Balancing budgets: tough choices we need

John Daley, CEO, Grattan Institute
2014 Economic and Social Outlook Conference
3 July 2014
Overview

Australian government budgets are in trouble

• For 7 years a structural deficit was masked by mining boom and GFC
• The Commonwealth has both a revenue and a spending problem
• Revenues are returning to long-run averages with bracket creep
• Health and infrastructure increased their share of government spending

Bracket creep is ‘solving’ the short-term structural problem

• Highly publicised budget cuts affect a wide variety of groups
• However, most of the structural improvement is a result of bracket creep
• Bracket creep hits middle income earners most, and is unlikely to be politically sustainable

Longer term structural budget problems require tougher choices

• Longer term budget settings are not sustainable given signature policies, rising health costs and other pressures
• All policy choices that improve the structural budget position are politically painful
• Some structural improvements are in place, but more will be needed
The Commonwealth’s structural deficits was masked by mining boom and GFC

Commonwealth budget balance
per cent of nominal GDP

Terms of trade
Cyclical impacts
Cash balance
Structural underlying 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 own purpose expenditures and revenues per cent of nominal GDP

- **C’wth Revenue (ex GST)**
- **C’wth Expenditure (ex tied grants)**

If mining prices fall faster

Financial year ended

Source: *Budget Pressures 2014*
Commonwealth tax receipts are returning to historic levels

Commonwealth taxes
per cent of nominal GDP

Source: Treasury, Budget Paper 1; Grattan Institute analysis
Health and infrastructure increased their share of government spending

Change in Australian governments’ expenditure 2003-2014
Real change in expenditure, 2003 to 2014, $2013 bn

Source: Budget Pressures 2014
Health increased and welfare reduced their share of Commonwealth spending

Change in Commonwealth recurrent expenditure
Real change in expenditure, 2003 to 2014, $2013 bn

Note: Includes funds transferred to States. 'Other' comprises all expenditure not elsewhere included. 'Social services' comprises ageing and aged care services, disability services, and community services. 'Govt & econ' comprises government operations and economy and finance.
Source: Budget Pressures 2014, Supporting Materials
Health and infrastructure drove increases in State spending

Change in State recurrent expenditure
Real change in expenditure, 2003 to 2014, $2013 bn

Note: Includes funds transferred to States. 'Other' comprises all expenditure not elsewhere included. 'Social services' comprises ageing and aged care services, disability services, and community services. 'Govt & econ' comprises government operations and economy and finance.
Source: Budget Pressures 2014, Supporting Materials
Health and Age Pensions spending were due to policy choices, not population ageing

Real increase in expenditure 2003-2013
$2012 bn

More, improved, and new services per person

Health inflation >CPI

Population ageing

Population growth

Rate & eligibility change

Indexation >CPI

Population growth and ageing

Grattan Institute, Budget Pressures 2014
Spending on health has risen for all ages, but is much greater for older age groups

Government spending on health per person
All governments, $2012 ‘000 per year per person

Source: Grattan Institute analysis of Productivity Commission An Ageing Australia: Preparing for the Future, p129
Capex has driven increase in State debt

State net debt and operating balance

$2013 bn

Grattan Institute, Budget Pressures 2014
Recurrent State budgets are now paying for past capex

Depreciation and interest expense as a percentage of State revenue

% of revenue

Grattan Institute, Budget Pressures 2014
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Budget cuts affect a wide variety of groups

2014-15 Budget measures, impact on 2016-17 budget

Annual impact, $2017 bn

- Patients: $1.7 bn
- Students: $1.0 bn
- Families: $1.8 bn
- Age Pensioners: $1.2 bn
- Unemployed: $1.2 bn
- High earners: $1.1 bn
- Fuel tax: $0.7 bn
- Other gov’ts: $0.4 bn
- Misc: $3.1 bn
- New infrastructure: $3.1 bn
- Election promises (defence pensions, Direct Action): $0.7 bn
- Overseas development: $10.5 bn

Net impact budget balance 2016-17

Source: Treasury, Budget Paper 2; Grattan Institute analysis
Most of the structural improvement is the result of bracket creep

Budget balance as a percentage of GDP
2016-17 budget compared to 2013-14 budget, % of GDP

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Source: Treasury, *Budget Papers 1 and 2*, Grattan analysis
Bracket creep hits middle income earners most

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
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Longer term budget settings are not sustainable

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
Few options for budget repair are both large and socially responsible

**Budgetary impact of tough budget choices in ten years’ time**

$2013 bn per year

<table>
<thead>
<tr>
<th>Option</th>
<th>Impact (bn)</th>
<th>Collateral impact</th>
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<tbody>
<tr>
<td>Age Pension assets test</td>
<td>$11b</td>
<td>Positive</td>
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<td>Negative gearing</td>
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<td>Pharmaceutical spend</td>
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<td>Pension and super access</td>
<td>$24b</td>
<td>Neutral</td>
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<td>CGT discount</td>
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<td>Higher ed subsidies</td>
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<td>Defence spending</td>
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<td>Cost effective medicine</td>
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<td>Super contr concessions</td>
<td>$12b</td>
<td>Mild negative</td>
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<td>Super earn concessions</td>
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<td>Fuel tax indexation</td>
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<td>Transport infra costs</td>
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<td>High risk in execution</td>
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<td>Industry support</td>
<td>$14b</td>
<td>Negative</td>
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<td>School class sizes</td>
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<td>GST broaden</td>
<td>$19b</td>
<td>Negative</td>
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<td>Health rebate</td>
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<td>Mining royalty</td>
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<tr>
<td>CGT owner occ</td>
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<tr>
<td>Payroll threshold</td>
<td>$40+b</td>
<td>Very negative</td>
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<td>Fuel tax credit</td>
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<td>Bracket creep</td>
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Source: Grattan Institute, *Balancing Budgets*
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Budgetary impact of tough budget choices in 10 years’ time

$2013 bn per year

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- Negative gearing
- Pharmaceutical spend
- Pension and super access
- CGT discount
- Higher ed subsidies
- Defence spending
- Cost effective medicine
- Super contr concessions
- Super earn concessions
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