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EVALUATION OF AN ALTERNATIVE
INCOME MAINTENANCE SCHEME
FOR AUSTRALIA

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ABSTRACT

A universal social dividend scheme whereby every permanent resident of Australia would receive approximately \$2,950 per annum is outlined, evaluated and compared with the current social welfare system. The proposed scheme would distribute \$113.46 fortnightly to each person in Australia regardless of age, income, health status or family size. Although the cost of the scheme would be nearly \$50,000 million, it could be financed by feasible increases to the existing progressive marginal income tax rates or by a flat rate tax of 46 per cent. Using standard welfare criteria such as adequacy, efficiency and equity, it is argued that the proposed scheme would be superior to the current system.

Introduction

In spite of two official national inquiries,¹ numerous other public and private studies, and countless changes that have been implemented during the last 15 years, there is still a widespread feeling that successive governments have failed to develop a coherent and equitable social welfare program for Australia. For many, government has yet to "get it right". A little reflection reveals why such a conclusion is easy to embrace and difficult to repudiate. The problems of the current welfare system are numerous and widely acknowledged. They include, inter alia, poverty traps, vertical and horizontal inequities, inadequate levels of assistance for families with children and significant levels of welfare fraud and abuse.

The problem facing welfare reformers is the difficulty of devising modifications which can alleviate some of the aforementioned problems without generating even more intractable problems in their wake. In 1975 the (Commission of Inquiry into Poverty recommended a guaranteed minimum income (GMI) scheme. During the subsequent 15 years numerous reformers have advanced variations on this scheme. None, however, have come close to being adopted. The most persistent criticism of GMIs is that their cost would be enormous and that the **marginal** tax rates necessary to finance them would be prohibitively high

In a recent article in Economic Papers, Peter Saunders concluded:

The concept of a GMI is appealing to many who champion the cause of the disadvantaged, and for them its failure to make any headway on the policy agenda may well signify a paradise lost.. For others, it may continue to burn as a guiding light, but the problem with continued gazing towards the heavens is that one can get distracted from the very real problems faced down here on earth [Saunders, 1988, p. 32].

In this paper we propose a guaranteed minimum income (GMI) scheme which would overcome many of the problems of the current system. We are not "gazing towards the heavens"; instead, we propose a workable solution to the "very real problems faced down here on earth". Furthermore, as we will demonstrate, our proposal is financially feasible. The fact, the real question is whether or not, in the long run, we can afford not to adopt such a scheme.

Basic Features of the Proposal

The proposed GMI is a **social dividend** which is universal and not subject to any eligibility requirement other than permanent resident status. Under the proposal a payment of \$2,950 per annum would be made to all permanent residents of Australia irrespective of age, race, marital status, income or sex. Thus the payment or demogrant is a single flat rate paid fortnightly to all eligible persons or their guardians. It would not be subject to income or asset tests.

The payment of \$2950 per annum is based on the actual income support levels that existed in 1986-87 and represents the **average** per capita payment for a single person with two dependants and a married couple with one dependant.² Benefit levels established by the Department of Social Security are shown in Table 1. The far right column of Table 1 indicates the annual per capita payments associated with these levels. The mean of the four entries with an asterisk is \$2936.18. Rounding to the nearest \$50, we have set the demogrant in our proposal equal to \$2950

Thus, the demogrant is derived from support levels which existed in 1986-87 for families of three persons. **As** can be seen from Table 1, under the current system the per capita level of support declines significantly as the family size increases. For example, a married couple would receive \$9209.20 (2 x \$4604.60), while two single persons (who might be living at the same address) would receive \$11044.80 (2 x 5522.40). The fact that the two single persons would receive 20 per cent more than a married couple is hard to justify and is an example of the horizontal inequities in the current system. The usual justification is that a married couple can live more cheaply than two single persons. **Of** course, there are economies of group living. But there is nothing to prevent two or more single persons from sharing accommodation, utilities, transport and many other expenses. The current system is not only inequitable, it discourages individuals from marrying and rewards them for concealing de facto relationships,

Single persons would receive less under our proposal than with the current scheme (\$2950 vs. \$5522.40); and if they live on their own, single persons will probably have lower real incomes than married couples. However, by living with others, single persons can take advantage of economies of scale and achieve a real income at least as high as that enjoyed by married couples.

