Financial stress in Australian households:

‘the haves’, ‘the have-nots’, ‘the taxed-nots’ and ‘the have-nothings’

KPMG Economics

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Contents

Key messages

KPMG has used data from the Australian Bureau of Statistics (ABS) Household Expenditure Survey (1988-89, 2003-04 and 2009-10) and analysed confidentialised unit record data from the Household, Income and Labour Dynamics in Australia (HILDA) Survey (Wave 6 to Wave 15) to review the incomes and spending patterns of Australian households to gain insights into the living standards of various income groups and whether they are becoming better or worse off. The results are surprising and contrary to conventional wisdom.

The 'have-nots'

Around 10 to 15 percent of households appear to be consistently unable to pay bills and debts as they fall due. These are the 'have-nots'. While their *share* of all households has not risen over the past decade or so, they comprise nearly 1.4 million households.

The 'have-nothings'

Households who live with entrenched disadvantage – unable to afford heating and meals, need to pawn possessions or require assistance from welfare organisations – appear consistently to represent about 3 to 5 percent of our society.

While the *proportion* of households in the 'have-nothing' category does not appear to have risen over time, through normal population growth they now constitute about 460,000 households. Since the turn of the century, more than 90,000 households joined the 'have-nothings'.

The 'have-nots' are getting into risky investment properties

The bottom 20 percent of households has recorded the highest rate of growth in investment income at 8.2 percent per annum, compared to about 2.2 percent per annum on average for the remaining households.

This increase reflects a greater exposure to investment activities over the past decade, such as negatively geared property investment, which is confirmed by the substantial increase in value of second mortgage payments being undertaken within this quintile.

While understandable that the poorest in our society are seeking to diversify and increase their incomes by other means, this income group is least able to take on the financial risk associated with geared investment activity.

The top 20 percent of households is the only cohort to have a greater relative exposure to investment income than the bottom 20 percent, but it has the highest levels of salaries and wages from which to buffer any downturn in investment returns if that were to occur.

Households have been progressively increasing their debt levels, and doing so at rates faster than the growth they have achieved in their disposable incomes.

Key messages (cont.)

Outstanding residential loans increased by about 7.3 percent per annum over the decade to 2015, while debt-servicing payments within the representative sample increased by only 1.5 percent per annum. This differential is due to a decline in mortgage interest rates over the period. However, as the world now starts to trend back towards 'normal' monetary policy settings, it is anticipated the cost of mortgage payments will increase and become a much higher proportion of the non-discretionary cost base of households in the coming years.

While financial stress appears relatively stable now, in the event interest rates increase – either due to rises in wholesale funding costs, a tightening in official cash rates, or both – it is likely that household financial stress will increase.

Virtually all households have maintained a relatively smaller proportion of their spending on discretionary items following the Global Financial Crisis (GFC). Uncertainty regarding the potential re-emergence of a global economic downturn, its impact on domestic employment prospects and its influence on investment returns are likely to be the reasons why households sought to curtail their spending permanently, and correspondingly save a greater proportion of their incomes.

How is the social safety net performing?

Australia's tax and transfer system plays an integral role in redistributing income from the richest in our society to those who are the poorest.

Over the past 35 years, transfers payments have risen from representing about 30 cents per dollar of tax revenue to now represent about 40 cents per dollar of tax revenue, an increase of 33 percent.

On the whole our social safety net system appears to be working as intended. Income from the top 40 percent of Australian households is being redistributed to pay for the transfer benefits received by the bottom 60 percent, the 'taxed-nots'.

The poorest 40 percent of households in Australia now receive about one-third of their income from government support payments, while the wealthiest households still receive a small amount of government support, most likely through some form on non-means tested payments. Surprisingly, one of our findings is the tax-to-transfer ratio for quintile 2 fell below quintile 1 in the early 2010's and has stayed there ever since. That is, the second quintile of households received more in transfer payments for each dollar they paid in tax than did the first quintile.

What should the government do?

While we have found that household financial stress and economic hardship has not gotten any worse in Australia in a relative sense, conversely this also means these issues have not gotten any better either. Policies targeted on lifting the educational outcomes for the poorest in our society, and reducing the single largest expenditure households face – housing – will go a long way to improve the life experiences of the 'have-nots' and 'have-nothings' in Australia.

Introduction

The Lucky Country

Australia is recognised globally as a standout economy.

As an economy we not only skirted the worst parts of the downturn associated with the GFC, but rather we continued to lift our standard of living while the rest of the world was in economic turmoil.

The 'rising tide' of our economic prosperity has been driven in part by the increase in the global demand and prices paid for our commodities and the growth in our population.

Despite this rosy picture social commentators are suggesting while various aggregate measures show an overall lift in our prosperity, there is a growing proportion of the population who are being 'left behind'. Simply, while the pie might have grown, there is a perception that not everyone has received their 'fair share' of the gains.

KPMG Economics has sought to assess this hypothesis empirically in this Research Paper.

In undertaking this study we have firstly analysed published data from the Australian Bureau of Statistics (ABS) Household Expenditure Survey, with particular emphasis on the financial stress indicators captured within the survey. We have then analysed confidentialised unit record data from the Household, Income and Labour Dynamics in Australia (HILDA) Survey, again with an initial focus on the financial stress indicators within this dataset. In addition to these 'perception' measures we have also examined household income and expenditure in more detail, including stratifying the analysis into income quintiles.

Midnight Oil famously sang

> *'The rich get richer, the poor get the picture'* [1]

and this perspective of income inequality in Australia continues to colour most social and political discussions today. In this Research Paper we examine whether this perspective still holds, or whether, as seemingly presented in the media, more people, families and households in our society are 'getting the picture' more starkly than has ever been the case.

