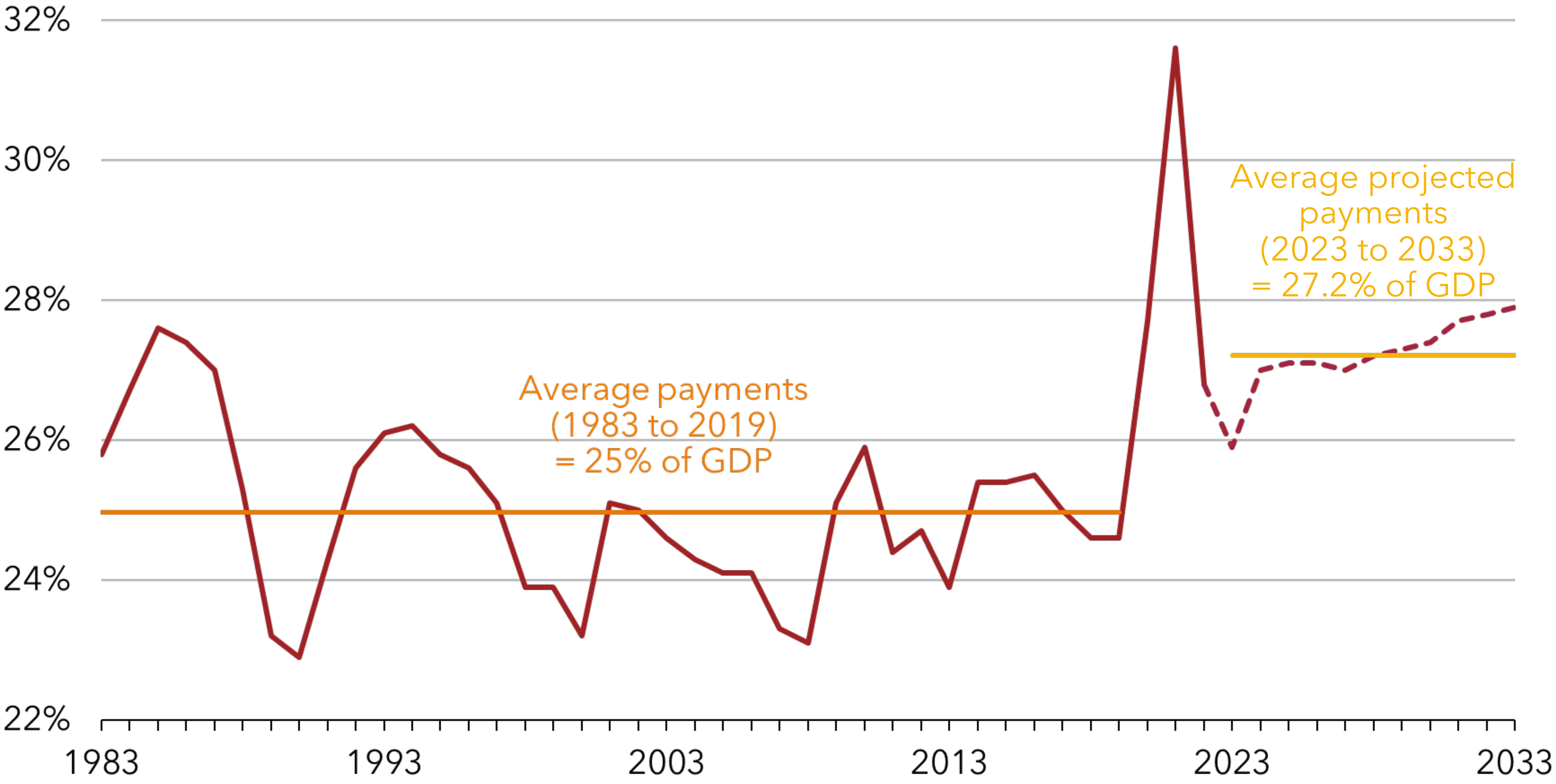
Back in black? A menu of measures to repair the budget