Is the Proposal Feasible?

To be taken seriously, any proposal for a **GMI** must be shown to be feasible. A discussion of the advantages and disadvantages of any reform proposal is premature until its financial feasibility can be demonstrated.

In an attempt to discredit **GMI** proposals, Peter Saunders argues that ". . . if the **GMI** is set at **40** per cent of average income, the required [average] tax rate will be 40 per cent, if the **GMI** is set at **50** per cent of average income, the required tax ratios will be 50 per cent, and so on" [Saunders, 1988, pp. 26-27]. Furthermore, such high tax rates would be necessary just to finance the **GMI**. "The above simple relationships become more complex once it is acknowledged that the income tax system must also finance other government activities" [Saunders, 1988, p. 27]. The mere thought of the marginal tax rates that would be required of high income earners is enough to discredit any **GMI** in the eyes of any politician who wants to be re-elected.

The logic underlying the examples given by Saunders is unassailable, but the examples are misleading in that they would represent support levels greatly in excess of those provided by the current system. Our proposal of a demogrant of \$2950, which is based on current support levels, is only **33.6** per cent of average per capita (taxable) income. Thus, an average tax rate of **33.6** per cent

would be necessary just to finance the GMI. Saunders' example of a demogrant of 50 per cent of average income would imply a social dividend of \$4395.53 per person; such a grant would be, on average, 49.7 per cent, higher than the level of support provided by the current system.³

The total cost of the proposal GMI would be \$47,615 million which is the product of the demogrant (\$2950) multiplied by the total Australian population in 1986-87 (16,140,825). For the financial year 1986-87, total government expenditure was \$75,491 million of which \$20,541 million was spent on social welfare. Hence, the proposed GMI would increase social welfare expenditure by \$27,074 million and raise total government expenditure to \$102,565 million.

There are two main approaches which could be used to determine a tax scale which would provide the required revenue. Firstly, all sources of revenue could be increased proportionately. Secondly, the increased expenditure could be financed entirely through increases in the individual income taxes. The second approach has the principle advantage of not imposing unknown (and possibly regressive) effects that would result from increasing non-personal income tax revenue; say, by increasing consumption taxes. In addition the second approach would be easier to implement. Hence, we assume that the additional revenue to finance the GMI is derived entirely from increases in personal income tax receipts.

Consequently, personal income tax receipts would need to be increased by \$27,074 million to \$65,148 million. This could be achieved by a flat rate tax of 45.91 per cent or by a progressive rate structure such as the one outlined in Table 2. The necessary flat rate is derived by dividing the total required revenue (\$65,148 million) by the total taxable income in 1986-87 (\$141,895 million).

Our preference would be for a progressive tax structure with marginal tax rates ranging from 35 per cent on the first dollar of taxable income to 65 per cent on income above \$22,000. Table 2 is based on the distribution of taxable income in 1986-87 (the latest year for which data is available). The suggested marginal rates are, of course, arbitrary but they indicate one possible structure that would raise the requisite revenue. The actual revenue raised by the structure would be \$66,005 million which is \$857 million more than required. This could be used to cover administrative costs during the transitional phase of the scheme.

In our view, either a flat tax rate of 45.91 per cent or marginal rates from 35 to 65 in combination with the proposed GM would be feasible and would be acceptable to the majority of Australians. Under the progressive tax rate structure, the highest rate for personal income tax earners is only 5 percentage points higher than that which existed until December 1986. Furthermore, it is much lower than the effective marginal tax rates which currently face those in receipt of social security payments.

