The Liberal-National Party Fightback! Package: a Distributional Analysis

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Abstract

This paper examines the distributional analysis of the impact of the Fightback! package on Australian households. The paper examines the veracity of both the results presented and the analysis undertaken by the Opposition. The critique by the Treasury is investigated, as are omissions by both Treasury and the Opposition. Some attempt to measure the direction and significance of these excluded impacts is also analysed.

> 'Are there any losers under Fightback!?'
> 'Yes of course there are ... smokers are losers.'[1]

1. Introduction

Few events concentrate attention on distributional issues and fiscal tax-expenditure more than a political-economic manifesto encompassing a major shift in the form of raising and disbursing government revenue. This was true at the time of the Government's Tax Summit and Draft White Paper in 1985 and so it is today.

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On 21 November 1991, the Leader of the Opposition, Dr Hewson announced a comprehensive set of policies which 'constitutes the most important and far-reaching program by any Government or Opposition in Australia this century' (Hewson and Fischer, 1991a, p. 11). He may well have added that it was accompanied by what appears to be the most detailed analysis of prospective implications conducted by a party not in government in our political history (Hewson and Fischer, 1991b).

The documents stress that the package is an integrated whole, with particular emphasis on the dynamic effects of policies on incentives to work and save.

However, aside from initiatives in the areas of industrial relations, tariffs and structural adjustment directed towards directed towards behaviour change, the principal distributional aspect of the package stems from the shift in the burden of taxation contingent upon the introduction of a Goods and Services Tax (GST). In broad terms the revenue from such a tax, together with cuts in government spending is to be used to abolish wholesale sales tax, petrol excise and payroll tax, and provide cuts in income tax whilst compensating low-income earners through welfare benefits/tax credits for this shift.

Over and above the distributional consequences of the dynamic effects on the economy, the Opposition claims that the immediate net benefits to households upon the introduction of the package is such that:

> all groups in the community show increases in average disposable income after allowing for the effects of the GST, and
>
> the distribution of net benefits is skewed in favour of the lower income groups . (Hewson and Fischer, 1991b, p. 297)

Not only in a dynamic but also in a comparative static sense, **all** groups in the community benefit on immediate introduction with the major beneficiaries being low income Australians. To quote the Fightback! document, 'this represents a major redistribution of income from those on higher income to those on lower income' (Hewson and Fischer, 1991b, 238). It is this claim and the documented analysis on which it is based that is the subject of this paper - in popular parlance: 'Who gains and who loses, in the short term'.

2. Fightback! Package

The first point to note is that, in aggregate, the Fightback! package is approximately revenue-neutral. Excluding privatisation proceeds, total ingoings of the Coalition's 3-year program from 1993-94 to 1995-96 are $42,291 million (1990/91 dollar terms) and total outgoings are $41,963 million (Hewson and Fischer, 1991b, Table 18.1, p. 314-5). The gross privatisation proceeds of $41,950 million from the sale of a number of government enterprises are to be used substantially for reducing public sector debt, although $1,870 million will be targeted to the wealth compensation package and sales tax credit scheme.2 In consequence, economic attention becomes attracted to the distributional consequences of the package.

Although the numbers can be arranged in a myriad of configurations, Table 1 outlines the broad parameters of the package.

The distributional analysis of the package by the Coalition is undertaken in the chapter entitled 'Distribution of the Net Benefits to Households': which 'quantifies the impact of the Coalition's reform package on the net financial position of Australian households' (Hewson and Fischer, 1991b).

It should be noted that the Coalition's analysis is **not** of the entire package. In the footnote to the relevant tables (17.4 and 17.6) which purport to show the gains in real disposable income generated by the package and the net benefits for community groups respectively, reference is made that the analysis:

> Includes GST; abolition of wholesale sales tax, petrol excise, customs duty, payroll tax; increases in dependent spouse rebate and family allowance; introduction of private health insurance tax credits; all compensation measures; and personal income tax cuts. (Hewson and Fischer, 1991b, pp. 310, 312, footnote (a))

These tables show an average net benefit across all households of $33.54 with an average real disposable income gain of 4.6 per cent. All community groups and all deciles within each group benefit in relative terms by from 1.56 per cent to 16.63 per cent, and in absolute terms by from $7.20 to $164.56 per week. Thus, explicitly, a number of the measures of the Fightback! program have either been ignored or assumed to have no net impact on households. Essentially, the tables show only the gross benefits of the package less the only acknowledged negative, the GST.

The impact upon households depends not merely on the fiscal shifts in statutory incidence but, through tax-shifting assumptions, the impact of such on both household income and the prices paid for household goods.

Reference back to Table 1 can serve to confirm the broad aggregate outcome on the mythical average household, given the Coalition's definition of 'net' benefits. The Coalition adopts the tax-shifting assumption that all indirect taxes are borne by the consumer and that half the payroll tax is borne by consumers and half is on dividends. This is consistent with the

Table 1. Fightback! Package in Aggregate (3 year program, $ million 1990/91 dollar value)

	Incomings			**Outgoings**	
Introduce:	GST	27152*	Abolish:	Wholesale Sales Tax	9365*
Increase:	Company Tax			Petrol Excise	6601*
	- Rate	975		Payroll Tax	5832*
	- Payroll Tax Clawback	1137		Customs Duty	160*
	Income Tax			Coal Export Duty	47
	- Bracket creep	2933*	Reduce:	Personal Income Tax	
	Tobacco Excise	343		- Thresholds and Rate	12486*
	Medicare Levy			- Tax free savings	520*
	surcharge adjustment	5		- Health Insurance tax credits	853*
Tax Evasion:	R&D abuse	50		- Dependent spouse rebate	98*
				- Capital Gains Tax	200
Gross Expenditure Decreases		9696	Gross Expenditure Increases		5801
	- Social Security	2415		- Pensions/Benefits	2440*
	- Health	1509		- Family Allowances	1028*
	- Housing	400		- Housing - FHOS	175*
	- Payments to States	775		- Education	403
	- Other	4597		- Charities	50
				- Health	678
				- GST Administration	125
				- Other	902
Total		**42291**			**41963**
Privatisation Proceeds		14950	Wealth Compensation		1470*
				Sales Tax Credits	400*
				Public Debt	13080
		57421			56913

* Measures included in the Opposition's analysis of distribution effects. *Source:* Adapted from Hewson and Fischer, 1992b, Table 18.3. (1991b, 156).

standard assumption adopted by Warren (1987), and is assumed to operate for both increases and decreases. In respect of household income, income tax cuts should be taken net of the amount assumed as return from bracket creep.

A dilemma exists as to what constitutes 'all compensation measures' in the Opposition analysis. This is nowhere explicitly defined. Here we assume it includes any measure explicitly designated in the text with a rationale based upon GST compensation and also the wealth compensation and sales tax credit schemes even though the revenue for these is to be funded by proceeds of the privatisation of government enterprises. All such expenditures are assumed to be benefits realised totally by households.

A summary of these ingoings and outgoings specifically mentioned in the limiting ambit footnote of the Coalition (marked in Table 1 by an asterisk) produces the aggregate outcome of Table 2.

Table 2. Aggregate 'Net' Benefits (Fightback!'s Ambit)

	Aggregate ($m, 90/91 values)	Aggregate per household[a] Annual $	Weekly $
Ingoings	27152	4269	81.88
Outgoings	35579	5594	107.29
'Net' Benefits	8427	1325	25.41

Note: a) The number of households is based on adjustments noted in Hewson and Fischer (1991b, p. 156)

This table reveals a substantial discrepancy from the average net benefit figure claimed by the Opposition of $33.54 in Table 17.6, and must cast some doubt on the results presented in that Table. Even the inclusion of $346m in payments to the states for loss of petrol franchise revenue fails to sufficiently make up the apparent discrepancy of $2,695m. We will return to Table 17.6 later.