Chart 1
Real GDP and Annual Growth, Australia

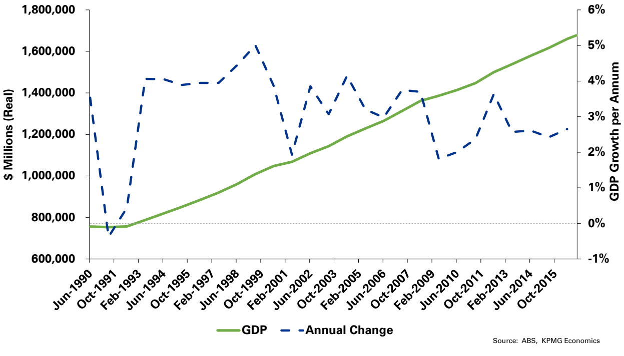


Chart 2
Household Income and Consumption, Australia
Rolling 12-month Values, Current Prices

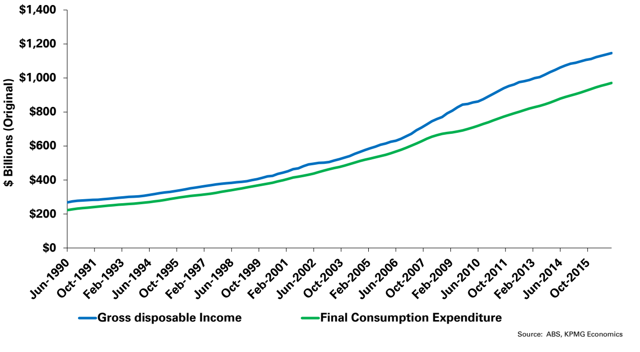
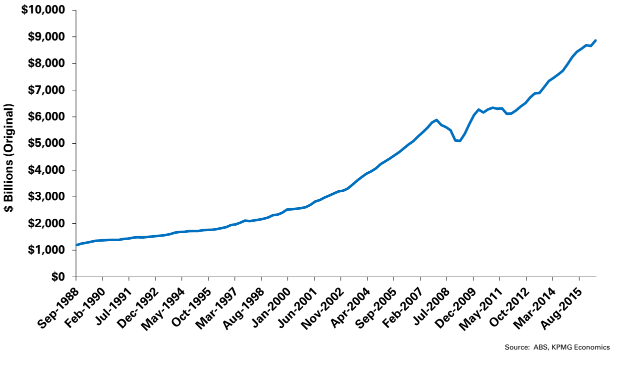


Chart 3
Household Net Worth, Australia (Current Prices)



What is household financial stress ?

Defining financial stress in households

Bray (2001)[2] defines financial stress as:

> *The difficulty that an individual or household may have in meeting basic financial commitments due to a shortage of money*

Household financial stress is a multi-dimensional concept, and is difficult to measure precisely as it incorporates factors that are absolute and relative, and often, has a temporal aspect to it as well.

It is important to recognise that the concept of household financial stress is different to the concept of absolute poverty. That is, absolute poverty can be defined as:

> *A state or condition in which a person of community lacks the financial resources and essentials to meet the basic needs of life, including food, clothing and shelter.*

A person or a household need not necessarily be 'in poverty' for them to be considered 'in financial stress'; but conversely, someone who meets the conditions of being 'in poverty' will necessarily also be experiencing 'financial stress'.

Measuring financial stress using the ABS Household Expenditure Survey

The Australian Bureau of Statistics (ABS) sought to capture information on financial stress in households in Australia through the Household Expenditure Survey (HES)[3], where respondents were asked to answer questions subjectively on their "economic well-being". Specifically, the ABS collected information within the HES on a range of 'financial stress' and 'missing out' experiences, including:

- whether they spent more money than they received;
- their ability to raise $2,000 within a week for an emergency;
- whether they could afford to take a week's holiday once a year; go out for a night's entertainment once a fortnight; afford to have friends and/or family over for a meal once a month;
- capacity to pay utility bills, insurance and/or car registration on time;

Chart 4
Incidence of Financial Stress, Australia
Household Expenditure Survey

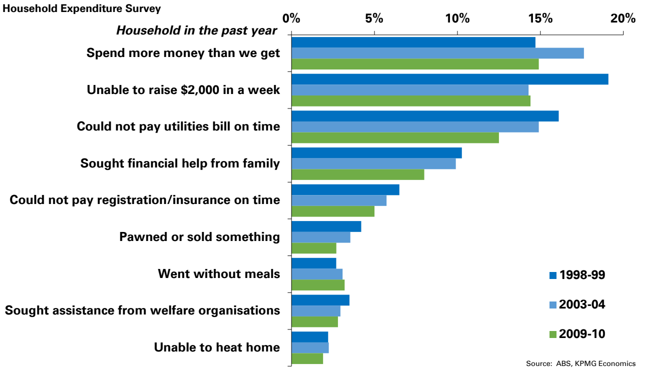
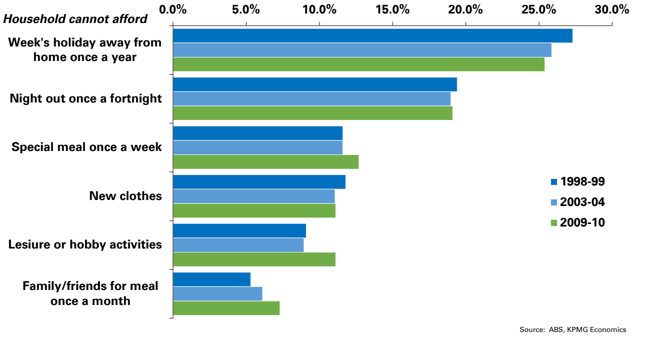


Chart 5
Missing Out Experiences, Australia
Household Expenditure Survey



- if they were unable to provide meals or heat their home; and
- whether they have sought assistance from welfare/community organisations, or asked family and/or friends to provide financial support.

While an important source of information on the financial wellbeing of Australian households, the HES is only conducted every six-years, with the latest survey only completing its data gathering element in the middle of 2016.

Although these survey results are now dated, they provide some compelling insights into the financial stress of households. Surprisingly , the HES results indicate that over the 12 years the three survey's were conducted there was no material change in the proportion of households experiencing financial stress or economic hardships.