Briefing pack

April 2023

The size of government has grown

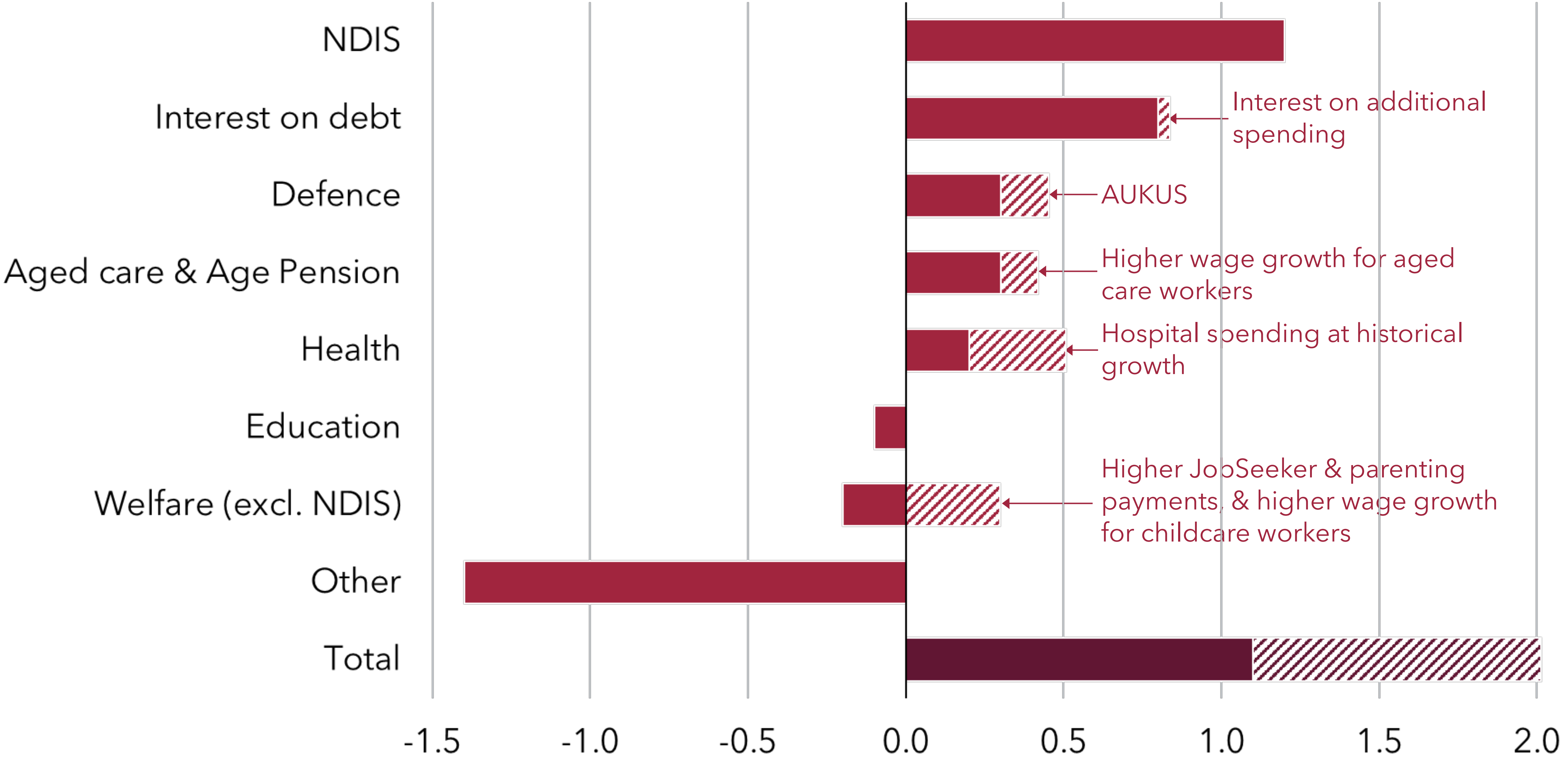
Federal government expenses as a proportion of GDP



Notes: Data are for the financial year. The dashed line represents Treasury's October 2022 Budget projections, which comprise forward estimates from 2023 to 2026 and medium-term projections from 2027 to 2033. Sources: PBO (2022a, Table 1); Treasury (2022a, Chart 3.13).

