THE 2022-23 FEDERAL BUDGET: AN IMMEDIATE ASSESSMENT

29TH MARCH 2022

SAUL ESLAKE

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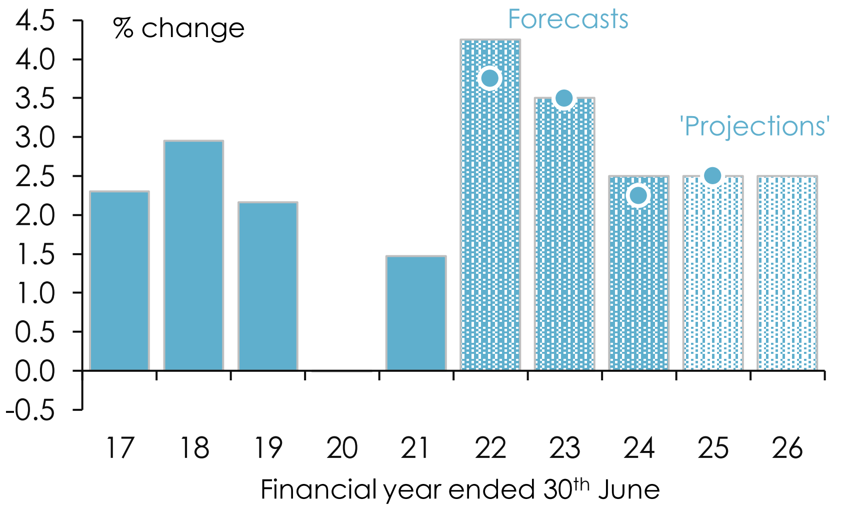
The 2022-23 Budget is, inevitably, framed with an eye to the upcoming election – but it could have been a lot worse

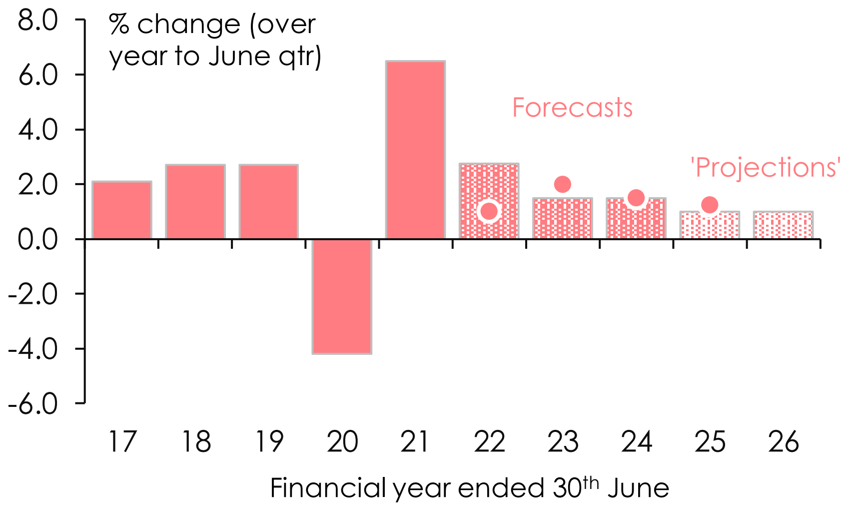
- **The 2022-23 Federal Budget is a pre-election Budget – an election has to be called no later than 18th April – but it isn't an 'irresponsible' Budget in the way that some previous pre-election budgets have been**
  - the 'policy decisions' in this budget amount to a much smaller 'net stimulus' to the economy than provided in the last Budget of the Howard Government, ahead of the 2007 election
- **The unexpected boosts to commodity prices (flowing in part from the conflict in Ukraine, though they were on an upward trajectory before that conflict erupted), combined with stronger-than-previously-forecast growth in economic activity and employment, have delivered substantial 'windfall' revenue gains (in excess of $150bn over the five years of this Budget's 'forward estimates' period)**
  - which have allowed the Government to offer assistance to pensioners & beneficiaries, and low-to-middle-income taxpayers, adversely affected by increases in fuel and energy prices; and to splurge on a range of (mostly dubious) infrastructure projects; while still foreshadowing significant reductions in the prospective budget deficits, and a lower debt trajectory
  - some of the 'cost of living' assistance is appropriately "targeted" (towards lower-income households) and "temporary" – but some of it, especially the 6-month, 50% cut in fuel excise, isn't (and will benefit households who can cope perfectly well)
  - yet more tax breaks for 'small business', and deposit guarantees for marginal first-time home-buyers, are 'bad policy'
- **The 'second phase' of the Government's fiscal strategy eschews any 'return to surplus' over the 'medium term' (ie the next decade), instead focusing on reducing debt as a pc of GDP relying largely on sustained economic growth**
  - this strategy is sustainable so long as interest rates on government debt remain lower than the growth rate of nominal GDP – which is a reasonable assumption for the next few years although may not be over the longer term
- **The cost of one of the worst policy decisions of the past 20 years – the changes to the way GST revenues are carved up among the states and territories – continues to escalate**
  - it's just scandalous that the Federal Government will be adding almost $20bn to its deficits in order to hand over the equivalent amount to WA, the only government in Australia running a surplus

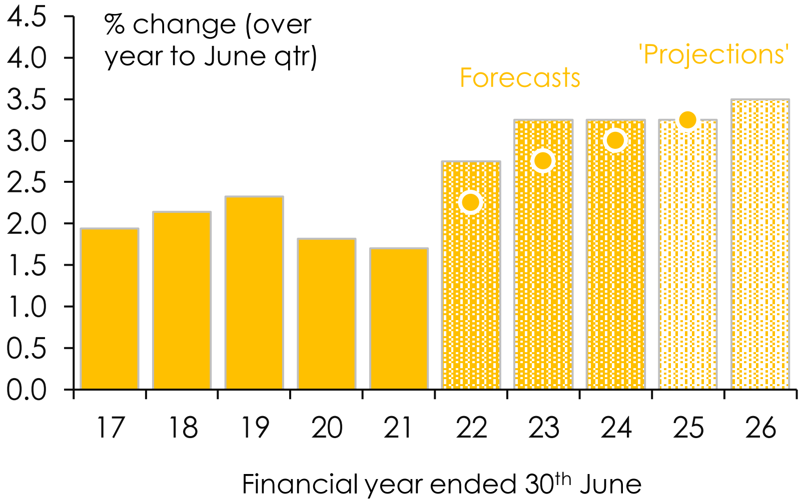
Higher commodity prices boost nominal (though not real) GDP in 2021-22, unemployment will fall below 4%, and inflation will temporarily exceed 4%