Aside from the doubt cast by this rudimentary aggregate analysis, the distributional effects then revolve around firstly, the accuracy of the aggregate costings and the validity of the exclusions from 'net benefits' by the Coalition, and secondly, the impact between and within the community groups defined in the analysis. The exclusions made by the Coalition are those items not marked by an asterisk in Table 1.

3. Treasury's Analysis: Taking the Fight Back to Fightback!

Treasury's much-publicised critique of the Fightback! package[3] (Treasury, 1992) concentrated on three aspects:

- the costing and treatment of the commitment to return all bracket creep over the analysis period (1993 to 1996);
- the impact of certain excluded expenditure cuts; and
- the impact of changes to the health policy.

In addition, the Department of Finance (Treasury, 1992) queried a number of the costings particularly on the expenditure decrease side.

Far from all households benefiting, Treasury concluded that *over 70 per cent of full-time wage and salary households* and over 60 per cent of self-employed and farm households would be *worse off* as a result of the Oppositions package. According to Treasury, the major beneficiaries would be the top ten per cent of households.

From an independent analysis, Savage and Jones (1992) add support to the Treasury results. They conclude:

- that over 70 per cent of *all* worker households lose
- for all types of income units average gains are negative for the bottom eight deciles
- for single earners 80 per cent lose and the gainers are the richest 20 per cent.
- for couples without children, 75 per cent lose and the significant winners are concentrated at the very top of the income distribution (earning over $100 000)
- for couples with children, 63 per cent lose. The largest average gain (over $2 400 pa) is for the top 10 per cent. (Savage and Jones, 1992, p. 7)

For the average employed Australian worker on $25,000 a year, struggling to hold a job, with dependent spouse and kids to support, the short-term choice is between a gain of $39.25 a week according to Fightback! and a loss of $7.50 a week according to Treasury - a difference of $46.75 a week or nearly $2,500 (or 10 per cent of income) a year.

Table 3 shows the differences between Fightback! and Treasury for the median household in each family group, ignoring those which Treasury correctly points out are statistically insignificant based on the sample size of the original data.[4]

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Table 3. Impact of Fightback! on Median Family Comparison of Coalition and Treasury

Family Type	Fightback!	Treasury	Difference Weekly	Annual
Married worker, dependent spouse	+22.69	-6.51	-29.20	-1552
Married worker, dependent spouse, kids	+40.74	-2.89	-43.63	-2275
Married two-income family	+26.79	-13.65	-40.44	-2109
Married two-income family, kids	+25.54	-25.38	-50.92	-2655
Single full-time worker	+18.75	-8.94	-27.69	-1444
Self-employed or farmer	+31.81	-0.24	-32.11	-1674
Unemployment beneficiary	+24.15	+17.04	-7.11	-371
Married age pensioner	+20.60	+19.45	-1.15	-60
Single age pensioner	+12.71	+10.27	-2.44	-127
Sole parent	+16.42	+234.93	+8.51	+443

4. Fightback! Analysis: Accepting the Parameters?

The Fightback! analysis is based on the STATAX model developed by Neil Warren at the University of New South Wales to trace through the impact on Australian households of the indirect tax measures and associated compensation included in the package (Warren, 1987).

The STATAX model analysis utilises the results of the 1988-89 Household Expenditure Survey conducted by the Australian Bureau of Statistics. This survey recorded the expenditures of 7225 households over a two-week or extended period (depending on the type of expenditure) as well as on data of the current weekly income of those households by various sources (see Raskall, forthcoming a). Despite its limitations it remains the only source of data available from which to obtain expenditure data and hence enable estimation of the impact of indirect tax changes. In combination with the ABS Input-Output Tables detailing the inter-relationship between industries and commodities - both the direct and indirect impact of such changes can be ascertained on each commodity group and in conjunction with the HES, on each household type and income level.

The critical parameter underlying the compensation measures and their adequacy is the one-off impact on prices of the imposition of the GST countered by the abolition of the existing indirect taxes. Whilst the impact of this will in detail depend on the precise Input-Output and Import Content of commodities and the expenditure composition of each household, the broad aggregate impact on prices can be readily adduced. *If all cost reductions* contingent upon the abolition of wholesale sales tax, petrol excise and payroll tax *are passed on* to the purchaser then the aggregate impact is the net revenue charge divided by the appropriate base.

Fightback! calculates the adjusted base private final consumption expen-

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diture ('adjusted for indirect tax reform, zero rating, input taxing, black economy and foreign tourist expenditure') at $181,013 million (Hewson and Fischer, 1991b, p. 66). The net revenue change in GST revenue ($27,152m) less abolished tax revenue ($19042m), that is, $8,110m. Thus the implied impact on CPI is 4.48 per cent. This is analogous to the aggregate estimate of 4.4 per cent in Fightback! (Hewson and Fischer, 1991b, p. 134, Table 8.1) and detailed STATAX estimate 4.94 per cent (Hewson and Fischer, 1991b, p. 158) as well as the estimate of Treasury of 4.77 per cent using its PRISMOD model.

Fightback! makes certain adjustments to the HES data before use. It is pertinent to examine not merely the validity of such adjustments but also their impact on the final results.

The 1988-89 HES sample totalled 7225 households. From this number, 472 households that either had negative ratios of expenditure to income or ratios in excess of 2.5 'were excluded on the grounds that such households were not in a sustainable position or were statistical outliers' (Hewson and Fischer, 1992b, p. 155). Aside from the inherent value judgement in excluding these households because ad hoc they 'cannot be', unfortunately the 6.5 per cent of all households so excluded from the analysis are primarily low-income households who, a priori, might be expected to be most affected by the shift to the GST.

One is reminded of the situation whereby despite predictions by scientists of an impending hole in the ozone layer, the US Government continually denied this because of the data taken from its various satellites. It was only when the computer program analysing the data was examined that it became apparent that the program was rejecting 'outriders' because their value 'couldn't exist'. Sure enough, all these ignored outriders were in one location - the Antarctic (Young, 1990, p. 147). The point is that certainly consideration needs to be taken of the limitations of the expenditure-income relationship of the HES data and adjustments made to account for the shortened expenditure and income reference periods. However, to reject en masse a sizeable and specific proportion of the sample on an ad hoc criteria itself could lead to misleading results. At the very least, the analysis should also have incorporated these so-called 'outriders' to test the sensitivity of the results to this critical ad hoc assumption.

Aside from this over-riding limitation, the results of the STATAX analysis are outlined in Tables 17.4 and 17.6 of the Fightback! document, leading to the conclusion outlined above that:

> On average, Australian household disposable incomes increase by $33.51 per week - that is, about 4.6 per cent after allowing for net price impact of the GST package. (Hewson and Fischer, 1992b, p. 297)

An examination of these tables gives rise to some considerable concerns:

- Table 17.4 (p. 310) purports to show the 'Gains in Real Disposable Income Generated by the Package (% change)'
- Table 17.5 (p. 311) the 'Average Decile Pre-GST incomes by Community Groups ($/week)
- Table 17.6 (p. 312), 'Net Benefits for Community Groups ($/week)'.

