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Symposium

Australia's Tax and Transfer System Under Review: Evaluating Harmer and Henry

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Abstract

Two timely reviews of Australia's transfer and tax systems were commissioned by the incoming government in 2008, although the GST, tax exemption of superannuation payments to people aged over 60, and pre-announced personal income tax cuts were placed outside the scope of inquiry. Most of the recommendations of the Harmer Pension Review have been implemented, but most of the recommendations of the Henry Tax Review have not. The Henry recommendations provided for enhanced equity and efficiency through a broader and simplified base, concentrating revenue raising on personal and business income, private consumption, and economic rents from natural resources and land. They provide an integrated blueprint for ongoing debate over tax reform.

JEL Codes: H21; H55; I38

Keywords

Pension adequacy; public pensions; tax equity; tax efficiency; tax simplicity; taxation system; social justice; transfer system.

In May 2008, the Australian government embarked on a far-reaching review of Australia's tax and transfer system. The process involved two separate reviews: the (Harmer) Pension Review, and the review into Australia's future tax system (the Henry Tax Review). Both were timely and comprehensive, and represented the first thorough reviews of public pensions since the Social Security Review of 1986–88 and of Commonwealth and state taxes for nearly 50 years. The reviews were both characterised by broad community consultation combined with input from policy, academic and private sector experts. However, the outcomes have been quite different. Almost all of the 30 findings of the Pension Review have been implemented or considered by government, while most of the 138 recommendations of the Henry Tax Review have been largely ignored.

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The Pension Review was commissioned in May 2008 and led by the Secretary of the Department of Families, Housing, Community Services and Indigenous Affairs, Dr Jeff Harmer. The focus was the financial security of seniors, carers and people with disability, and the investigation was to include a review of the Age Pension, Carer Payment and Disability Support Pension. Aspects examined included pension adequacy, indexation arrangements, pension design and delivery, the concessions and services that support the pension system, targeting, and the long-term sustainability of the pension system (Harmer 2009).

The government responded in the May 2009 Budget with the 'Secure and Sustainable Pensions' package of reforms (Australian Government 2009). Almost all of the recommendations of the Pension Review were accepted and subsequently implemented, including:

- an increase in the single pension from 25 per cent to 27.7 per cent of male total average weekly earnings (MTAWE), reflecting an increase in the single pension from 60 per cent to 66 per cent of the couple pension;
- a consolidation of the piecemeal pensioner benefits and allowances into a single Pension Supplement paid fortnightly, plus additional support for Carers, Disability Support Pensioners and Veterans;
- enhanced indexation of pensions and benefits, with pension increases to be benchmarked to the greater of the CPI, MTAWE and a new Pensioner and Beneficiary Living Cost Index;
- improved targeting, with an increase in the income test taper from 40 cents to 50 cents;
- better incentives for continued labour force participation of elderly workers, through a concession in the Age Pension income test for employment income; and
- a gradual increase in the Age Pension qualifying age for both men and women to age 67 by 2023.

The review into Australia's future tax system, chaired by Dr Ken Henry, Secretary of The Treasury, was similarly comprehensive. The terms of reference noted that 'the review … will examine and make recommendations to create a tax structure that will position Australia to deal with the demographic, social and environmental challenges of the 21st century' (AFTS 2008: 261). Almost all Commonwealth and state taxes and their interactions with the transfer system were under consideration, including:

- taxes on work, investment and consumption and the role of environmental taxes;
- the interface of the tax and transfer system for individuals, families and retirees;
- the taxation of savings, assets and investments, including the role and structure of company taxation;
- the taxation of consumption and property and other state taxes;
- tax system simplification, including the interactions between federal, state and local government taxes; and
- the interrelationships among the elements of the tax system, as well as the (then) proposed emissions trading system.

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Explicitly excluded was consideration of the GST, the tax free superannuation payments to the over 60s, and the pre-announced personal income tax cuts (Swan 2008).

The final report was delivered to the Treasurer in December 2009 and then released to the public prior to the May 2010 Commonwealth Budget. The recommendations provided an integrated framework for a comprehensive and substantial renovation of the Commonwealth–state tax architecture. The key focus was to enhance equity and efficiency through base broadening and simplification and to concentrate revenue raising on four tax bases: personal income, business income, private consumption, and economic rents from natural resources and land. Over time, this would allow for the abolition of numerous complex and inefficient Commonwealth and state taxes, including insurance taxes; payroll tax; property transfer taxes; stamp duties; resource royalties; luxury car tax; tax on superannuation contributions; income taxes on all government pensions, allowances and benefits; and fuel and vehicle registration taxes (AFTS 2010a).

The immediate government response was disappointing. Rather than release the comprehensive and informative report for public debate, the government immediately announced plans to introduce just a handful of the 138 recommendations. These included a Resource Super Profits Tax, a modest cut in the company tax rate, and an increase in the superannuation guarantee from 9 per cent to 12 per cent (which had not been advocated by the review). More than a handful of recommendations were specifically ruled out (Swan 2010). Subsequent developments led to a revision of the original Resource Super Profits Tax into a Minerals Resource Rent Tax, and piecemeal implementation of some of the minor recommendations. Public debate on the tax system was then belatedly invited through participation at a national Tax Forum in October 2011. Nevertheless, the three volumes that comprise the Final Report of the Henry Tax Review provide a comprehensive and well-integrated blueprint for ongoing debate about Australia's future tax system (AFTS 2010a, 2010b, 2010c).