Real GDP

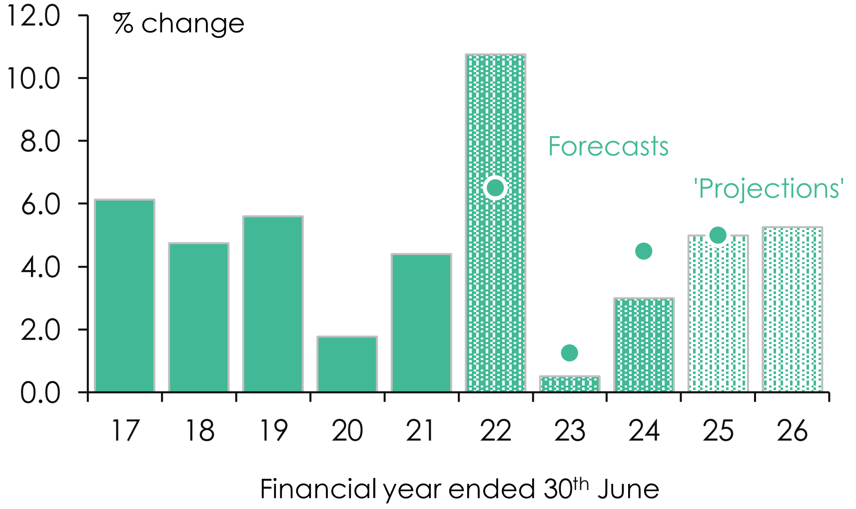


Employment

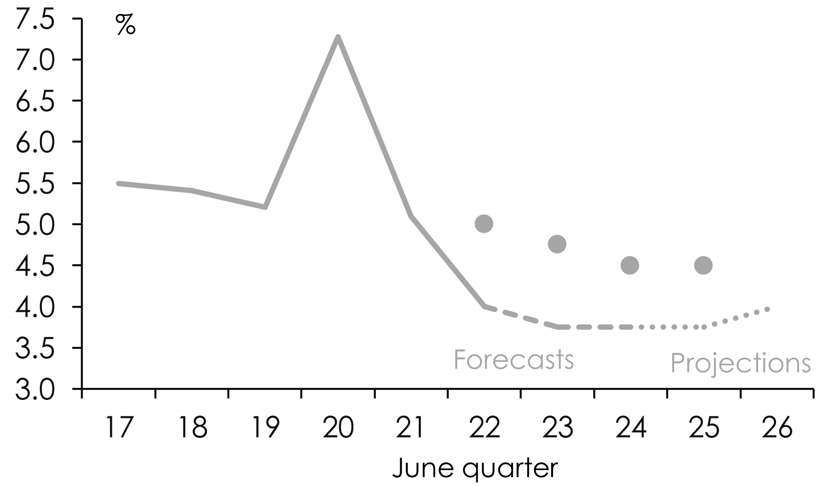




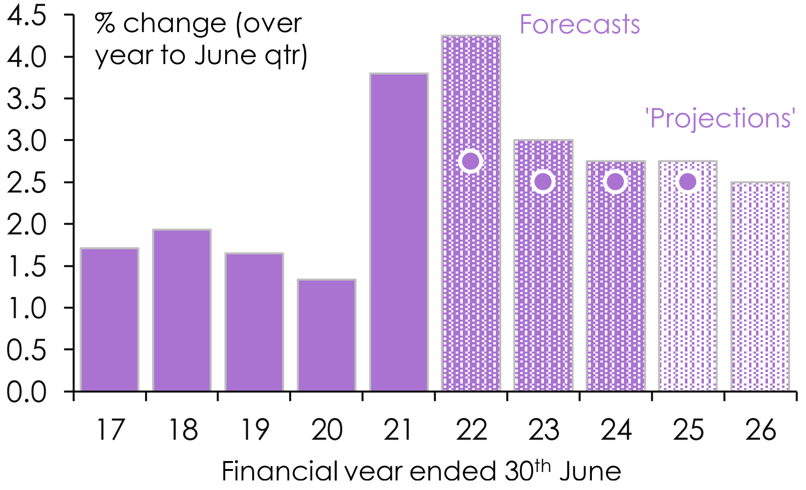
Nominal GDP



Unemployment rate



Consumer price index



Note: Dots represent the forecasts and projections from the 2021-22 Mid-Year Economic & Fiscal Outlook (MYEFO) published in December last year. 'Forecasts' are Treasury's 'best endeavours' estimates for the current and following two financial years. 'Projections' for 2024-25 and 2025-26 are *not* forecasts, but rather are based on assumptions about the path by which output converges on its 'potential' level. Iron ore price assumed to fall to US$55/t FoB by Q3 2022; metallurgical and thermal coal prices to US$130/t and $60/t respectively by Q3 2022; and Tapis oil prices to $100/bbl by Q3 2022. Sources: ABS; 2021-22 MYEFO and 2022-23 Budget Paper No. 1, Statement No. 2, 29th March 2022.

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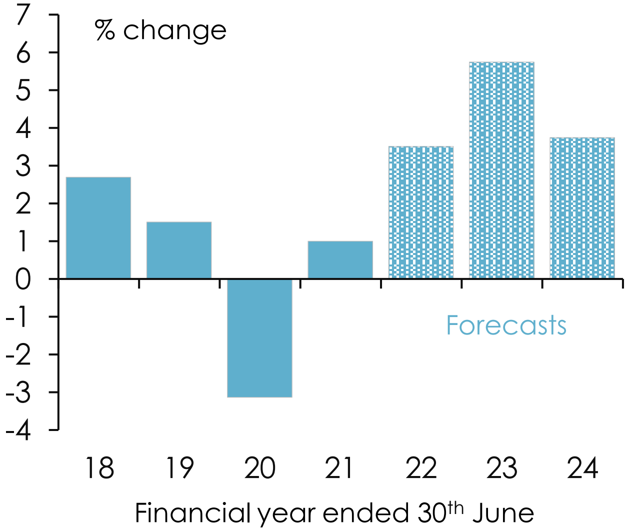
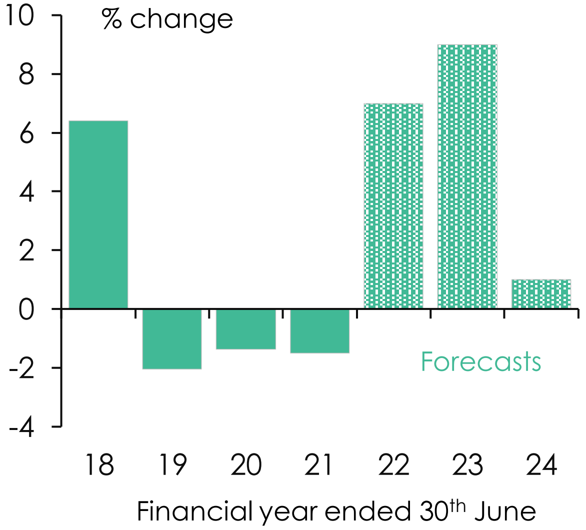
Consumer spending and, until 2023-24, residential and business investment, are forecast to be the main drivers of economic growth