What is household financial stress ?

Households who experience ‘hardship’, which includes an inability to afford heating and meals, needing to pawn possessions, or requiring assistance from welfare organisations, appear consistently to represent about 3 to 5 percent of our society. Further, between 10 and 15 percent of households appear to be consistently unable to pay bills and debts as they fall due.

From a ‘missing out perspective’, it appears that about:

- one-quarter of Australia’s households cannot afford annual holidays for one-week a year away from home;
- one-fifth of households are unable to entertain themselves away from home once a fortnight; and
- 10 percent of households cannot afford to have a special meal with their families or purchase new clothes.

This inability for a significant proportion of households to enjoy pleasures creates division in society, and reinforces the concept of ‘the haves’ and ‘the have-nots’.

While upsetting for the people involved, ‘missing out’ is at the lower end of spectrum from a societal ‘hierarchy of difficulties’[4] perspective. Rather, it is the 3 to 5 percent of households who consistently experience extreme financial stress, to the point of being unable to heat their homes, have regular meals, needing to pawn a valuable to get money, and/or reaching out to a welfare organisation for help, that is of a much greater concern from a community fairness perspective.

The HES results indicate that based on the number of households in Australia today[5] about 460,000 households are suffering economic hardships. While ‘missing out’ creates a class in society of ‘the have nots’, living with entrenched disadvantage creates another distinct class of households in Australia, ‘the have-nothing’s’.

Measuring financial stress using the HILDA Survey

KPMG appreciates the HES results are dated, and also due to the intermittent timing of the survey, are possibly influenced by the economic conditions at the time of the survey.

The HILDA survey overcomes these two potential problems by the fact it is an annual survey, and the most recent survey results (Wave 15) are sourced from the 2015 calendar year.

HILDA is Australia’s first nationally representative household-based longitudinal survey, and it provides data on the lives of Australian residents on a range of issues, including family make-up, financial and economic factors, labour market dynamics, and health and well-being[6].

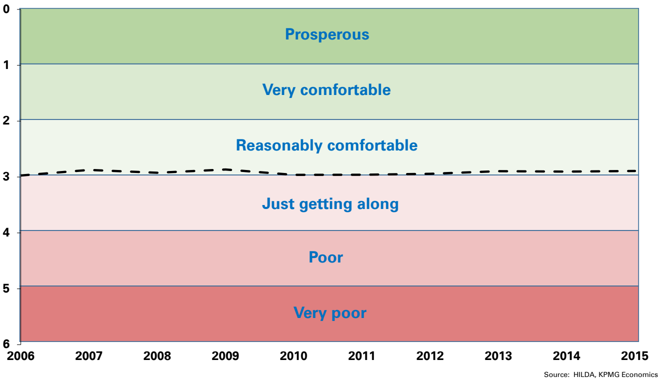
The survey commenced in 2001, collecting data from nearly 14,000 respondents, while the latest survey (Wave 15) captured information from just over 17,500 respondents, of which about 60 percent were respondents from the Wave 1 cohort. HILDA therefore gathers information that allows a story to be told and updated each year about the same group of representative Australians.

In completing this analysis we filtered the dataset for each year to include only those respondents who participated in each HILDA Survey from Wave 6 (2006 survey) to Wave 15 (2015 survey). This filtering process created a longitudinal dataset of 6,347 individuals, which has allowed KPMG Economics to ‘follow’ the behavioural patterns of these respondents over the nine-year survey period.

Chart 6 below presents a measure of ‘Financial Prosperity’, where survey respondents were asked

> *Given your current needs and financial responsibilities, would you say that you and your family are…*

Chart 6
HILDA Financial Prosperity Index
Identified Longitudinal Survey Participants



Source: HILDA, KPMG Economics

What is influencing household financial stress ?

Despite the last decade being a period of significant economic change and turmoil, the longitudinal survey respondents on average considered themselves to 'reasonably comfortable' from a financial prosperity perspective. These aggregate results are virtually stable from year-to-year which is consistent with the HES results discussed earlier.

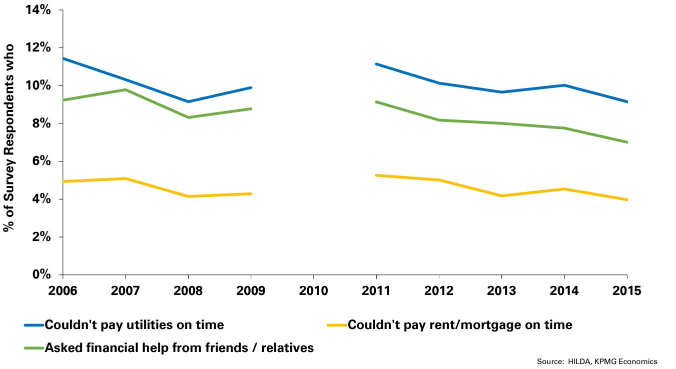
As mentioned previously, the HILDA Survey also captures information on respondents experiences of financial stress and economic hardship. Specifically, respondents are asked whether they have been unable to pay a household bill on time or experienced some form of economic hardship due a shortage of money during the survey period. Similar to the HES, these experiences can be classified into 'financial stress' or 'economic hardship' measures[7].

Chart 7 shows over the decade to 2015, 5 to 10 percent of households experienced some form of financial stress on a consistent basis. This measure of financial stress captured in the longitudinal HILDA survey respondents is slightly lower than the equivalent measures of the HES, although it is significantly similar to suggest that about 10 percent of domestic households consistently experience financial stress.

Chart 8 shows that households experiencing economic hardship are a small, but consistent, proportion of households in Australia. The analysis also shows a slight upward trend in the number of survey respondents indicating they have experienced some form of economic hardship over the survey period. It would seem that prior to the global economic shock of 2008 and 2009, about 2 to 3 percent of households experienced economic hardship, whereas post-2010 this has increased to around 2.5 to 3.5 percent.

