GENDER EQUITY IN THE TAX SYSTEM
FOR FISCAL SUSTAINABILITY

Workshop:
Gender Equity in Australia’s Tax and Transfer System
4-5 November 2015

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Two of the most fundamental changes in the Australian economy since the middle of the 20th century are:

- the decline in the TFR, from around 3.5 in 1960’s to 1.8 today
- a dramatic rise in the female labour force participation rate.

OECD (2014) stats for 2012: female rate = 70.5%; male rate = 82.2%. A gap of less than 12 percentage points.

However, the female participation rate is misleading. The 12 percentage point gap conceals a far wider gender gap in labour supply, in the order of 40 to 50 per cent during the prime working age years due to the high proportion of women in part-time work.
Introduction

Policy challenge:

A large fall in a country’s TFR creates the potential for a significant “social dividend” due to the high parental time costs of a child, mostly of the mother.

The challenge is to put in place a policy setting that leads to productivity gains from the reallocation of female time from the home to the market.

With the optimal policy setting we would expect to see an expansion of the tax base that provided additional revenue for investments in child care, education, health care and infrastructure.

This paper discusses tax policies that work against this outcome.
Introduction

Analysis focuses on the negative incentive effects of gender/second earner discrimination in three areas of tax policy:

- the Family income tax system
- GST
- tax advantaged superannuation

We begin with an analysis of time use and expenditure data to show:

- the large and persistent life cycle gender gap in labour supply
- the negative impact on household private income, saving and the tax base.
Life cycle time use

Data: ABS 2005-06 Time Use Survey and full sample of couples drawn from the 2009-10 Household Expenditure Survey (5252 records).

Life cycle is defined not on the “age of head” of household as in the economics literature, but on presence and age of children.

Five phases:

- Pre-children
- At least one child of preschool age is present
- Children are of school age or older but still dependent
- Parents are of working age but with no dependent children at home
- Retirement.
Life cycle time use: ABS data

5 phases:
1. pre-children – almost identical female and male market hours
2. at least one child 0 to preschool age – dramatic fall in female market hours
3. children of school age or older and still dependent
4. post-child phase (under 60)
5. retirement (60+)

Gender gap persists from phase 2 to phase 4 with no children at home. Literature attributes persistence to loss of human capital.
The gender gap in labour supply in phase 2 reflects the additional work choice created by the arrival of the first child.

One parent, typically the mother on a lower wage, can work at home providing child care and domestic services as an alternative to working in the market and buying in care and related services.

Choice will depend on the net-of-tax gender pay gap and access to child care at an affordable price and acceptable quality.

Life cycle profiles of income, saving and taxes indicate the potential losses from tax policies that widen the net-of-tax gender pay gap.
Life cycle income, saving and taxes

Household private income, saving and taxes track female earnings which, in turn, track female labour supply.

<table>
<thead>
<tr>
<th>Phase</th>
<th>Household income*</th>
<th>Female earnings*</th>
<th>Saving*</th>
<th>H income tax- (FTB+C**)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>116141</td>
<td>47502</td>
<td>19760</td>
<td>19410</td>
</tr>
<tr>
<td>2</td>
<td>83824</td>
<td>6240</td>
<td>5824</td>
<td>11411</td>
</tr>
<tr>
<td>3</td>
<td>110244</td>
<td>30212</td>
<td>9776</td>
<td>19387</td>
</tr>
<tr>
<td>4</td>
<td>94744</td>
<td>26208</td>
<td>14040</td>
<td>17113</td>
</tr>
<tr>
<td>5</td>
<td>6980</td>
<td>0</td>
<td>1404</td>
<td>4179</td>
</tr>
</tbody>
</table>

* Median  **C = CCB + CCTR

Profiles conceal high degree of heterogeneity within phases 2 to 4.
Heterogeneity – female labour supply

Phases 2 to 4 are split into two types according to median second hours.

