Summary and Recommendations

1. In considering reforms to the social security system, it is important to deal with immediate priorities, but it is also important to consider medium and longer term objectives.

2. The main aim of the Australian social security system is to provide adequate support to people in financial need (promote “vertical equity”). A related objective is to promote” horizontal equity”.

3. In meeting this fundamental objective, it is also necessary for the system to minimise adverse incentives to work and save. The benefits system should also treat different types of households equitably, and the system should be politically and economically sustainable, both in terms of current taxpayer funding and future funding requirements in the context of population ageing and economic risks and uncertainty.

4. Overall, the Australian social security system has many strengths: Australia targets income support to the poorest groups in the population to a much greater extent than any other rich economy, allowing us to provide minimally adequate support at relatively low financial cost. A lower proportion of the population are receiving income support payments than most other rich economies, and it can be argued that despite the importance of means-testing in the Australian system, we have less of a “poverty trap” problem than other countries.

5. Despite these strengths, there are major challenges facing the system. The current system is complex. There are around 40 income support, family and supplementary payments, with overlapping application for different individuals and family types, plus various tax concessions. This multiplicity of payments means that the system can be difficult to manoeuvre for recipients and raises the possibility that people in broadly similar circumstances can receive different levels of payments. This in turn raises the possibility that some payments are less adequate than others, and there can be incentives for low income people to qualify for the most advantageous payments.

6. Payments for the unemployed are considerably lower than pensions for the retired, people with disabilities or carers, and there is evidence that Newstart payments are becoming increasingly inadequate. Current indexation arrangements mean that this gap will grow over time.

7. Those facing high housing costs in the private sector need more adequate rent assistance.

8. To meet these urgent current challenges, the single rate of Newstart should be increased by around 20%, and rent assistance should be increased substantially (with a rent threshold of around 20% of income before support is payable). The liquid assets test threshold should be increased substantially or abolished.

9. In the longer run, Rent Assistance should be indexed to rental costs, and the indexation of unemployment payments needs to be regularly reviewed and adjusted to ensure payments are adequate when compared to community benchmarks.

10. These initiatives can be paid for through the taxations changes recommended by the Henry Review, including changes in the taxation of alcohol and tobacco, better targeting of tax offsets, changes in the taxation of fringe benefits, a more comprehensive income test for pensions and benefits and improved targeting of family payments.
1 Introduction

In a Forum on the Australian tax system why should we be looking at the social security system?

The importance of looking at the taxation and social security systems together has long been recognised in Australia (Podger, Raymond and Jackson, 1980); the rationale for this is threefold:

- Taxation is the source of financing for social welfare spending and correspondingly welfare spending is one of the most significant uses to which tax revenues are dedicated - social spending (social security, health and community services) accounts for just under 50% of total government spending in Australia;
- The taxation and transfer systems are the two main instruments used by governments to achieve distributional outcomes; and
- The tax and transfer systems overlap and can reinforce or offset each other, with implications for incentives to work and save and for household formation and other behaviour.

Despite these well-recognised links, previous reviews of the tax system in Australia have not focused in as much detail on the role of the social security system. For example, the 1975 Report of the Taxation review committee (the Asprey Report) discussed the social security system in an eight page chapter of its 776 page report, while the 1985 Draft White Paper did not focus on the social security system except to the extent that transfers were a vehicle for compensation for the price effects of the proposed Goods and Services Tax, and there were proposals to reduce poverty traps associated with overlaps between the tax and social security systems. A New Tax System (ANTS) (1998) proposed more wide-ranging changes to the social security system including increases in pension, benefits and family payments and reductions in income test withdrawal rates, but again the main driver of these changes was the need to compensate for the price effects of the GST.