Advantages of the Proposal

One of the main problems of the current system of welfare provision in Australia is that the poverty traps associated with high effective marginal tax rates (EMTRs) which discourage workforce activity and can perpetuate welfare dependence. As can be seen in Figure 1, EMTR'S often exceed 100 per cent under the current system.

Furthermore, they are especially high over the taxable income range of \$150 to \$500 per week. The example of a sole parent with two dependant children is typical and similar patterns of excessively high EMTRs face other household configurations. In contrast, the EMTRs in our proposed GMI never exceed 66 per cent and they are consistently progressive. We would suggest that the pattern of EMTRs under the proposed GMI reform (solid bars) represent much greater vertical equity than the current system (crossed bars).

Table 3 provides details of the effect of the proposed GMI on disposable income for various taxable income classes. Generally, the level of assistance provided for single persons is lower under the GMI proposal. This is justified by the fact that our proposal assumes that single persons can live in groups of two or more and take advantage of economies of scale in group living. If they do not wish to live with others, then they may have to face the consequence of lower real incomes; this can be considered an opportunity cost of their independence.

The disposable income for families with children is significantly greater under the proposed scheme than with the current system. The proposed GMI would make a significant contribution towards the removal of child poverty. **Some** might argue that the proposal is too generous in its treatment of children: the cost of caring for a child does vary with the age of the youth and is generally **less** than that of an adult. And yet, our proposal treats all individuals, regardless of age, the same. Such a scheme can be justified once the level of likely family assets are taken into account. Holding current income constant, a family with older children (who are more expensive to care for) is more likely to have accumulated wealth (in the form of housing, motor vehicles, etc.) than a family with younger children. Consequently, a constant universal payment made irrespective of age along with accumulated wealth combine to provide approximately similar standards of living for families in various stages of the life cycle.

As previously indicated, the proposed GMI would provide assistance to all permanent residents of Australia. Using this method, eligibility is automatically determined at birth for Australian citizens or when permanent residential status is achieved. This would greatly reduce the administration costs and would increase the likelihood that individuals would receive all the benefits for which they are eligible. Discrimination against persons poorly informed and unable to cope with government bureaucracy would be greatly reduced. Furthermore, welfare fraud would **be** more difficult as everyone would receive the same demogrant and pay taxes on **all** earned income.

In order to be eligible for welfare payments under the current system, the income unit is required to not only meet the means test requirements but also some other criteria such as illness, age and marital status. These criteria, along with the means test requirement foment stigma effects due to the differentiation from the general community. The GMI provides universal support, and by doing *so* eliminates the stigma effect.

Universal schemes are generally regarded as less target efficient than selective schemes as even those who do not require assistance are provided with transfers in a universal scheme. However, in selective schemes *there is* always the problem of those who **do** require assistance being unable to meet the selective criteria. This paper argues the GMI proposal is no more technically inefficient than the current system, and indeed, with allowance **for** the integration of the income tax system may be more target efficient.

The GMI proposal pays a demogrant to all eligible individuals, and if those persons earn income, tax is paid upon this income. The amount paid may be less, equal or more than the demogrant. This transfer to, and transfer from represents low technical efficiency.

The current welfare system takes income levels into account before payments are made. This means duplication of transfers does not occur (with the exception of year end rebates and payments). Thus, it may be argued that the current system **is** more technically efficient than the reform proposal. However, two important points need to be understood.

Firstly, technical efficiency does not directly contribute towards the social welfare objectives. Secondly, the administrative costs associated with means testing are substantial. Although administration costs involved in the duplication of transfers in the reform proposal may lead to technical inefficiency, the social dividend's administration costs are anticipated to be significantly lower than the current system. Thus, although the current system achieves higher technical efficiency, it is at a cost which infringes upon the amount available for social welfare provision.