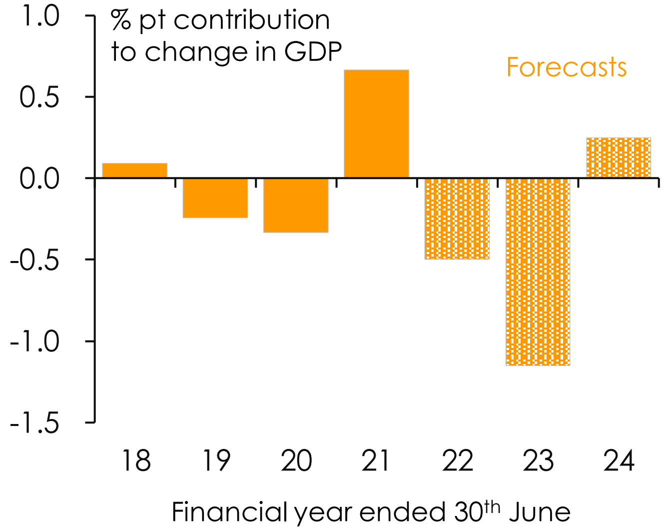
Household consumption



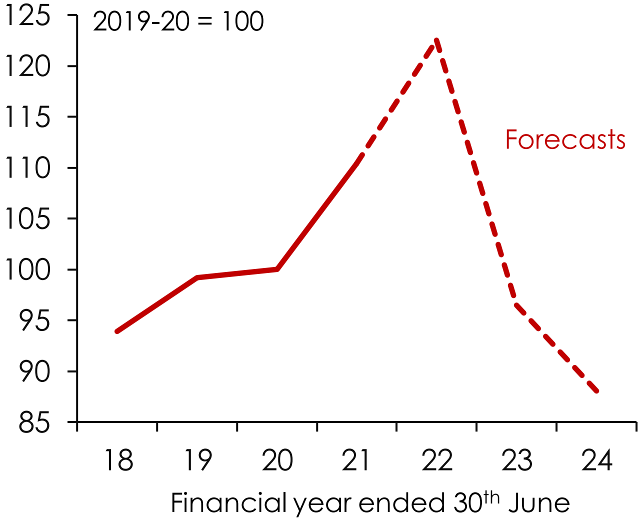
Business investment



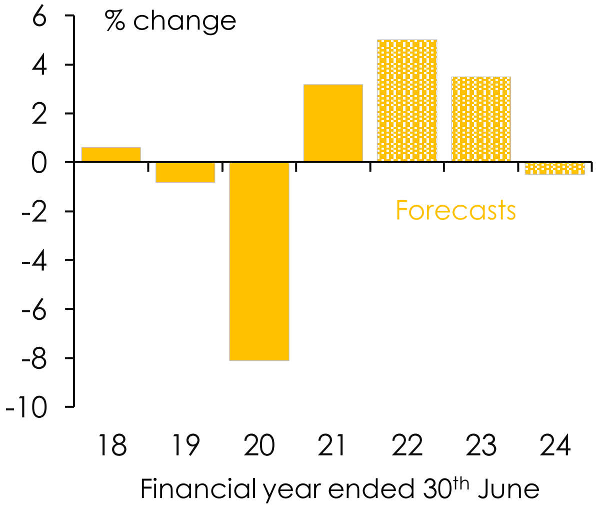
Change in inventories



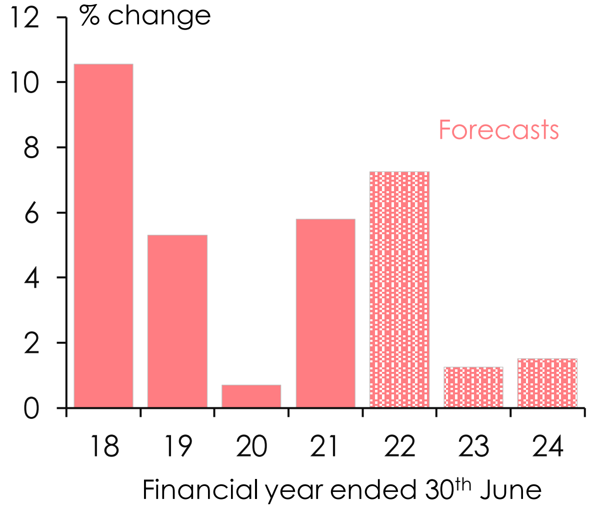
Terms of trade



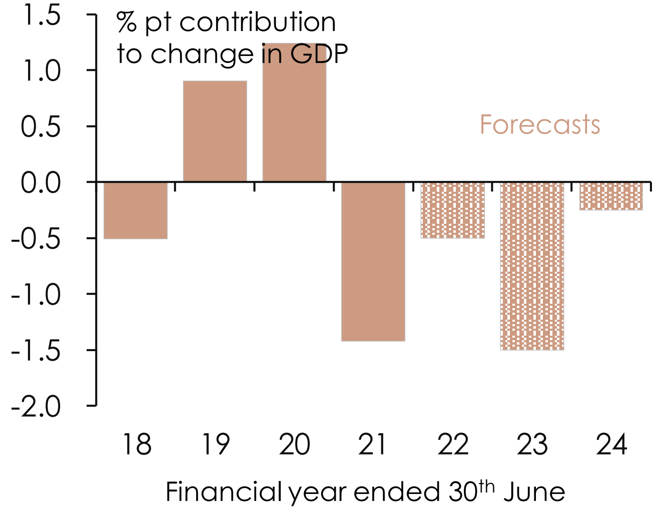
Dwelling investment



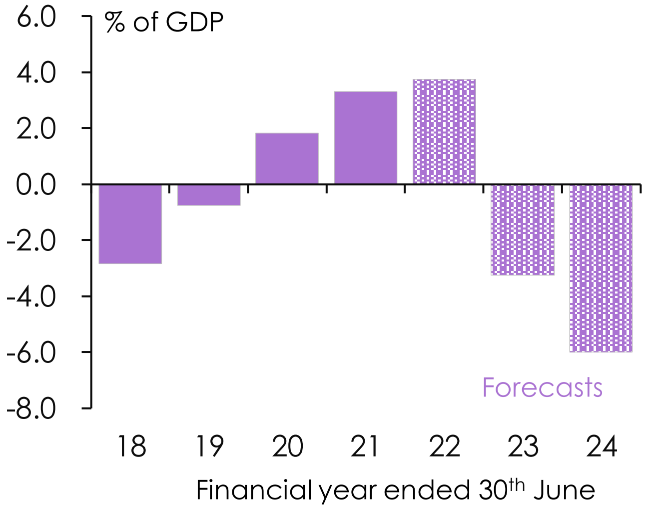
Public spending



Net exports



Current account balance



Note: The iron ore price is assumed to fall to US$55/t fob by Q3 2022; metallurgical and thermal coal prices to US$130/t and $60/t respectively by Q3 2022; and Tapis oil prices to $100/bbl by Q3 2022. Sources: ABS; 2021-22 MYEFO and 2022-23 Budget Paper No. 1, Statement No. 2, 29th March 2022.

