Australian National University

CASTLES AND HENRY: DEBATING SHORT AND LONG-TERM REFORM OF TAX AND SOCIAL SECURITY

ROUNDTABLE SUMMARY

HC Coombs Policy Forum

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Workshop summary

Castles and Henry: debating short and long-term reform of tax and social security

12 and 13 October 2011 Canberry/Springbank Room, JG Crawford Building, ANU

Ken Henry may well have been right that the Tax Forum discussions could have been scripted beforehand. But a roundtable of experts in tax and social security held after the Forum made a lot more headway while also highlighting the areas where more expert and public debate is needed.

The experts, from the bureaucracy, academia and elsewhere (including several Henry Committee principals), met in honour of Ian Castles who passed away a year ago. The former Statistician and Finance Secretary was the supreme academic bureaucrat, and made major contributions to tax-transfers policy in the 1970s and 1980s including as Chair of the Income Security Review under Whitlam and Fraser. His work still resonates, with several aspects bearing remarkable similarity to Henry's recommendations 30 years later; others, however, suggest a different approach.

The Castles Roundtable identified several immediate priorities:

> Increasing the tax threshold and simplifying the personal income tax scale

> Addressing the growing gap between the maximum rates of age and disability pensions and those for NewStart and sole parents

> Increasing rent assistance

> Addressing the lack of lifetime annuities in our superannuation system

> Reducing the subsidies for superannuation for high income groups.

These priorities, all consistent with Henry's recommendations, would not just improve equity in the tax and transfers system where inequities are most evident, but would also reduce complexity and improve the effectiveness of superannuation policies. They were also identified because any adverse impact on efficiency would be limited (and, in the case of the tax changes, they should improve economic efficiency).

Roundtable participants recognised the challenges for a minority government, particularly its already substantial health and welfare agenda (including the major Productivity Commission agendas on aged care and disability) and tight fiscal constraints. The priorities identified therefore are modest, and should be attractive across the political spectrum.

The Government has announced initial steps towards increasing the tax threshold as recommended by Henry, and removing the complex array of income-tested tax offsets. But it needs to go the full distance to Henry's recommended $25,000 (almost exactly equivalent to the threshold level set by Fraser in 1978 on Castles' recommendation) and to index this.

The case for increasing Newstart is based not only on equity (there is no evidence that levels of ‘adequacy’ differ between pensioners and the unemployed and sole parents) but also on data suggesting that eligibility conditions (including work tests) are more important to work incentives than levels of payment.

Increasing rent assistance would help the indisputably most disadvantaged social security recipients: those in private rental housing. It would also reduce the gap with the much higher subsidies for those in public housing which adds to public housing demand and presents an obstacle to longer-term reform of public housing and housing markets.

The absence of life-time annuities is perhaps the most stark weakness in Australia’s superannuation arrangements. Regrettably, the Government ruled out even considering the Henry option to sell annuities. Yet there is clearly market failure here, and the absence of life-time annuities (only about thirty – yes, thirty – were sold across Australia in the last six months) means superannuants are relying on age pensions to cover their longevity risk, at unnecessary cost to taxpayers.

The other glaring problem in superannuation tax arrangements is the generosity to high income groups, with the considerable risk of tax avoidance. While there was debate about the preferred long-term model for taxing superannuation, there was no disputing the need to increase the tax on higher income groups. The simplest option is to increase the tax on contributions from incomes above $180,000 from 15 to 25 per cent, consistent with Henry’s approach.

The two main unresolved issues at the roundtable were the role of family assistance in achieving horizontal as well as vertical equity, and the preferred long-term model for taxing superannuation. On both issues I admit to being the one who was most uneasy about the Henry approach, drawing heavily on the work of Castles who was the instigator of the 1976 family allowance reform and the 1983 changes to taxing superannuation lump sums.

Henry highlights the tension between horizontal and vertical equity, giving priority to the latter. But horizontal equity – ensuring tax truly reflects capacity to pay – is not necessarily in conflict with vertical equity as it allows revenues to be maximised, which could then be used to achieve vertical equity. Moreover, having a significant part of family assistance universal offers substantial efficiency gains, reducing the overlap between tax and income tests.

While there was agreement that more universality would rate better on Henry’s simplicity and efficiency criteria, there was disagreement about how it would rate on equity and pragmatism.

Henry was constrained by his terms of reference to leave superannuation benefits untaxed. Yet the orthodox approach to superannuation is to exempt contributions and to tax benefits, in order to facilitate the spreading of lifetime earnings. In theory the two approaches are equivalent, one just bringing forward revenue otherwise received later. But is that fiscally responsible with an ageing population? And is the Henry approach still overly generous? On the other hand, is it now impossible to unwind Costello (and aspects of Keating) and move back towards the orthodox approach?

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