Administrative expenditure in **1986-87** represented 4.06 per cent of all Commonwealth Expenditure on social security and welfare. In **1987-88** this was reduced to 3.73 per cent of outlays on social security and welfare, but represented an increase of **\$4** million over the previous year to **\$838** million. As administrative expenditures are real costs and not just a transfer payment, it is apparent that in Australia, administration of social welfare represents a significant real cost to the community. Part of this problem is the degree of complexity in the criteria for assistance. As part of any selective scheme, in order to achieve target efficiency, the criteria of eligibility is comprehensive for all types of assistance measures. Since this criteria must be checked in association with an individual's application for assistance, the administrative infrastructure is created.

The comparison to the current scheme, criteria for assistance in the GMI scheme is simple. Once in place, it would require very little administrative effort to continue. Indeed, the administrative cost of the new taxation/demogrant scheme would not differ significantly from that currently incurred by the Taxation Department.

Economic efficiency **is** violated under the current 'system in several ways, Firstly, current welfare benefits include non-cash benefits which are inefficient and paternalistic compared to direct cash targeting [Hawke, A.E., 1988]. The reform proposal aims to provide benefits in cash and to eventually remove all non-cash payments which should increase economic efficiency.

As mentioned above, the reform proposal does not discriminate against persons less able to appreciate their eligibility (such **as** the sick, aged and poorly educated) due to the relative automatic eligibility and administrative simplicity. This principle of equal treatment, irrespective of education, **sex**, marital status or age are all encapsulated with the social dividend scheme, It is true that the demogrant is paid irrespective of income and this **may** seem to violate the principles of vertical equity. However, due to the interaction of the taxation and social dividend scheme, the net benefits accrue only to lower income earners who are effectively subsidised by the higher income groups whose demogrants are exceeded by tax payments.

The current system effectively discriminates on the bases of sex, education, age and marital status. For example, a woman who is eligible for a widow's pension receives a higher level of assistance than a woman of same age and income who is unemployed,

Persons who attempt to undertake workforce activity whilst still in receipt of assistance will, for some income ranges, be faced with withdrawal of assistance which may even lower his or her disposable income. This is associated with EMTRs which are significantly higher than those who are faced with only the marginal income tax rates. All these points contribute to the

overwhelming conclusion of vertical and horizontal inequity within the current system.

As shown in Table 2 the EMTRs gradually increase throughout the entire range of incomes under the reform proposal. This means that under the reform proposal vertical and horizontal equity is maintained throughout the entire range of taxable income.

So far we have said nothing about possible labour supply responses to the proposed changes. In fact, we implicitly assumed there would be no net changes in the hours worked or the incomes earned when estimating the marginal tax rates that would be necessary to finance the GMI. Of course there will be some supply responses to changes in the average and marginal rates of taxation. There will also be shifts in labour supply as a result of the introduction of the \$2950 annual demogrant. Although the exact magnitude of any supply side effects is difficult (perhaps impossible) to estimate accurately, we would argue that they are likely to be small. Furthermore, the combined effects are likely to shift the aggregate supply schedule to the right which will increase the total number of hours worked and aggregate taxable incomes.

Why might the aggregate supply curve shift to the right? The reason becomes apparent when one thinks about the implications of Figure 1. Under the GMI reform proposal the EMTRs for most individuals would decrease. The slashed bars (representing EMTRs under the 1986-87 regime) are above the solid bars (representing EMTR for the GMI reform) for all levels of taxable income between \$42 per week and approximately \$500 per week. Nearly 78 per cent of all income earners were in this range. Furthermore, the reductions are substantial, reducing EMTR from 150 per cent to 60 per cent in some cases). Although the EMTR would be increased from zero per cent to

35 per cent on incomes up to \$42, very few people (less than one per cent of the taxpayers) were in this category. The increase in EMTRs for individuals with incomes exceeding \$500 would be small and unlikely to cause significant supply responses. Thus, the biggest changes affecting the largest number of taxpayers will be reductions in EMTRs, This is likely to increase the supply of labour.⁴

As a result of the new marginal tax structure the net effect of the GMI proposal is likely to be an increase in participation, higher taxable incomes and hence higher taxation revenues. This would allow for even lower marginal tax rates than those proposed in Table 2.