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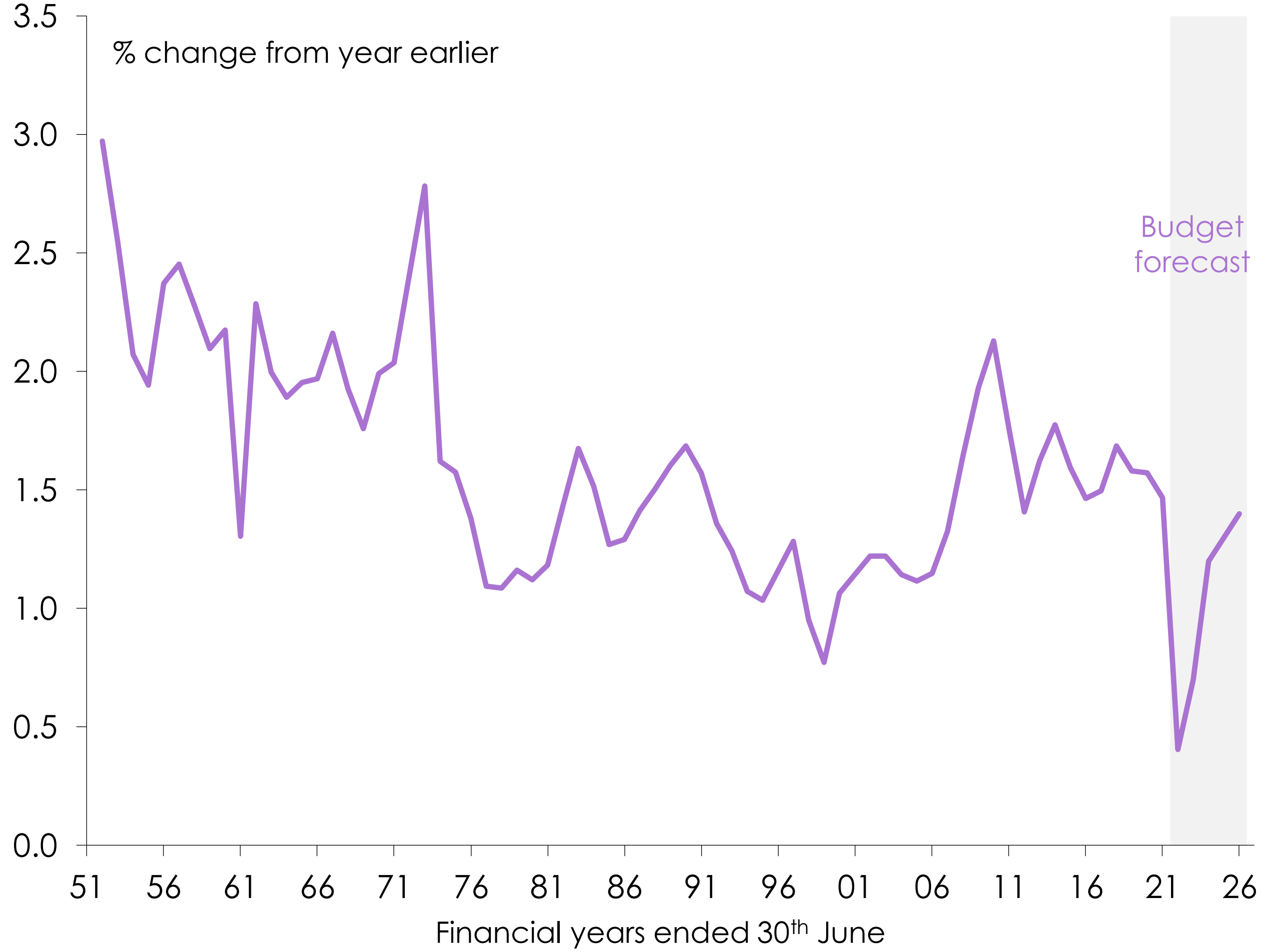
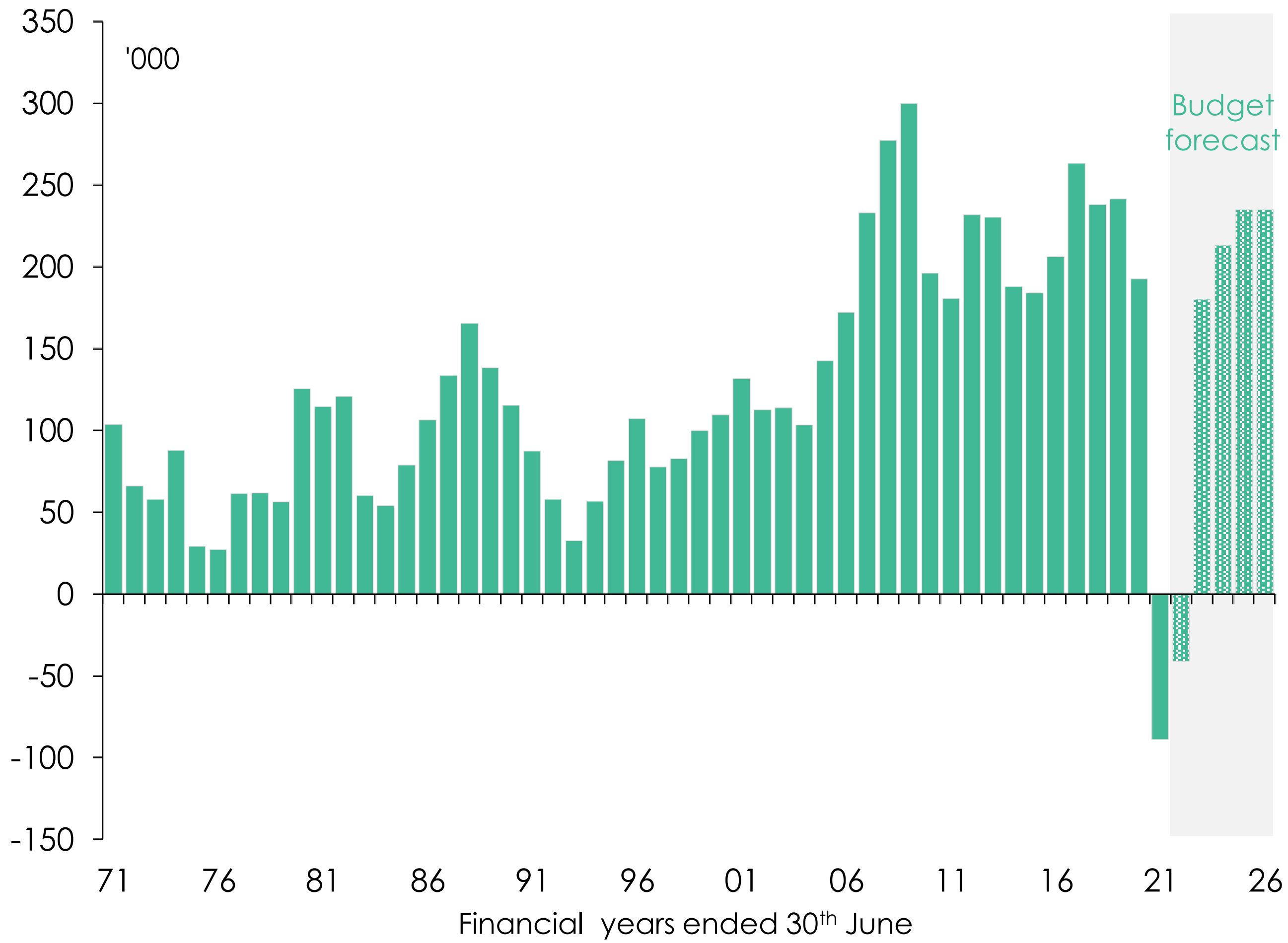
An important assumption underlying the Budget forecasts is that net immigration resumes in 2022-23 and returns to previous levels by 2024-25

Population growth



Net overseas migration



- **Net overseas migration may not return to pre-Covid levels as quickly as the Budget assumes (or at all) if (a) China actively discourages students from coming to Australia (as it may well); and (b) if prospective migrants' views of Australia as a desirable destination has been adversely affected by the way in which Australia 'managed' its border controls during Covid (as they may well have been)**

Sources: ABS, National, state and territory population; Australian Government, 2022-23 Budget Paper No. 1, Statement No. 2, 29th March 2022.

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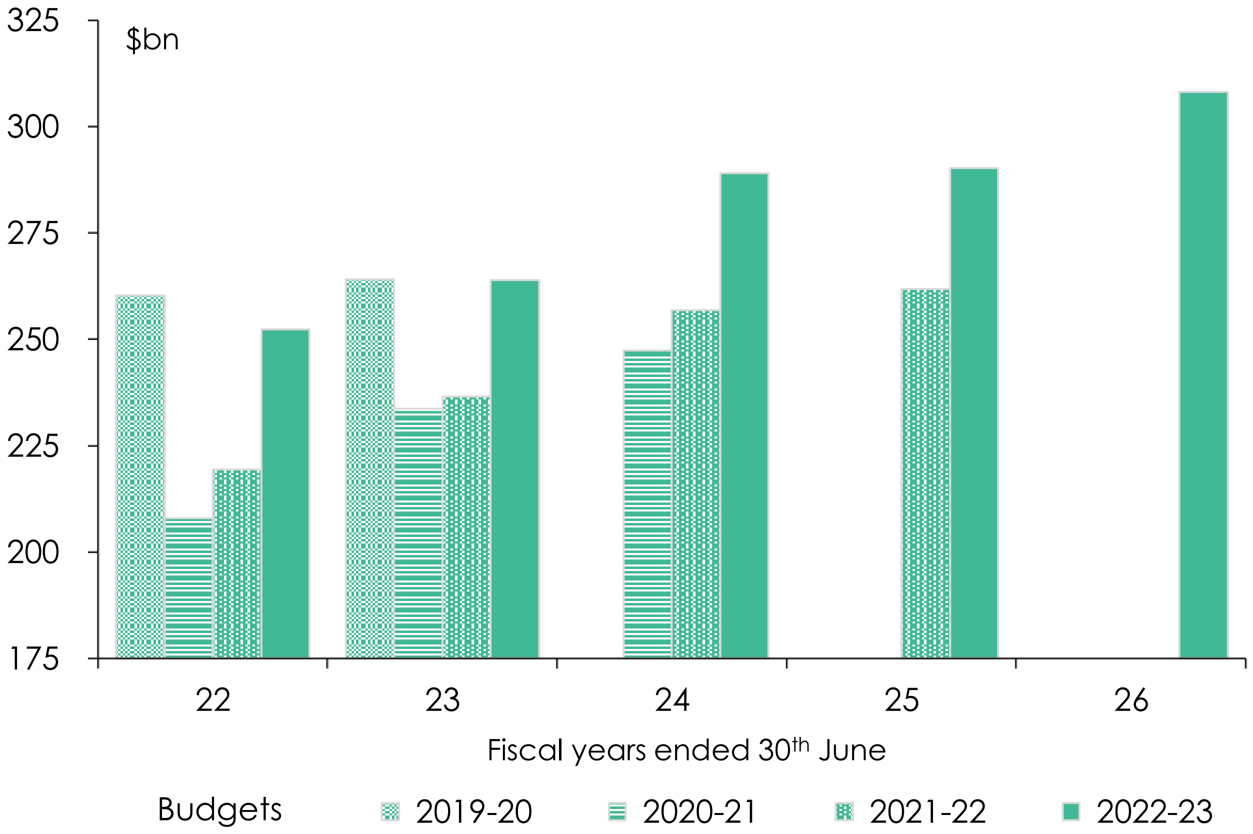
Higher commodity prices, and stronger growth in economic activity and employment have resulted in large upward revisions to revenue forecasts

