Making sense of the budget ‘crisis’

ACOSS National Conference
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Grattan Institute
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Overview

What sort of budget ‘crisis’ do we have?

- Australia’s debt levels are relatively manageable
- However, the Commonwealth has an underlying and substantial structural deficit
- Both revenue and expenditure are worse than longer-run levels
- The problems will get worse, driven by signature initiatives, health spending, and deteriorating terms of trade

Budget deterioration was predominantly driven by tax cuts, and increases in health and infrastructure spending

- Commonwealth tax receipts are returning to historic levels as bracket creep undoes the Howard tax cuts.
- Health and infrastructure spending grew faster than GDP
- Policy choices, not population ageing, drove health and pension spending

Budget repair will require tough choices

- Bracket creep, which dominates the 2014-15 budget, is not a sustainable strategy
- Inevitably health, welfare, education, and social services spending will be under pressure
- There are few options for budget repair that are both large and socially responsible
- Better targeting of age pensions, superannuation, and asset taxation dominate the attractive options
- Budget repair is almost impossible without tax reform
Australia’s debt levels are relatively manageable

General government net debt
per cent of nominal GDP

Source: Grattan Institute, Budget Pressures 2014
The Commonwealth’s structural deficits was masked by mining boom and GFC

**Commonwealth budget balance**
per cent of nominal GDP

**Graph**

- **Terms of trade**
- **Cyclical impacts**
- **Structural underlying balance**
- **Cash balance**

**Note:** Cash balance is equal to receipts minus payments, minus Future Fund income, (under 0.25 per cent of GDP)

**Source:** Budget Pressures 2014
Both revenue and expenditure are worse than longer-run levels

Commonwealth and State expenditures and revenues per cent of GDP

- C’wth Revenue (ex GST)
- C’wth Expenditure (ex tied grants)
- State Expenditure (inc tied grants)
- State Revenue (inc GST, ex tied grants)

Forecast

If mining prices fall faster

Note: Revenue collected by the Commonwealth and transferred to states is shown as Commonwealth revenue only.

Source: Budget Pressures 2014
The problems will get worse on current trends

Potential annual deficit of Australian governments’ budgets by 2024
(Percent of GDP)

- Forecast deficit 2016-17: -0.5%
- Signature initiatives e.g. NDIS, defence: -0.5%
- Health 2003-2014 trend: -1.5%
- Welfare response to inequality increase: -0.5%
- Terms of trade potential fall: -0.5%
- Deficit 2024 on current trends: -3.5%

Grattan Institute, Budget Pressures 2014
Commonwealth tax receipts are returning to historic levels

Commonwealth taxes per cent of GDP

Source: Treasury, Budget Paper 1; Grattan Institute analysis
Health and infrastructure spending grew faster than GDP

Change in Australian governments’ expenditure 2003-2014

$ bn relative to CPI

Source: Budget Pressures 2014
Policy choices, not population ageing, drove health and pension spending

Real increase in expenditure 2003-2013
($2012 billion)

Source: Budget Pressures 2014
The budget deficit in 2014 was mostly due to bracket creep, not budget measures. The budget deficit in 2017 was due to tax increases and spending reductions. The budget deficit would have been higher if current policy had remained in place.

**Budget balance as a percentage of GDP**

<table>
<thead>
<tr>
<th>Year</th>
<th>Budget deficit 2014</th>
<th>Tax increases (net)</th>
<th>Spending reductions (net)</th>
<th>Spending shrinkage (net)</th>
<th>Income tax bracket creep</th>
<th>Other tax shrinkage (net)</th>
<th>Budget deficit 2017</th>
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<td>2014</td>
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<td>-2</td>
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<td>-3</td>
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**Source:** Treasury, *Budget Papers 1 and 2*, Grattan analysis
Taxpayers in middle income brackets will lose most in bracket creep

Impact of bracket creep, 2013-14 to 2016-17
Additional percentage of income paid in tax, by taxpayer income decile

Source: Treasury, Budget Paper 1, ATO, Taxation statistics 2010-11, Grattan analysis
Welfare, health, education and social services spending will be under pressure

Combined government expenditure 2013-2014
100% = $545b

- Welfare 22%
- Education 16%
- Health 16%
- Infrastructure 7%
- Defence 6%
- Everything else 26%
- Ageing, community & disability 6%

Grattan Institute, Budget Pressures 2014
There are few options for budget repair that are both large and socially responsible

Budgetary impact of tough budget choices
2013$b per year

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<th>Option</th>
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<td>Negative gearing</td>
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<td>Pharmaceutical spend</td>
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<td>CGT discount</td>
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<td>Cost effective medicine</td>
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<td>Super contr concessions</td>
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Collateral impact
- $11b Positive
- $24b Neutral
- $12b Mild
- $14b Negative
- $19b Negative
- $40+b Very negative

Source: Grattan Institute, Balancing Budgets
Better targeting of age pensions, super, and asset taxation dominate the attractive options

Budgetary impact of tough budget choices
2013 $b per year

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Budget repair is almost impossible without tax reform

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