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# **Tax Reform, the GST and Women**

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## INTRODUCTION

New Zealand introduced its Goods and Services Tax (GST) in October 1986. Like the Australian Opposition's Fightback! package, the tax was part of a package of reforms to the income tax and social security tax system.<sup>1</sup> This makes it important to look at New Zealand's GST, and its Australian sibling in Fightback!, as an element of a wider system.

There are obvious similarities between the New Zealand reforms and the proposed Fightback! package, but there are also important differences. These differences mean the Fightback package cannot be so easily justified by extreme inequities and inefficiencies in the system it replaces. They also mean that the effects of the tax reform package on revenue, prices, incentives, and in particular on equity of a GST, would not necessarily be the same as in New Zealand. In particular it is likely, for reasons outlined below, that introducing a GST in Australia as proposed by the Fightback! package will be more inequitable in its overall impact than the New Zealand tax reforms. And, as in New Zealand, women are likely to be particularly disadvantaged by the introduction of GST and the shift to greater indirect taxation.

These similarities and differences are identified below. The evidence on the effect of the New Zealand tax is examined with a particular emphasis on how the changes affected New Zealand women. Such a review highlights a covert agenda of the Fightback! package which has important implications for Australian women.

The paper is structured as follows. Firstly, the article overviews the New Zealand tax system in 1985-86, to see how it compares with Australia's current tax system. Then it looks, in turn, at how the changes have affected taxation equity; inflation and prices; family finances and the financial status of women; and government revenue.

## BACKGROUND TO NEW ZEALAND'S GOODS AND SERVICES TAX

It is generally taken to be a Bad Thing to raise revenue by high rates of tax on a narrow range of incomes. Economists argue such taxation is economically distorting, encourages evasion and avoidance, and is highly inequitable between taxpayers. It also makes the income tax system less progressive<sup>2</sup> as tax avoidance allows high income earners to reduce their burden and contribution to taxation revenues.

When the GST was introduced, the New Zealand tax system was in considerable disrepair - rather like the Australian tax system was in 1985, and in some respects worse.<sup>3</sup>

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<sup>1</sup> The post-1986 reforms expanded the coverage of income and consumption taxation. Income tax base-broadening included abolishing various income tax concessions, exemptions and deductions, introducing a fringe benefits tax, introducing tax-withholding arrangements for interest income, and reforming the taxation of superannuation contributions and benefits. Income tax rates were lowered and the scale simplified to a three-step scale. Social security and family assistance was also increased and rationalised.

<sup>2</sup> A progressive tax is one for which the tax burden (tax as a share of income) increases with income.

<sup>3</sup> New Zealand in 1985-6 raised the equivalent of around 30 per cent of Gross National Product in taxes. Some three quarters of this came from income taxes. This made New Zealand more reliant on

Australia, while raising a similar share of GNP in tax revenue, has by comparison a somewhat more diverse, efficient and equitable tax system.<sup>4</sup>

New Zealand's GST replaced its wholesale sales tax (WST). Specific excise taxes remained on commodities such as tobacco, alcohol, motor vehicles and fuel. GST was introduced at twice the rate needed to replace WST, at 10 per cent. The extra revenue was used to reduce income taxes, as well as to compensate some groups disadvantaged by the move to GST. As a result there has been a change in the taxation mix - a reduction in (progressive) income taxes and a corresponding increase in (less progressive) consumption taxes.<sup>5</sup>

The Federal Opposition proposes a similar strategy for Australia, increasing indirect tax reliance, introducing broad based consumption taxation, and reducing personal income taxation. As in New Zealand, the Opposition proposes introducing a GST at a rate well above that needed to replace the WST, and using the surplus revenue to cut other taxes or provide compensation for the regressive effects of the change.

However, while the New Zealand WST had many similarities to our current WST, the Australian WST had a substantially broader coverage. This makes it a less distorting and less inequitable tax.<sup>6</sup> It also means that it is a more productive tax than WST was in New Zealand.<sup>7</sup> It followed from this that any GST introduced into Australia must be at a higher rate than in New Zealand to replace the revenues from WST. The Opposition also plans to use GST revenue to replace the fuel excise and payroll taxes.<sup>8</sup> This too means the rate of GST must be higher than in New Zealand; in Fightback! the rate of GST proposed is 15 per cent.

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income tax than any other OECD country (OECD, annual) This tax was levied at high rates on a narrow base.

<sup>4</sup> Australia has relied on income tax for around half of total taxes (OECD annual). However, in comparison with New Zealand in 1985-6, and particularly as a result of the post-1985 Keating tax reforms, the current Australian income tax is relatively broadly based. Unlike the New Zealand income tax in 1985, it now taxes capital gains and fringe benefits. It also has substantially fewer concessions, exemptions, or deductions from income than did New Zealand in 1985.

<sup>5</sup> Since GST was introduced, the share of indirect taxes has increased, from around 20 to 33 per cent of all taxes. GST now also accounts for a greater share of indirect taxes than did the previous wholesale tax (around 46 per cent of indirect taxation compared to 40 per cent in 1985-86).