In contrast, the Henry Review undertook a much more detailed analysis of the social security system, looking not only at the interactions between taxation and transfer policy, but also analysing specific transfer policy issues in their own right. The Henry Review was also preceded by the Harmer Pension Review which reported in February 2009 and which was followed by significant changes in pension policy (for Age Pensioners, Disability Support Pensioners and Carers) in the 2009-2010 Budget. In fact, the Harmer and Henry reviews in tandem provided the most detailed analysis of Australia’s social security system undertaken in more than 20 years, since the Social Security Review chaired by Professor Bettina Cass between 1986 and 1988.

This paper provides a summary of the Henry review’s evaluation of the Australian social security system and its recommendations for reform. Part Two outlines some of the main design features of the Australian social security system. Part Three describes the recommendations made by the Henry Review and the response of the Commonwealth Government on its release. Part Four provides a critical assessment of selected recommendations of the Review and identifies a number of immediate priorities for reform following the Tax Forum. It is also important to note that reforms to the social security system should be preceded by extensive public discussion. This paper concentrates on what it sees as urgent priorities, but there are many other long-term issues that should be discussed as part of the ongoing process of reform.
2 Background – the Architecture of the Australian Transfer System

As discussed in greater detail in Whiteford (2009, 2010), the Australian social security system differs markedly from those in most other developed countries apart from New Zealand. In Europe, the United States and Japan, most cash transfers are financed by contributions from employers and employees, with benefits related to past earnings. In Australia, benefits are flat-rate entitlements financed from general revenue, and there are no separate social security contributions. Benefits are income-tested or asset-tested, so payments reduce as other resources increase. The rationale for this approach is that it provides the most efficient means of reducing poverty, by concentrating available resources on the poor (“helping those most in need”), while minimising adverse incentives by limiting the overall level of spending and taxes.

In terms of resources spent on social security payments Australia was the 7th lowest spender in the OECD in 2007, spending 7.4% of GDP, a level below the United States (8.0% of GDP), and well below that in many European countries which spend 14-17% of GDP on social security. The main reason for Australia’s low spending is that we spend less than half the OECD average on age pensions, but our spending on payments to people of working age (the unemployed, people with disabilities, and families with children) is just above the OECD average.

In terms of spending on income-tested cash benefits, however, Australia stands out, spending more than 6 per cent of GDP on income-tested programmes, close to 80 per cent of its total spending on cash benefits. Australian spending on income-tested benefits is more than four times the OECD average, and five times the level in the United States, for example, despite the similarity in total spending.

As a result of its reliance on income-testing, Australia has the most progressive benefit structure in the OECD by an extremely wide margin. Comparing the share of transfers received by the poorest 20% of the population to the share received by the richest 20%, it can be calculated that in 2005, the average OECD value was 2.1, but the Australian ratio was 12.4 – that is the poorest 20% of the population received more than 12 times as much in social security benefits as the richest 20% (Whiteford, 2010).

As a consequence of these design features, Australia has less “middle class welfare” than any other developed country, and Australia has the most “target efficient” system of cash transfers in terms of inequality reduction of any OECD country – for each dollar of spending on transfers Australia reduces income inequality by about 50 per cent more than the United States, Denmark or Norway, two and a half times as much as Japan or Italy, and three times as much as France (Whiteford, 2009, 2010).

Overall, however, disposable income inequality in Australia in 2008 was above the OECD average, as a result of higher than average inequality in market incomes (OECD, 2008). Australia also apparently has above average relative poverty rates, particularly among people of pension age, but this observation should be qualified by noting that the average “poverty gap” – the difference between the average incomes of poor households and the poverty line - was among the lowest in the OECD; that is Australia has a high share of the pensioner population with incomes just below the poverty line, although those receiving allowances are further below the poverty line (OECD, 2008).
3 The Henry Review’s assessment of the transfer system

The Henry Review set out its broad principles for reform as follows:

“A 21st century tax and transfer system should reflect the commitment to Australian values of fairness and support for those who are disadvantaged, but do so in a way that is efficient, sustainable, simple and transparent, and internally consistent” (Overview Report, p.59).