Table 17.6 is thus the result of applying the per cent gains in Table 17.4 to the incomes in Table 17.5. The quote above which links the two tables confirms this (4.6% x 637.30 = 33.49). However, if we then relate the two tables together for each of the 140 groups (14 family types and 10 deciles), some extremely odd results occur. Table 4 below outlines these implied disposable incomes for selected groups and the other part of the table reproduces the supposed actual average incomes as outlined in Table 17.5.

The first point to note is that the implied disposable incomes when examined across deciles for each household type are patently illogical. Taking the group of a single income family with no children as an example, the first (that is, lowest) decile has an implied income (from Tables 17.4 and 17.6) of $492 a week. This jumps to $904 for the second decile but declines to $801 in the third and $414 in the fourth. In fact, the eighth decile (the supposedly third highest income decile by income rank) has *less* income than the second decile.

This illogical and inconsistent pattern is replicated in each of the groups and is confirmed when reference is made to the actual incomes produced by Fightback! There is absolutely no correlation either in magnitude or direction with the actual average incomes of each decile of each community group. For instance, the second decile of one income families without children has an implied income ($904) over double that of the purported actual ($443) whereas the fourth decile has one ($414) less than three-quarters of the purported actual.

Clearly, either Table 17.4 or Table 17.6, or both, is grossly incorrect. This is particularly disturbing given that they are the *key* distributional results of the Fightback! analysis, and are continually quoted by Opposition spokesmen.

One suggestion to reconcile the two would be that they refer to different concepts: that 'net benefit to households' is somehow different to 'gains in real disposable income'. However this proposition is negated by the Fightback! package's written connection of the two in its own summary quoted above and the thrust of explanation of the derivation of the tables in the text (p. 301), and indeed in the footnotes to the relevant tables.

One possibility is that some alteration has been made to the original tables and that one of the presented tables (probably 17.6) has been calcu-

Table 4: Comparison of Implied and Actual Incomes in Fightback! Distributional Analysis

Implied Disposable Income - Fightback!

Group	Decile 1	2	3	4	5	6	7	8	9	10	Mean
One Income/No Children	492	904	801	414	834	626	910	849	1510	1894	1077
One Income/Children	484	894	583	719	712	752	875	962	987	1666	853
Two Income/No Children	495	1261	1237	1432	1252	1259	1082	1390	1735	2560	1460
Two Income/Children	573	774	1016	1159	1013	1061	1189	1087	1615	2882	1266
Single	364	463	452	339	565	671	682	858	1015	1574	751

Actual Income - Fightback!

Group	Decile 1	2	3	4	5	6	7	8	9	10	Mean
One Income/No Children	381	443	494	560	634	770	864	1008	1270	2254	850
One Income/Children	427	502	558	617	692	767	856	973	1148	1886	842
Two Income/No Children	522	762	879	968	1063	1154	1240	1344	1499	2113	1154
Two Income/Children	582	752	843	926	1018	1108	1218	1360	1571	2326	1170
Single	337	446	508	565	628	706	817	999	1195	1752	797

Source: Hewson and Fischer, 1991b, Table 17.5 (rounded to nearest dollar).

lated independently of the described analysis. This seems likely to be the case when reference is made to the aggregate 'net benefits' discrepancy cited in Section 2.

This concern for the integrity of the stated benefits extends when examination is made of the benefits to the various cameo households outlined. These 'illustrate that across a diverse group of families and individuals in a wide range of circumstances the net benefit of the package is substantial' (Hewson and Fischer, 1991b, p. 303). These cameos of individual families are illustrative only and thus 'the final net effect does not mirror the exact results for average households' in the relevant Table 17.6. This is accepted. However, the data presented in the cameos allows calculation of the implied savings ratio, which in turn, shows a consistent bias in the selection of the cameos towards households which have much higher than average saving and conversely much less than average consumption. Consequently the 'costs' of a GST are much less and the 'net benefits' much greater. As illustrations, pointed out by the Treasurer, the unemployed woman in the cameo is able to save $36 after costs from her weekly income of $139 a week, and the pensioner couple out of their combined income of $252 a week is saving $118 or nearly half (Dawkins, 1992, p. 10). This is considerably at odds with the admittedly uncertain results of the HES which note that such people on those declared incomes are in fact net dissavers drawing on their financial assets to survive.

The regrettable conclusion that is drawn from this examination is such as to treat key results of the Fightback! distributional analysis with more than considerable caution as regards its veracity, even under its own terms.

5. Treasury Analysis: 'No Questions Asked'

Treasury's analysis takes as its starting point an approach based on 'no questions asked'. That is, it accepts the underlying parameters of the Fightback! package, attempts to replicate the analysis and considers the impact of what it considers uncontroversial omissions.

5.1 Basic Analysis

After pointing out (correctly) the statistical insignificance of the results in 49 of the 140 household groups due to insufficient sample size in the HES, Treasury obtains base analytical data different to the published Fightback! analysis. This possibly reflects the concerns with that data observed above.

Table 5. Difference Between Fightback! and Treasury's Replication of Fightback!

	Group						
Decile	2	3	4	5	7	10	11
1	+3.44	-1.27	-1.67	-0.76	-3.47	+3.30	-1.19
2	-4.29	-8.36	-9.55	-2.27	-0.07	+3.29	+1.10
3	-8.30	-5.73	-8.44	-1.48	-1.25	+0.65	-1.34
4	-14.10	-13.58	-9.00	+2.17	+9.13	-1.02	-0.43
5	-9.00	-3.63	-1.29	-4.39	-8.09	-1.16	-2.43
6	-13.07	-6.68	-4.20	-3.97	-2.20	-2.33	-0.79
7	-10.77	-4.52	+0.95	-1.73	-6.10	-5.15	-0.64
8	-10.18	-12.54	+6.69	-2.48	-2.83	+4.34	+1.87
9	-1.96	-6.22	+6.00	-3.16	-9.61	-2.47	+3.60
10	-16.06	-15.14	-25.54	+1.82	-41.68	-1.18	+4.56

Group: 2: Wage and salary earner. full-time, married, spouse not working,children
3: Wage and salary earner, full-time, married, spouse working, no children
4: Wage and salary earner, full-time, married, spouse working, children
5: Wage and salary earner, full-time, single
7: Self-employed or farmer
10: Not in the labour force, married, principal source of income government benefits
11:Not in the labour force, single, principal source of income government benefitsbut not sole parent or widows pensions.

Numbering system refers to community groups outlined in Hewson and Fischer, 1992b, Chapter 17. Only those groups where all deciles are statistically valid have been included.

Source: Hewson and Fischer, 1992b, Table 17.6, p. 312., Treasury, 1992, Attachment 4,Table 8

Table 5 outlines these differences between Treasury's replication of the Fightback! analysis on its own assumptions and the results presented by the Opposition. As can be seen they are quite significant. In 58 of the 70 cells outlined, Treasury calculates a higher figure. Particularly large discrepancies occur in the second to fourth deciles However, any resolution of 'who's right and who's wrong' would require another analysis which is at this stage beyond the resources of this author and requires more exact detailing of the base assumptions.[5]

This is particularly disturbing since the exercise is essentially an accounting manipulation not an economic modelling exercise requiring assumptions about behaviour other than acceptance of the Fightback! assumptions that there is no avoidance or evasion of the GST and that each trader passes on the full reduction in costs contingent upon abolition of the WST and Petrol Excise and half the reduction in Payroll Tax. Beyond this, Treasury points to three omissions and limitations in the Fightback! analysis - the neglect of expenditure cuts, the treatment of health changes and the adequacy of compensation when consideration of the promise to return bracket creep is taken into account.