Type “H1”: households with second hours below the median
Type “H2”: households with second hours at or above the median

<table>
<thead>
<tr>
<th>Type</th>
<th>Phase</th>
<th>Male hours</th>
<th>Female hours</th>
<th>Female income</th>
<th>H inc. tax- (FTB+C**)</th>
<th># Kids</th>
</tr>
</thead>
<tbody>
<tr>
<td>H1</td>
<td>2</td>
<td>2058</td>
<td>11</td>
<td>2170</td>
<td>7555</td>
<td>2.08</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>2105</td>
<td>438</td>
<td>16375</td>
<td>17335</td>
<td>1.90</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>1743</td>
<td>454</td>
<td>14894</td>
<td>14180</td>
<td>-</td>
</tr>
<tr>
<td>H2</td>
<td>2</td>
<td>2116</td>
<td>1410</td>
<td>42764</td>
<td>17674</td>
<td>1.85</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>2080</td>
<td>1949</td>
<td>52833</td>
<td>24776</td>
<td>1.72</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>1983</td>
<td>1830</td>
<td>51120</td>
<td>23672</td>
<td></td>
</tr>
</tbody>
</table>

**C = CCB + CCTR

Female earnings and taxes track female hours within each phase.
Family income tax system

Transformation of Australia’s income tax system since 1980s.

1980s: rate scale of the Personal Income Tax (PIT) was highly progressive and family payments were universal. The system ranked well in terms of gender equity and female labour supply incentives.

During the Howard years:

• the progressivity of the rate scale declined dramatically despite rising inequality. Gave massive tax cuts to top incomes (Apps, 2015).

• individual as the unit of taxation for families was replaced by a system of “quasi-joint” taxation by withdrawing family payments on joint-income. Many partnered mothers as second earners face marginal tax rates that are well above the top rate on personal income. We now have a large net-of-tax gender pay gap (Apps, 2010).
Joint taxation

Progressive joint taxation is recognised to discriminate against the second earner, by imposing a higher MTR on her income. - supported by the fallacy that household income is a reliable indicator of the living standards of couples.

Household income omits the contribution of a partner specialising in child care and work at home, effectively setting its value to zero. **Women at home are made invisible.**

Joint income can seriously misrepresent living standards due to the high degree of heterogeneity in second earner labour supply and the relatively flat profile of the primary wage distribution until the top percentiles.

Data show that when the second earner of a low wage family in quintile 1 of household income goes out to work, the family can be reranked to quintile 4 and misrepresented as just as well-off as a single-earner family on twice the wage working half the hours.
Quasi-joint family taxation

Howard’s system of “quasi-joint” taxation supported by “targeting fallacy” – argument that withdrawing family payments as income rises achieves a “cost”/revenue saving by reducing “middle class welfare”. Example:

Re:think: “Reducing effective tax rates is not straightforward because reducing the rate at which payments are withdrawn, or removing them altogether, would extend assistance to higher income levels”.

View contradicts one of the most important lessons of modern tax theory: any tax system that gives a payment and then withdraws it as income rises is equivalent to one with the same universal payment and a new structure of MTRs and lump sums.

The relevant basis for evaluating the “cost” of a tax system is not the “universality” of the payment, but the value of the payment and the incentive effects of the MTR structure.
By targeting family payments the Howard system replaced the progressive rate scale of the PIT with an inverted U-shaped scale. MTRs on partnered mothers rose sharply while the top PIT rate fell.

The additional revenue from the growth in the tax base with the rise in female participation since the 1960s offered a source of funding for productivity-improving investment in a public child care system.

Instead the revenue funded cuts in top tax rates with little to no gain. Male wage elasticity tends to zero towards the top percentiles.

High tax rates on second earners under joint taxation have long been rejected in the literature due to evidence of strong disincentive effects on female labour supply.
Using household income as a measure of living standards also leads to a serious misreading of the data on household saving.

Table: phases 2 to 4 are split into household types, H1 and H2, according to median second hours within each primary income quintile.

