

Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Supplementary Budget Estimates

17 October – 18 October 2012

Question: SBT 167-172

Topic: Automatic Fiscal Stabilisers

Written: Received from Committee – 26 October 2012

Senator JOYCE asked:

Regarding the automatic fiscal stabilisers on the Budget's revenue side:

167. What are the key tax and non-tax items in the revenue that act counter-cyclically (or at least partly so) to economic activity over the modern business cycle? (For example, arguably business and other tax losses.)
168. Of those items listed, which ones tend to have the greatest impact in terms of smoothing the cycle?
169. Of those items listed, which ones have impediments that prevent them from working as counter-cyclically as they could? What are those impediments – that is, what would the benchmark policy or treatment look like and what would be required to remove those impediments?
- For example, business and other tax losses being refunded immediately, and not quarantined until certain conditions exist or are met.
170. Have any such impediments been reduced or removed in recent times?
171. What more could be done to improve such counter-cyclicality?
172. If the effects of such impediments are reduced or eliminated, and the counter-cyclicality of the tax and revenue system is improved, would that help to reduce the need for certain discretionary demand management policies that will be otherwise typically activated over future downturns and cycles?
- For example, discretionary fiscal spending, with the practical problems of timing (when) and targeting (who) that inevitably result?

Answer:

167. As a general principle, the amount of receipts collected varies with the economic cycle, as income, consumption and investment depend upon economic conditions. As taxes are determined mostly on these various elements, tax receipts fluctuate without the influence of policy measures, and are accordingly considered as automatic stabilisers. In addition, Australia's progressive personal tax system acts as an automatic stabiliser. This progressivity means that taxpayers' after-tax income in aggregate grows more slowly than taxable income in times of rising incomes, and falls less quickly than taxable income during economic downturns (when people may work less). Non-tax items, such as dividends, which account for around 1.5 per cent of GDP, are a much smaller proportion of total receipts and tend not to move closely with the economic cycle.

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168. Taxes and changes to tax arrangements are usually designed in the first instance to achieve equity, efficiency or integrity objectives. But there are some cases where measures have been introduced to specifically address counter-cyclicality considerations – see answer to question 170.

The degree to which tax receipts rise or fall, and which taxes are most affected, depends on the source of the economic shock and the resulting ramifications on the economy.

Economic income and income for tax purpose have differences in timing and definition that can affect the operation of automatic stabilisers. Examples are allowing investment losses to be carried forward so that they may reduce taxable income in a subsequent year, rather than being refunded within the same income year in which they are incurred and the use of expanded definitions of income to means test eligibility for levies, concessional offsets and transfer payments.

169. See answer to 168.

170. In the 2012-13 Budget, companies will be allowed to carry-back tax losses so they receive a refund against tax previously paid. Previously, businesses were only able to carry forward their tax losses to offset future profits and reduce future tax liabilities. Such a change means that during an economic downturn, companies have increased cash flows.

In the 2009-10 Budget, changes to quarterly PAYG instalments for small businesses, self-funded retirees and small superannuation funds were made to ensure that instalment amounts for the 2009-10 income year more closely approximated actual tax liability for that income year.

171. See answer to 168.

172. In normal circumstances, monetary policy should be used as the primary tool for demand management. Outside of the automatic stabilisers, discretionary fiscal policy should be used for supporting demand during extreme circumstances, such as when:

- the effectiveness of monetary policy is impeded; and/or
- a shock is sufficiently large and sufficiently sudden that monetary and fiscal policy should work together effectively to support activity, such as during the GFC.