5.2 Expenditure Cuts

As indicated previously the omission by Fightback! of the distributional implications of any expenditure cuts is a severe limitation on any claim to reflect the impact of the package on households.

Treasury includes a number of expenditures items which it believes are amenable to distributional analysis in that they bear directly on existing identifiable households. These include:

- Introduction of the proposed family income test for the dependent spouse rebate.
- Lowering the income test threshold for family allowance.
- Tightening of the incomes and assets test for pensions and allowances.
- Removing AUSTUDY where present eligibility is less than $30 a week.
- Introducing a Medicare Levy surcharge for higher income earners.
- Removal of the sole parent pension where the child is aged 12 or over.

Table 6. Impact of Expenditure Cuts Directly Attributable to Identifiable Households

	Group						
Decile	2	3	4	5	7	10	11
1	-12.05	-0.80	-11.52	-1.13	-1.25	-	-
2	-19.02	-	-2.65	-3.81	-2.10	-	-
3	-14.89	-1.21	-5.49	-4.50	-9.79	-	-
4	-15.16	-5.19	-17.08	-0.88	-14.66	-	-
5	-8.26	-1.74	-18.80	-3.49	-8.60	-	-
6	-4.39	-3.96	-15.74	-4.32	-4.92	0.01	-
7	-2.18	-5.68	-14.53	-3.91	-4.32	-	-
8	-11.37	-3.74	-6.88	-3.14	-2.08	-1.47	-0.28
9	-20.79	-3.08	-6.81	-1.65	-5.37	-4.52	-0.20
10	-11.04	-4.64	-3.45	-3.42	-5.99	-4.24	-1.78

Note: See Table 5 for designation of community groups.

Source: Treasury, 1992, Attachment 4, Tables 8 and 6.

- Introduction of a new parental income and assets test for 18-20 year old JSA recipients living at home.

Treasury's analysis of these (derived from Treasury (1992)) is shown in Table 6. If should be noted that no attempt has been made at this point to verify the magnitude of the impacts claimed by Treasury. The impacts are substantial particularly affecting those households with children as may be suggested by the nature of the expenditure cuts included.

Treasury (Treasury, 1992, Document 15, Appendix 3) outlines a further $744m (Department of Finance costing) reductions in direct cash transfers which it was unable to allocate to households. These include the proposed extension to 3-weeks of the wait for both the Job Search and Sickness Allowance, the two year benefit wait for migrants, the restriction of pension eligibility to wives of disability support pensioners and the extension and tightening of liquid assets test and leave deferment waiting periods. Conversely, it identifies $109m of spending increases which 'unambiguously have distributional implications but the benefits of which have not been allocated to households in the Opposition's distributional analysis, nor in the Treasury distributional analysis'.

Other less direct expenditure reductions may also have distributional effects on the material well-being of households. However, the mechanics of imputation introduce an unacceptable level of non-verifiable assumptions given our current state of knowledge. In the extreme, of course, expenditure reductions stemming from efficiency savings without affecting the quality and quantity of service provision will have no adverse distributional implications.

However, even the Opposition must concede that those expenditure reductions related to direct cash transfers contained in the package must impact upon the well-being of those households affected. In most cases, by their very nature, these are likely to be already low to moderate income recipients.

5.3 Health Policy Changes

The second major omission according to Treasury is the Opposition's neglect of the impact of changes to health policy.

Whilst maintaining the 1.25 per cent Medicare Levy, the Opposition proposes to encourage people to take out private health insurance. In respect of income earners below $30,000 this will take the form of an incentive by way of a refundable tax credit of up to $400 per family or $200 per single. For those with family incomes of greater than $50,000 (singles

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$40,000) this incentive becomes a stick in the form of a surcharge on the Medicare Levy of up to $800 per family or $400 per single reflecting a value 'approximately equivalent to the costs of private health insurance' (Hewson and Fischer, 1991c, Supplementary Paper No. 3, p. 20). The tax credit benefit has been incorporated into the Fightback! analysis but the surcharge 'stick' has been omitted. Treasury includes that omission.

However, it goes further and examines the implication on households of the decision to abolish bulk billing for all except veterans, war widows, pensioners, health care card holders and the disabled combined with the decision to reduce the general rebate level from 85 per cent to 75 per cent. Treasury claims that the abolition of bulk billing will mean that most families would have to pay the AMA standard rate for a doctor's visit rather than the Medicare rate (a difference of $7.50 per visit) but would get less back as a maximum rebate.

5.4 Bracket Creep

The third major discrepancy Treasury claims to identify is in respect of the Opposition's treatment of 'bracket creep' return. The Opposition states that it will 'guarantee the return of revenue from tax bracket creep to taxpayers' (Hewson and Fischer, 1991a, p. 4).

'Bracket creep' refers to the additional taxation revenue obtained by the government as a consequence of increases in nominal earnings (real earnings remaining unchanged) with tax threshold levels remaining fixed in nominal terms (but reduced in real terms). As a result, taxpayers find a greater proportion of their income is subject to taxation at a higher rate and real disposable income decreases.

The generally accepted mechanism for compensation (thus maintaining real disposable income) is to index the taxation thresholds for the rate of inflation. Indeed, the Coalition itself uses price inflation as the touchstone in its critique of 'tax by stealth' by the Government (Hewson and Fischer, 1991b, p. 11).

The Opposition allocates $2.9b of the proposed $12.2b income tax cuts as compensation for this bracket creep over the 1993 - 1996 period. Treasury argues that the income tax cuts proposed are not sufficient to compensate fully for the price impact of the GST over and above the underlying rate of inflation so that real after-tax disposable income is maintained. Indeed, it suggests an approximate $3b shortfall which then translates into a substantial reduction in the benefit of the Fightback! package, and for most taxpayers a net loss.

At no point in the Fightback! Document is the relevant underlying rate

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of inflation utilised in its analysis specified. It claims (Hewson and Fischer, 1991b, p. 323) that the $2,933 million commitment is based on 'an assumed earnings growth rate of 3.5 per cent' in each year of the triennium. To the extent that the underlying inflation rate is greater than this then the announced tax cuts are inadequate to compensate both for the underlying inflation and the GST - induced price increase (assuming that this is as estimated at 4.94%). Indeed the Opposition's figure of $2,933 million cumulatively apparently stems from application of the 3.5 per cent figure as an inflation measure, implying an assumption, unexplained, of a maintenance of gross real earnings.

In the absence of a specific inflation rate, Treasury resorted to the rates specified as the outcome of the Option C scenario of the accompanying Access Economics document at 5-7 per cent over the relevant 1993-96 period. This document, attached as a Supplementary Paper No. 1 to the Fightback! document (Hewson and Fischer, 1991c) is the source of the Opposition claims of two million jobs being created over the decade. This 'preferred' scenario C incorporates the increase in labour efficiency contingent upon *full* implementation of microeconomic reforms and relative tightening of fiscal policy (Access Economics, 1991, p. 12).

To the extent that the scenario C, or High Road scenario, 'does not purport to portray the outcomes which would be achieved' by the Coalition's policy package (Hewson and Fischer, 1991b, p. 333), in particular the change in the tax-mix, then the Opposition has a point in crying 'unfair'. However, equally though, the claims made by the Opposition of creating two million jobs out of the same analysis must be judged 'unfair', on the same criterion.

