge the major parties and the Parliament to **not** gamble the Budget and the essential services and social security payments we all need at some stage in our lives, and **not** to commit to large tax cuts six years in advance off the back of shaky budget figures.

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<sup>1</sup> Labor proposes to increase the first round of tax cuts by 75% and has not decided whether to support the second or third rounds. The Australian Greens have decided to oppose the tax cuts entirely.

## Step 1: The Coalition's tax cuts - Budget 2007

*"All Australian taxpayers will share in new personal tax cuts worth \$31.5 billion. This builds on the \$36.7 billion in personal tax cuts provided in the last budget."  
[Budget Overview 2007]*

The 2007 income tax cuts, estimated to cost **\$31.5B over 4 years**, were staged over three years. They began with tax cuts that mainly benefited middle income earners (including an increase in the Low Income Tax Offset) and proceeded later to changes that mainly benefited high income-earners.

In 2007:

- 30% threshold increased to \$30,000 (from \$25,000).
- Low Income Tax Offset increased from \$600 to \$750 pa with phase out from \$30,000 (up from \$25,000). Cuts out at \$48,750 (up from \$40,000)
- Equivalent to an extra \$19.16 per week for a taxpayer on \$30,000

In 2008:

- 40% threshold increased to \$80,000 (from \$75,000)
- 45% threshold increased to \$180,000 (from \$150,000).

In 2010:

- The top marginal tax rate is reduced from 45% to 40%

### Coalition tax cuts (2007)

Current	From 1 July 2008		From 1 July 2009		From 1 July 2010		
Taxable income (\$)	Rate (%)	Taxable income (\$)	Rate (%)	Taxable income (\$)	Rate (%)	Taxable income (\$)	Rate (%)
0 - 6,000	0	0 - 6,000	0	0 - 6,000	0	0 - 6,000	0
6,001 - 30,000	15	6,001 - <b>34,000</b>	15	6,001 - <b>35,000</b>	15	6,001 - <b>37,000</b>	15
30,001 - 75,000	30	<b>34,001</b> - 80,000	30	<b>35,001</b> - 80,000	30	<b>37,001</b> - 80,000	30
75,001 - 150,000	40	80,001 - 180,000	40	80,001 - 180,000	<b>38</b>	80,001 - 180,000	<b>37</b>
150,001 +	45	180,001 +	45	180,001 +	<b>43</b>	180,001 +	<b>42</b>

Note: Low Income Tax Offset (LITO) to be increased from \$600 to \$750 per year and phase out from \$30,000 (up from \$25,000).

### Cost of 2007 Coalition tax cuts (\$m)

Year	2007-08	2008-09	2009-10	2010-11	Over four years
Coalition (2007)	-5,305	-8,350	-8,785	-9,050	<b>-31,490</b>

Source: Budget Paper No 1 (2007)

## State of the economy and budget in 2007

The economy at this time was in a very strong position, and the Budget recorded a surplus in 2007-08 of \$20B.

	2006-07 %	2007-08 %
Gross domestic product	2.5	3.75
Unemployment	5.1	4.75
Consumer price index	2.75	2.5
Wage cost index	4.25	4.25
Underlying cash budget balance	\$17B	\$20B

Source: Budget Paper No 1. 2007

## Step 2: Labor's tax cuts (Budget 2008)

In the 2007 election campaign, Labor matched most of the Coalition tax cuts, and announced its tax cuts in its first budget in 2008.

*"The Government is implementing its election policy to reduce personal income tax to enhance workforce participation and ease the financial pressures on families. All Australian taxpayers will share in personal tax cuts worth \$46.7 billion over four years.*

*This Budget will reduce the drain on tax revenue from tax concessions by around \$8.7 billion while promoting fairness. This builds on the Government's election commitments which produced tax savings of over \$6 billion, including deferring tax cuts for high income earners."*  
Budget Overview, 2008

### Labor's Personal Income Tax Cuts - (\$26b over 3 years)

Key changes from 1 July 2008 were that:

- the Low Income Tax Offset (LITO) will increase from \$750 to \$1,200 and begin to phase out (at 4 cents per dollar of additional income) from \$30,000 rather than \$25,000. It will not phase out entirely until taxable income reaches about \$60,000
- the 30 per cent threshold will increase from \$30,001 to \$34,000
- the 40 per cent threshold will increase from \$75,000 to \$80,000
- the 45 per cent threshold will increase from \$150,000 to \$180,000

The difference with the \$29b in Coalition tax cuts over the remaining three years from 2008-2010 was \$2b in savings by deferring tax cuts for those earning over \$180,000 (a top marginal rate of 40%, which was never implemented). An additional \$9B was saved by reducing various income tax concessions.