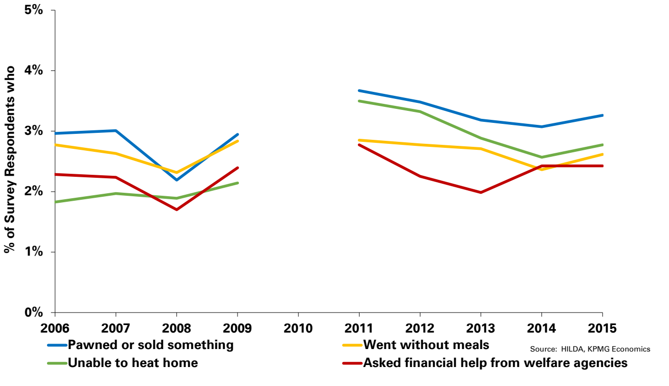
Again, an important finding of this analysis that neither household stress nor economic hardship in Australia appears to have materially worsened in a relative sense since the beginning of the new century despite the general feeling in the community that it has. However, as our population has grown, the absolute number of households experiencing these adverse financial conditions has correspondingly increased.

Chart 7
HILDA Financial Stress Indicators
Identified Longitudinal Survey Participants



Source: HILDA, KPMG Economics

Chart 8
HILDA Economic Hardship Indicators
Identified Longitudinal Survey Participants



Source: HILDA, KPMG Economics

That is, it seems there are absolutely more 'have-nots' and 'have-nothings' in Australia today, but not relatively more than a decade ago. Whether this outcome is acceptable in terms of our community expectations, or further redress is needed to make Australia an even fairer society is a value judgement and beyond the scope of this paper. However, before that issue can be addressed it is important to understand what factors have been influencing household financial stress and economic hardship in Australia. The following section discusses this in the context of household income, expenditures, taxes and transfers.

What is influencing household financial stress ?

Influences of household financial stress

Income

The role of money, or more importantly the lack thereof, in meeting basic financial commitments is recognised in the definition of household financial stress as the root cause of this problem.

Over the 10 years to 2015 household incomes grew between 2.3 and 4.0 percent per annum, with the lowest income quintile recording the strongest income growth of all the quintiles.

This stronger growth at the lowest end of the income spectrum has resulted in an improvement in the gini coefficient[8] calculated for the HILDA survey participants, down from 0.426 in 2006 to 0.411 in 2015, with a low of 0.396 in 2012.

Despite this improvement, household incomes differ markedly between income quintiles, with the ratio of income for Q5/Q1 in 2015 about 8.5 (albeit down from 9.8 in 2006).

For all quintiles it appears growth in household income has not be driven by increases in wages and salaries, but rather through government transfers and investment income. That is, wages and salaries have grown on average by 1 and 4 percent between 2006 and 2015, with the strongest growth achieved in quintile 1. This outcome has in part been influenced by the growth in the Australian minimum wage, which increased from $511.86 per week in 2006 to be $656.90 per week in 2015.

Further, our analysis also reveals earnings from investments represent between 5 and 11 percent of household income for all quintiles over the past decade.

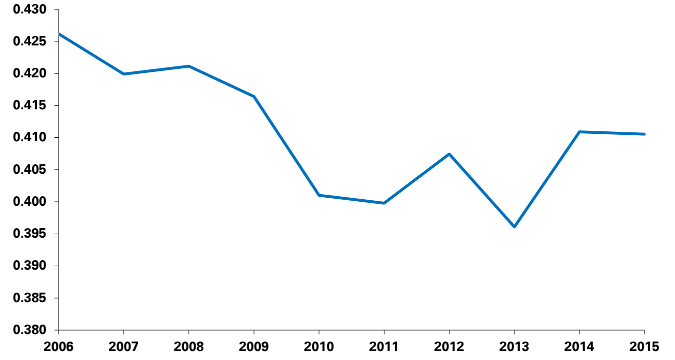
Surprisingly, quintile 1 has achieved the highest rate of growth in investment income at 8.2 percent per annum, compared to about 2.2 percent per annum on average for the remaining income quintiles. This increase reflects a greater exposure to investment activities over the past decade, such as negative geared property investment, which is confirmed by the substantial increase in value of second mortgage payments being undertaken within this quintile.

While we have presented all of our analysis on a quintile basis, this finding is likely to correspond to households in the second decile, as opposed to households in the bottom decile.

Chart 9

Gini coefficient - Pre-tax household income

Identified Longitudinal Survey Participants

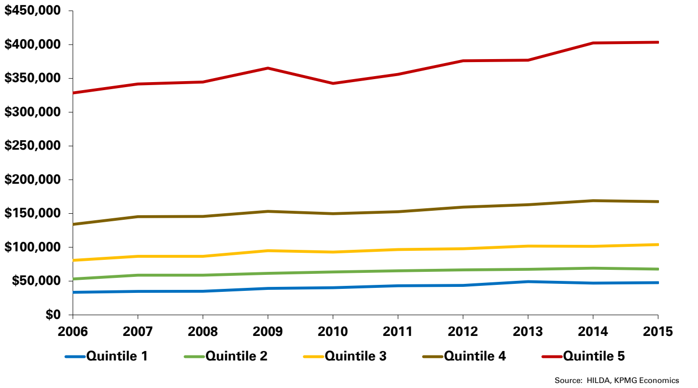


Source: HILDA, KPMG Economics

Chart 10

Annual Household Income by Quintile

Identified Longitudinal Survey Participants

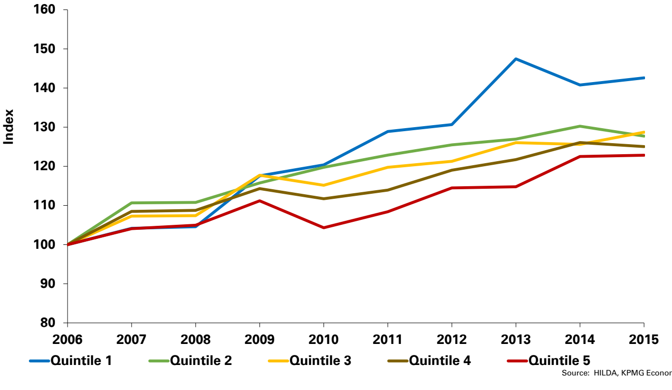


Source: HILDA, KPMG Economics

Chart 11

Household income growth by Quintile

Identified Longitudinal Survey Participants



Source: HILDA, KPMG Economics

What is influencing household financial stress ?