The official figures understate the extent of the spending pressures

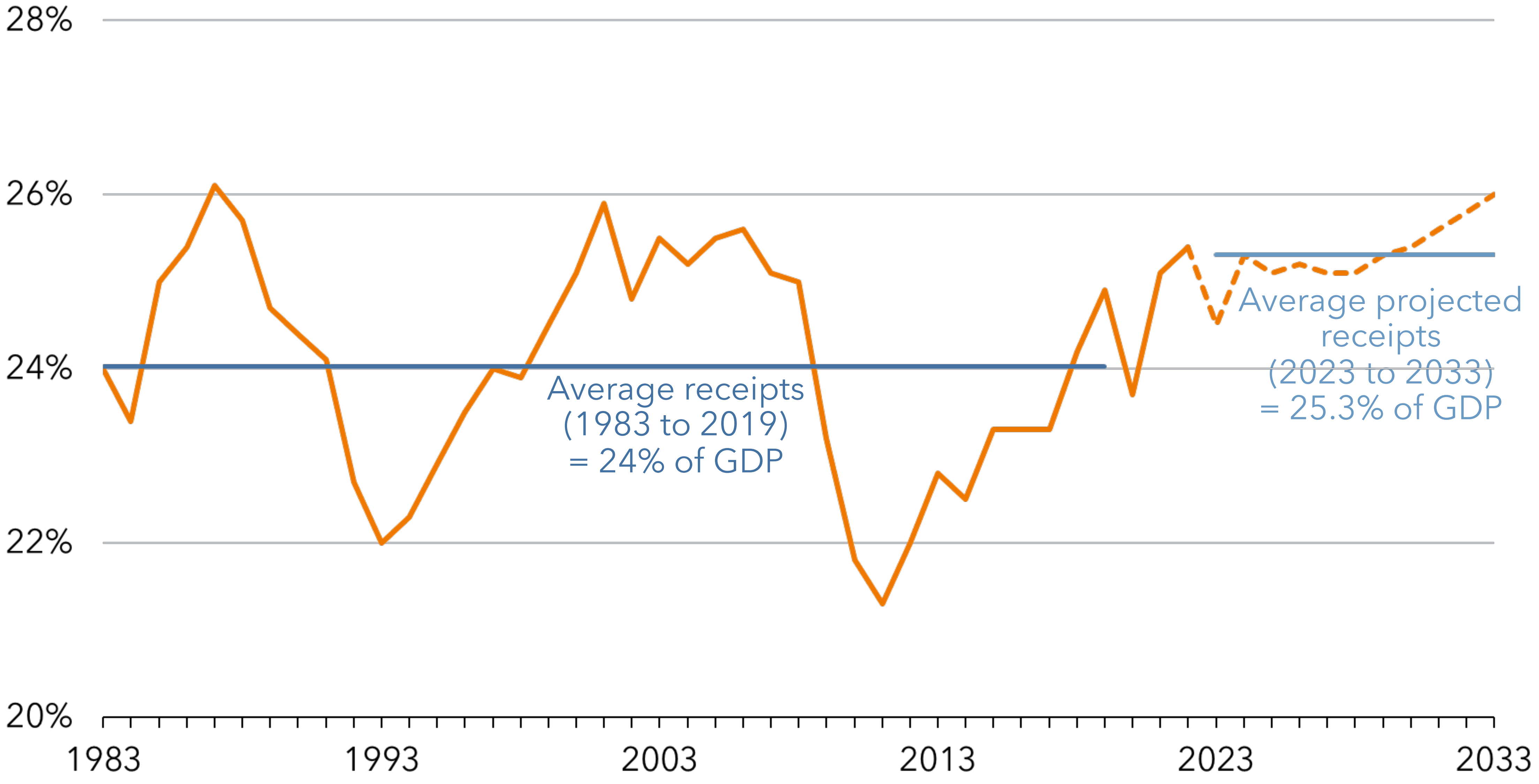
Projected change in yearly spending as share of GDP from 2023 to 2033 (percentage points)



Notes: See Figure 1.2 in Chapter 1 of Grattan's Back in Black report (2023) for a full explanation and sources.