The 'debate' over bracket creep is in reality a debate over real wages under the Opposition package. To the extent that underlying inflation is greater than earnings growth, then real incomes will decline, and in consequence so will real disposable incomes. If, as the Opposition states in its distributional analysis, benefits should be measured in positive increases in real disposable incomes then households may be said to have lost (Hewson and Fischer, 1991b, p. 301). Treasury's argument essentially boils down to: what is the benefit of tax cuts if the spending power of wages before tax is to be reduced to a greater degree?

If the Coalition agrees to return bracket creep to maintain real disposable income it is in part subsidising real wage cuts which would clearly be anathema to the strategy outlined in the 'High Road' scenario. This possibly explains the creative use Coalition spokesmen have made of the notion of 'returning' such bracket creep. Rather than returned as income tax cuts the proceeds are to be returned in 'a discretionary way' (Reith, Press Statement, 28 November 1991). An indication of this 'discretionary way' is gleaned from the Fightback! document in reference to the 1996/97 financial year. Tax bracket creep is estimated at $866m yet income tax cuts total only $480m. The remainder is subsumed in customs duty cuts ($60m), the schools program ($150m) and community service obligations of public enterprises ($270m) (Hewson and Fischer, 1991b, p. 320). The tax cuts are in fact a carry-over from the 1995-96 cuts. Returning bracket creep through government expenditure gets very close to the 'taxation by stealth' charge issued at the Government.

Clearly the Opposition is under some obligation to specify in more detail the mechanisms to be used to calculate bracket creep and to return it, and that means some specification of the anticipated underlying inflation rate as a consequence of the package.

Some idea of the more 'politically neutral' result would be to take an illustrative 4 per cent inflation rate for 1992-93 through 1996-97 on the assumption that the GST will have a one-off impact only. This is consistent with a 0.5 per cent cut in real wages. Treasury undertakes such an analysis in Document 16 (Treasury, 1992). It concludes 'the tax cuts in the Opposition document are not large enough to achieve both tax indexation and GST compensation (in the sense of maintaining real disposable income) at incomes of $30,000 [1996 dollars] and less' (Treasury, 1992, Document 16, Attachment 7). This relates to about 50 per cent of taxpayers as compared to the 70 per cent of taxpayers estimated using the scenario C inflation estimates.

6. Extending Treasury Analysis

As indicated above, Treasury's analysis was based on a 'no questions asked' approach in respect of the Fightback! parameters and the impact of including a number of direct redistributive omissions. However, not all expenditure cuts or taxation changes were included. This section considers some of these omissions and their likely redistributive impact.

6.1 Expenditure Cuts

The Department of Finance identifies 162 expenditure cuts in the Fightback! package, 'costed' by the Opposition at $8.5 billion (excluding privatisation sales). Whilst the few direct income transfers considered earlier are amenable to distributional analysis, in most cases the specific impact on various groups is not such given our existing state of knowledge. In other cases, the extent of the impact is not transferable into comparative money-value terms. Impacts may be specific or general, direct or indirect, or shifted forward to users or backward onto providers. A re-arrangement of the portfolio allocation in the Fightback! documents to functional categories in Table 7 at least indicates the extent of expenditure changes likely to have distributional implications on Australians.

Table 7. Expenditure Cuts By Type

		($m, 1990-91 dollars)
Efficiency/administrative savings		1474
Increased fees/charges/cost recover		520
Eligibility tightening/restriction		2596
Program cuts		914
Overseas incidence		230
Transfers	budgetary[(a)]	902
	states[(b)]	750
	private sector[(c)]	1059

Notes: a) Refers to abolition of Diesel Fuel Rebate Scheme for the Primary and Mining Sectors contingent upon abolition of all excise on diesel fuel. In a sense this should be deducted from the revenue yield from petrol excise.
b) Refers to cuts in general purpose grants to the States and transfers of responsibility.
c) Refers to 'the moving to private health insurance' (Hewson and Fischer, 1991b, p. 263) and is the converse of the health changes analysed above.

Source: Derived from Hewson and Fischer, 1991b, Chapter 16.

Efficiency and administrative savings, if achieved, would provide net benefit to all, increased fees are likely to be borne by the users of such government services; and eligibility restrictions by those seeking to use the service. Overseas cuts (for example, in Foreign Aid and migrant assistance) do not directly impact on Australians and effects of cuts in transfers to the states depend upon how the states respond to this in terms of further cuts in expenditure or increased taxes and charges. All up, some $4.8 billion can be expected to have a distributive impact on the well-being of households.

The proceeds from privatisation whilst providing the funding for the savings tax credits and the wealth compensation measures will also imply a cost in terms of lost government dividend and community service obligations for the social nature of such enterprises. A full analysis of these is far beyond the scope of this paper.

6.2 Taxation Measures

Far more amenable to distributional analysis are measures relating to taxation. Whilst the lack of readily available data on the incidence may have hampered such analysis, it seems remarkable that both the Opposition and Treasury omit reference to several measures.

Fringe Benefits Tax

The Opposition claims that it 'will reduce the rate of the existing fringe benefits tax from 48.25 per cent to 46.25 per cent and later to 43.25 per cent in order to align it with the top marginal rate plus the Medicare Levy' (Hewson and Fischer, 1991b, p. 34). The revenue cost of this measure is omitted from the net costings of the Fightback! program and in fact the item is not mentioned again.

For the year ended 31 March 1991, tax payable on Fringe Benefits totalled $1228.6m (Taxation Statistics 1989-90, Table 7.1, 293). The rate applicable for that year was 47 per cent. Assuming no change to the amount of fringe benefits subject to tax, the revenue cost of the measure proposed would be:

	1993-94	1994-95	1995-96	Cumulative
Rate	48.25	46.25	43.25	
Revenue Loss		$19.6m	$98.0m	$117.6m

Whilst ABS currently only provides data on receipt (but not value) of fringe benefits, research undertaken within the Inequality Study indicates that the distribution of fringe benefits is more unequal than that of wages and a greater proportion is concentrated in the hands of already-high money wage earners (see Raskall, forthcoming b).

Table 8 outlines the share of value of selected fringe benefits received by full-time employees received by the highest 20 per cent of wage-earners. Clearly the reduction in fringe benefits tax largely benefits higher-income earners.

Capital Gains Tax

The Fightback! package makes a number of major changes to the capital gains tax system which are estimated to have a cumulative cost of $200m. The distributional implications of this, too, is omitted from both the Fightback! and Treasury analysis.

The Taxation Statistics 1989-90 indicate that 57.5 per cent of net 1989-90 capital gains tax payable is from individuals whose taxable income

Table 8. Inequality in the Distribution Of Fringe Benefits - 1990 Received by Full-time Employees

	Gini Coefficient	Share of Value Bottom 20%	Share of Value Top 20%
Entertainment Allowance	0.66	1.6	71.9
Club fees	0.63	3.2	71.1
Union Dues	0.56	3.7	65.8
Shares	0.52	3.6	59.0
Telephone	0.50	5.1	57.0
Education Expenses	0.49	3.9	56.0
Medical Expenses	0.48	4.0	57.4
Vehicle	0.47	4.9	54.2
Low-Interest Loan	0.44	4.7	51.9
Holiday Expenses	0.43	4.4	50.2
Housing	0.37	9.4	47.2
Electricity	0.26	13.3	41.6
Goods and Services	0.18	12.5	31.3
Superannuation	0.31	7.2	38.8
Study Leave	0.38	5.1	42.2
Long-Service Leave	0.27	8.0	35.9
Sick Leave	0.24	9.5	34.3
Annual Leave	0.24	9.6	34.6
Wages	0.23	10.2	34.3

exceed $50,000 (Taxation Statistics, Table 1.17, p. 118) - the top 5 per cent of taxable income recipients. Again higher income earners are the principal beneficiaries of this move.