While noting that the broad architecture of the Australian transfer system was well suited to these goals, reflecting effective targeting of support to low income households, the Report identifies a number of weaknesses, noting that the system is overly complex, can treat people of similar means differently, and can result in people making choices that potentially undermine long-term wellbeing. The report notes that the system could benefit from a more principles-based approach to setting payment levels and the design of payments to improve incentives to participate in the workforce.

“Streamlining payment types and applying a comprehensive means test base would ensure a more consistent treatment of payment recipients. Establishing adequacy benchmarks for transfer payments not considered in the Pension Review would make the system more robust, particularly if the benchmarks were preserved through a common but sustainable indexation arrangement” (Overview Report, p.59).

The report notes that it considers that full integration of the tax and transfer systems is impracticable, given their different objectives, but better coordination is desirable, with a coordinated approach supporting greater equity between transfer recipients, reducing the inherent disincentives to work created by taxes and transfers and underpinning a better client experience of the tax and transfer systems.

Given these broad observations the report went on to make more than twenty detailed recommendations for reform. In addition, the Report made a number of recommendations about the personal income tax system that have significant implications for the transfer system, and these are summarised below.

Main Recommendations

In relation to the personal income tax scale, the Review recommended that progressivity should be delivered through the personal income tax rates scale and transfer payments. A high tax-free threshold with a constant marginal rate for most people should be introduced. The Medicare levy and structural tax offsets — the low income, senior Australians, pensioner and beneficiary tax offsets — should be removed and incorporated into the personal income tax rates scale. The primary unit in the personal tax system should continue to be the individual, and subsidies for dependants through the tax system should be restricted. However, there could be a case for optional couple assessment for people of late retirement age. It was also recommended that income support and supplementary payments should be tax-exempt, as should similar payments, such as scholarships.

The Review recommended that there should be three categories of income support payments:

- a pension category for people not expected to support themselves through paid work, because of their age, disability or because they are providing full-time care for another person;
- a participation category for people of working age expected to support themselves through paid work now or in the near future, including the unemployed, youth, those who are temporarily incapacitated, people with a partial capacity to work and primary
carers of dependent children. The rate of payment should provide a basic level of adequacy while maintaining incentives to work. This would be less than the pension rate; and

- a student assistance category for people engaged in full-time study.

A more consistent approach to payment relativities would mean an increase to base rates for single income support recipients in the participation and student assistance categories. Payments and income test parameters should be indexed in a consistent way to maintain relativities across payment categories and to reflect changes in community standards. The current standard for pensions is set by reference to Male Total Average Weekly Earnings. Indexing all payments to this standard has been projected to involve a significant increase in budgetary outlays over the coming decades so the Review notes that it will be necessary for governments to regularly review the appropriateness of this measure and the level of the benchmark. This issue was also discussed in the Harmer Pension Review Report which recommended an alternative approach to MTAWE based on a net measure of household incomes as a better indicator of changes in community living standards. Using a net measure would allow the automatic feeding through of changes in the income tax structure which in time could partly offset costs.

The Review recommended that income support arrangements for parents should support and encourage participation in work while maintaining adequate levels of assistance to families. As a condition of payment parents should be required to look for part-time work once their youngest child turns four and conditional on the provision of universal pre-school and affordable child care. Parents would receive supplements based on family status and age of children. People with disability who have a partial capacity to work, excluding people receiving Disability Support Pension (DSP), should also have a part-time work requirement. Students should have an income test that facilitates significant part-time work at a level that does not compromise educational outcomes.

The Report also made a range of recommendations about income and assets tests, specifically that current income and asset tests for income support payments should be replaced with a comprehensive means test based on combined measure of employment income, business income and deemed income on assets. The means test exemption for owner-occupied housing should be continued up to a high indexed threshold, and there should be different free areas for pensions and allowances. The liquid assets waiting period and the sudden-death cut-out that applies to people on certain payments should be removed.