<sup>6</sup> The NZ WST had rates ranging from 10 to 50 per cent, the standard rate being 20 per cent. However, in New Zealand nearly 70 per cent of goods and all services were exempt (Australian Taxpayers' Associations 1988). This made the New Zealand sales tax more narrowly based than the current Australian sales tax, which exempts only around 70 per cent of the total consumption tax base (Groenewegen 1985). The rates of Australian sales tax are also somewhat lower and less variable: the standard rate is 20 per cent while rates range from 7 1/2 to 32 1/2 per cent. Reforms to WST currently being pursued by the Government may extend the Australian WST base somewhat.

<sup>7</sup> To replace revenues from the Australian WST a GST needs to be at a rate of least 7 per cent. Indeed, Australia ranks about average with other OECD countries in its reliance on indirect taxes, while New Zealand has been well below the average (Head 1983, p11).

<sup>8</sup> In fact some 80 per cent of GST revenue would go to replacing existing indirect taxes, rather than reducing income taxes.

These differences between New Zealand's 1985 income and consumption tax system, and Australia's current tax system are significant. They suggest that economic arguments for a shift in the balance of taxation, that is reducing income taxation and increasing consumption taxes, are less compelling in Australia than they were in New Zealand. Australia's greater current reliance on indirect tax revenues, and the higher rate of GST proposed also makes compensation more of an issue than it was in New Zealand

Keeping in mind these important differences in the policy context, the following sections examine the results of tax reforms in New Zealand and the implications for women in Australia under the similar Fightback! proposals.

### TAX EQUITY AND THE PROGRESSIVITY OF TAXATION

Consumption taxes are generally regressive, taking up a higher share of the incomes of lower income earners than higher income earners.<sup>9</sup> Income taxes are generally viewed as progressive, because the average tax imposed rises with income.<sup>10</sup> A traditional concern over raising revenue through indirect taxes has therefore been the effect on 'vertical equity' - the overall progressivity of taxation.

It was argued in 1985-6 in New Zealand that the indirect tax reforms including GST would not necessarily be more regressive than the existing wholesale sales tax.<sup>11</sup> It was also expected that the reforms overall would increase the progressivity of the tax system by making income taxes more effectively progressive.<sup>12</sup>

However, the 6 years of experience in New Zealand with a GST has shown this has not been the case. Studies of the effect of the post-1986 tax changes in New Zealand show that the reforms reduced overall tax progressivity; the effect of higher consumption taxation outweighed changes in the incidence of income tax.<sup>13, 14</sup>

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<sup>9</sup> Higher income earners tend to save a greater share of their income, thus avoiding consumption taxes, and making a flat-rate tax on consumption a regressive tax on income.

<sup>10</sup> However, if high income earners can substantially avoid tax, the income tax system may not be effectively progressive even if its structure is nominally progressive.

<sup>11</sup> See Scott et al 1985; Broad and Bacica 1985.

<sup>12</sup> The income tax reforms - base broadening and anti-tax avoidance measures, plus lower rates - were anticipated to reduce both the incentive and opportunities for higher income earners to avoid tax (New Zealand Treasury 1987). Higher social security and family assistance payments were to offset the effect of higher taxes on the disposable incomes of lower income groups.

<sup>13</sup> See Snively 1989; Stephens 1989; Stephens 1990.

<sup>14</sup> Measured in the slightly different way preferred by the Australian Opposition as a measure of equity - as the share of taxation levied on the better off - the changes have also been shown to have worsened the fairness of the tax structure (See Snively 1988). Measured in the same way, there was a slight improvement in the nominal progressivity of the income tax up to 1988. However, for individual women, the benefit of such improved progressivity of household incomes is more ambivalent: the change appears to be due to rises in the income tax burden on secondary earners - usually women - in high income households as a result of fiscal drag and the strategy of concentrating income tax reductions at the higher end of the scale. Although low and middle income earners in total paid a slightly lower share of total income tax from 1986, this was more than offset

In spite of expectations that GST would be less regressive than the existing WST - this has not been the case. GST is in fact more regressive than the WST it replaced. In addition, the regressivity of remaining excise taxes worsened from 1986.<sup>15</sup>

These studies of tax incidence are based on surveys of household expenditure. They assume that people pay the income taxes they are supposed to pay. Especially in the case of high income earners under the pre-1985 New Zealand income tax system, this was unlikely to be the case. An important issue which has not been settled in New Zealand, is how the actual tax burden has changed. That is, can we be sure that the reduced opportunities for income tax avoidance really ensured higher income earners actually pay of their (now somewhat smaller) true income tax liability, and are therefore carrying more of their share of the tax burden? The answer it would seem, is 'no'.<sup>16</sup> However, there is little doubt that the apparent reduction in indirect taxation for the well-off and the increase in indirect taxation for the less well-off did occur; it is virtually impossible for consumers to avoid GST.

All but one of these studies relate to the tax system in place in New Zealand from 1986 to 1988. After these studies were done, there were substantial cuts to income taxation for higher income earners and GST was increased to 12.5 per cent without any compensation other than to beneficiaries. These measures reinforce the regressive effect of the 1986 package and reduce the overall progressivity of taxation in New Zealand to an even greater extent than evidenced in the above-mentioned studies.<sup>17</sup>

Combined with the post-1986 erosion of the value of compensation (discussed below), post-1988 changes to taxation in New Zealand must cast strong doubts on whether the tax system was made more progressive or equitable by the 1986 package.<sup>18</sup>

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by their increased share of indirect taxes with a reduction in the share of indirect tax borne by the more well off. See Snively 1988, 1989.