Government revenue has not kept pace with spending

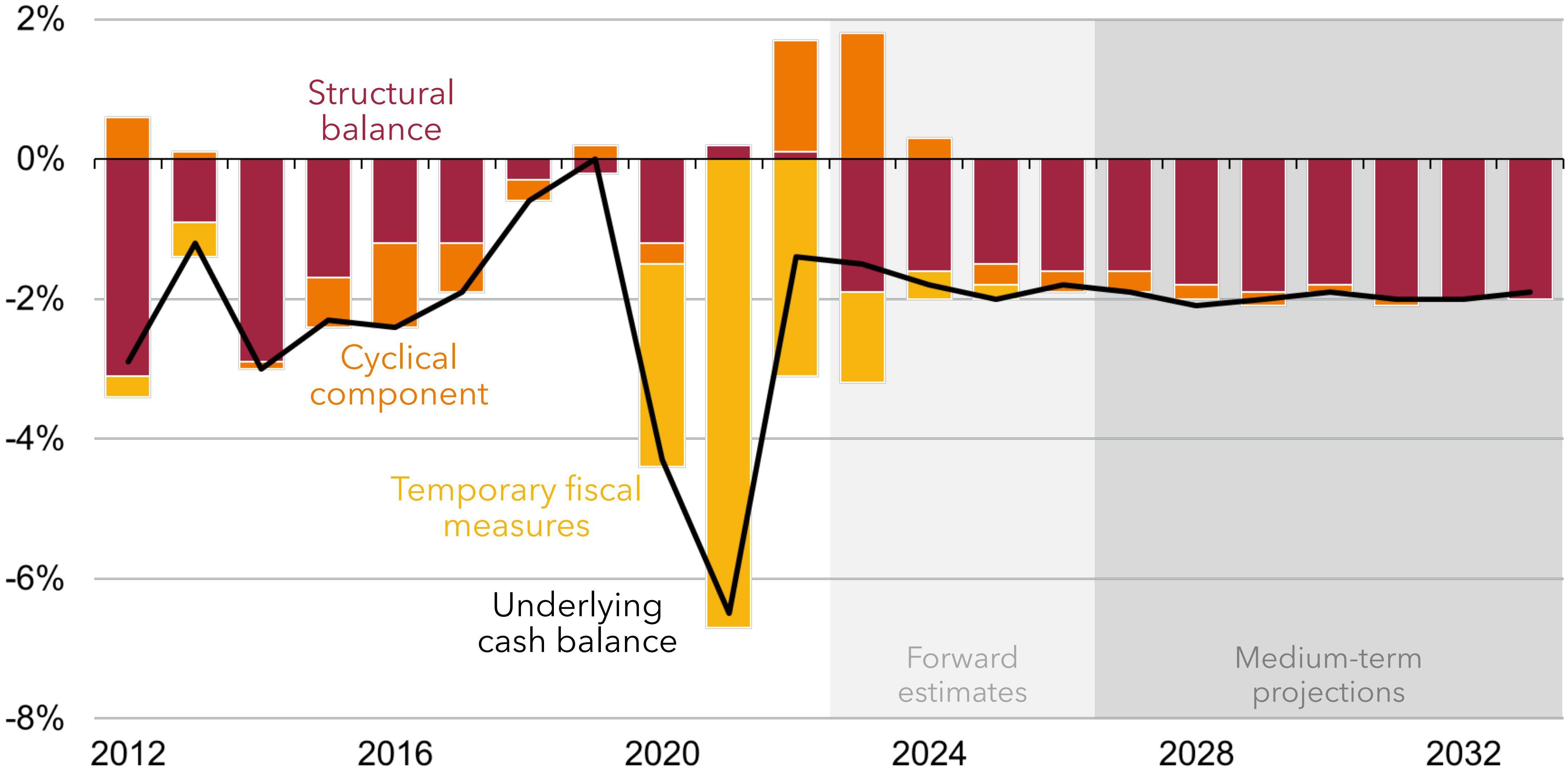
Federal government revenue as a proportion of GDP



Notes: Data are for the financial year. The dashed line represents Treasury's October 2022 Budget projections, which comprise forward estimates from 2023 to 2026 and medium-term projections from 2027 to 2033. Sources: PBO (2022a, Table 1); Treasury (2022a, Chart 3.12).

A structural deficit of about $50 billion is projected every year over the next decade