Another problem with the current system of social welfare is that its complexity makes it virtually impossible to estimate the total level of support that is given to low income families. No one really knows whether the social security system is too generous or too mean [Gruen, 1982]. Levels of cash assistance from the Department of Social Security are difficult to estimate, in part because they depend on the category of the recipient. One also has to take into account levels of other cash grants such as Family Allowances, Secondary Bursary Grants and Austudy. But the real difficulty is trying to estimate the dollar equivalency of numerous in-kind payments which include a variety of goods and services which are free or available at a subsidised price to the poor. These include subsidised housing, child care, pharmaceutical products, dental care, telephone rates, transportation and electricity. The value of these subsidies is extremely difficult to estimate and varies considerably from household to household. Because of shortages of public housing and subsidised child care places some low income families miss out on these benefits altogether.

Two points are clear. Firstly, the actual level of assistance overwhelming conclusion of vertical and horizontal inequity within the current system.

Secondly, there are horizontal inequities arising from the fact that the actual level of total assistance varies significantly for families in similar financial circumstances.

In contrast, under the GMI scheme the level of assistance provided each person (the size of the demogrant) would be known to all and people could make informed decisions about its adequacy. Furthermore, EMTRs for all levels of income could be easily determined. The gradual shift from a mixture of in-kind and cash payments to a system of cash payments (the demogrant) would greatly reduce administrative costs, increase the individual's freedom of choice and substantially reduce horizontal and vertical inequities.

Concluding Remarks

Fundamental changes such as the proposed GMI are never easy to sell to the general public let alone to special interests groups that are adversely affected; nor are such changes easy to implement. Transitional arrangements would be necessary to assist those in the social security bureaucracy who would be displaced. Special transitional arrangements would also be necessary for those

recipients whose benefits would be reduced (**for example** some single person households). Marginal tax rates would have to **be** increased slightly for the highest income earners. **Nevertheless**, these and other problems can be overcome. The proposed **GMI** scheme **is**, in our view much fairer than the current system and it is financially feasible. Its adoption would provide an income net for all individuals, eliminate most of the horizontal and vertical inequities that plague our current system and encourage greater participation in the labour force.

FOOTNOTES

1. The Australian Commission of Inquiry into Poverty (1972-75), chaired by Professor Ronald Henderson recommended fundamental changes to the system while the Social Security Review (1986-88), directed by Associate Professor Bettina Cass has recommended numerous but relatively minor changes. See Sanders (1987).
2. The amount of the demogrant would be in real 1986-87 dollars and automatically adjusted to increases in the CPI. The year, 1986-87, has been chosen as it is the latest year for which the distribution of individual taxable incomes in Australia is known,
3. Total taxable income in 1986-87 was \$142,895,030,000 and the population of Australia was approximately 16,140,825; hence, taxable income per capita was \$8791.06. Our proposal of a demogrant of \$2950 is 33.6 per cent of taxable income per capita while a demogrant of \$4395.53 would be 50 per cent of taxable income per capita.
4. This assumes that leisure is a normal good and that the substitution effect is greater than the income effect. These assumptions are consistent with empirical estimates of aggregate labour supply functions. Empirical studies have shown that women are especially responsive to increases in wage rates (net of taxes and changes in welfare payments) and our proposal is likely to increase the labour participation of women more than it increases the participation of men.