<sup>15</sup> Although it is difficult to compare the two directly as some items previously covered by the WST were taxed instead by excises after 1986 (Snively 1989).

<sup>16</sup> The increased tax burden on high income earners shown in such studies reflects the abolition of income tax deductions which gave the most benefit to high income earners. To the extent that this was the only form of tax avoidance, the reforms increased the effective income tax burden on higher income earners. However, high income earners could also avoid tax through channelling income through trusts, partnerships and companies or into forms of income subject to lower marginal rates of tax. It is not clear to what extent this kind of tax avoidance has been prevented by the reforms, as capital gains are an important source of such tax benefits and New Zealand has not followed through its intention to implement a capital gains tax.

<sup>17</sup> Accompanying the rise in GST were reductions in petrol excise taxes. Excise taxes are generally somewhat more regressive than GST, which taxes services consumed proportionally more by higher income households. However, while the reduction in excise moderated the effect on the CPI, it is unlikely to significantly reduce the regressivity of indirect taxation. As the increased GST was a revenue measure, and intended to increase the indirect share of taxes, the overall tax mix is likely to have become less progressive.

<sup>18</sup> Stephens (1990) surveys the New Zealand tax system since the 1989 increase and concludes that the reforms have significantly increased the disposable income of higher income individuals, with negligible or negative effects on disposable incomes of low and middle income groups.

Although the former New Zealand Minister for Finance showed considerable interest in introducing some sort of annual wealth tax, proposals to maintain equity during the tax mix change in New Zealand did not include extending New Zealand's wealth taxes.<sup>19</sup> Wealth and death taxes are the theoretical complement to indirect taxation. In Australia, the 1975 Asprey Review of the Taxation System, which first recommended a shift towards consumption taxation, saw wealth taxes as essential to such a strategy.<sup>20</sup> Wealth or wealth transfer taxes, notably a reformed system of estate and gift duties, were the means by which progressivity would be retained under such a system, and windfall gains to higher income individuals from income tax cuts offset.

In summary then, there is evidence that even the substantial income tax broadening and social security measures accompanying the introduction of GST in New Zealand did not offset the increased consumption tax burden on low- to middle-income households. There appears to be no evidence that the reforms increased the effective income tax burden on higher income earners. The evidence suggests New Zealand tax system is less redistributive as a result of the tax reforms.

The major implication of this for Australia is that replacing WST and other taxes with a GST is indeed likely to be to place a heavier tax burden on low and middle income groups. In particular, there are no proposals in *Fightback!* which would substantially improve the progressivity of income tax; indeed opportunities in Australia to offset the regressive effects of higher indirect taxation through making the income tax broader based and more progressive have been largely exhausted.<sup>21</sup> For Australia, maintaining even the existing degree of tax progressivity with the tax-mix change contemplated in *Fightback!* requires extending or introducing wealth or wealth transfer taxes or removing existing politically sensitive taxation concessions for implicit dwelling rents, capital gains and superannuation.

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<sup>19</sup> Unlike Australia, New Zealand has retained estate and gift duties, more commonly known as 'death taxes'. However, the tax is levied only on very high valued estates over \$250,000, exempts most matrimonial property and is widely avoided. There are reasons to suspect it is no longer considered an important element of the tax system; its revenue yield has dwindled to insignificant levels with a blind eye turned to avoidance and evasion, and there are pressures for further watering down of the tax.

<sup>20</sup> Taxation Review Committee 1975. In fact every major expert review of Australian taxation in the post-war period, (the 1964 Downing study (Downing et al 1964), the Taxation Review Committee (TRC 1975) and two Senate inquiries into the Commonwealth Estate and Gift Duties in 1972-3 and 1974), recommended the maintenance and/or extension of wealth taxation in Australia. The Commonwealth Treasury in its submissions to the Asprey Committee (Treasury 1974a; Treasury 1974b) also supported retaining death duties for equity reasons. Since the politically opportunist abolition of estate duties during the 1970s, Australia is virtually unique among OECD countries in having no such general tax on wealth (Pedrick 1981). While the administration of wealth taxes is often cited in opposition to such taxes, the OECD in its survey of member countries' experiences with wealth taxes reported that 'no country with a net wealth tax considered it more difficult to administer than income tax and some specified that it was less so.'(OECD 1979, p127).

<sup>21</sup> In any case the Opposition does not propose any income tax base broadening measures, and is known to favour reversing some previous base broadening measures.

## INFLATION AND PRICES

The GST in New Zealand was introduced at a rate of 10 per cent on virtually all goods and services, including electricity, telephone charges, rates, insurance, new homes and agents fees, and childcare and government-provided goods and services such as health services. The major exemptions from the tax were dwelling rents, most second hand goods and financial services.

In Australia the Opposition proposes that dwelling rents and financial services be exempt, as in New Zealand.<sup>22</sup> However, unlike in New Zealand the Opposition proposes zero-rating health and education and non-commercial government activities (presumably including local government rates).

Shifting the mix of taxation towards indirect taxes can be expected to produce an increase in the price level. GST raises prices directly and indirectly if the initial shift in prices is built into price expectations and bargaining behaviour.