Company Tax

The Fightback! package proposes to increase the company income tax rate to 42 cents in the dollar at a cumulative revenue cost of $975m. However, whereas reduction in corporate tax liabilities in the form of indirect sales taxes, payroll and excise duties are assumed to be partly or fully passed on in lower prices, the actual incidence of the increased company income tax rate is ignored. There is no reason why this should be done.

Indeed, fiscal incidence studies such as that by Warren (1987, p. 123) in the STATAX model simulation adopt a standard tax shifting assumption in respect of payroll tax and company income tax that 50 per cent is borne by dividends and 50 per cent borne by consumers. That standard assumption was applied for payroll tax in the Fightback! analysis but not for corporation tax which was excluded totally. If it is borne wholly by consumers then this implies a price impact of about half of one per cent on the private final consumption expenditure base. A 50:50 shifted burden assumption has half this impact.

Tobacco Excise

Both Fightback! and Treasury analysis omit the proposal to increase the excise on tobacco by 25 per cent. Whilst this increase is part of the Health Policy, the package is, in the Opposition's words, an integrated whole. Whilst this increase can arguably be excluded in assessing the adequacy of compensation for GST-related measures, the argument for excluding it from a distributional analysis of the entire package is far more tenuous. Indeed, the quote at the beginning of this paper suggests the imperative to include it.

Unfortunately, in more ways than one, lower-income households spend a higher proportion of their budget on cigarettes and tobacco. According to the 1988 HES the lowest decile of households spent 4.7 per cent of their disposable income on tobacco whereas the highest income-receiving decile spent only 0.6 per cent.

6.3 Wealth Compensation

In addition to the income effects of the GST and related measures, there is the question of wealth effects. The Opposition argues that there will be an adverse wealth effect due to the one-off CPI effect of the package on the value of savings (wealth) particularly in the form of financial assets with institutions. Other forms of wealth are anticipated more or less to adjust. In other words, each dollar in the bank buys about 5 per cent less goods and services.

Unlike the Draft White Paper (Treasury, 1985), the Opposition argues the case *for* compensating retirees for this loss in value of their accumulated savings. To this end, it 'guarantees to spend $1.4 billion on wealth compensation' (Hewson and Fischer, 1991b, p. 169).

In the absence of comprehensive data on wealth,[6] the Opposition imputed this cost on the basis of income received as interest from the 1988-89 HES data by persons aged 60 years and over. It proposes to target the capped refundable tax credit of up to $2 500 (5 per cent of the eligible imputed wealth stock) to those receiving taxable income of less than $30,000 per annum.

However, in terms of the veracity of the distributional analysis the principle holds in reverse. The package would have adverse wealth effects for *all* holders of financial assets. That *some* are to be compensated has the converse that others are not compensated and thus 'lose' in consequence.

Whilst the compensation in the form of a rebate may have been included in the 'all other compensation measures' the losses should also. The question is who bears the losses?

The income data used to calculate the 'wealth' of those aged 60 and above as outlined in Fightback! (Hewson and Fischer, 1991b, pp. 170-171) can also be used to calculate the 'wealth' of those not so compensated. This is particularly important for those households who are dissavers. To quote the Opposition:

> 'When Y <C, full income compensation is not by itself sufficient to maintain real living standards as measured by consumption. Consumption is being financed in part by a run-down in wealth. Wealth compensation is need to preserve the real value of the stock of that wealth, and thereby the capacity to finance real living standards out of that wealth.' (Hewson and Fischer, 1991b, p. 174)

Table 9 shows this wealth loss by age and by income group.

Table 9. Estimated Wealth Loss In Value (1990-91 $m)

	Interest Income	Imputed Wealth Stock A[a]	B[b]	Wealth'Loss'[c] A	B
Individuals 15-59					
Less than $30 000 gross	2 479	35 414	24 790	1 771	1 240
Greater than $30 000	1 105	15 786	11 050	789	552
Total	3 584	51 200	35 840	2 560	1 792
Individual 60+					
< 30 000	2 604	37 200	26 040	1 860	1 302
≥ 30 000	668	9 528	6 680	476	334
Total 3 272	46 743	32 720	2 337	1 636	
All Individuals					
< 30 000		5 083	72 614	50 830	3 631
≥ 30 000		1 772	25 314	17 720	1 266
Total	6 855	97 928	68 550	4 897	3 428

Notes: a)A - assumes 7 per cent interest rate b)B - assumes 10 per cent interest rate c)equal to 5 per cent of the eligible wealth stock with cap.

Source: Based on 1988-89 HES adjusted for price inflation from data date to 1990-91.

The Fightback! package calculates a wealth loss for single adults aged

60 or more of $1,938 million (7% assumed interest rate) and $1,356 million (10% interest rate). This compares with the $1,860 million and $1,302 million calculated in Table 9.

On Fightback!'s base assumption of 7 per cent interest rate, Table 9 indicates that over $3,037 million of wealth losses to individuals is uncompensated for. This represents the loss from 62 per cent of all wealth stock in financial assets.

Most significantly, 58 per cent ($1,771 million) of this uncompensated wealth loss is borne by individuals under 60 with gross incomes of less than $30,000. This includes 'older' people saving for retirement and younger people saving for a home.

When disaggregated by age, two distinct distributional patterns of interest income emerge, as outlined in Table 10, excluding the bottom decile which is affected by business losses.

Table 10. Interest Income as Proportion of Gross Income

Decile	All Individuals 15-59	All Individuals 60+
2	16.63	3.34
3	6.36	5.71
4	3.62	5.10
5	1.88	5.84
6	1.50	8.13
7	1.42	15.57
8	1.32	16.29
9	1.36	17.95
10	1.48	13.01
Average	1.86	12.25

Source: ABS 1988-89 HES.

This adverse, and uncompensated, wealth effect is more significant for 'younger' lower income individuals than for higher income recipients whereas for the 60 years and over group, the significance is reversed, and despite popular mythology it is higher-income older people who are more reliant upon interest income from financial assets than lower-income pensioners.

This suggests that the wealth effects for lower income non-aged persons may be far greater than the Coalition has assumed and it may need to re-examine its decision not to grant these individuals compensation.

The Opposition could argue that the provision of tax-free savings scheme benefits these wealth-holders. However, this is explicitly incorporated in the compensation measures in the calculation of the 'Net Benefits'. Similarly, the provision of $2 000 to first home buyers earning up to $40,000 per annum household income could be argued as an attempt to mitigate the impact of GST-induced CPI increases on new home buyers savings. This, too, is integrated into the 'all compensation measures' of the 'benefits'. In this light, the case for including the non-compensation as an off-set in the distributional analysis is significantly strengthened.

7. Questioning the Parameters

A full analysis of the Fightback! should extend even further and question some of the basic parameters underlying the analysis, the compensation offered and the distributional impact.

The key parameter accepted by both the Coalition and the Treasury relates to the assumption that traders pass on the entire benefit of the indirect tax abolition (half in the case of payroll tax).

It is as a consequence of this that both analyses conclude a net price impact of 4.5-5 per cent on imposition of a GST. The Fightback! compensation is directed towards providing households through tax cuts/credits and welfare benefit increase with compensation of at least 4.8 per cent. All tax rebates, including those for dependent spouse and sole parent are to be indexed by 4-8 per cent.