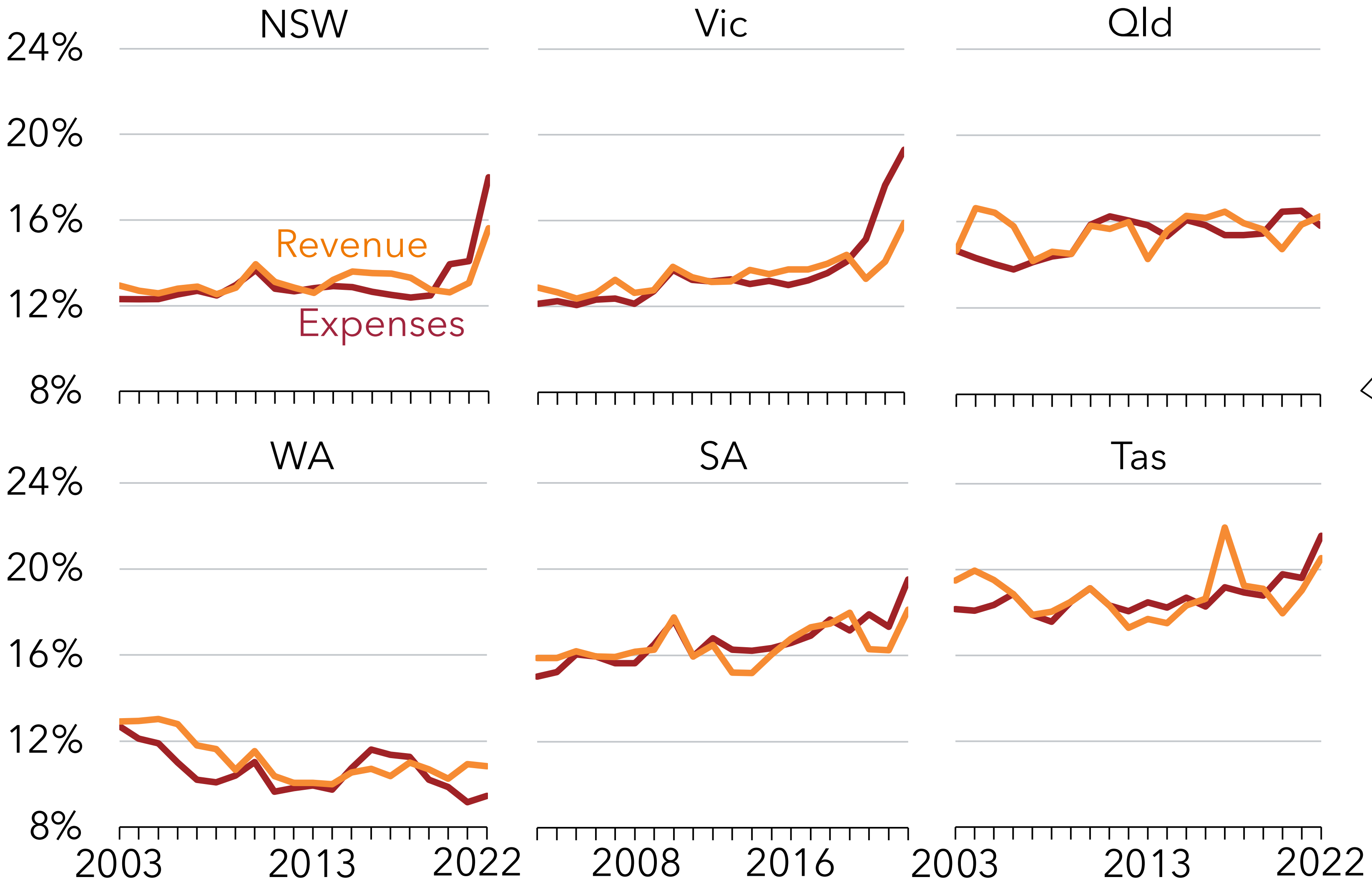
Budget components as a proportion of GDP



Notes: Data are for the financial year. The cyclical component includes automatic stabilisers and cyclical movements in commodity and asset prices. Other fiscal measures include COVID-related direct economic and health support measures. Source: Treasury (2022a, Chart 3.20).