The overall effect a GST on inflation was significantly under-estimated in New Zealand. This was very important because compensation was based on estimates of inflation from GST, not the actual effect. Because the WST was abolished when GST was introduced, it was not expected that the whole 10 per cent rate of GST would be reflected in price increases; the net direct effect was anticipated to raise prices by only around 5-7 per cent.<sup>23</sup> In the event, it appears that the introduction of GST fed nearly fully into prices, with traders fully passing on the tax to consumers; inflation increased initially from 13 to 18 per cent as a direct result of the change. This raised prices by at least 7 or 8 percentage points in total. Subsequent indirect effects appeared to add another 2 to 3 per cent.<sup>24</sup> The higher inflationary impact meant compensation was generally inadequate.

The Consumer Price Index (CPI) used to measure inflation (and calculate compensation for GST) is only an average of price changes. However, some of the most important effects of GST for individual consumers were relative price changes: some goods and services increased in price being are taxed for the first time, some prices increasing by less because they had previously included WST. The effect on individual families or family types of introducing GST thus depends on their consumption patterns. Those with relatively high household consumption such as larger families and those with children will be harder hit than other households.

The New Zealand studies found that the larger the family, and the lower family income, the higher the relative burden of the indirect tax changes.<sup>25</sup> This is because the

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<sup>22</sup> This means that these industries will be 'input taxed' that is, they would be subject to taxation by virtue of facing the cost of taxation on inputs to their production of goods and services. This represents concessional taxation relative to industries subject to GST but higher taxation compared to industries which would be zero rated and could therefore claim a rebate of any GST paid against their GST liability.

<sup>23</sup> Scott 1985, Australian Taxpayers' Associations 1988.

<sup>24</sup> Australian Taxpayers' Associations 1988.

<sup>25</sup> Stephens 1990.

compensation offered to families with children was particularly inadequate for larger families; the purchasing power of family assistance has also since been allowed to erode with inflation.

This provides some pointers on the effect on Australian families of the Fightback! compensation measures. The Opposition has promised to double Family Allowance, and increase family assistance to low income families (Family Allowance Supplement) by 6 per cent (the expected average increase in prices from the indirect tax changes). However, as was the case in New Zealand low income families with children, especially those receiving Family Allowance Supplement and larger families, are likely to be significantly undercompensated for GST as compensation based on average rises in prices will not accurately reflect their increased costs.<sup>26</sup>

One of the most important items of concern to women that became newly taxed under New Zealand's GST was childcare services. Childcare is provided in the home is of course exempt from GST, but when provided for a fee by public or private childcare organisations it is subject to GST. Taxing childcare under GST in New Zealand from 1986 raised its cost significantly, as it was a service previously exempt from WST. Childcare is an important cost in many families' budget. It is also relevant to many consumption and production/work decisions that are ignored by most economists.<sup>27</sup> GST in New Zealand increased existing discouragements to paid labour force participation by secondary earners, usually women, in families with children. It especially affected women two-earner families reducing the net incomes of mothers in the paid workforce.<sup>28</sup>

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<sup>26</sup> Family allowances in Australia are currently very inadequate reflections of the costs of supporting children; the proposed increase in family allowance from its very low levels would be well below the levels needed to compensate for the higher than average food and clothing increases especially impacting on families from the GST. The timing of the promised doubling in family allowances is also not clear. Given the current system of indexing family allowances, doubling the current level of family allowances is not that different from where family allowances would be anyway by the time the GST would be implemented.

<sup>27</sup> Childcare is an important example of a 'service' which can be either provided in the home or in the market. In principle, a flat-rate GST on all goods and services does not distort consumption or production decisions because it does not change relative prices of different goods and services. What economists often forget however, is that such a tax may still distort work and consumption choices because it does not tax consumption of non-marketed goods and services. Of particular relevance to women, it excludes from taxation home-produced goods and services - that is the economic value of unpaid housework. Contrary to the assumptions of most economists, a GST changes the relative prices of such domestic goods and services in a way that WST, by exempting services, does not. According to Australian Bureau of Statistics' and others' estimates, such unpaid domestic production may add between 30-60 per cent to the value of Gross Domestic Product (*Australian Bureau of Statistics* February 1990; Ironmonger 1989; Smith 1987). They are thus clearly potentially significant in evaluating the economic efficiency implications of a GST imposed on the marketed alternatives to home produced goods and services.

<sup>28</sup> Interestingly in view of the Opposition's proposal for a childcare tax rebate, New Zealand's housekeeper/childcare tax rebate is one of the few income tax rebates that has survived the post-1986 tax reform process. This appears to be partly because direct government support for childcare has till recently been relatively low, and partly because of the disincentive the high cost of childcare presents to sole parent beneficiaries and married women with children.



It is not clear from the Federal Opposition's Fightback! document whether childcare services are classed as 'education' and hence zero-rated under the Opposition's GST proposal, or whether it would be fully taxed as a service.<sup>29</sup> Nevertheless, the point to note in relation to the Fightback! package is that the tax rebate for childcare in the package is no free lunch. If childcare is not zero-rated along with education, the tax rebate may well be just an offset (perhaps even partial) to the higher cost of childcare under the package. The tax rebate proposed by the Opposition is also unlikely to be fully available to many sole parents in the workforce whose incomes would be too low to fully benefit from the rebate. Ironically, the Coalition's GST may thus contribute to 'poverty traps' and perceived problems of 'welfare dependency' among this group of women. Presumably, such considerations underlie the Fightback! proposals to also provide some increased funding for childcare centres in addition to the childcare tax rebate. However, the arithmetic of taxing 'marketed' paid childcare is such that the cost of childcare will rise in spite of such tax and funding offsets for childcare in the Fightback! package. Women will be worse off, with childcare and employment choices even more constrained than now by the cost and availability of childcare.