## Labor's tax cuts 2008

2007-08		2008-09	
Tax thresholds	Tax rates	Tax thresholds	Tax rates
0 - 6,000	0%	0 - 6,000	0%
6,001 – 30,000	15%	6,001 – 34,000	15%
30,001 – 75,000	30%	34,001 – 80,000	30%
75,001 – 150,000	40%	80,001 – 180,000	38%
150,001+	45%	180,001+	45%
LITO: \$750 up to \$25,000		LITO: \$1,200 up to \$30,000	

## Cost of Labor's 2008 tax cuts (\$m)

Year	2008-09	2009-10	2010-11	Over 3 years
Coalition (2007)	-8,350	-8,785	-9,050	-26,185
Change (2008)*	0	1,150	2,000	2,160
Labor (2008)	-8,350	-7,635	-7,050	-23,035

\* Due to deferral of tax cuts for those earning over \$180,000

## Step 3: The GFC in 2008

The economy was unexpectedly hit by the international recession in late 2008. Due to slower economic growth and temporary stimulus measures, the Budget recorded a deficit in 2008-09 of \$27B.

*"The forecasts for MYEFO have been prepared against the backdrop of the most significant upheaval in global financial markets since the Great Depression. The fallout from the sub-prime crisis in the United States has spread around the world, with the global downturn now expected to be deeper and more widespread. The G7 economies are expected to be in recession in 2008, leading to a slowdown in growth in emerging economies. These global developments will have inevitable consequences for the Australian economy, with growth expected to slow to 2 per cent in 2008-09, ¾ of a percentage point lower than expected at Budget. However, Australia's sound fiscal and monetary policy position means it is better placed to navigate through this crisis than most countries."*

*MYEFO, November 2008*

### State of the economy and budget in 2008

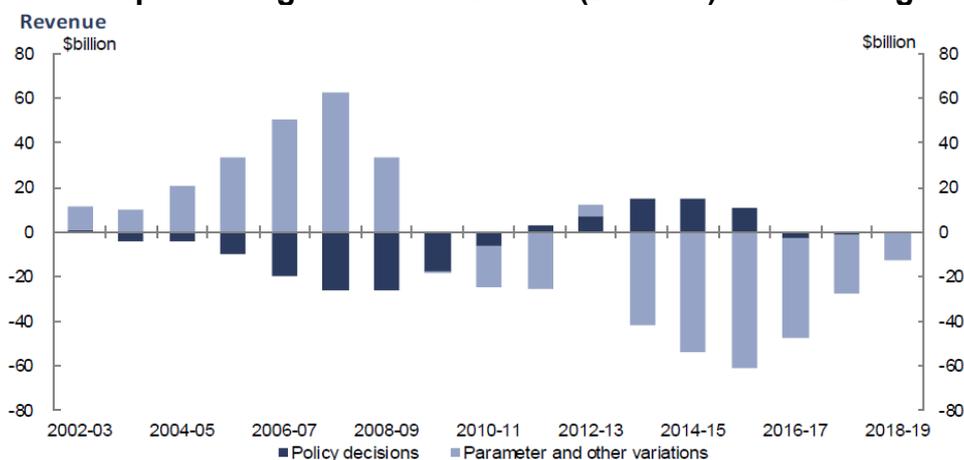
	2007-08 %	2008-09 %
Gross domestic product	3.9%	2%
Employment	2.5%	0.5%
Unemployment	4.3%	5.0%
Consumer price index	4.5%	3.5%
Wage cost index	4.2%	4.25%
Household consumption	3.9%	2.0%
Underlying cash budget balance (\$B)	\$20B	-\$27B

Source: Budget Paper No 1. 2008

### Step 4: A decade of budget deficits (2008-18)

The eight tax cuts provided from 2003 to 2010 had a major impact on the budget that was masked by the 'rivers of gold' from the mining and housing booms.