In relation to family and youth assistance, the Report recommended that current family payments, including Family Tax Benefit Parts A and B, should be replaced by a single family payment, covering the direct costs of children in a low-income family and assisting parents nurturing young children to balance work and family responsibilities. Rates of payment should increase with the age of the children to recognise the higher costs of older children. This would require higher payments rates for 12, 16 and 17 year olds. The Baby Bonus should be abolished and a small supplementary payment should be paid over the first three months. Additional payments for larger families, including the Large Family Supplement, the Multiple Birth Allowance, and higher thresholds for larger families should be reconsidered as the case for these payments is not strong. A supplement for parents nurturing young children (aged less than six years) should be provided as a per-family payment, means tested on family income in addition to Paid Parental Leave arrangements. Assistance for families should also recognise that there are specific circumstances, such as parents caring for disabled children and foster care children with higher needs, for which additional support beyond the early years is appropriate. The total amount of family assistance should be withdrawn with a single
means test to avoid cumulative withdrawal rates which create unnecessarily high disincentives for working. A single low withdrawal rate of 15–20 per cent was suggested.

Youth payments should be the main form of income support from the age of 18 until the age of independence. Youth payment rates should reflect the fact that most young people have lower needs than adults but need adequate assistance to participate in education and training. Dependent youth payment recipients should be subject to a parental income test consistent with that applying to family payments. The age of independence should be aligned for full-time students and non full-time students. While family payments should be the main assistance for families with children up to the end of secondary school, youth payments should be available to older children in some circumstances. Dependent older children for whom a suitable pathway may be leaving school and looking for work or combining part-time work and part-time study should have access to a youth payment, governed by strict participation requirements. Children without financial support from their families should continue to have access to a youth payment, governed by strict criteria.

In relation to child care assistance, Child Care Benefit and Child Care Rebate should be combined into a single payment to parents (or centres) based on a percentage of costs. The payment should provide a high rate of subsidy for low-income families that covers most of the costs of child care (up to 90 per cent), and a base rate of assistance for all families participating in work, education or training. The base rate of assistance should be set as a proportion of child care costs, with reference to the marginal tax rate faced by the majority of taxpayers (35 per cent). The full costs of child care should be covered for at-risk children and children facing multiple disadvantages, without participation requirements on parents.

The Review made a number of recommendations about housing assistance, specifically that the maximum rate of Rent Assistance should be increased and the rent maximum should be indexed by movements in national rents. To better target this increase in the maximum rate, Rent Assistance should be part of the income support system, with eligibility based on rent paid and the income support means test, rather than on eligibility for another payment (for example, Family Assistance). Rent Assistance should be extended to public housing tenants and income-linked rent setting in public housing be removed. A high-need housing payment should be paid to social housing providers for their tenants who have high or special housing needs or who may face discrimination in the private market.

4 Assessment and Discussion

In looking at reforms to the social security system it is important to bear in mind the fundamental objectives of social security. **The main aim of the Australian social security system is to support people in financial need; put simply, the most important objective of the system is to provide adequate support for those in need.**

In meeting this fundamental objective, it is also necessary for the system to minimise adverse incentives to work and save. The benefits system should also treat different types of households equitably, and the system should be politically and economically sustainable.

Proposing reforms that meet all or more than one of these objectives at the same time is the real challenge for inquiries like the Henry Review. For example, the earlier Harmer Review of the pension system proposed significant increases in rates of payments and simplification of supplementary payments, but these were partly financed by raising the age pension eligibility age over time and by increasing the withdrawal rate in the income test to target available assistance to those in need. When systems have multiple objectives, then trade-offs like these are unavoidable.
The Henry Report supports the view that Australia’s system of social security transfers has many strengths. However, there are areas of clear need where benefits and services need to be improved.

- Payments for the unemployed (including people with disability assessed as having a partial capacity to work and single parents with older children), youth and students are considerably lower than pensions for the retired, people with disability or carers and single parents with young children. There is evidence that these payments are becoming increasingly inadequate (i.e. the poverty gap is increasing).

The introduction of differential indexation arrangements for pensions and allowances in the late 1990s meant that the gap between pensions and allowances for singles on the lower rate would grow in line with MTAWE and that this would also create a growing gap for partnered recipients and singles on the higher rate.