In summary, considering the New Zealand experience, the adequacy of the measures proposed for childcare and family assistance under Fightback! might justifiably be regarded with suspicion by Australian parents.

#### **FAMILY FINANCES AND 'COMPENSATION'**

When GST was introduced in New Zealand, it was accompanied by substantial changes in family assistance arrangements.<sup>30</sup> A new family assistance program, Family Support (FS)<sup>31</sup> was the main form of compensation provided to low- to middle-income earners for GST; these households did not benefit significantly from the income tax cuts associated with the changes.

Because of such reforms to tax and family assistance, there were significant changes to the distribution of such payments within the family. Abolishing tax rebates for children and merging the amount with direct payments for children meant some low- to middle-income men's pay-packets were reduced. So instead of directing child

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<sup>29</sup> Whether or not childcare is zero-rated under Fightback!, the proposed zero-rating of education also raises a number of potential inequities and intractable 'boundary' problems in relation to pre-schools, and after-school- and holiday- care programs. In addition, a more intractable definitional problem will arise as to whether related educational services of this kind, such as vacation classes or camps in pottery, horseriding, etc would be zero-rated under the Fightback! package.

<sup>30</sup> Tax rebates (the Family Rebate and the Principle Earner Rebate) paid to principle earners were abolished or phased out, and various child payments to beneficiaries and low income families (Child Supplement, Family Care and Special Family Care) were merged into a program called Family Support (FS).

<sup>31</sup> This program is similar to Australia's Family Allowance Supplement but is paid through the tax system as an income-tested tax credit. The Department of Social Welfare sends payments to those who are not taxpayers. An element of FS is the Guaranteed Minimum Family Income (GMFI), which provides a tax credit to working families whose after-tax income falls below around \$17000 p.a. This provision produces effective marginal tax rates of 100 per cent for families with incomes below this amount. However, so few families (2000) are currently receiving GMFI that most discussion centres on FS 'proper'.

assistance to the primary carer (usually the mother), the new FS payment was paid half to the father, half to the mother.

This meant that while the new consumption tax resulted in increased shopping and household bills, much of the supposedly offsetting compensation for low- and middle-income families was paid to the man of the house, either through income tax cuts or increased family assistance. The major tax cuts to higher income individuals combined with tighter means-testing of FS in 1988 and the rise in GST in 1989, reinforced such intra-family distributional effect of the reforms. The net effect of this was to reduce the financial independence of women in New Zealand.

That this effect is a significant issue for social policy is demonstrated by studies in the UK,<sup>32</sup> New Zealand<sup>33</sup> as well as in Australia on family finances and married women's financial status within the family.<sup>34</sup> Such studies demonstrate that a significant minority of women have little say in how household income is distributed, especially those with no independent income source; many women relying on breadwinner support were found to have a significantly lower standard of living than their partners within the same household, and their status within the family declined along with their independent income. Referring to a New Zealand study of family finances,<sup>35</sup> the New Zealand Planning Council noted the importance women placed on having an independent income, observing that:

`a significant proportion of women do not have access to income earned by others, and where they do, it cannot be assumed that they share equally in the benefits of the income that is available, or have an equal say in how it is used.<sup>36</sup>

Significantly in the context of the GST debate, the Australian studies show that increases in prices are not always reflected in higher housekeeping money.<sup>37</sup>

The effect on women of this inequitable distribution of financial resources within the families thus raises important concerns at the strategy underlying the New Zealand reforms and the Fightback! tax proposals.

New Zealand in its income tax reforms has followed a strategy of `taxing the threshold', reducing rates on lower income earners less than for higher income earners on the presumption that most taxpayers in these low income brackets are `secondary' earners.<sup>38</sup> Most women are `secondary earners' - if they earn at all. Stephens notes that

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<sup>32</sup> Edwards 1981, reviews these and other studies.

<sup>33</sup> Society for Research on Women 1981.

<sup>34</sup> Edwards 1981; Office of Status of Women June 1985; see also ANOP May 1985.

<sup>35</sup> Society for Research on Women 1981.

<sup>36</sup> New Zealand Planning Council 1988, p67.

<sup>37</sup> Housekeeping money, often managed by the mother on behalf of the family, is in addition, often her only personal spending money.

<sup>38</sup> `Secondary' with the meaning `non-essential', `frivolous', `insignificant' `subordinate'. As noted above, it was mainly the higher tax rates on `secondary earners', in the main women, that increased the progressivity of the New Zealand income tax between 1986 and 1988.

the equity of this strategy rests on standards of living being based on the level of joint family income rather than individual income.<sup>39</sup>

However, research findings such as that by Edwards<sup>40</sup> undermine the equity justification for such a strategy of joint taxation and 'taxing the threshold'. As Stephens correctly observes, such studies were influential in New Zealand's decision in 1990 to pay all family assistance including Family Support to the primary carer.