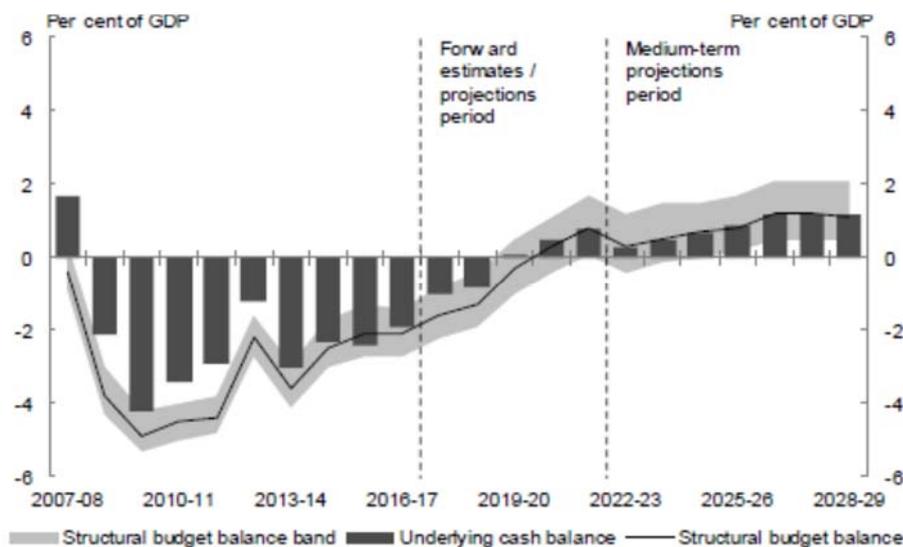
#### The impact of eight annual tax cuts (2003-11) on the Budget



Source: Parliamentary Budget Office (2016): Impact of policy divisions and parameter variations on the Budget outlook. Note: Dark shaded bars show the impact of policy decisions (tax cuts and increases) and the light bars show the impact of economic conditions (the boom up to 2008, and subsequent downturn).

The economic downturn, together with the impact of multiple tax cuts, sharply eroded public revenue. This was the main reason for the decade of budget deficits from 2008-18.

## Ten years of budget deficits (2008-18)



Source: Budget Paper No 1 (2018)

### Step 5: Spending cuts in the 2014 Coalition Budget

After the Coalition was elected in 2013, it declared a 'budget emergency' and following a 'Commission of Audit' announced the harshest spending cuts in decades in its first budget in 2014.

*"Repairing the Budget is necessary to protect living standards and prepare for an ageing population. Without action we face a decade of deficits and debt growing to \$667 billion by 2023-24. This equates to \$23,000 for every person in Australia, and would see the Government spending more on interest than on aged care by 2023-24."*

*"Budget repair also ensures future generations are not left to pay the price for **a level of Government services and support that we are simply not prepared to pay for.**" (emphasis added)*  
Budget Outlook (2014)

*"In order to repair the budget and deliver important structural reforms that will facilitate future growth in living standards, we are asking all Australians to contribute:*

- *In addition to major structural budget reforms to health, welfare and higher education, the Government is also implementing some time limited measures to deliver budget repair that is fair and equitable.*
- *Indexation for a large number of payments and programmes will be paused for two to three years. These include eligibility thresholds for transfer payments, thresholds for the Medicare Levy Surcharge and Private Health Insurance Rebate, and Medicare Benefits Schedule fees (except General Practitioner Services).*
- *As a group, lower income households will continue to receive significant transfer payments.*
- *Higher income earners, who already pay significant amounts of tax, will contribute further through the Temporary Budget Repair Levy.*
- *Public hospitals and schools funding paid to the States with borrowed money will be placed on a more sustainable footing."*

While some of the harshest measures (such as the six month wait for unemployment benefits for young people) were opposed in the Parliament; between 2014 and 2017, over \$15B was removed from social security and community services, including:

- \$12B in social security cuts over four years (from 2013) including freezes in family payments for the poorest families, a tougher penalty system for unemployed people, and longer waiting periods for payments for people with no private income;
- The ongoing freeze in Medicare rebates and cuts to public hospital funding;
- \$1.5B per year cut from essential community services, including Aboriginal and Torres Strait Islander services, community legal centres and refuges for victims of domestic violence.

More spending cuts are still on the books but have so far rejected by the Senate, including:

- A three year wait for social security for new migrants with no source of income, extended to four years in the latest Budget despite the Parliament’s rejection of the original proposal;
- Cuts to payments to assist people of working age on pension payments to study;
- Abolition of the \$4-7pw Energy Supplement for pensioners and unemployed people.