<table>
<thead>
<tr>
<th>Primary income quintiles</th>
<th>34265</th>
<th>54701</th>
<th>71982</th>
<th>96648</th>
<th>201855</th>
</tr>
</thead>
<tbody>
<tr>
<td>H1: 2nd earnings $pa</td>
<td>330</td>
<td>9745</td>
<td>9494</td>
<td>16794</td>
<td>12835</td>
</tr>
<tr>
<td>Saving $pa</td>
<td>-8227</td>
<td>331</td>
<td>4095</td>
<td>14268</td>
<td>54642</td>
</tr>
<tr>
<td>H2: 2nd earnings $pa</td>
<td>24425</td>
<td>37410</td>
<td>43001</td>
<td>60451</td>
<td>67281</td>
</tr>
<tr>
<td>Saving $pa</td>
<td>297</td>
<td>9075</td>
<td>16167</td>
<td>30634</td>
<td>76973</td>
</tr>
</tbody>
</table>

Table reports regression estimates of household saving by primary income that control for demographics within each quintile.

By switching from H1 to H2, saving in q2 to q4 rises above that of H1 in q5.
Standard argument for shifting from income to consumption taxation (see Henry Review + recent Treasury papers) is based on two mistaken assumptions.

**Assumption 1:** The optimal tax rate on capital income is zero. (Note that under a GST capital income is tax exempt.)

Contradicts the central tenet of modern tax theory, that the optimal tax rate on a given source of income, whether labour or capital, can only be determined on the basis of empirical evidence on distributional outcomes and behavioral effects because we are in a “second best” setting.

With a shift in the tax burden from capital to labour, female hours and, in turn, household saving can be expected to fall as indicated above.
**Assumption 2**: A consumption tax is equivalent to a tax on earnings.

We label this the “equivalence fallacy”.

The proposition draws on a model of intertemporal choice that assumes:

1. A perfect capital market
2. All households are single-person
3. Consumption and leisure are weakly separable

All three reflect very poor powers of observation:

1. Life cycle profiles: borrowing rate > lending rate (Apps & Rees, 2010)
2. Most adults live in couple households and most have two earners
3. Consumption (e.g. bought-in child care) and “leisure” (e.g. home child care) tend to be substitutes
Efficiency merits an income tax

A well-designed labour income tax will always be superior to a consumption tax because it is a less constrained policy instrument.

Individual earnings can be observed and taxed progressively, allowing a lower tax rate on the 2nd earner, typically the female partner with the more responsive labour supply and higher saving rate at a given wage.

Individual consumptions cannot be observed. We can never observe whose consumption has been reduced to fund household saving

A broad based consumption tax is inevitably a flat rate joint tax.
GST vs income tax - couples

Additional tax burden under a 5 percentage point rise in GST rate and under an increment in all income tax rates that raises same revenue.

Much of the GST revenue will be spent on compensation targeted on the basis of joint income – MTRs on female labour will rise. A rise in the GST will hit the “middle” and women (Apps, 2013).
GST – fictional efficiency claims

RE:think
Draws on Treasury Working Paper (TWP), Cao et al. (2015). TWP claims that GST is more efficient than a flat rate earnings tax using a computable general equilibrium model (CGE)

Model is entirely fictional.
Household is represented as a single person with a single “…uncompensated elasticity of labour supply of 0.15…”

Whose labour supply elasticity? Whose saving elasticity?

Makes no sense to model the household as single person.
Similar findings in Treasury funded KPMG (2010, 2011) studies.

Why is Treasury presenting fictional results for a GST?
Australia’s defined contribution superannuation system, with employer contributions and entity earnings taxed at 15%, has also directed billions of dollars of tax cuts towards the top percentiles of income.

According to modern public economic theory, the key objective of a retirement incomes policy is the provision of insurance against longevity and aggregate (or social) risk. A defined contribution superannuation system fails on both counts.

The system is essentially a tax advantaged saving scheme that is now justified in terms of lowering taxes on capital income (Henry Review). The greatest gains go to those with the most income to save.
Super: gains go mostly to high income primary earners

With the concentration of women in lower paid jobs, women as a group cannot gain. The system widens the overall net-of-tax gender pay gap.

Gender equity requires a public sector retirement income insurance policy.
Demographic change

Tax advantaged saving is not a solution to the perceived problem of fiscal sustainability with demographic change.

The solution lies in raising female labour supply and productivity. We require tax and expenditure policies that rank well in terms of gender equity and labour supply incentive effects. Two key policy directions:

- A return to a highly progressive income tax with universal family payments
- Incremental investment in a learning focused public child care system

Nothing can be gained by raising the GST and lowering taxes on capital income.
References