Such research also implies that the Fightback! combination of higher consumption taxes on the household budget with 'compensating' income tax cuts to high-income earning individuals may significantly disadvantage many women within their own households. As the Convener of the National Women's Consultative Council observed at the 1985 Australian Tax Summit,

'The theory of money in the pocket after tax to meet extra demands on the purse is all very well - as long as the pocket and the purse belongs to the same person.'<sup>41</sup>

Another important aspect of compensation for the New Zealand GST was that it made many low- to middle-income families with children into 'welfare' recipients. Since GST was introduced, many more families are dependent on government income support to maintain decent living standards.<sup>42</sup> Furthermore, it should be noted that these family assistance programs are not indexed for inflation. This made families with children very vulnerable to Government budget stringency; since 1986, the purchasing power of this compensation has reduced markedly for this reason.

Compensation through the income tested FS program also increased poverty traps and effective marginal tax rates on all low- to middle income families with children receiving the payment.<sup>43</sup> This is because the amount of FS is reduced as family income rises, thus levying tax at the highest rates on the income of the lower earner in the family.<sup>44</sup> The extended reach of the FS program means that the effective marginal tax rate scale for all those - men and women - with children in New Zealand is not the 15, 28, 33 scale, but 100 per cent, 46 per cent, and 58 per cent.<sup>45</sup>

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<sup>39</sup> Stephens, 1990.

<sup>40</sup> Edwards 1981.

<sup>41</sup> Commonwealth Parliament 1985.

<sup>42</sup> The new FS program is income-tested, like the Australian FAS, on family income. But unlike FAS, FS is paid to many middle - as well as lower income families. Depending on the number of children, a family can still received FS on an income of \$30,000 pa or more. Brashares and Smith 1991.

<sup>43</sup> Brashares and Smith 1990.

<sup>44</sup> The original rate of abatement was 18 per cent on family incomes above \$14,000 p.a. In October 1988, to help offset the Budget costs of income tax cuts, the rate of withdrawal of FS was raised to 30 per cent for those in families with incomes above \$27,000 p.a.

<sup>45</sup> Marginal tax rates only reach 28 per cent or 33 per cent once family income increases above \$27,000 pa or higher, depending on the number of children. Only at that point does the nominal income tax scale apply to the tax assessments of New Zealand family members.

As a result, the group of taxpayers facing the highest effective marginal tax rates in New Zealand are not high income earners in top tax brackets, but sole parent beneficiaries, and secondary earners - usually women - in families; these people face rates much higher than the top income tax rate of 33 per cent.<sup>46</sup> Because of these high marginal rates it is these people that face the greatest discouragement to paid work (or saving) in New Zealand. Ironically, these are the groups whose labour force participation has been shown to be most responsive to taxation and other financial disincentives.<sup>47</sup>

Perhaps most importantly in the longer run however, New Zealand's compensation package implicitly extended the principle of family unit taxation to a major part of the New Zealand population.<sup>48</sup> Only members of relatively high income families, or those without children are now taxed as individuals.<sup>49</sup> As the New Zealand Treasury itself admitted in its evaluation of the 1986 reforms, while the changes, including the abolition of the Principle Earner and Family Rebates, removed a penalty on the second earner in a household:

`the changes to the tax structure did not go far enough in reducing the substantial disincentive effects formerly present;...Family Support and GMFL... continue to confuse the appropriate tax unit.<sup>50</sup>

If the tax system is based on the individual unit while social security and family assistance rests on family unit assessment, any compensation for GST made through these instruments will extend family income taxation to a larger part of the population. Most Australian women would resist this, the individual unit of assessment now being supported by most OECD countries because it is fairer between individuals, minimises distortion of the choice between paid employment and unpaid employment in the home, and is consistent with equal employment opportunity and independence for women.<sup>51</sup>

Thus it is significant that the Fightback! package, offsetting GST's deleterious effects on families by social security or income tested family assistance, would take the Australian taxation system towards family unit assessment. Proposals to tighten the income test on Family Allowance will, as it did in New Zealand, produce high effective marginal tax rates on middle income families, worsen poverty traps and further distort intra-household income distribution.

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<sup>46</sup> Brashares and Smith *ibid.*

<sup>47</sup> Killingsworth 1983.

<sup>48</sup> This is because the instruments used to compensate for GST (FS and welfare benefits) are income tested on family income, whereas taxation is generally levied on individual income.

<sup>49</sup> On account of FS alone, a significant part of the non-beneficiary population, some 150,000 adults, are subjected to effective family unit taxation. Some 500,000 others are beneficiaries facing income tests on joint or family incomes. Around 150,000 of these face even higher effective marginal tax rates on earned income from the combination of both FS and benefit withdrawal. Brashares and Smith 1990.

<sup>50</sup> New Zealand Treasury 1987.

<sup>51</sup> Commonwealth of Australia June 1985.

In summary, experience with New Zealand's tax reforms highlights that using social security and family assistance to maintain progressivity in a switch to indirect tax is at the expense of financial independence for many members of low- to middle-income families. The loss of financial independence and living standards is especially severe in its impact on women. This hidden implication of the Fightback! package needs to be more carefully scrutinised by Australian women.

## GOVERNMENT REVENUE

On the face of it, there is no reason why introducing a GST would necessarily be a bad thing in the long run. It is a very efficient, silent revenue raiser. The most redistributive countries in the world, in Scandinavia and Western Europe, make heavy use of such a tax to fund their generous social welfare system.