## Step 6: Tax cuts again

In the 2018 budget, the government announced \$140 billion in income tax cuts, in addition to \$65 billion in company tax cuts and the abandonment of a \$13B increase in the Medicare Levy. The new tax cuts would be implemented in three phases over six years, beginning with tax cuts for middle income-earners (again using low income tax offsets) and proceeding later to those for high income-earners (again by lifting top tax thresholds):

- (1) From 2018: A Low and Middle Income Tax Offset (on top of the existing Low Income Tax Offset) worth up to \$10pw for people earning \$21,000-\$125,000, plus a further increase in the lower threshold for the 37% rate from \$87,000 to \$90,000, worth \$3pw for those earning over \$90,000 (Cost: \$13B over four years);
- (2) From July 2022: The new tax offset is removed, the lower threshold of the 32% bracket is lifted from \$37,000 to \$41,000, the LITO is increased from \$445 to \$645pa, and the lower threshold for the 37% rate is lifted from \$90,000 to \$120,000;
- (3) From July 2024: The 37% tax bracket is abolished altogether, so that people earning \$41,000-\$200,000 all share a marginal tax rate of 32.5% (Table 1)

### The Coalition’s 2018 tax cuts

Marginal tax rate	Tax brackets (2018-19)	Tax brackets (2024-25)
0	Up to \$18,200	Up to \$18,200
19%	\$18,201 - \$37,000	\$18,201 - \$41,000
32.5%	\$37,001 - \$87,000	\$41,001 - \$200,000
37%	\$87,001 - \$180,000	-
45%	Above \$180,000	Above \$200,000

Source: Australian Government (2018): Budget Papers

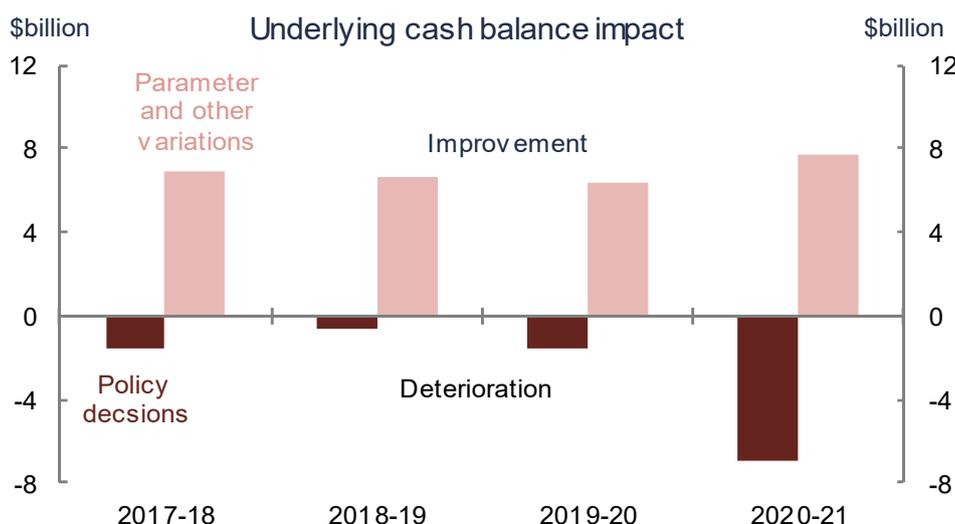
### Cost of the Coalition's 2018 tax cuts (\$m)

Year	Step 1 2018-21*	Steps 1+2 2022-28	Step 3 2024-28	Total 2018-28
Coalition (2007)	13,400	102,000	42,000	144,000

\* The Low and Middle Income Tax Offset introduced in 2018 is abolished in 2022, and its cost is included in the second column.

As was the case a decade ago, the budget assumes that these tax cuts can be delivered along with healthy budget surpluses, as the budget returns to surplus off the back of strong growth in personal and company tax revenues. Few expert commentators believe the budget projections, especially those for wages growth and growth in expenditure.