State governments have budget challenges too

Revenue and expenses as a proportion of gross state product

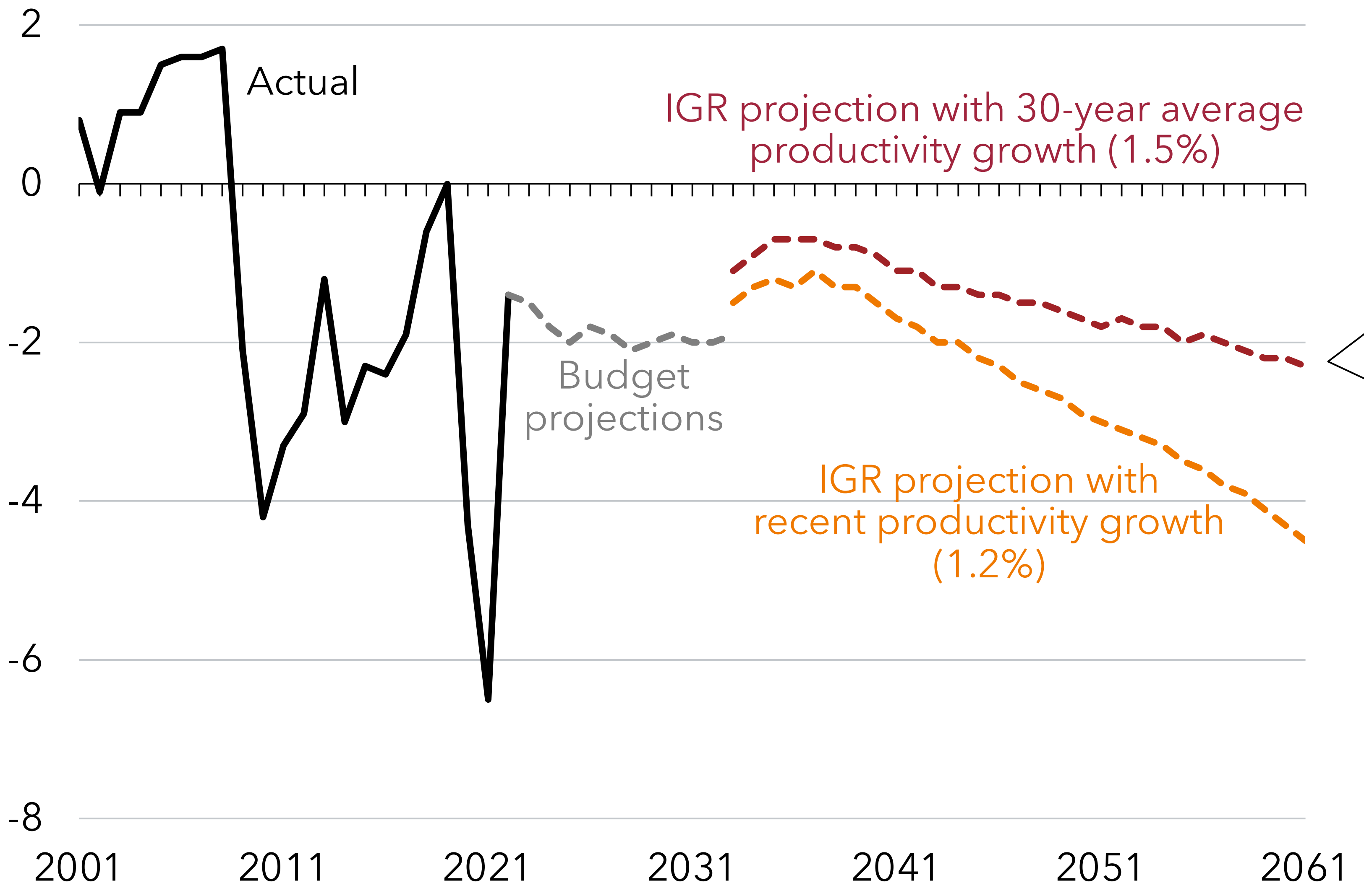


State budget pressures inevitably **squeeze the federal budget too**: state gov'ts are effective at bringing political pressures to bear on the federal govt for more money to help fund critical services

Notes: Data are for the financial year. Expenses excludes the net acquisition of non-financial assets. Sources: PBO (2022c, Tab D11) and ABS (2022c, Table 1).