However, it is clear that in New Zealand, the cuts to income tax rates offered as part of the tax reform process, especially the 1988 cuts to higher income earners, were not affordable in the longer term. This highlights another covert agenda of the Fightback! tax reforms, severe cuts to public spending. Significant casualties of Budget problems caused by the tax reforms have been:

- . tighter income-testing of FS from 1988, (to offset the household distributional effects of the October 1988 income tax reductions for individuals<sup>52</sup>);
- . an uncompensated increase in GST from 10 to 12 1/2 per cent from July 1989, to reduce the fiscal deficit;<sup>53</sup>
- . the abolition by the National Government of Family Benefit (the New Zealand equivalent of Australia's Family Allowance) as a cost-cutting measure, with such allowances for children now seen as middle class welfare rather than equity in taxation between those with children and those without;
- . the reduction in the level of sole parents benefits and unemployment benefits to fix the perceived work incentive problems caused by high effective marginal tax rates on these groups;

<sup>52</sup> Note the comments above regarding the implications of such changes for the financial status of women working in the home and for income distribution within families.

<sup>53</sup> The budgetary need for the uncompensated increase in GST can be traced directly to the 1988 cuts in income tax, which mainly benefited higher income earners. Estimates of the significant adverse budgetary implications of the 1988 cuts were also an important element of the controversy surrounding Finance Minister Roger Douglas's aborted 1987 flat tax proposal and the alternative income tax changes in October 1988. Income tax scales after October 1986 had been:

Up to 9500	15 per cent
9500 to 30000	30 per cent
Over 30000	48 per cent

From October 1988 the rates were reduced to:

Up to 9500	15 per cent
9501 to 30875	28 per cent
Over 30876	33 per cent

- . general cutbacks to public spending on services such as health, education and welfare.
- . a significant reduction in the real value of compensation to low and middle income families for GST (the thresholds and rates of payment of family assistance, notably Family Support, were not indexed).

These budgetary policy measures are significant contributing factors to the worsening position of low or middle income families relative to high income households since 1986.<sup>54</sup> As a Commonwealth Treasury officer observed in a recent Brookings survey of world tax reform,

'Using tax cuts to force the pace on expenditure reductions - is inherently risky. It did not work in the United States. It has worked in Australia.'

And, one might add, it has worked in New Zealand.

The importance of the overt and covert fiscal agenda of the Fightback! tax reforms needs to be emphasised in the light of the New Zealand experience. The overt fiscal agenda is emphasised by the fact that only around one fifth of the cost of the Opposition's income tax cuts are funded by increases in other tax revenues. The Fightback document makes clear that most money for the tax cuts would come from cuts to public spending on health, housing, social security and other community services.<sup>55</sup> While the impact of these cutbacks on the distribution of incomes is difficult to pin-point, a 1987 Economic Planning and Advisory Council (EPAC) study concluded that such 'social wage' items were a redistributive instrument, with most outlays directed at low and middle income earners.<sup>56</sup>

The more covert fiscal agenda behind the Fightback! strategy is the significant possibility that the package is not revenue neutral as is claimed. There are good reasons for thinking that a significant amount of revenue, perhaps a billion dollars or more, is 'fudged' in the Fightback! estimates<sup>57</sup> If this is the case then there will be even more extreme pressures on public expenditures. Additional expenditure cuts would inevitably focus on the largest areas of Commonwealth expenditure such as social security and family assistance. Furthermore, it is clear, based on the New Zealand experience, that compensation for GST - once it is renamed 'middle class welfare' - is one of the first targets of such cutbacks. As in New Zealand, family allowance has been seen by many Australian conservatives as a form of 'middle class welfare' since dependent child tax rebates for mainly male taxpayers were replaced by direct child-

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<sup>54</sup> Stephens, 1990, *op cit*.

<sup>55</sup> Cuts of about \$2 1/2 billion are proposed to income support and federal funding for public housing would be severely reduced. Including cuts to health and other expenditures, the Opposition expects to reduce Commonwealth spending by around \$10 billion. Disney *op cit*.

<sup>56</sup> Economic Planning and Advisory Council 1987.

<sup>57</sup> Commonwealth Department of Finance, 'Costings of the Liberal-National Parties Tax/Expenditure Package; Outlays Proposals', mimeo, 9 December 1991, cited in Disney 1992.

payments to mothers in the mid-1970s.<sup>58</sup> Hence the indexation of family assistance and perhaps even the existence of family allowance is likely to come under scrutiny in the context of Commonwealth budget stringency.<sup>59</sup>

Expenditure pressures would also inevitably focus on Commonwealth payments to the states, which in turn fund hospitals, schools, and public housing and other services provided by state governments.<sup>60</sup> Many of these state services are of particularly direct importance to women in their role as principal care-givers in families and community groups.

None of this bodes well for the future of important public spending programs of interest to women. One must also view with considerable scepticism claims that the regressive effects of a GST will be fully compensated. No government can commit future governments to maintain the real value of compensation. That the New Zealand Labor government responded to its fiscal difficulties by an uncompensated increase in GST just 3 years after it was introduced also suggests little credibility can be given to the Opposition's claim that it would not increase the GST above 15 per cent at some time in the future.