### Budget 2018 assumes the cost of tax cuts is more than offset by the effects of stronger growth in wages and profits

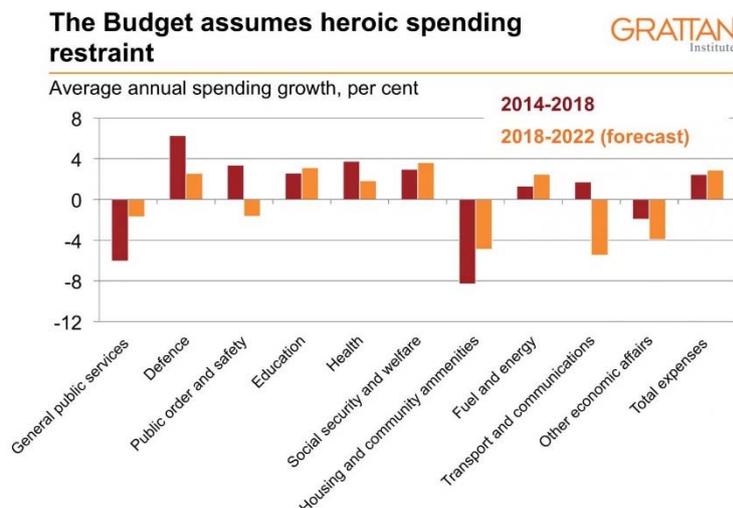


Source: PBO Chart pack (2018 budget)

Note: "Parameter variations" refers mainly to stronger than previously expected growth in wages and company profits. 'Policy decisions' refers mainly to the proposed personal income tax cuts.

The Budget projects average real (after inflation) growth in spending of just 1.6% per year from 2018 to 2022, below population growth and average federal government spending growth over the last 50 years. As the Grattan Institute points out, the Budget "assumes heroic spending constraint". For example, health spending is projected to grow by just 1.9% a year even without discounting for inflation.

## Budget 2018 rests on shaky spending projections



Sources: Commonwealth Budget Papers, 2018-19; Grattan analysis.

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Source: Coates & Wood (2018), Budget 2018: built on good fortune, relying on luck, Inside Story, Wednesday 9 May <https://grattan.edu.au/news/budget-2018-built-on-good-fortune-relying-on-luck/>

Note: These figures are not adjusted for inflation. On average, after inflation, the Budget projects annual spending growth from 2018 to 2022 of just 1.6%.

The Budget also rests on shaky revenue projections because by 2020-21 wages are assumed to grow by 3.5% a year (well above the last recorded outcome of 1.9% in 2016-17). There is no evidence to date to suggest that wages will accelerate that quickly. In addition, according to Deloitte Access Economics Budget Monitor, revenues from company income tax are over-stated in later years.<sup>2</sup>

### State of the economy and budget, according to 2018 Budget projections

	2018-19	2019-20	2020-21	2021-22
	%	%	%	%
Real GDP	3.0%	3.0%	3.0%	3.0%
Nominal GDP	3.75%	4.75%	4.5%	4.5%
Consumer Price Index	2.25%	2.5%	2.5%	2.5%
Wage Price Index	2.75%	3.25%	3.5%	3.5%
Employment	1.5%	1.5%	1.25%	1.25%
Unemployment	5.25%	5.25%	5.25%	5.0%
Household consumption	3.9%	2.0%	2.0%	2.0%
Underlying cash budget balance (\$B)	-14.5B	2.2B	11.0B	16.6B

Source: Budget Overview (2018)

Note: First two years are estimates, second two years are projections.

<sup>2</sup> Deloitte Access Economics (2018), Budget Monitor.

## Conclusion

The proposed tax cuts are before the Senate, with Labor and the cross bench yet to decide whether they will bake them into legislation covering the next six years.<sup>3</sup>

If the goal of the tax cuts is to compensate tax-payers from bracket creep, it makes no sense to lock in that “compensation” years in advance, before we even know how people will be affected by bracket creep. The risk to the budget, and to programs such as health, education and social security, are obvious.

‘Those who do not learn history are doomed to repeat it.’<sup>4</sup>

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### About ACOSS

The [Australian Council of Social Service \(ACOSS\)](http://www.acoss.org.au) is a national advocate for action to reduce poverty and inequality and the peak body for the community services sector in Australia. Our vision is for a fair, inclusive and sustainable Australia where all individuals and communities can participate in and benefit from social and economic life.

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<sup>3</sup> Labor proposes to increase the first round of tax cuts by 75% and has not decided whether to support the second or third rounds. The Australian Greens have decided to oppose the tax cuts entirely.

<sup>4</sup> Philosopher George Santayana