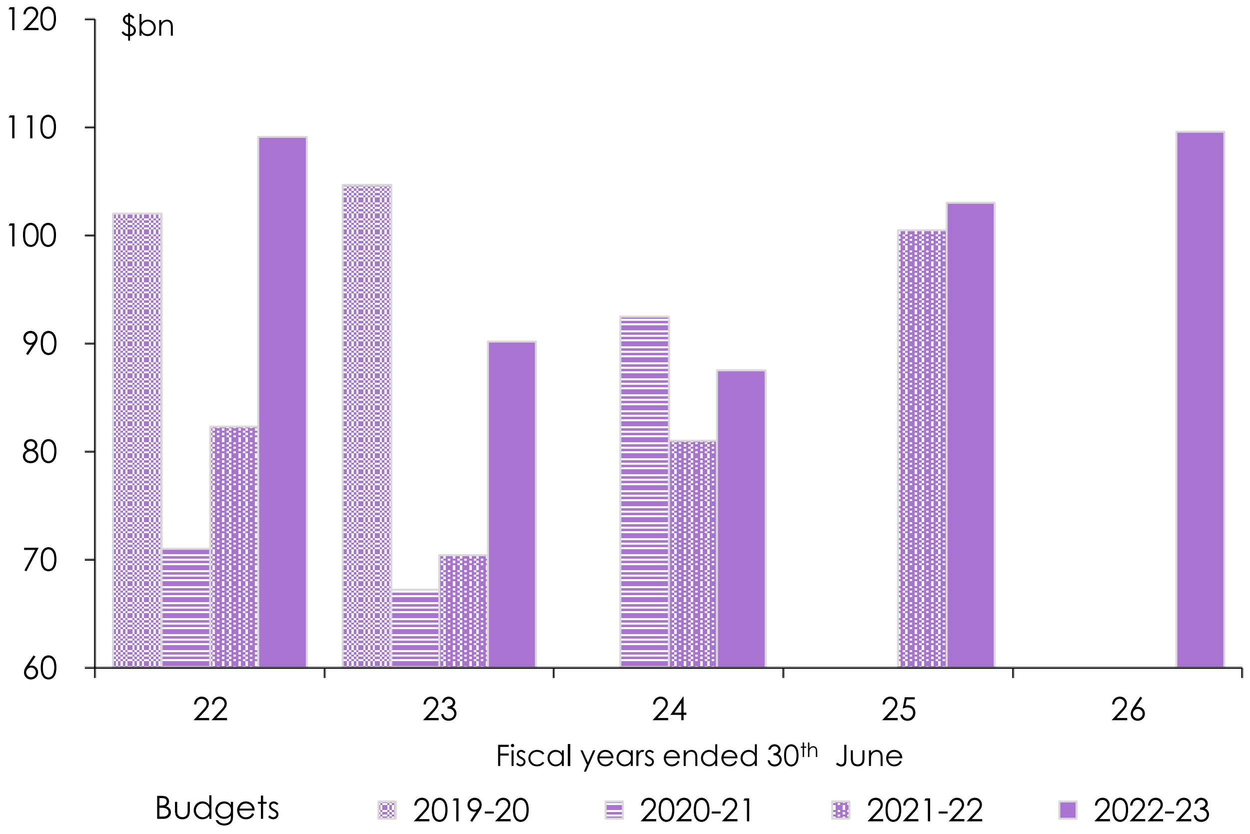
Successive budget estimates of personal and company income tax collections

Personal income tax



- Forward estimates of personal income tax collections for the years 2021-22 through 2023-24 have been revised up by $92bn since last year's Budget, and by $116bn since the 2020-21 Budget

Company income tax



- Forward estimates of company income tax collections for the years 2021-22 through 2023-24 have been revised up by $53bn since last year's Budget, and by $56bn since the 2020-21 Budget

Source: Australian Government, 2022-23 Budget Paper No. 1, Statement No 4, 29th March 2022.

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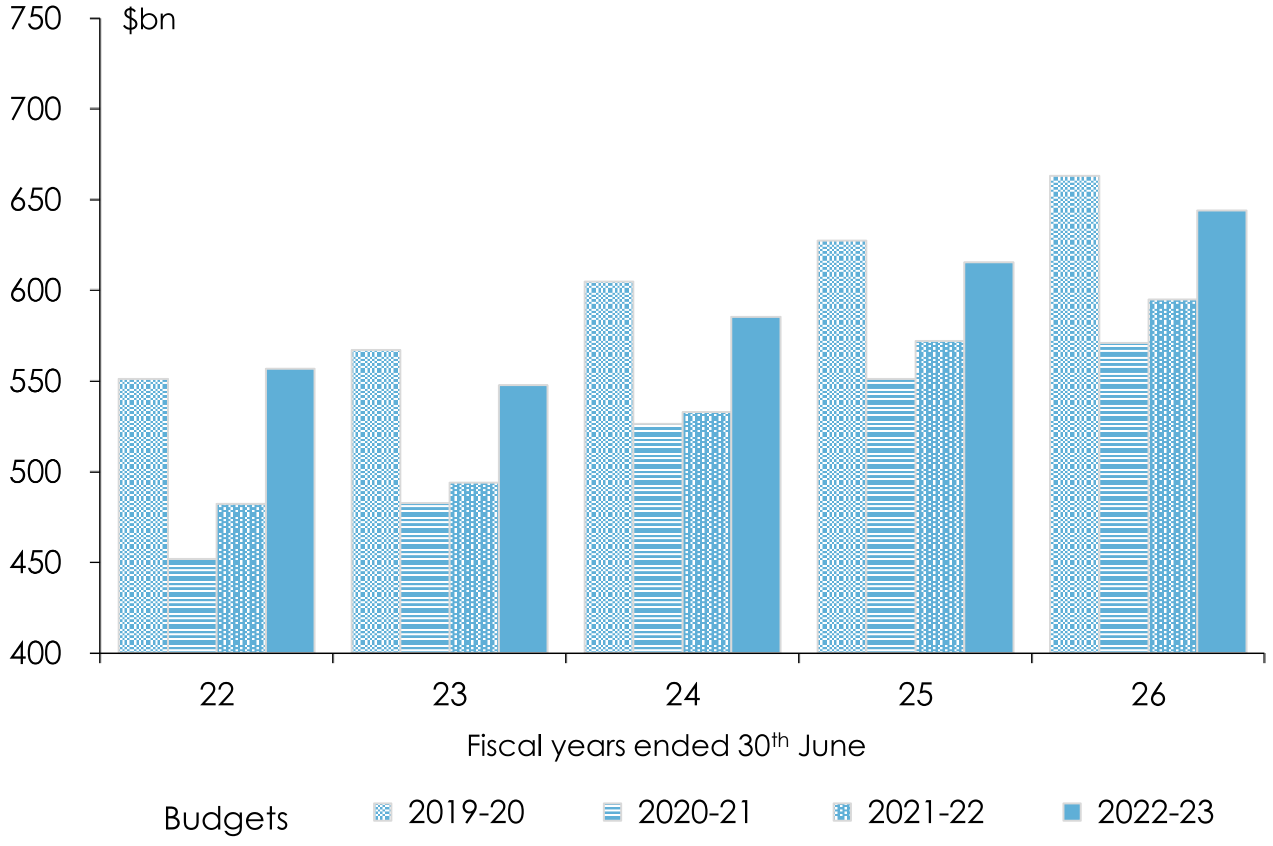
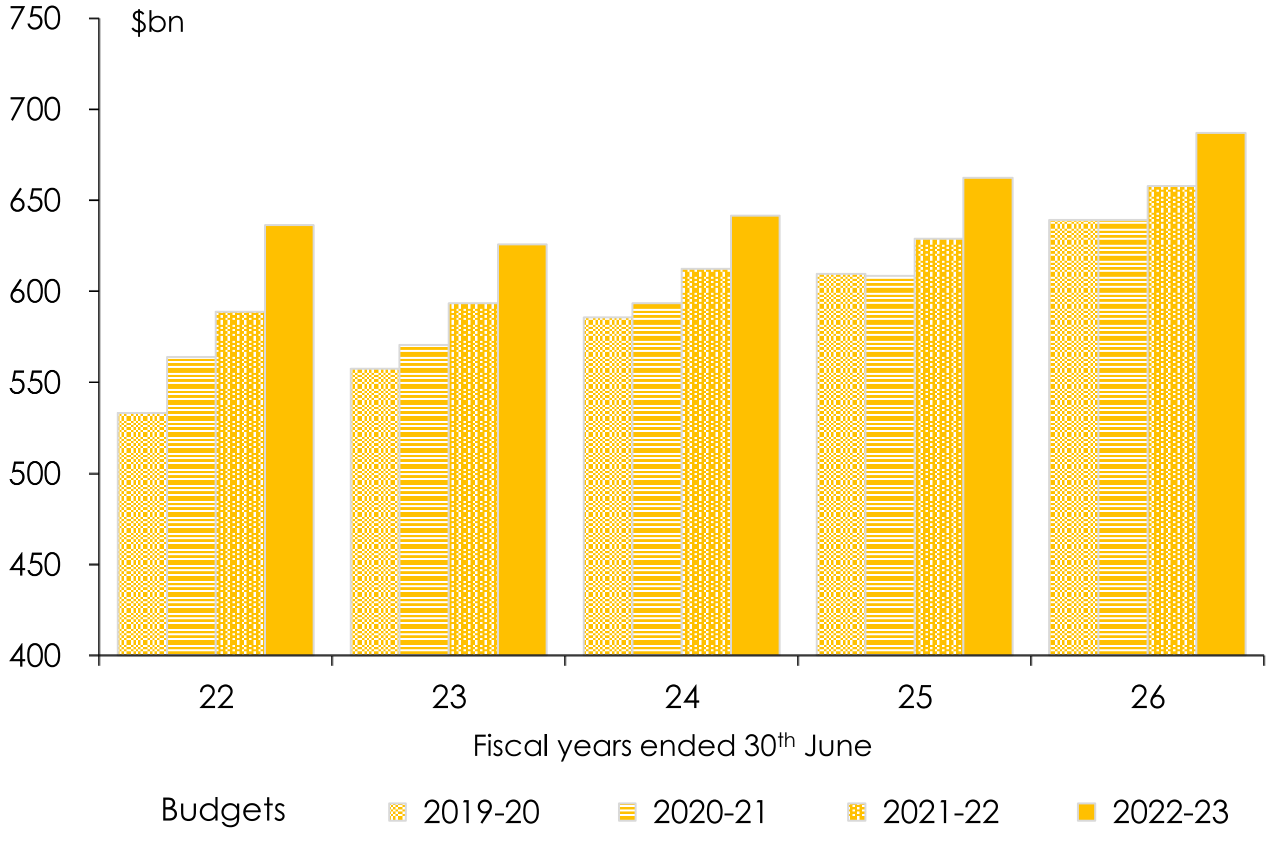
Revenue forecasts have been revised upwards by much bigger amounts than spending projections