## CONCLUSION

Being generally lower income earners and owning fewer assets than men, women have a strong interest in a progressive taxation system - one that collects proportionately more tax from higher income earners and the wealthy. Often being the lower earner in a family, women's interests are also generally best served by taxation and social security assessment which treats them as individual rather than merely an element of a family unit. Carrying the primary responsibility for childrearing in our society, women have a particular interest in family assistance measures and childcare alternatives. Women's child-rearing and often unpaid or lower earner role also makes us most vulnerable to inequitable distribution of resources *within* families. Being disproportionately represented among the poor in Australian society, women have a strong interest in an adequate system of publicly funded social security system. Finally, women are advantaged by a strong public revenue base from which to finance community services such as health, housing and education.

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<sup>58</sup> This is reflected in the Coalition's proposal to tighten the existing income test for family allowance. See the discussion above on the effects of tighter income testing on the financial implications for women of increasing poverty traps and loss of independent income.

<sup>59</sup> The dependent spouse rebate, available to mainly male taxpayers, and income tested on the 'dependent's' individual income rarely faces the same questioning by the Treasury at Budget time although it costs the Budget some three quarters of a billion dollars in 1989-90 (Treasury 1990).

<sup>60</sup> Under the Fightback! proposals, one of the states' most important taxes, payroll tax, will be taken over by the Commonwealth. States' spending programs will thus become more dependent than ever on Commonwealth budget policies and grants. Even if a Coalition Government could negotiate a suitable compensation arrangement with the states for the loss of their major tax revenue base (and doubts about this have been expressed above), such grants would be very vulnerable to future Commonwealth budgetary stringency and the centralist tendencies in federal financial arrangements.

This survey of the New Zealand experience with GST and tax reform highlights that Australian women would have reasonable and particular grounds for concern about similar proposals for Australia.

Firstly in spite of the rhetoric, there is no evidence that the New Zealand tax reforms made taxation more progressive, even with the supplementary income tax reforms intended to increase the tax contribution of the wealthy. It is clear that no such income tax base broadening or anti-avoidance measures are contemplated as part of the Australian Opposition's taxation package - indeed most of such base broadening and anti-avoidance measures are already in place in Australia. This increases the prospect that a tax mix change under any future Coalition Government would reduce tax progressivity. Indeed unless Labor becomes more courageous than it has been on the issue of wealth or wealth transfer taxation, there is also little scope for a Labor Government to reform indirect taxation without worsening tax progressivity.

Any move to introduce GST in Australia must - as the Asprey report envisaged - include some form of wealth taxation, reintroducing a reformed system of estate duties and perhaps introducing a tax on net worth. Wealth and wealth transfer taxation is also the only means open to future Australian governments for offsetting windfall gains to higher income individuals from any income-to-consumption tax switch without disadvantaging ordinary women through reducing their financial independence. Wealth taxes and death duties are the most important, perhaps the only practicable, way to maintain tax progressivity between individuals in a tax mix change. Yet neither the Government or the Opposition has dared to include wealth taxes in the tax reform strategy. They need to be reminded of this third leg in a tax reform Trinity.

Secondly, the New Zealand experience suggests that there are real risks for women associated with the usual forms of 'compensation' for GST. Compensation made through social security or family assistance - based on the family income tests - inevitably extend family unit 'taxation' to include many of those who are presently taxed as individuals. Whether paid directly or through tax cuts, compensation for GST will also reduce women's real disposable income within families - money in the 'purse' rather than the 'pocket'. Compensation measures in New Zealand have also made hundreds of thousands of working families into welfare dependents, relying on social security payments and vulnerable to government cutbacks. Budget stringency and income-testing compensation for GST has meant effective marginal tax rates are now at their highest on New Zealand parents, especially women, sole parents and 'secondary earners'. These factors suggest that compensation to families for a GST must be not only adequate but made predominantly through the most universal child payments such as family allowances. It also highlights that to avoid inequity to women and their families and offset further disincentives to paid work, there must be full allowance for increased childcare costs under GST. If education is zero rated in the Opposition's GST as proposed, then all childcare services, and not just pre-school education or childcare centres, must also be zero rated. Zero-rating childcare along with education is the minimum needed to leave working mothers no worse off than before the GST. The proposed tax and spending measures for childcare are not sufficient and are unlikely to keep up with inflation in future budgets.



The other major aspect, the third chapter of the New Zealand story, is the effect of the tax reforms on government revenue and public spending. There is no reason why the introduction of GST could be a positive for women, in providing a more resilient, less visible and perhaps less unpopular revenue raising instrument to fund community services and benefits. Income taxation appears to have reached its political limits in Australia at the current time. Indeed introducing a GST is risky for a 'smaller government' Liberal/National Coalition. (It was this risk that drew opposition to a broad-based-consumption-tax from such conservative politicians as National Party Senator John Stone at the 1985 National Tax Summit.) A broad-based consumption tax might be a very useful instrument for subsequent Labor governments to expand social security and the role of the public sector.

However, the New Zealand experience of GST under both Labor and National governments should warn of the likelihood that Fightback's consumption and income tax reforms are intended to drive public spending cuts. New Zealand governments have had considerable success in using 'tax reform' to mask unaffordable and unjustifiable cuts to income tax for high income earners. Experience in that country suggests the most likely casualties of post-tax reform Budget cutbacks are the consumption tax-compensation measures, and the adequacy of family assistance and social security payments.

The moral for Australian women of the New Zealand consumption tax parable is in fact, *caveat emptor* - let the buyer beware.

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