While understandable that the poorest in our society are seeking to diversify and increase their incomes by other means, it must also be acknowledged that this income cohort is least able to take on the financial risk associated with geared investment activity. Quintile 5 is the only cohort to have a greater relative exposure to investment income than quintile 1, but it has the highest levels of salaries and wages from which to buffer any downturn in investment returns if that outcome were to occur.

One possible explanation for this finding is the fact that there is a fixation in Australia about growing wealth through investing in property. This attitude is reinforced in television shows we watch and the newspaper and magazine articles we read. It should not be surprising that the poorest in our society, who are exposed to these messages and who see others growing their wealth through investing in negatively geared property, also want to participate in this investment activity.

Government transfers have played an increasingly important role in bolstering household incomes over the past decade, particularly for the low income households. The poorest 40 percent of households in Australia now receive about one-third of their income from government support payments, while the wealthiest households still receive a small amount of government support, most likely through some form on non-means tested payments, such as the $7,500 child-care rebate.

While there is a clear upwards trend in government payments to households, there was also a noticeable spike in transfers in 2009. This spike reflects the once-off payments made to pensioners, low-to-middle income families and children as part of the broader $52.4 billion stimulus packages implemented by the Commonwealth Government to respond to the economic slowdown caused by the GFC.

Expenditure

In considering household financial stress it is important to delineate between non-discretionary expenditure, such as food, rent/mortgage payments, medical expenses, and education costs, and discretionary expenditure, such as spending on entertainment, alcohol, cigarettes, and second mortgages for investment activity.

Chart 12
Government Transfers as a % of Total Household Income
Identified Longitudinal Survey Participants

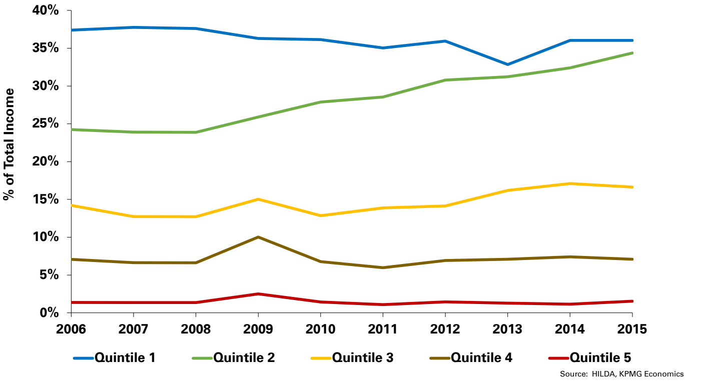


Chart 13
Ratio of Annual Household Discretionary v. Non-Discretionary Spend by Quintile
Identified Longitudinal Survey Participants

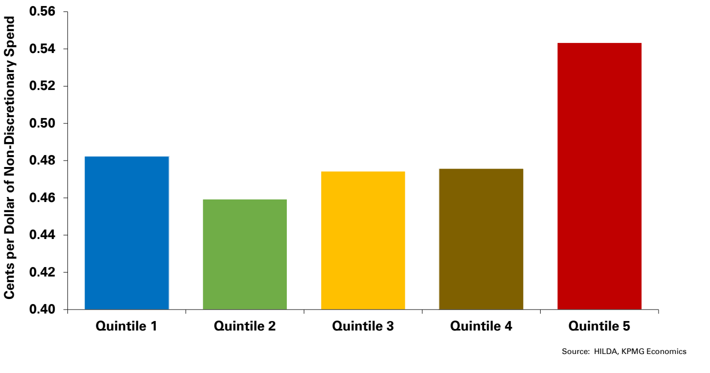
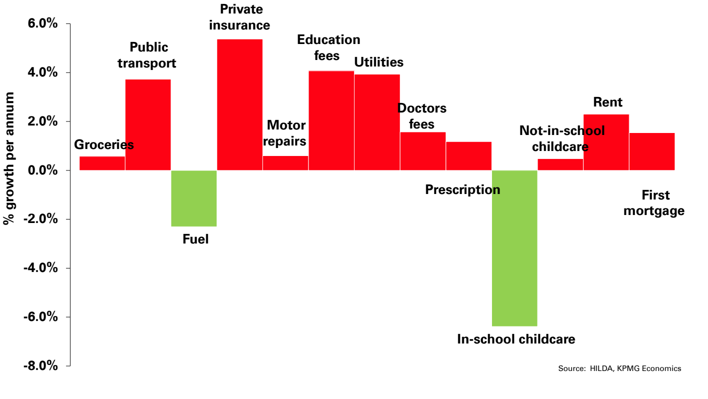


Chart 14
Average annual growth in Non-Discretionary Expenditure by Type
Identified Longitudinal Survey Participants



What is influencing household financial stress ?

Chart 13 shows that for the majority of households in Australia, for every $1.00 of non-discretionary expenditure they are able to spend around 46 to 48 cents on discretionary spending. The wealthiest households spend a consistent premium on discretionary purchases, with this incremental spend mainly directed towards entertainment activities and meals away from home.

Over the 10 years to 2015 households' non-discretionary expenditure grew on average by about 1.3 percent per annum in nominal terms. Household spending on private insurance recorded the strongest growth of all expenditure categories, growing by, on average, 5.4 percent per annum over the past decade. Public transport, education costs and utilities all recorded annual expenditure growth of around 4 percent per annum, while spending on groceries and motor vehicle repairs grew at only 0.6 percent per annum (reflecting the downward price pressures these sectors have been experiencing as a consequence of global competition).