Beyond this, on the basis that

- 'the price impact for those on government pensions and benefits is larger, on average than for wage and salary earners',

  and

- 'in particular, there are a few lower income deciles in receipt of government pensions that have price effects of more than 7 per cent'. (Hewson and Fischer, 1991b, p. 158)

the compensation provided for those in receipt of government pensions and benefits is greater. Benefits are to be indexed by 6 per cent and pensions by 8 per cent.

In summary, the compensation depends upon the estimated price effect which in turn requires that all downward cost impacts from abolition of existing taxes is passed forward in lower intermediate and final prices. Traders margins are assumed to remain the same and no trader will use the opportunity of GST introduction to increase existing margins.

To the extent that this does not occur the question of the adequacy of the compensation rapidly emerges. Even pensioners, which both Treasury and Opposition analysis concur will be net gainers, will be forced to face a drop in their standard of living as price increases for their existing basket of goods, exceeds their nominal rise in income. In the case of pensioners this is a mere 1 per cent above the 8 per cent promised compensation.

Clearly, the Coalition needs to be very certain of its ability to ensure that the parameter assumption is maintained. To this end it will provide an additional $1 million (of 3.5 thousandths of one per cent of the GST revenue) to the Prices Surveillance Authority to

- inform consumers 'about how prices of key goods and services will be affected',
- 'encourage vendors to pass on savings' via public information programs;
- 'look into consumer complaints'; and
- 'monitor public utilities'. (Hewson and Fischer, 1991b, p. 137)

In view of the massive number of transactions which will occur under the GST a reasonable person could well question the effectiveness of this activity in virtually eliminating any trader margin increases, as is necessary.

A more accurate idea of the possible outcome (and the validity of the key analytical parameter) comes from the Opposition itself. In attempting to establish that the GST will have only a one-off impact and no on-going inflationary effect the Coalition quotes from an IMF Report on the experience in New Zealand:

> The authorities went to great lengths, using an extensive advertising campaign to reduce the public's fear about price increases and to contain any possible attempt by traders to take advantage of uncertainty to widen margins. (Alan A. Tait, *Value Added Tax: International Practice and Problems*, International Monetary Fund, Washington, 1988 quoted in Hewson and Fisher, 1991b, p. 136)

The pertinent part of the quote continues:

> It was estimated that about half of the 10 per cent VAT yield would be needed to replace the existing sales tax; this left about a further 5 per cent net increase to be reflected in higher prices. *As it turned out, some traders did increase their margins and the actual outturn for the first quarter, after the introduction of VAT, was a price increase attributable to VAT of 6.5 per cent.* (quoted in Hewson and Fisher, 1991b; p. 136, emphasis added)

Thus, despite the authorities going to 'great lengths' instead of the predicted 5 per cent net increase in prices attributable to VAT the actual increase was 6.5 per cent, according to the IMF. This means that only 70 per cent (3.5 per cent of the expected 5 per cent decrease from existing sales tax) of the cuts in sales tax were in fact passed on. 30 per cent was retained in higher margins and maintained prices.

If this is replicated in Australia, then the base price effect for compensation becomes such as to translate apparent over-compensation into under-compensation for most pensioners and beneficiaries.

The Opposition does not provide a detailed breakdown of its estimates of the individual price effects of the abolition of payroll tax, excise taxes and wholesale sales tax or imposition of its GST in its detailed analysis. However, Treasury, in its analysis, using the Opposition's assumptions, does (Treasurer's Statement, 1991, Attachment 6). Remembering that this analysis in fact produced a *lower* net price impact then the equivalent analysis in Fightback!, we can calculate the magnitude of this effect of 30 per cent retention by traders of the tax abolitions.

Treasury estimates the percentage price effects as:

	Imposition of GST		11.31
Less	Abolition of Payroll Tax	0.94	
	Abolition of Excises	2.28	
	Abolition of Wholesales Sales Tax	4.00	7.22
	Net impact of Tax Changes		4.09
Plus	Health Policy Change (implicit)		0.68
	Package of changes		4.77

(Treasurer's Statement, 1991, Attachment 6)

If we ignore the implicit estimated impact of the health policy changes and concentrate on the net result from the tax changes, then we can see that, if only 70 per cent of the reduction from tax abolition is passed on in lower prices then, instead of a net tax impact of 4.09 per cent, the net impact rises to 6.256 per cent - a difference of 2.166 per cent. Thus, following the Opposition's own argument not only beneficiaries (receiving only a 6 per cent rise) and low and middle income wage and salary earners (receiving a 4.8 per cent increase in rebates), but also pensioners (who are to receive an 8 per cent increase to compensate for the anticipated 7 per cent increase in prices of goods affecting them) will find that with an additional 2.17 per cent impost, they become *net losers* from this component of this package.

This assumption about passing on all tax reductions also begs the question as to how businesses will benefit from the so-called cut in taxes on business of 'at least $20 billion' (Hewson and Fischer, 1991b, p. 25) so as to have the funds to create the two million jobs? At best, $2,916 million in payroll tax abolition is assumed by the Opposition to remain in the hand of business. And of that $1,137 million is 'clawedback' to the government in corporate tax and a further $975 million is to be paid by the business sector contingent upon the increase in the corporate tax rate to 42 cents in the dollar. The net impact is then reduced to $804 million or about $100 per year per currently employed worker, not 'at least $20 billion'.

Given the hard times facing many small businesses in particular, the temptation will be strong for businesses to utilise the confusion attendant upon introduction of the GST to retain some of the extra 'revenue' in their hands to restore or build up margins. This temptation will be especially large for small businesses who are currently beneath the threshold for which payroll tax is to be paid. Large businesses will find their costs falling more with the abolition of payroll tax which, if they maintain their current margin, will result in larger price falls than small business. This change in relativity will be particularly marked if large corporations act as either a price-maker or price-leader in the market.

Related to this aspect is the question of compliance costs. To quote the Opposition: 'The Liberal and National Parties have estimated the compliance costs associated with the wholesale sales tax at approximately $400 million annually' (Hewson and Fischer, 1991b, p. 143). It makes no equivalent estimate for the GST. However, Sandford (1986) reports on a UK study of which he was an author (Sandford, Godwin, Hardwick and Butterworth (1981)) which calculated aggregate compliance costs of VAT at 'about 9 per cent of tax revenue'. If this were to be translated to Australia it would imply a compliance cost of $2,444 million. Net compliance costs imposed on business would increase by around $2 billion. Part of this will no doubt be passed on to consumers in the form of higher prices or increases in trader margins.

What is particularly disturbing is that the Opposition did not accommodate the possibility of increased trader margins despite being aware of the position in New Zealand as demonstrated by its use of the quote cited above. Similarly, concern must be expressed about its emphasis on existing tax evasion in the so-called black economy without making *any* provision for evasion of the GST, particularly in the new-to-tax services sector. Every one per cent of evasion reduces GST revenue yield by $272 million.

It is these sorts of basic assumptions in this form of partial distributional analysis that particularly require sensitivity testing to see how robust the critical results are to variations in these parameters.