We can't rely on higher economic growth to save the day

Underlying cash balance of the federal government as a proportion of GDP

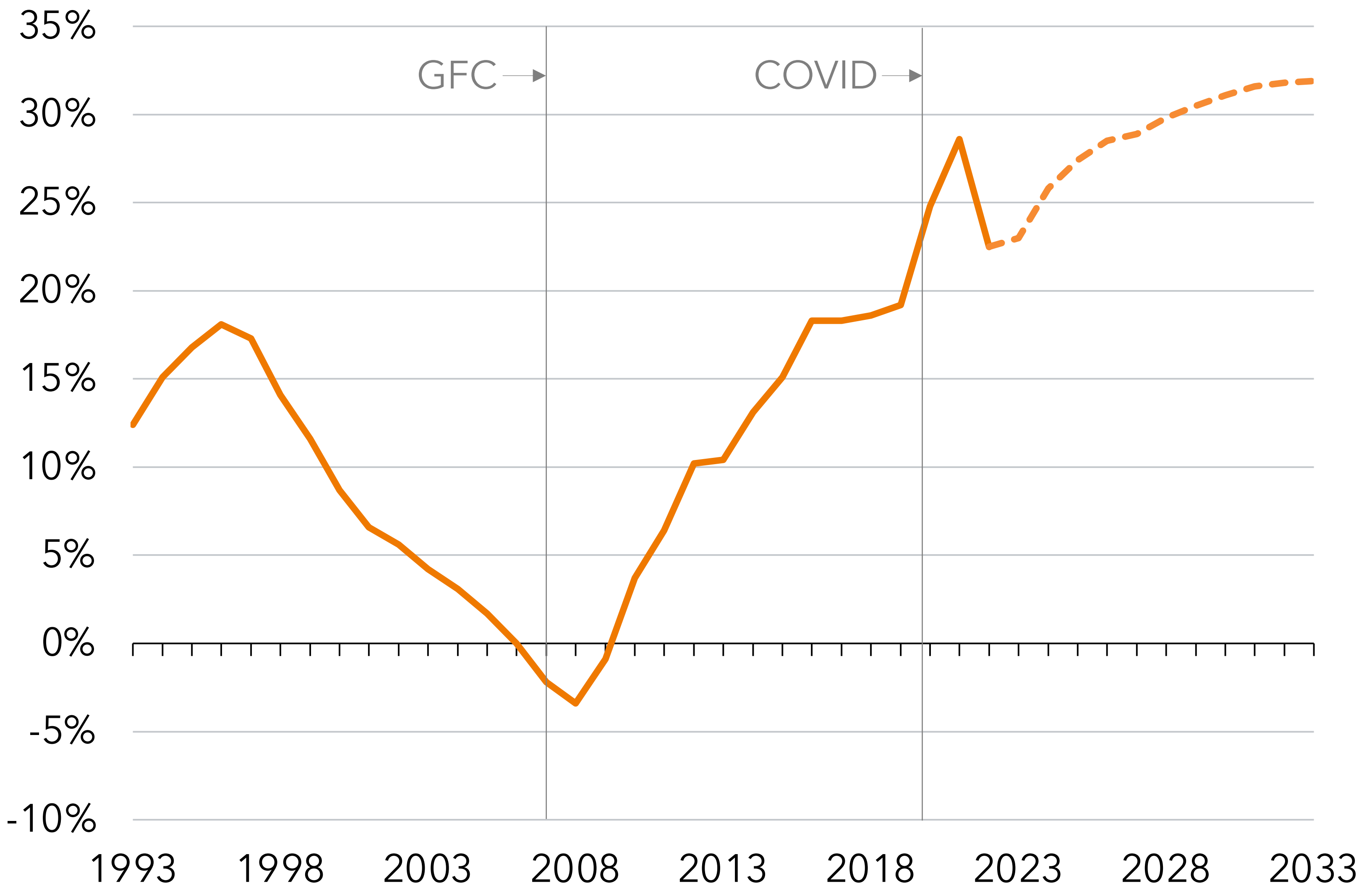


Even if productivity growth lifted to 1.5%, that would probably still be insufficient on its own to overcome the long-term budget challenges

Notes: IGR = Intergenerational Report. Data are for the financial year. Projections from the 2021 IGR are shown from 2033 only. October 2022 Budget projections assume productivity growth of 1.2 per cent. Sources: PBO (2022a, Table 1); Treasury (2022a, Chart 3.2); and Treasury (2021, Chart 4.6).

Without policy change, the debt will continue to grow

Federal government net debt as a proportion of GDP



We estimate that the government would need to shrink the deficit by 1.2% of GDP each year – **more than halving the structural deficit** – for gross debt to remain stable over the next 10 years

Notes: Data are for the financial year. The dashed line represents Treasury's October 2022 Budget projections, which comprise forward estimates from 2023 to 2026 and medium-term projections from 2027 to 2033. Sources: PBO (2022a, Table 2); and Treasury (2022a, Chart 3.15).

Why budget repair matters

Outside of economic downturns, persistently growing debt can threaten fiscal sustainability. Containing growth in debt over time matters for three reasons:

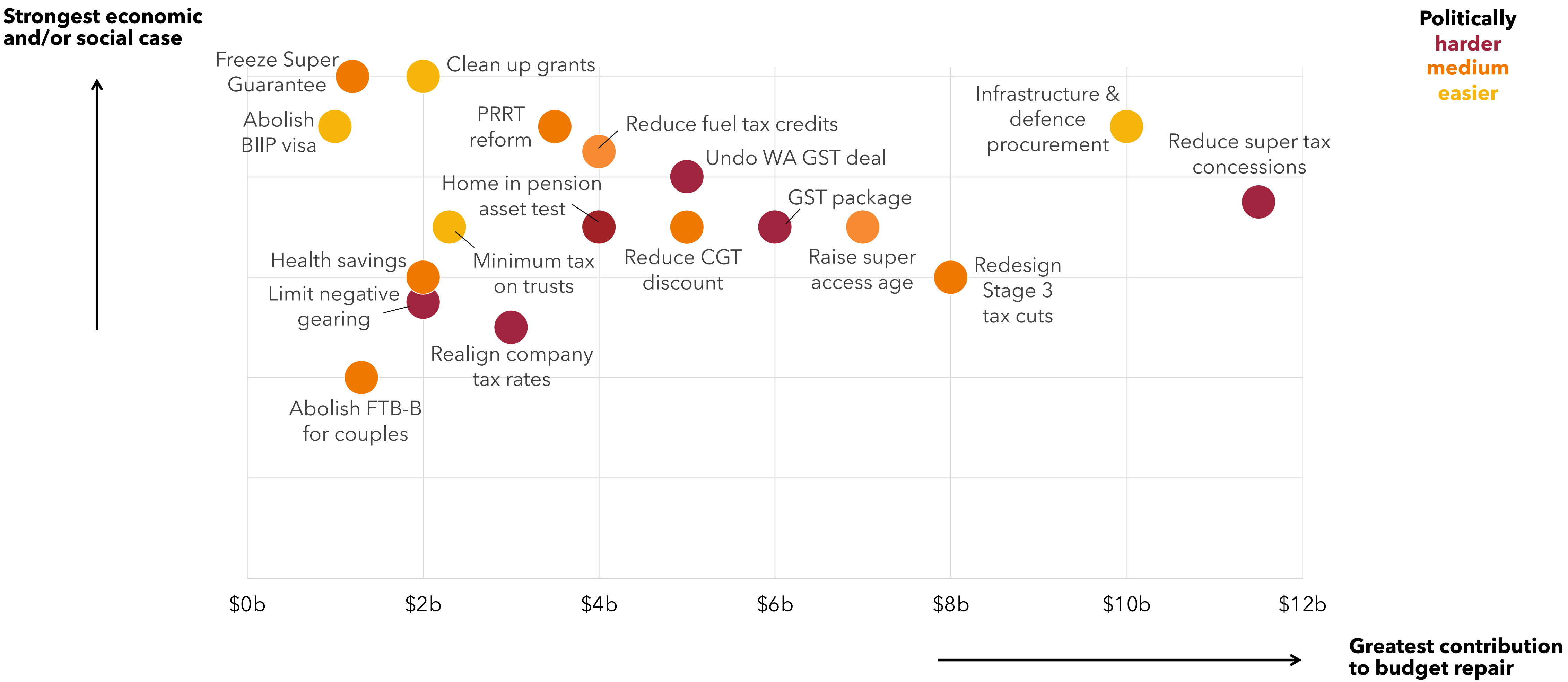
1. **Market access and the price of debt**
   – If lenders are sceptical of a government's ability to soundly manage the economy and its debt obligations, the extra risk is priced in, making it more expensive to borrow and increasing future drain on budgets from interest costs