It is hard to imagine that the Parliament that legislated for this change ever imagined that the gap between two rates that was only $15.85 a week for singles on the lower rate ($2.70 if on higher single rate and $1.35 each if partnered – the value of Pharmaceutical Allowance) would grow to $127.20 a week ($107.75 if on the higher single rate and $60.50 each if partnered) in less than 14 years, or that in terms of relativities that the lower single rate would fall from 91.0% of the single pension to just 65.1% today (partnered rate has fallen from 98.4% to 78.0%).

At the time the Minister for Social Security Senator Newman committed to continuing the previous Government’s policy of reviewing the need for ad hoc increases to allowance.

“Over previous years governments of the day have made decisions on an ad hoc basis across the whole area. In future we are saying we will make a commitment under legislation for the pension but we continue the ad hoc arrangements of the past for allowees.” Senate Community Affairs Legislation Committee, Budget Estimates, 3 June 1997

Since September 2009, maximum basic rates of pension have also benefited from indexation to the greater of the CPI or PBLCI. This change, while less significant than the MTAWE benchmark, can further increase the gap between pensions and allowances where prices increase faster than wages. Replacing CPI with indexation to the PBLCI for allowances would more accurately reflect changes in the cost of living faced by allowees.

- Those facing high housing costs in particular need additional rent assistance. Rent assistance has not been increased in real terms since July 2000, despite substantial real increases in private rents since that time

- The liquid assets test applying to certain benefits is now much more stringent than when it was introduced in 1991, as a result of tightening in 1997. At that time, a single unemployed person could have up to $5,000 before affected (around $8,400 in current terms), and they would have to wait 4 weeks before being entitled to payments. For a single person the current level is $3,000 – or about 36% of the 1991 level – and the waiting period can be up to 13 weeks. This tightening of the liquid assets test reduces the capacity of the benefit system to respond appropriately to economic downturns. It also penalises savings among those most disadvantaged in the workforce. Forcing the unemployed to run down their savings also reduces their resilience to cope with the financial shock of a period of unemployment, which compounds the financial stress of the inadequate Newstart rate.
• It is also clear that the current system is complex. There are now around 40 income support, family and supplementary payments, with interlinking and overlapping application for different individuals and family types, plus various tax concessions. This multiplicity of payments means that the system can be difficult to manoeuvre for recipients and raises the possibility that people in broadly similar circumstances can receive different levels of payments. This in turn raises the possibility that some payments are less adequate than others, and there can be incentives for low income people to qualify for the most advantageous payments.

Many of these problems are inter-related. Currently, for single people on the average wage losing their job, Australian benefits are about the lowest in the OECD. A single unemployed adult receives about $475 per fortnight, or $33.90 per day. If they’re renting privately, they’re entitled to up to $116 per fortnight in rent assistance, but to get that amount their rent has to be more than $258 per fortnight, leaving them with just $23.75 per day for everything else; and that assumes you can find somewhere to rent for $258 a fortnight. The NSW government’s Rent and Sales Report found that in June 2011 the cheapest one-bedroom homes in Sydney’s outer ring were in Wyong and Gosford and cost “just” $180 a week. If you were on Newstart and paying that rent would have just $16.50 a day left over for your food, clothing, transport and other bills. Given this, it is hardly surprising that the 2009-10 Household Expenditure Survey found that nearly 80% of people receiving unemployment payments experienced three or more types of financial stress in the previous financial year compared to about 10% of people not receiving government benefits.

Adequate payments are also important for incentives: if the gap between pensions and allowances widen further then incentives to claim disability payments will increase. High housing costs can also price the unemployed out of areas where job opportunities are greater, while some State public housing policies can provide disincentives for work for people on waiting lists, as income-related rents increase EMTRs and may provide a disincentive to relocate to take up work opportunities.