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Table 1 : Benefits and Pensions Under the
1986-87 Australian Welfare System

Category	Maximum Payment (\$/fortnight)	Annual Payment Per Capita. (\$)
Benefits		
Single Rate		
- no child	212.40	5522.40
- 1	246.40	3203.20
- 2	280.40	2429.96*
- 3	314.40	2043.60
Married. Rate		
- no child	354.20	4604.60
- 1	406.20	3520.40*
- 2	440.20	2861.30
- 3	474.20	2465.84
Pension		
Single Rate		
- no child	212.40	5522.40
- 1	246.40	3203.20
- 2	280.40	2429.96*
- 3	314.40	2043.60
Married Rate		
- no child	354.20	4604.60
- 1	388.20	3364.40*
- 2	422.20	2744.56
- 3	456.20	2372.24

Source : Department of Social Security, 1988.

Table 2: Possible Personal Income Tax Regime Under the GMI Proposal
(Taxable Income of Individuals - Income Year 1986-87)

Taxable Income (\$)	Number of Taxpayers	Average Taxable Income (\$)	Marginal Tax Rates per cent	Taxation Payable For Average Person (\$)	Average Taxable Income plus the Social Dividend minus taxation Payable	EMTR *
Under 4891	67099					
4891-4999	18152	4903.39	35	1716.19	6123.38	36
5000-5999	190667					
6000-6999	375474					
7000-7999	314997	7383.19	40	2652.93	7666.44	41
8000-8999	273437					
9000-9999	264844					
10000-10999	256978	10479.06	45	3964.83	9450.41	46
11000-11999	251536					
12000-12999	252197					
13000-13999	252410	13516.81	50	5407.21	11045.78	51
14000-14999	264144					
15000-15999	289297					
16000-16999	299152	16513.16	55	6980.54	12468.80	56
17000-17999	299673					
18000-18999	296458					
19000-19999	294853	19919.27	60	8949.31	13906.14	61
20000-21999	519153					
22000-23999	434976					
24000-25999	366194	24745.31	65	11981.60	15699.89	66
26000-27999	309306					
28000-29999	258003					
30000-34999	443600	32664.18	65	17128.22	18472.14	66
35000-39999	248721					
40000-49999	194999					
50000-99999	127266	57626.71	65	29453.86	31109.03	66
100000 over	18278					
Total	7181864	19757.41		9190.53		

a. Marginal tax rate plus medicare levy of 1 per cent which prevailed in 1986-87
Source (for columns 1 and 2 only) :

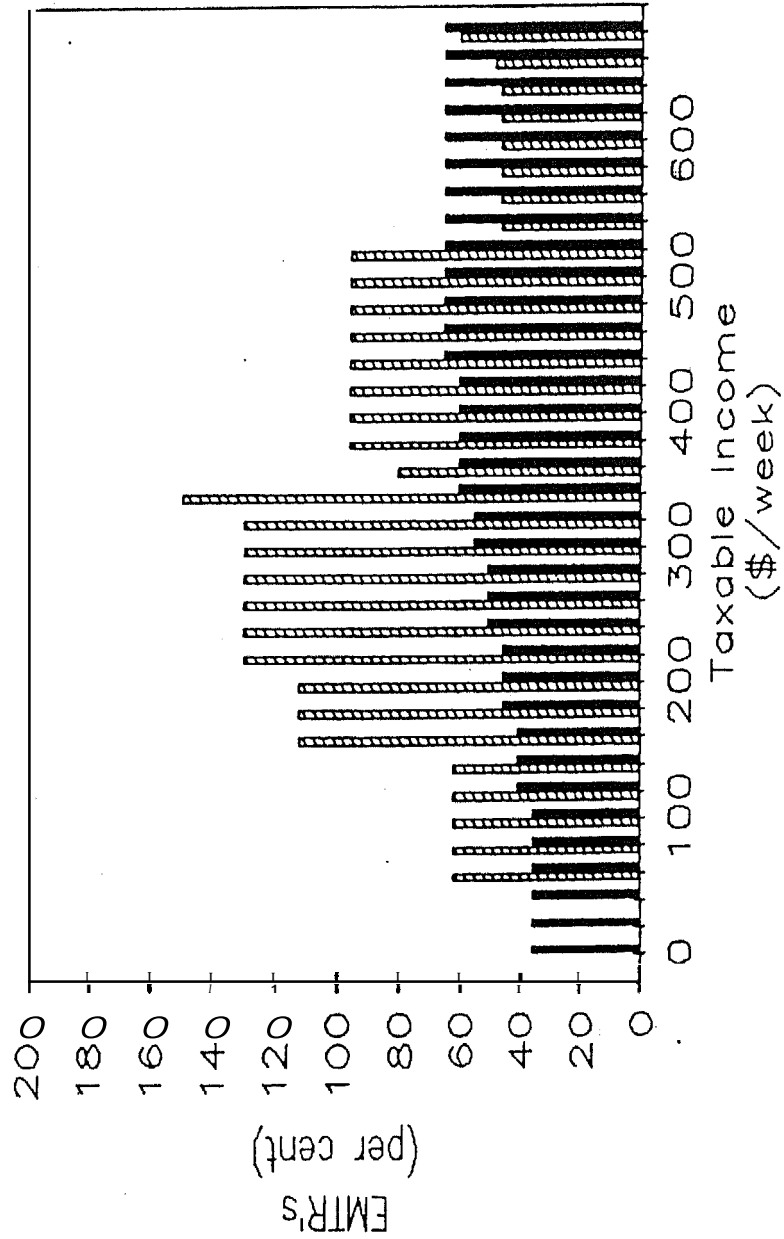
Australian Department of Treasury, 1988, p.4.