1. **Economic firepower**
   – Being on a fiscally sustainable path – and being seen to be so – is an important pre-condition for a government to be able to ramp up spending and/or reduce taxes in response to economic shocks

2. **Intergenerational equity**
   – Budget deficits borrow from the future. Ongoing deficits can be rationalised if borrowing is funding productive investments that benefit future generations. But in practice, much of current spending is more valuable to current generations than future generations
   – Sizeable intergenerational transfers are particularly difficult to defend when future generations already face substantially greater fiscal headwinds from the ageing population and climate change

Note: See Box 2 in Chapter 1 of Grattan's Back in Black report (2023) for a fuller explanation.

There are no easy options, but some are worth a lot more than others



Notes: BIIP = Business Innovation and Investment Program; CGT = Capital Gains Tax; FTB-B = Family Tax Benefit part B; PRRT = Petroleum Resource Rent Tax. Labels are short-hand for the reforms detailed in Chapters 3 and 4. In ranking the tax measures, we focused on efficiency (whether the reform fixes or creates additional distortions in decision making), rather than the distributional consequences (factoring in the distributional consequences would provide additional impetus for some reforms). In ranking the spending measures, we focused on both efficiency and impacts on the vulnerable. Source: Grattan analysis.

A menu of options to repair the federal budget

Options to reduce spending	Time horizon	Annual value
Improve infrastructure and defence procurement	5-to-10 years +	**Several billion**
Undo the WA GST deal	Immediate	**~$5b**
Include more of the family home in the Age Pension asset test • All equity over $750,000	5-to-10 years	**~$4b+**
Cut costs in hospitals, pathology, & pharmaceuticals	Immediate	**~$2b+**
Clean up grants and advertising	Immediate	**~$1b-$2b**
Abolish Family Tax Benefit part B for couples • Keep the payment for single parents	Immediate	**~$1.3b**
Abolish the Business Innovation and Investment Program visa	10 years +	**$1b+**
Other options • Mitigate aged care cost growth • Mitigate NDIS cost growth • Evaluator-General to identify and reduce ineffective spending	5-to-10 years +	Uncosted

Options to increase revenue	Time horizon	Annual value
Redesign the Stage 3 tax cuts • Retain the 37% tax bracket	Immediate	**$8b**
Reduce income tax breaks • Super tax concessions • Capital Gains Tax & negative gearing • Trusts	Immediate-to-5 years +	**~$21b** $11.5b+ $7b+ $2.3b
Raise the super preservation age • Gradually raise from 60 to 65 Plus freeze Super Guarantee rate	10 years +	**~$7b+** **$1.2b**
Raise the GST • 15% GST + low-income compensation • Cwth keeps half the extra revenue	Immediate-to-5 years +	**~$6b+**
Wind back fuel tax credits • Count the cost of roads and pollution	Immediate	**$4b**
Redesign the Petroleum Resource Rent Tax • Change method for pricing gas; and/or • Introduce a 10% Commonwealth royalty on offshore gas	 5-to-10 years Immediate	 **~$3b-$4b** **~$4b**
Bolder options • Realign company tax rates at 30% • Carbon tax • Inheritance tax	5-to-10 years	Uncosted

Note: See Chapters 3 and 4 of Grattan's Back in Black report (2023) for a full explanation of each option.