Households have benefitted from government policies that have subsidised the cost of childcare, either at in-school or not-in-school facilities. Fuel costs have also declined in 2015 relative to the average household spend on fuel throughout the majority of the past decade, reflecting the global reduction in oil prices and improvements in the fuel efficiency of motor vehicles.

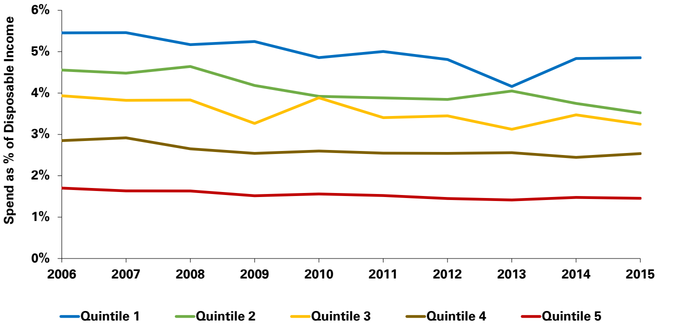
The lowest three quintiles have experienced a (slight) declining trend in their relative expenditure on alcohol and cigarettes since 2006, while quintiles 4 and 5 have maintained a consistent proportion of expenditure on alcohol and cigarettes throughout the past decade. The 'kick-up' in expenditure in 2014 and 2015 reflected the almost 50 percent increase[9] in tobacco excise duty payable per stick over that time. While expenditure on tobacco by households in quintile 1 had risen by about 18 percent, given the excise increases are more than two-and-one-half times this, cigarette consumption must have fallen within this cohort by about 20 percent over the two years to 2015.

While the cost of first-mortgage payments to households increased by less than 2 percent per annum over the past decade, the impact of this non-discretionary expenditure item on household stress is underplayed by in statistic. Specifically, while over the past decade Australia has generally faced declining home-loan interest rates, households have experienced a small increase in the cost of mortgage payments during the same period.

Chart 15

Average Household Expenditure on Alcohol and Cigarettes as a proportion of Disposable Income

Identified Longitudinal Survey Participants

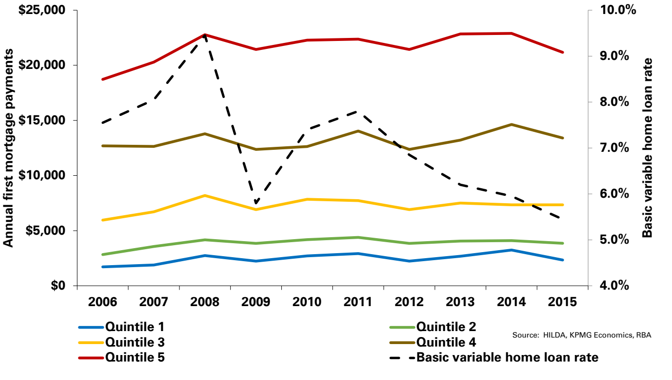


Source: HILDA, KPMG Economics

Chart 16

First Mortgage Payments and Home Loan Rates

Identified Longitudinal Survey Participants

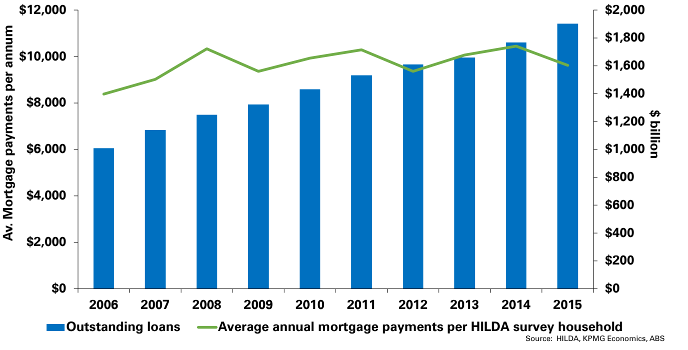


Source: HILDA, KPMG Economics, RBA

Chart 17

Average Annual Mortgage Payments and Outstanding Residential Housing Loans (Australia)

Identified Longitudinal Survey Participants



Source: HILDA, KPMG Economics, ABS

What is influencing household financial stress ?

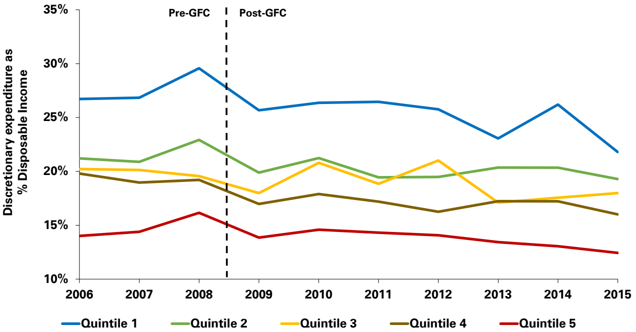
As shown in Chart 17 households have been progressively increasing their debt levels, and doing so at rates faster than the growth they have achieved in their disposable incomes. This analysis also shows growth in outstanding residential loans increased by about 7.3 percent per annum over the decade to 2015, while debt-servicing payments within the representative sample increased by only 1.5 percent per annum. This differential in growth rates is due to the decline in debt service costs; that is mortgage interest rates. However, as the world now starts to trend back towards 'normal' monetary policy settings, it is anticipated the cost of mortgage payments will increase and become a much higher proportion of the non-discretionary cost base of households in the coming years.

Finally, it also appears that all households have adjusted their discretionary spend as a consequence of the GFC. That is, virtually all households have maintained a relatively smaller proportion of their spending on discretionary items following the GFC proportion of their incomes.

Chart 18

Discretionary expenditure as proportion of Disposable Income

Identified Longitundinal Survey Participants



Source: HILDA, KPMG Economics

Uncertainty regarding the potential re-emergence of a global economic downturn, its impact on domestic employment prospects, and its influence on investment returns are likely to be the reasons why households sought to curtail their spending permanently, and correspondingly save a greater proportion of their incomes.

