In this series - Budget policy checks - we look at the government’s justifications for policies likely to be in this year’s budget and measure them up against the evidence.

In this piece we look at the need for personal income tax cuts.

A large proportion of any cut in personal income tax - especially if the cuts were skewed towards lower and middle-income households with a higher propensity to spend - would likely provide a greater direct stimulus to the Australian economy than an equivalent cut in company tax.

Cutting personal income taxes seems likely to provide much more of a boost to the Australian economy than cutting company income tax. As the government’s own published modelling shows, the benefits of its proposed cuts to the company income tax rate are small relative to their cost.

Do we need income tax cuts to provide relief from financial hardship?

The treasurer and I have been working on how we can provide more tax relief for hard-working middle income Australian families.

- Prime Minister Malcolm Turnbull

Over the last five years, household spending has grown by just 2.6% per annum in real terms, on average - of which more than half has been the result of population growth - compared with an average of 3.6% per annum over the preceding 12 years. Even with that lower growth rate in their spending, households have reduced their saving rate, from around 7% of disposable income five years ago to around 2.5% in 2017. That’s the lowest saving rate since before the financial crisis.

The key reason for this "squeeze" on household spending and saving is of course the ongoing weakness in the growth rate of household disposable income. Over the past five years, real per capita household disposable income has grown at an average annual rate of just 0.4%, compared with an average of 2.6% per annum over the preceding 12 years.

One reason for this is that Australian households have been paying an increasing proportion of their income in taxes. In the years prior to the onset of the financial crisis, almost every budget included personal income tax cuts in some form or other.

By contrast, there have been no changes to Australia's personal income tax scale since 2008 - apart from the increase in the tax-free threshold (paid for by an increase in the bottom rate) in 2012, the temporary surcharge on top-rate taxpayers which applied between 2014-15 and 2016-17, and the increase in the threshold for the second-top rate (from A$80,000 to A$87,000) which took effect in the 2016-17 financial year.

As a result, in 2017, Australian households in aggregate paid 19.5% of their taxable incomes in income and other direct taxes - the highest proportion since 2005, and continuing a steady rise since 2011.

Households are also spending almost two and a quarter percentage points more of their after-tax disposable incomes on education, health, insurance and other financial services, and utilities than they did five years ago.

Given all this, it's little wonder that household spending in more "discretionary" areas has been so weak in recent years.

Well-targeted personal income tax cuts could thus help to ameliorate this multi-faceted "squeeze" on household incomes, and provide a direct boost to the economy.

Do we need income tax cuts to make up for the fact that we haven't had a pay rise in a while?

It's been a long time since any Australians had a decent pay rise…this is a real pressure on Australians…we can give them some relief when it comes to their personal income tax.

- Treasurer Scott Morrison

The other major reason for the very slow growth in real household disposable income over the past few years has been the unprecedented slowdown in wages growth. Wages have risen at an average annual rate of just 2.2% over the past five years (only 0.3 of a percentage point above the inflation rate), down from 3.7% per annum over the preceding 12 years.

Although, as RBA Governor Phillip Lowe noted in a speech that "the latest data suggest that the rate of wages growth has now troughed", he went on to warn that the pickup which the RBA expects "is likely to be only gradual".

Recent experience in other advanced economies clearly suggests that the unemployment rate needs to be lower for longer than in previous business cycles before wages growth starts to pick up. So even assuming that Governor Lowe is right, it may be one or two years before Australian households can expect any meaningful improvement in their financial position from faster growth in their wages or salaries.

Well targeted personal income tax cuts could help provide at least some offset to this likely continuing stagnation in wages growth over the next year or so.

What's the verdict?

Targeted personal income tax cuts could reduce the squeeze on households and make up for persistent low wages.

Of course, it remains crucial that any cuts in personal income tax be sustainable - that is, that they are not funded by bigger deficits, and do not materially detract from the task of putting the nation's public finances on a sounder footing. This is so we are better placed to withstand any unforeseen economic shocks.

And it's important to remember that government spending has moved to what appears to be a permanently higher level as a proportion of GDP since the financial crisis. The government's underlying cash payments averaged 25% of GDP from 2011-12 through 2017-18, up from 24% from 2001-02 through 2007-08. That also represents a constraint on the scope for tax cuts.

However, the apparently greater improvement in the budget so far this financial year , compared with what was forecast as recently as last December's Mid-Year Economic and Fiscal Outlook, could give the government a little more latitude for financially sustainable personal income tax cuts in the upcoming budget.

Perhaps the most sustainable way of providing the "relief" which the treasurer says many Australian households need, would be to abandon the tax cut for companies turning over more than A$50 million a year. The government hasn't been able to get these through the Senate. These cuts would do far less to boost the Australian economy than well-targeted personal income tax cuts of a similar order of magnitude.

Saul Eslake does not work for, consult, own shares in or receive funding from any company or organization that would benefit from this article, and has disclosed no relevant affiliations beyond their academic appointment.

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