The five articles in this Harmer–Henry symposium present a collective evaluation of key components of the Harmer Pension Review and the Henry Tax Review.

The political debate which led to the establishment of the Pension Review concerned the adequacy of the Age Pension and, as noted above, the main finding of the Pension Review, subsequently implemented, was for an increase in the single rate of pension both in absolute terms (25 per cent to 27.7 per cent MTAWE) and relative to the couple rate (60 per cent to 66 per cent). While it was argued that this would improve 'adequacy', no specific benchmark for evaluation was offered. The opening article from **Peter Saunders and Melissa Wong** contributes to this debate by examining the impact of these pension changes on 'adequacy', as defined under a deprivation framework. The authors identify 'deprivation' as existing when someone does not have and cannot afford items that are regarded as essential or necessary for everyone to achieve a minimum standard of living. Estimation of deprivation measures for different groups of social security recipients before and after the Pension Review reveals that the case for increasing the Age Pension was actually weaker than the case for increasing payments to persons affected by disability, sole parenthood or unemployment.

As well, within the age pensioner group itself, the strongest case for payment increase was actually for those living in rental accommodation — not those living alone, who were the recipients of the significant increase implemented in the Secure and Sustainable Pension package of May 2009.

The next contribution by **Geoffrey Kingston** presents an overview of the basic structure of Australia's tax and transfer arrangements, as well as a summary of the key proposals among the 30 findings of the Harmer Pension Review and the 138 recommendations of the Henry Tax Review. On the Pension Review, Kingston supports the renewed emphasis on targeting, the simplification of the pension means tests through deeming, and the renewed focus on labour force participation for Disability Support Pension recipients. However, he is critical of the failure to address the favoured treatment of owner-occupier housing in the pension assets test. He is also sceptical that an increase in the Age Pension age will facilitate the affordability of the pension increase, with most men and women currently retiring well before the current Age Pension eligibility age of 65. Kingston expresses moderate support for many of the recommendations of the Henry Tax Review, but is particularly critical of the recommended Resource Super Profits Tax (and its successor, the Minerals Resource Rent Tax), which ignores the option value to delay or abandon projects. He also laments the lost opportunity to revisit the allocation of spending and taxing between state, local and federal governments.

An underlying theme in the Kingston contribution is that neither the Pension Review nor the Henry Tax Review took place at arm's length from the central bureaucracy. The Pension Review was chaired by the then head of the Department of Families, Housing, Community Services and Indigenous Affairs, and the Tax Review was headed by the then head of the Treasury. Kingston suggests that this led to the predictable result of unconditional increases in spending (for example, through the increase in pension amounts), combined with the announced tax increases via a Resource Super Profits Tax. Kingston argues that while there is a lot to like in the Harmer and Henry reviews, future reforms of the tax-transfer system should focus more on promoting saving and investment, including in human capital.

The article by **Ben Spies-Butcher and Adam Stebbing** looks more specifically at the recommendations and outcomes of the two reviews as they apply to retirement income policy. The focus of these authors is the dual welfare model, which combines direct spending (such as through the provision of the Age Pension) with private welfare subsidies (by virtue of the tax expenditures for superannuation and housing). They argue that while the initial expansion of superannuation may have brought Australia closer to the distributional outcomes of European models of income-related public pensions, the expansion of superannuation alongside broader deregulation, and the continued tax subsidy of savings, led to potentially less equitable effects, increasing not only inequality but also exposure to market risk. Spies-Butcher and Stebbing conclude that because the analysis and recommendations of both the Pension Review and the Henry Tax Review are based upon, and support, the dual welfare model, there is limited scope to improve equity and efficiency over the longer term without broader reform of the policy framework.

The standard criteria for public policy consideration of taxes and transfers are the competing claims of efficiency, equity and simplicity. The article by **Anthony Asher** takes a less conventional approach by evaluating the Australian retirement system post the Pension Review and the Henry Tax Review using a framework of 'justice'. Asher defines justice as an extension of equity, requiring a full consideration of the criteria of needs, equality, liberty and 'just deserts'. He argues that applying these criteria leads one to conclude that the Australian retirement system intrudes on the liberty of some groups of stakeholders inconsistently and inappropriately. Examples highlighted include requiring mandatory superannuation contributions at younger ages, imposing unnecessarily bureaucratic means tests on public benefits, and failing to provide adequately for the incapacitated older aged. Asher argues that none of these deficiencies was sufficiently addressed by either review. He concludes with four suggestions to better address considerations of justice. These include access to superannuation (within appropriate limits) to repay mortgage debt, compulsory annuitisation of superannuation accumulations at retirement, exclusion of personal effects from the pension assets test, and integration of the means tests tapers with the tax system.

A notable feature of the Henry Tax Review was the exclusion of the GST and the tax exemption for superannuation benefits under the terms of reference. In the final contribution to the symposium, **John Freebairn** presents the case for changes in the GST as a key part of fundamental tax reform in Australia. He suggests that a more comprehensive tax base for the GST, along the lines of that applying in New Zealand, would remove distortions to consumption and some production decisions. As well, the revenue gains of a broader base for the GST, and/or a higher rate of GST, could be used to eliminate some of the more distorting and less efficient taxes, such as state stamp duties, and fund lower income tax rates. Freebairn argues that, overall, a broader and higher GST would bring efficiency gains, enhance simplicity, and allow the equity goals to be better and more appropriately met by the income transfer system.

Overall, the contributions to the symposium provide a compelling case for continued attention to be paid to the ongoing reform of Australia's tax and transfer architecture.

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