Does Australia's tax and transfer system help or hinder?

The Commonwealth Treasury has stated:

> *The primary roles of the tax-transfer system are revenue collection and income redistribution. Income is redistributed to Australians through the combination of a progressive tax system and targeted transfers[10].*

This statement clearly recognises the role our progressive tax system plays in redistributing income from 'the haves' to the 'have-nots'.

In practice this is visible through the step-down in the gini coefficients calculated for different income measures. That is, the gini coefficient for pre-tax market income has been calculated using the longitudinal HILDA survey respondents to be about 0.47 (on average). Over the 10 years to 2015 this income inequality measure has been reasonably stable.

Once transfer payments are included in household income the gini coefficient falls[11], which means income inequality in Australia declines materially due to the role of the transfer system. Further, the gini coefficient for pre-tax household incomes has been declining steadily over the past decade, indicating the transfer system has continued incrementally to redress income inequality in Australia.

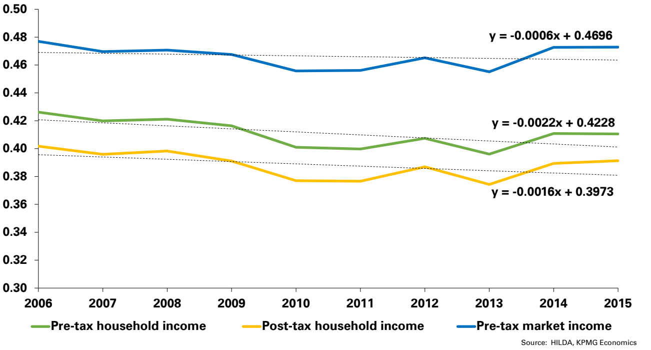
Further, once our progressive tax system is engaged, the inequality of household incomes is further reduced. While still a downward trend, the slope of the trend line is marginally flatter than the gini coefficient trend line calculated for gross household incomes, suggesting flexibility exists in the tax system that enables higher-income households to implement tax planning to reduce their relative tax liabilities.

Chart 20 shows the relative proportion of Commonwealth Government tax receipts (excluding GST since this is passed onto the States and Territories) that are applied to funding Commonwealth Government transfer payments. This analysis reveals that over the past 35 years, transfers payments have risen from representing about 30 cents per dollar of tax revenue to now represent about 40 cents per dollar of tax revenue; an increase of 33 percent.

Chart 19

Gini coefficients - Market, Pre-tax and Post-tax

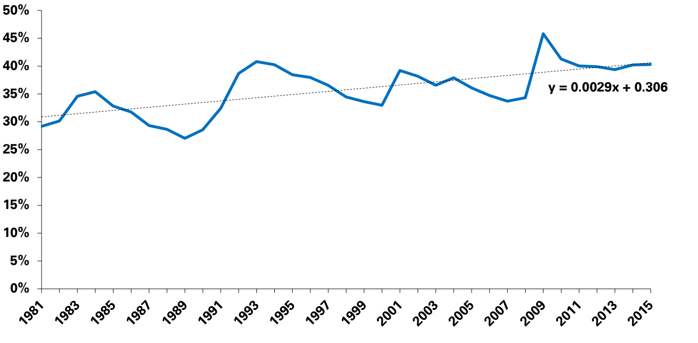
Identified Longitundinal Survey Participants



Source: HILDA, KPMG Economics

Chart 20

Commonwealth Government Transfer Expenditure as a proportion of Tax Receipts (excl. GST)

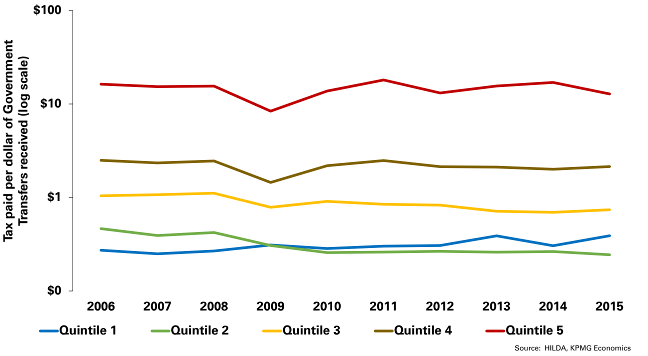


Source: ABS, KPMG Economics

Chart 21

Tax receipts paid and Government Transfers received by Quintile

Identified Longitudinal Survey Participants



Source: HILDA, KPMG Economics

Does Australia's tax and transfer system help or hinder?

Income tax paid by each respondent and household is available as part of the HILDA data set. KPMG has calculated the ratio of income tax paid to transfer payments received by households over the past decade for each quintile.

In 2006, quintile 1 received $1.00 in transfer payments for every 27 cents paid in income tax, while for quintile 2 the same ratio was $1.00 for every 46 cents paid. The transfer payments initiated as part of the stimulus packages implemented to respond to the GFC resulted in the tax-to-transfer ratios for quintiles 1 and 2 converging at around $1.00 for every 31 cents paid in tax. Surprisingly, the tax-to-transfer ratio for quintile 2 fell below quintile 1 in the early 2010's and has stayed there ever since. That is, the second quintile of households received more in transfer payments for each dollar they paid in tax than did the first quintile.

The cause of this is likely to be a combination of the increased tax free threshold, reductions in the marginal tax rates, an increased proportion of part time and casual employment, and growth in the utilisation of child-care benefits (particularly the non-means tested Child Care Rebate which allows for 50 percent of all approved out-of-pocket child care costs up to a maximum of $7,500 per child).

This finding suggests the targeting of transfer payments loosened up as a response to the GFC and never tightened up sufficiently once the need for the stimulus subsided. Further, this analysis also suggests that once middle-class welfare is given, it is politically difficult to take it away. Simply, once voters attach a property right to a temporal benefit, even if that benefit is no longer needed in its proper sense, voters will react bitterly towards any government if they attempt to claw it back.