Table 3 : Comparisons of Disposable Income for 1986-87
under the Current System and the GMI Reform Proposal

Family Taxable Income (\$p.a.)	Number of Dependants	Disposable Income (\$ per annum)			
		Single Earner		Dual Earners	
		1986-87	Reform	1986-87	Reform
0	- none	5522.40	2936.18	9209.20	5872.36
	- one	6406.40	5872.36	10561.20	8808.54
	- two	7290.40	8808.54	11445.20	11744.72
4903.39	- none	7350.20	6123.38	12848.99	9059.56
	- one	9350.20	9059.56	14356.99	11995.74
	- two	10106.20	11995.74	15240.99	14931.92
7383.19	- none	6686.14	7666.44	12849.43	10671.43
	- one	10461.88	10602.62	14357.43	13607.61
	- two	11345.88	13538.80	15240.43	16543.79
10479.06	- none	8903.25	9450.41	16066.09	12669.72
	- one	10434.13	12386.59	17574.09	15605.90
	- two	11318.13	15322.77	18458.09	18542.08
13516.81	- none	11236.32	11045.78	13094.19	14553.13
	- one	11509.92	13981.96	13367.79	17489.31
	- two	11900.52	16918.14	13758.39	17459.31
16513.16	- none	13333.76	12468.80	14682.38	16335.96
	- one	13607.36	15404.98	14955.98	19272.14
	- two	13997.96	18341.16	15346.58	22208.32
19919.27	- none	15651.72	13906.14	17236.95	18277.45
	- one	15925.32	16842.32	17510.55	21213.63
	- two	16315.92	19778.50	17901.15	24149.81
24745.31	- none	18257.78	15699.89	20739.42	20841.87
	- one	18531.38	18636.07	21013.02	23778.05
	- two	18921.98	21572.25	21403.62	26714.23
32664.18	- none	22441.16	18472.14	26397.43	24598.04
	- one	22714.76	21408.32	26671.03	27534.22
	- two	23105.36	24344.50	27061.63	30470.40
57626.71 1	- none	32707.07	31109.03	30136.41	36349.34
	- one	32707.07	34045.21	38136.41	39285.52
	- two	32707.07	36981.39	38136.41	42221.70

Source : Hawke, (1988)

Figure 1
 Effective Marginal Tax Rates
 For a Sole Parent
 With Two Dependant Children



Source : Hawke, 1988.