Successive budget estimates of receipts and payments

Receipts



Payments



- **Revenue projections for the five years to 2025-26 have been revised upwards by $164bn compared with last December's MYEFO, $273bn compared with last year's Budget, and $366bn compared with the 2020-21 Budget**
- **Payments projections for the five years to 2025-26 have been revised upwards by only $40bn since MYEFO, by $172bn compared with last year's Budget, and $278bn compared with the 2020-21 Budget**

Source: Australian Government, 2022-23 *Budget Paper No. 1, Statement No 3*, 29th March 2022 (and previous issues).

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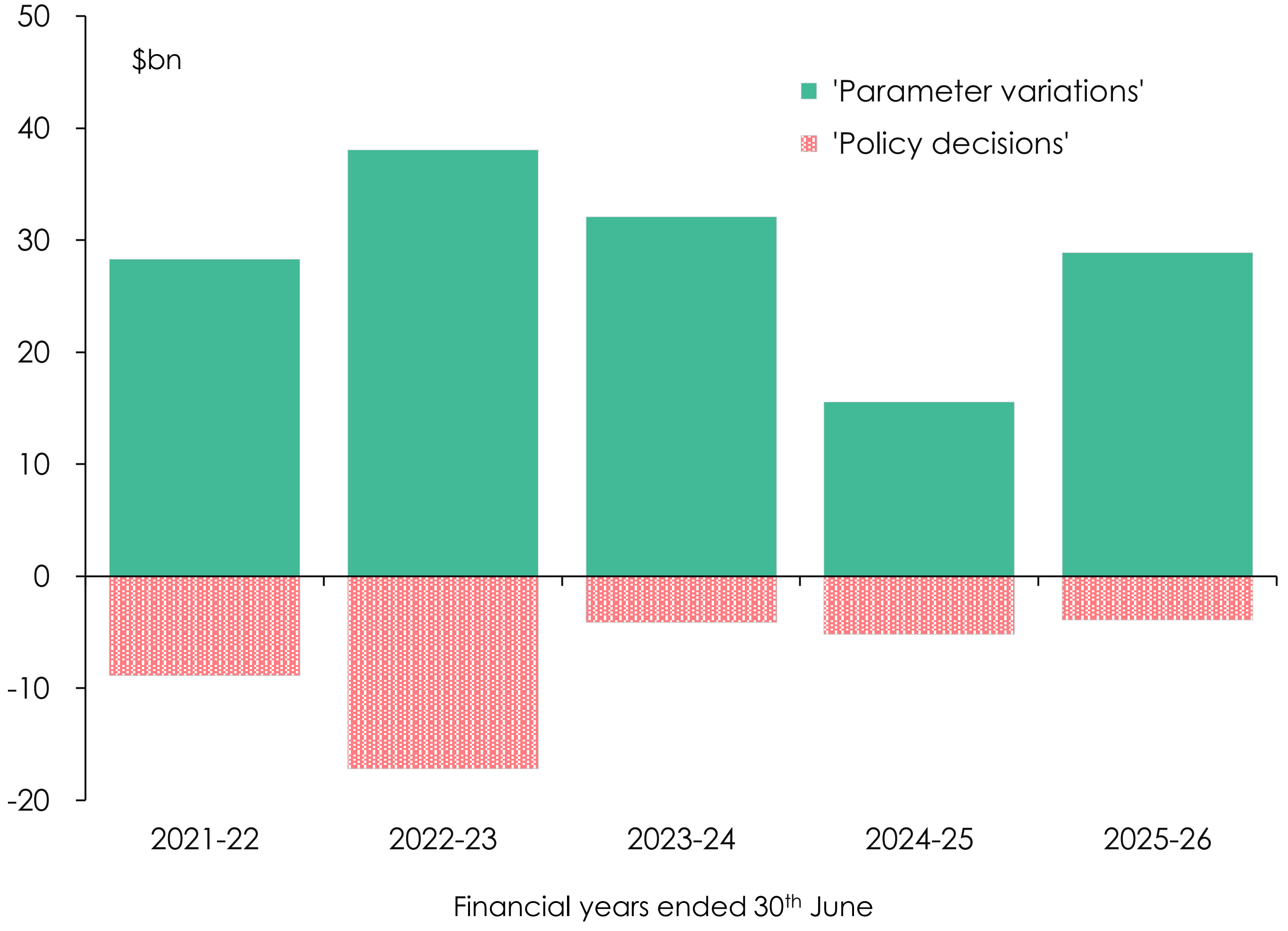
The increase in the deficits forecast for 2022-23 and 2023-24 is the result of conscious policy decisions to increase spending and cut taxes

Sources of the changes in forward estimates of the 'underlying cash balance' between the 2021-22 MYEFO and the 2022-23 Budget