In addition to this finding with regard to low-income households, it appears that households at the other end of the spectrum (quintile 5) have on average over the past decade received $1.00 in transfer benefits for every $14.50 in income tax paid.

Chart 21 also reveals, that in effect, income from the top 40 percent of Australian households is being redistributed to pay for the transfer benefits received by the bottom 60 percent of Australian households. To the extent that the income tax take of the top two quintiles is disrupted, the pressure on Australia's budget position will become even further exacerbated.

KPMG appreciates various politicians and social commentators often suggest the solution to the problem of an ever increasing public sector funding requirement is the 'ratcheting up' of marginal tax rates for higher income earners. While such a solution may be popular amongst the median voter, our analysis shows that households in quintile 5 already pay 50 percent more income tax than quintiles 1 to 4 combined.

Academic research suggests to continue to ask top income earners to pay an ever increasing proportion of their gross income towards tax payments runs the risk of provoking the movement of high value labour to other lower effective tax rate jurisdictions. The research also notes that even if the observed mobility of high income earners may be different from actual mobility, it is the credible threat to move to lower tax jurisdictions that should matter most to government and policy makers[12][13]. That is, 'soak the rich' taxes[14] do not necessarily result in increased tax revenue from top income earners, but rather often creates the impetus to amend their pattern of labour supply, including changing the intensity of how they work, the compensation arrangements by which they are remunerated, and as mentioned above, their mobility[15].

Concluding remarks

In this Research Paper we have examined whether, as Midnight Oil echoes, the rich have gotten richer and the poor have gotten the picture in Australia over the past few decades.

Our analysis of irregular (and now dated) data from the ABS HES and longitudinal and contemporary data from HILDA showed, to our surprise, consistent findings.

Despite the general feeling in the community that life has become harder in Australia, our empirical analysis suggests that household financial stress and economic hardship have not become any worse in a relative sense since the turn of the century.

There appears to be about 3 to 5 percent of households in our community who have entrenched disadvantage, and despite the goodwill of government agencies and NGOs to lift these people 'out of poverty', there seems to consistently be this cohort who live in extreme economic hardship (although we recognise that it might not be the same households within this from year-to-year). Although we have suggested it seems the relative level of household financial stress has not worsened over the past few decades, given the population growth Australia has undergone over that period, it should be recognised that since 2000 an extra 94,000 households will have been added to the bottom 5 percent of our society, 'the have-nothings'.

We have also found that while household incomes have grown, it is not primarily because of rising wages and salaries, but rather due to increasing investment income and government transfers. It seems that even some of the poorest in our society are taking on negative geared investments.

Households are also taking on larger amounts of mortgage debt. While financial stress appears relatively stable now, in the event interest rates increase – either due to rises in wholesale funding costs, a tightening in official cash rates, or both – it is likely that household financial stress will increase.

Australia's tax and transfer system plays an integral role in redistributing income from the richest in our society to those who are the poorest. On the whole it appears to be working as intended.

While our tax-transfer system is broadly achieving its objectives, we also found that households in quintile 2 are receiving relatively more, in terms of the ratio of income tax paid to transfers received, than households in quintile 1.

Our analysis has also shown a little more than one-third of the income of the poorest 40% of households in Australia (quintiles 1 and 2) is received through government transfers. Further, about 60 percent of households in Australia receive transfer payments from the Commonwealth Government equal to, or greater than, the amount of income tax they pay.

This suggests there is an opportunity for the Commonwealth Government to consider whether improvements could be made in the targeting of welfare payments to these income cohorts.

Our analysis also confirms the importance of the top two quintiles in generating tax revenues for the funding of transfer payments and other government expenditure. For example, households in quintile 5 pay income tax equal to 150 percent of the combined income tax paid by quintiles 1 to 4.

While we have found that household financial stress and economic hardship has not gotten any worse in Australia a relative sense, conversely this also means these issues have not gotten any better either. Policies targeted on lifting the educational outcomes for the poorest in our society, and reducing the single largest expenditure households face – housing – will go a long way to improve the life experiences of the 'have-nots' and 'have-nothings' in Australia.

End notes

1. Midnight Oil, 'Read about it', 1982
2. Bray, J.R., *Hardship in Australia: An analysis of financial stress indicators in the 1988-89 Australian Bureau of Statistics Household Expenditure* Survey, Department of Family and Community Services, Occassional Paper No.4, December 2001
3. Australian Bureau of Statistics, Household Expenditure Survey, Australia, cat.no. 6530.0, edn's 1998-99, 2003-04, 2009-10
4. Bray (2001)
5. Estimated to be approximately 9.2 million
6. www.dss.gov.au
7. Information on respondents experiences of financial stress and economic hardship are not available in the HILDA wave 10 survey results. This is due to an error in the Self Completion Questionnaire in Wave 10 where the time period for which those questions should relate was not updated. As a result, the variables are not provided in the dataset.
8. The Gini coefficient is a measure of statistical dispersion intended to represent the income distribution of a nation''s residents. The coefficient varies between 0, which reflects complete equality, and 100 (or 1), which indicates complete inequality (one person has all the income or consumption; all others have none).
9. Excise duty payable per cigarette/cigar weighing less than 0.8 grams was $0.35731 in August 2013, $0.46268 in September 2014 and $0.53096 in September 2015. Source: www.tobaccoaustralia.org.au
10. Australian Treasury, *Architecture of Australia's Tax and Transfer System*, August 2008
11. A decline in the gini coefficient for Australia indicates income distribution is becoming more equal.
12. Esteller, A., Piolatto, A. and Rablen, M., *Taxing high-income earners: tax avoidance and mobility*, Institute for Fiscal Studies, IFS working Paper W16/07, 2016
13. Moretti and Wilson (2015) estimated for top income earning scientists a 1 percent decline in the after-tax income in the destination state relative to the origin state is associated with a 1.6% increase in the number of scientists who leave the origin state and relocate to the destination state.
14. Popular reference to the United States of America *Revenue Act 1935* which raised income tax rates on high income earners.
15. Esteller, A et al (2016)

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