Adequate payments are necessary for job search and participating in training and study: if levels of assistance are less than adequate a recipients of payments may not be able to undertake sufficient or effective job search; a student may compromise their study efforts. It is difficult to imagine how someone who doesn’t have enough to get by can actually make a concerted and effective effort to find work or participate in study.

The difference between payment rates can also create major equity problems. The Australian community provides support to people caring for others who have a disability, but if the person being cared for dies then the carer who has been encouraged to commit many years to providing support can experience a massive drop in income after the bereavement period of 14 weeks is over. A carer under 60 years of age whose disabled partner dies moves from half the partnered pension rate, plus Carer Allowance (and a Pensioner Concession Card) to the single rate of Newstart, a reduction in income of more than $200 per fortnight.

The Harmer Review proposed improvements in the adequacy of payments for age pensioners, disability pensioners and carers, but support for other recipients of working age was not part of its Terms of Reference, but they were within the scope of the Henry Review. These improvements for pensioners have meant that the gap between payments for the unemployed and for people with disabilities has widened – currently the total gap is more than $230 per fortnight. As the system is currently configured this gap cannot narrow over time, it can only grow.
Long-term sustainability is important. Over the next 40 years the number of people of working age will halve relative to those 65 years or older. This will push up expenditure and place pressure on the workforce, economic growth and Australia’s capacity to raise revenue from its existing tax base. As pointed out by the Henry Report, policy responses, that affect Australia's demography, boost workforce participation and lift productivity can help to offset this fiscal challenge.

The 2010 Intergenerational Report (IGR) has identified the scale of this fiscal challenge. While in the longer run, population ageing is likely to lead to higher social expenditures, according to the 2010 Intergenerational Report most of this increased spending will be on health care (rising from 4.0 to 7.1% of GDP between 2010 and 2050) and aged care services (projected to rise from 0.8 to 1.8% of GDP). Spending on income support for persons of age pension age is also projected to rise from 2.7% to 3.9% of GDP, but spending on payments to people of working age are projected to fall from 2.4 to 2.1% of GDP with spending on Newstart and Youth Allowances almost halving and assistance to families is projected to fall from 1.6 to 0.9% of GDP. Overall, the projected rise in transfer spending on the aged will therefore be largely offset by reduced spending on individuals of working age and families with children.

However, this projected shift is almost entirely due to the assumptions used to project spending levels. The IGR assumes that current indexation policies apply into the future so that age and disability pensions will be indexed to wages, while most other payments for people of working age and families will be indexed to prices. Over a 40 year period these indexation provisions will produce a remarkable change in the relative levels of support for pensioners and beneficiaries – pensions are projected to rise by 4% a year on average, while benefits and allowances would rise by 2.6% a year. The result – if actually continued for 40 years – would be that in 2050 a single unemployed person would be receiving a payment of about 11% of the average male wage, compared to 20% now. The gap between pensions and allowances would widen enormously, and an unemployed person would be receiving a payment that was little more than one-third that of an age or disability pensioner. The result would be that relative poverty among working age allowance recipients including families with children would increase significantly, but also incentives for the unemployed to qualify as eligible for disability payments would be strengthened.

Would raising benefits to a more adequate level keep the unemployed out of jobs or even cause low paid workers to give up jobs?

It is certainly true that the best way to help the unemployed is to get them into jobs. Australia has been very fortunate in having one of the lowest increases in unemployment of any OECD country since 2008, but we shouldn’t overlook the fact that unemployment has still risen significantly, and there are many people relying on an increasingly inadequate payment. It is worth noting that since 2006, an increasing number of Newstart recipients are not considered

\[\text{In June 2008 the number of people receiving Newstart Allowance was just under 430,000, its lowest level since the 1980s; this rose to 602,000 in February 2010 and has come down to 556,000 in July 2011 (the most recent available figure). The number of people on Newstart for twelve months or more rose from 250,000 in late 2008 to around 340,000 from the middle of 2010, and has stayed roughly the same since then.}\]
suitable for full-time work, including people with a disability, whose work capacity is less than 30 hours a week, and primary carers of dependent children aged 6-15 years. These recipients are expected to be on payment long term, and for them the aspiration may be a combination of earnings and income support.