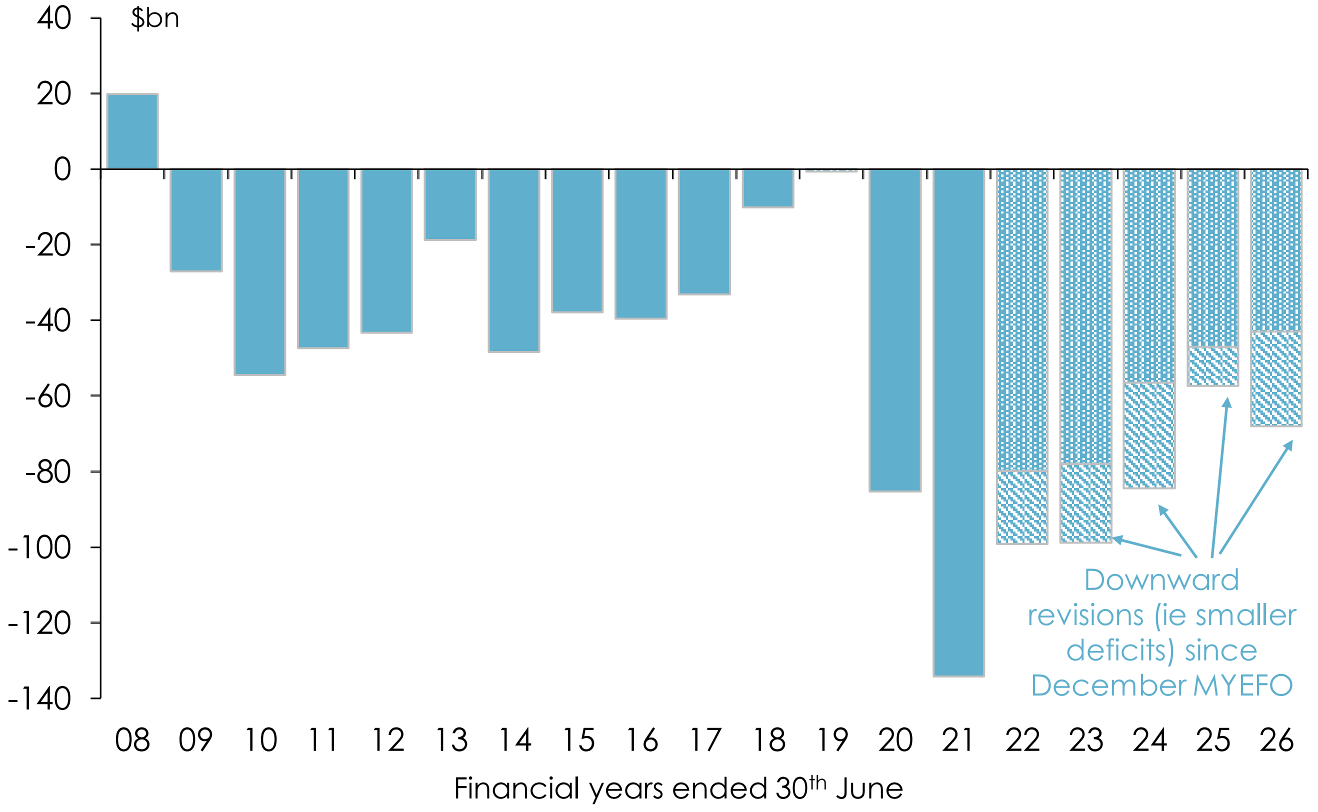
- The budget affects the economy (through the 'policy decisions' which the Government makes as it puts the Budget together) – but the economy also affects the Budget (via what the Budget Papers call 'parameter variations' in receipts and payments)
- 'Parameter variations' between last December's Mid-Year Economic & Fiscal Outlook (MYEFO) and this year's Budget improved the 'bottom line' over the five years to 2024-25 by a total of $143bn
  - 'parameter variations' in revenue projections improved the 'bottom line' by $153bn, but 'parameter variations' in payments projections worsened it by $10bn
- 'Policy decisions' absorbed $39bn of those windfall 'parameter variations' over the five years to 2025-26
  - of which, revenue reductions accounted for almost $8bn, and new spending $31½bn
- … leaving $104bn to be applied to reducing the deficits in prospect for the five years to 2025-26

Source: Australian Government, 2022-23 Budget Paper No. 1, Statement No 3, 29th March 2022.

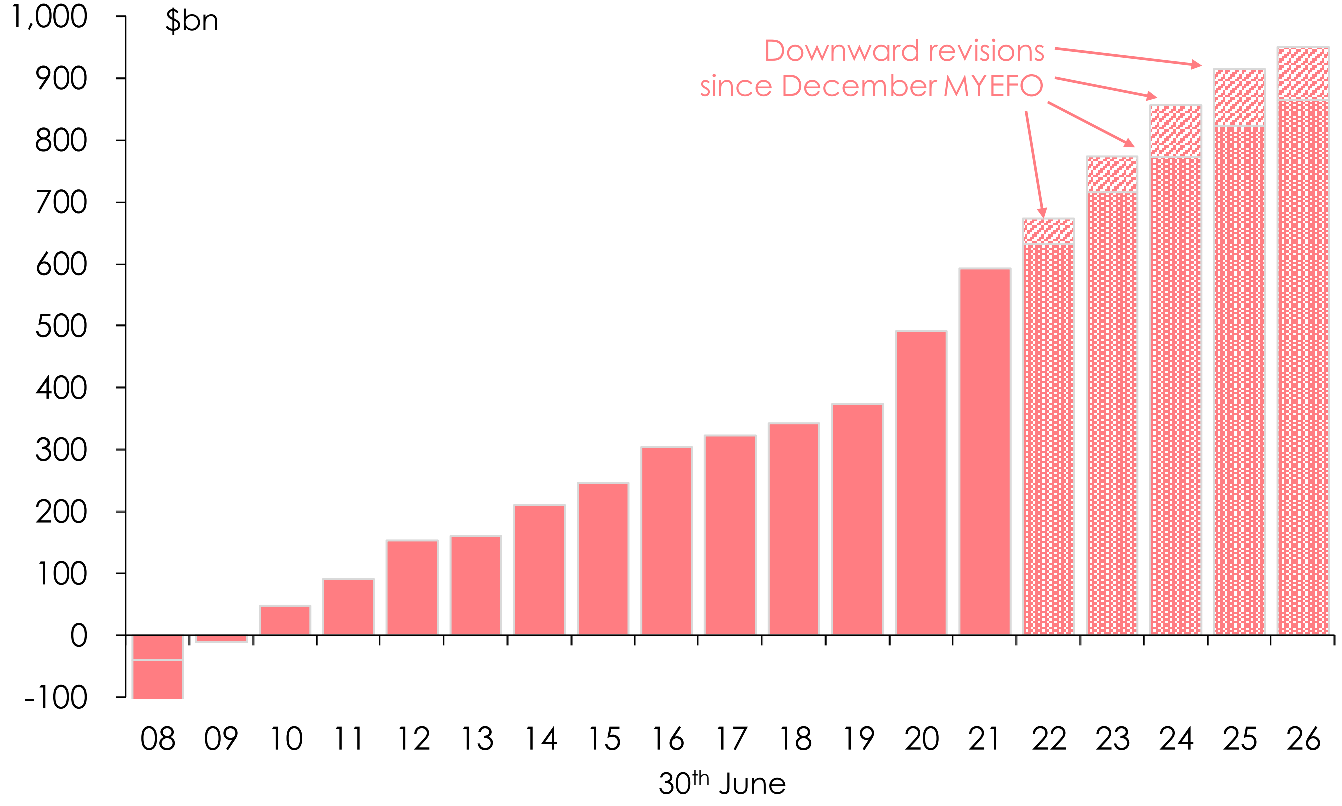
As a result, the budget deficits for the current and next four financial years have been revised down by a total of $104bn, and net debt by $86bn

2022-23 Budget forward estimates compared with those from December's MYEFO

'Underlying' cash balance



Net debt



- The deficits for the five financial years 2021-22 through 2025-26 have been revised down by a total of $103.7bn (or 25%) from those projected in last December's Mid-Year Economic and Fiscal Outlook
- The forecast for net debt as at 30th June 2026 has been revised down by $86bn (9%) from that in last December's Mid-Year Economic and Fiscal Outlook

Source: Australian Government, 2021-22 *Mid-Year Economic and Fiscal Outlook*, 16th December 2021, and 2022-23 *Budget Paper No. 1, Statement No 3*, 29th March 2022.