8. Some Observations

It seems appropriate at this point to reflect upon the limitations of this sort of distributional analysis. Statistical calculation of incidence studies of the type undertaken by the Opposition and Treasury and the ABS (ABS, 1987 and 1992) have been criticised by public finance economists for effectively eliminating behavioural responses from the model (Piggot, 1987). As such it is claimed that such studies are biassed against policy changes which have as their goal efficiency objectives. Piggot goes as far as to claim that the estimates produced by such statistical calculation studies 'can generate seriously misleading perceptions of the redistributive impact of government programmes' (Piggot, 1987, p. 47). He goes to argue for a general equilibrium approach to incorporate efficiency gains. This is particularly important for the Fightback! package which makes it quite clear that its over-riding objective is to 'achieve a generational change in policies and attitudes ... by creating more incentives and opportunities for all Australians to work harder and be rewarded for it, to save and to invest' (Hewson and Fischer, 1991b, p. 1).

None of the efficiency gains that might be forthcoming from the tax-mix change is incorporated either explicitly or implicitly in the partial equilibrium analysis of redistribution discussed in this paper. At a rudimentary level, if indeed the microeconomic reforms encompassed in the package achieve the goal of two million jobs created then there are clear redistributive gains to those currently unemployed who would be provided with a job and a wage income.

Much debate in the literature has centred around the conceptual formulation of such general equilibrium models and the empirical effects on work and savings incentives. The fact that these are less clear-cut than statistical incidence impacts is reflected in the Opposition's failure to include them in any specific form in the Fightback! analysis, despite them being the thrust of its changes. Whilst there will no doubt be studies undertaken to examine these efficiency effects of the package in the future it is a sad reflection on the current state of distributional analysis in the economics discipline that much conceptual work remains to be done to develop models which *simultaneously* determine redistributive and efficiency impacts. In part, this is a reflection of the 'marginalised' role distributional analysis has been cast into in the last two decades where economic analysis has been almost solely geared towards efficiency modelling.

This poverty in the distributional 'state of the art' is also reflected within the limitations of partial statistical incidence. Largely as a consequence of the efforts by the Australian Bureau of Statistics in fiscal incidence studies of the Household Expenditure Surveys (ABS, 1987 and ABS, 1992) and development of operational concepts of the social wage (Harding, 1984; Norris, 1990 and McHutchison and Urquhart, 1992), more attention is being directed towards examination of the distributive impact of government expenditure. However, as reflected in the treatment analysis in this paper many conceptual, methodological and empirical difficulties remain (see McHutchison and Urquhart, 1992).

Aside from the difficulty of identifying existing households which use such government services, many services relate to the future position of households. For example, moves to limit eligibility for unemployment benefits affects not merely the currently employed but those likely to be unemployed in the future. Within the social wage literature, one school (as illustrated by ABS, 1992) allocates social expenditure on the basis of utilisation rates (recipients who actually use the service first hand). Other researchers (Smeeding and Moon, 1980 and LIS, 1987) consider that social expenditure should be treated like insurance and allocated whether people utilise the government service or not, on the basis that such public expenditure provides protection that can be made use of if the need arises.

Other problems arise out of the existence of externalities. Investments in human capital, through expenditure on education and health not only benefits the individuals who directly utilise these services but the society as a whole. Moreover, many of the benefits received are not amenable to conversion to a dollar value nor indeed is the aggregate expenditure necessarily an appropriate value of inputs.[7]

It is only in recent times that appropriate policy attention has been directed towards the explicit distributional impact of government decisions. As economists and other social researchers respond to the demands of policy-makers, and policy-makers recognise the significance of inequality as both a cause and consequence of economic phenomena, then we can expect more rapid improvements in our understanding of these issues.

9. Conclusion

The unfortunate conclusion to be drawn from this analysis reflects more on the rudimentary state of distributional analysis in economics than on the accuracy of either the Opposition or Treasury analyses. This, however, should not be taken as an imprimatur to ignore or discount the results presented but rather as a challenge to improve this form of analysis.

The Coalition is to be congratulated for the attempt it has made to quantify the statistical incidence impact. Indeed the effort it has imposed upon Treasury to develop a statistical modelling unit will greatly aid the efficacy of policy development in the future. There can be little doubt that the analysis established by the Opposition in Fightback! has set the touchstone by which future manifestos will require corroborative analysis. This applies the Government's One Nation document. The days of politicians being able to rely on unbridled rhetoric seem to be over.

That said, however, several disturbing features relating to the veracity of the analysis require the attention of the Coalition, in particular:

- the apparent discrepancy in the two key tables outlining the benefits, as calculated by the Coalition, to households;
- the failure to incorporate or test the assumption that traders will pass all tax reductions on in lower prices, particularly in the light of the Coalition's apparent endorsement of the IMF document detailing the actual end impact in New Zealand (Tait, 1988); and
- the failure to incorporate the wealth losses requiring compensation whilst at the same time incorporating the wealth compensation package as a 'benefit'.

As it stands the results presented, as distinct from the analysis, suggest a level of creative accounting which in terms of its representation of reality suggests that the creator was in the ilk of Salvador Dali. Beyond this, the exclusions of the direct expenditure cuts and the downside of the changes to the health policy imply a significant over-estimation of the net benefits of the package to households.

The inclusion of both the omissions identified by Treasury and those identified by this paper in relation to wealth loss, actual price-effect of the GST, corporate tax increase, and compliance costs dramatically reduces these net benefits. Far from all households benefiting, a large number of households become net losers. Distributionally, these losers are concentrated in the lower and middle-income deciles. When combined with the omitted benefits in the form of capital gains and fringe-benefits tax reduction, those households benefiting are overwhelmingly concentrated amongst the higher income earners.

One is reluctanly forced to be somewhat cynical the claim that:

> The Coalition has taken great care to ensure the reliability of the numbers presented in this reform package. We have on all occasions sought to err on the conservative side when making our calculations. (Hewson and Fischer, 1991b, p. 326)

On the other hand, it is unlikely that the Government can sustain the magnitude of its argument regarding bracket creep. However, in part the Government's capacity to raise it at all stems from the Opposition's failure to specify and justify an on-going inflationary outcome contingent upon the implementation of the entire package. The ball remains in its court.

Given that the thrust of the Fightback! package is on the beneficial efficiency gains on labour and savings, it would have been better advised to have concentrated on the distributional impact of these, rather than make grandiose statements from a flawed partial statistical incidence study.

In summary, far from everyone gaining as suggested by the Coalition, there are definite losers and those losers are likely to be low and middle income earners. When all the issues raised in this paper are resolved, the estimate of Treasury that only 70 per cent of wage and salary earner households are likely to be losers may well seem optimistic.

To quote the Marquess of Salisbury 120 years ago, 'The optimistic view of politics assumes there must be some remedy for every political ill, and rather than not find it, it will make two hardships to cure one'.

Notes

1. Deputy Leader of the Opposition and Shadow Treasurer Peter Reith, interviewed on ABC Four Corners program, 2 March 1992.
2. What happens to these measures if such sales are not forthcoming is not addressed.
3. This was tabled in Parliament by the Treasurer on 3 March 1992 following a Freedom-of-Information request from the Shadow Treasurer.
4. The Coalition data is based on the 1988-89 HES sample of 7225 households. Breaking this sample into different community groups and then deciles of such groups can reduce particular cohorts to below a size sufficient to give a statistically valid result (about 30 households).
5. Suffice to say an attempt to replicate even the base sample used in each analysis revealed significant problems in terms of both the excluded households and the population weightings by community groups.
6. It is ironic that the Opposition cites the lack of such data as a rationale for not extending compensation, given the decision by ABS to terminate a wealth survey in 1979 as a result of funding cuts by the then Liberal-National Party Government.
7. It is one of the aims of the Inequality Study to extend our scant and simplistic knowledge of such distributional impacts of forms of government expenditure.

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