Since 1996 the level of Newstart for a single person has fallen from around 54 per cent to 45 per cent of the after-tax minimum wage. If it were still 54 per cent of the net minimum wage, then benefits would be around 19 per cent higher. It is difficult to see that going back to the 1996 relativities between Newstart and the minimum wage would pose serious disincentives to work.

These problems are not going to go away. Current policies are simply going to make the problems more difficult to deal with the longer decisions are postponed.

Paying for these improvements in the adequacy of income support payments can be achieved through adopting a number of the other taxation and social security reforms advocated by the Henry Review.

- For example, the review recommended that a single means test for family payments be introduced at a rate of 15-20%, which would replace the current multi-tier income tests on Family Tax Benefit. This is likely to reduce the income level at which family payments phase-out, more effectively targeting payments.

- The review also recommended a more comprehensive means test on pensions and benefits, which extended the role of deeming and abolished the separate assets test. As implied by the Henry Review, it would be more equitable to include part of the value of owner-occupied housing – above a high threshold – in the comprehensive means test.

- Increased levels of rental assistance could be targeted to those paying higher levels of rent through an increase in the rent level over which assistance becomes payable. For example, one approach would be to require those renting privately to pay around 20% of their benefit income in rent before Rent Assistance became payable.

- A number of the tax changes proposed by the Henry Review should be implemented, including indexation of tobacco excise to wages rather than prices and the introduction of taxation of all alcoholic beverages on a volumetric basis. The proposal to tax all forms of wage and salary for Australian resident taxpayers on an equivalent basis without exemptions should be introduced.

- Consideration should be given to the appropriate taxation of superannuation. Australia currently has the lowest level of direct taxation on households with a head aged 65 years and over of any OECD country. In part, this reflects the progressive nature of the tax system and the effects of the Low Income Tax Offset; to a large extent it also reflects the post-2007 exemption of superannuation benefits from tax when paid from a taxed fund. In the context of an ageing population, it is reasonable to question why the most rapidly growing section of the population should face much lower tax rates than those of working age.

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2 As an illustration, the value of the threshold for owner-occupied housing could be set at $1.5 million or $2 million, with only the level of assets above this threshold counted. This would improve equity between pensioners and achieve better targeting of assistance.
In summary, many of the proposals put forward in the Henry Report were particularly well-crafted both given the long-term challenges facing the social security system and also considering areas where the system needs immediate improvement.

The Report’s identification of the adequacy and incentive challenges arising from the gap between pension and allowance payments, exacerbated by the differing indexation mechanisms and the problems associated with high housing costs and differential assistance for those in private rented accommodation and those in public housing are both well-based and provide a clear vision of how to address these challenges.

There are other recommendations of the Henry Report that merit further debate and analysis. The Report recommended a very substantial increase in the tax threshold and abolition of some of the special measures currently in place such as the Low Income Tax Offset. A major component of the government’s subsequent plans for a clean energy future is an assistance package to compensate for higher prices affecting households. The centrepiece of the package is an increase in the income tax threshold from $6,000 a year to $18,200 in 2012-2013 and $19,400 in 2015-16, with some offsetting changes to the Low Income Tax Offset.

The recommendation to make most income support payments exempt from tax actually raises effective marginal tax rates (EMTRs) to some extent over some income ranges, since the withdrawal of non-taxable benefits causes more stacking of EMTRs than the withdrawal of taxable benefits.

It can also be questioned whether reducing the tax clawback on pensions and benefits is desirable in a period when demographic ageing is likely to increase the share of pensioners in the Australian population.

On balance, however, the Henry Review in combination with the related Harmer Review of pensions provides the most up-to-date and comprehensive assessment of the Australia transfer system in nearly 25 years. The identification of problems and challenges by the Report is well-based. On the whole, the recommendations of the Report appear to go in the right directions, although there will inevitably be differences of opinion about specific recommendations.

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