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Overall, the 'policy decisions' in this year's Budget are relatively small, especially considering it's a pre-election Budget

Budget impact of major 'policy decisions' funded in the Budget

$ million	2021-22	2022-23	2023-24	2024-25	2025-26	Total
Revenue measures -						
Cost of living tax offset		3,900	200			4,100
Fuel excise tax cut	1,870	1,105				2,975
Small business incentives			680	630	340	1,650
Change to uplift factor for tax instalments		1,850	-1,850			0
Tax Avoidance Task Force extension			-481	-926	-727	-2,134
Spending measures -						
Covid measures	2,808	2,090	12	3	3	4,916
Infrastructure investment		601	1,334	1,384	1,013	4,332
New PBS listings	178	647	587	507	519	2,438
Regional Accelerator Program		435	559	521	280	1,795
Women's economic security, health & safety	40	148	429	511	526	1,653
Skills development	-20	379	389	466	253	1,467
Energy Security & Regional Development		119	219	473	596	1,407
Flood assistance	154	1,196				1,350
Regional telecoms	480	104	177	175	183	1,119
Defence	188	-15	260	279	58	770
Other	2,355	3,655	1,033	990	1,961	9,994
Total	8,052	16,214	3,547	5,013	5,005	37,831

- The discretionary policy measures in the Budget are, in total, relatively small – especially considering that it's a 'pre-election' Budget
- The 'net stimulus' implied by the 'policy decisions' contained in the Budget is equivalent to 0.4% of GDP in 2021-22, 0.7% of GDP in 2022-23, and 0.2% of GDP in 2023-24 and 2024-25
- By contrast, the Howard Government's policy decisions in the lead-up to the 2007 elections were equivalent to a net stimulus of 1.3% of GDP in 2007-08, and 2.1-2.5% of GDP in each of the following three years
- So this Budget does put some additional upward pressure on inflation and hence interest rates, but it's fairly small

Source: Australian Government, 2022-23 [Budget Paper No. 2, Budget Measures](#).

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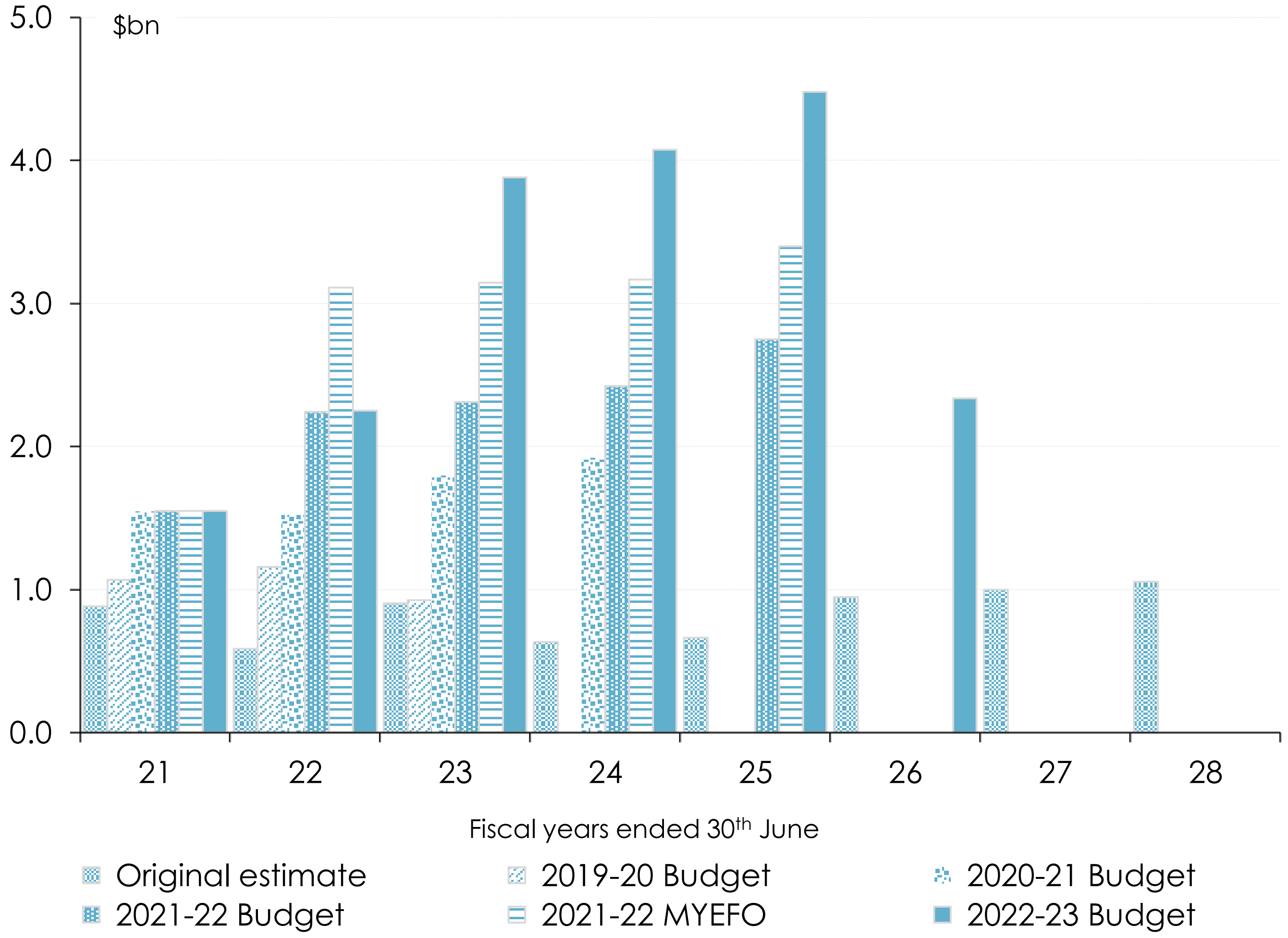
That's not to say that all the measures in the Budget are 'good'

- There can be no reasonable objection to targeted measures aimed at assisting lower-income households cope with increases in their 'cost of living' arising from higher fuel and food prices
  - such measures were explicitly endorsed by the OECD in its assessment of the impact of the Ukraine conflict
  - the one-off cash payment to pensioners and other social security beneficiaries, and the one-time addition to the "Low & Middle Income Tax Offset", are appropriately targeted and time-limited responses to cost-of-living pressures
- Likewise it's entirely appropriate that the Federal Government provide generous assistance to households and businesses affected by the recent severe floods in northern NSW and south-eastern Queensland
- However it's far from clear that *all* households are in need of assistance to cope with higher fuel and food prices
  - Australians have squirreled away an additional $249bn in bank deposits since just before the onset of the pandemic – what are they supposed to be used for? Treasury notes that households' "strong financial position [will] allow households to comfortably normalize [sic] the household savings rate" with household consumption spending forecast to grow by 5¾% in 2022-23
  - the 50% cut in fuel excise for 6 months is poorly targeted (benefiting all fuel users irrespective of their financial situation) and may prove politically difficult to reverse (as have previous reductions in fuel excise)
- There are *yet more* new tax preferences for 'small business' – this time for investments in digital technology and skills training – despite all the evidence that existing preferential tax treatment for small businesses has had no net benefit in terms of boosting employment, investment or innovation
  - no matter how often politicians chant the mantra, small business is *not* the 'engine room of the economy'
- The measures purportedly directed at boosting home ownership – increases in the number of people able to get government guarantees for that part of the required deposit that they can't accumulate themselves – will add (at the margin) to upward pressure on house prices, privilege some would-be first-time buyers at the expense of others, and potentially expose some successful buyers to additional risk if house prices fall

The cost of giving WA more revenue from the GST than it 'deserves' keeps getting higher

Successive estimates of the cost to the Federal Budget of the 'transition' to the new GST revenue-sharing arrangements 'agreed to' in 2018



- **The 2022-23 Budget Papers put the cost to the Federal Budget of the 'deal' imposed on the states and territories in 2018, in order to appease Western Australia's demands for larger share of GST revenues than it was 'entitled' to under the long-standing principles hitherto used by the Grants Commission to recommend how that revenue should be distributed among the states and territories, at $18.6bn over the six years to 2025-26**
  - this is four times the original estimate of $4.6bn
  - because the iron ore price has stayed much higher than assumed when the original estimate was made,
  - so the 'guarantee' that no other state would be worse off while WA never gets less than 70% of what it would have obtained under a notional 'equal per capita' distribution has become much more expensive
- **It's simply scandalous that the Federal Government has to add almost $20bn to its deficits in order to transfer a similar amount to the only government in Australia which is running budget surpluses**

Sources: Australian Government, interim response to Productivity Commission inquiry into horizontal fiscal equalization, 5th July 2018; and 2022-23 Budget Paper No. 3: Federal Financial Relations, 29th March 2022.

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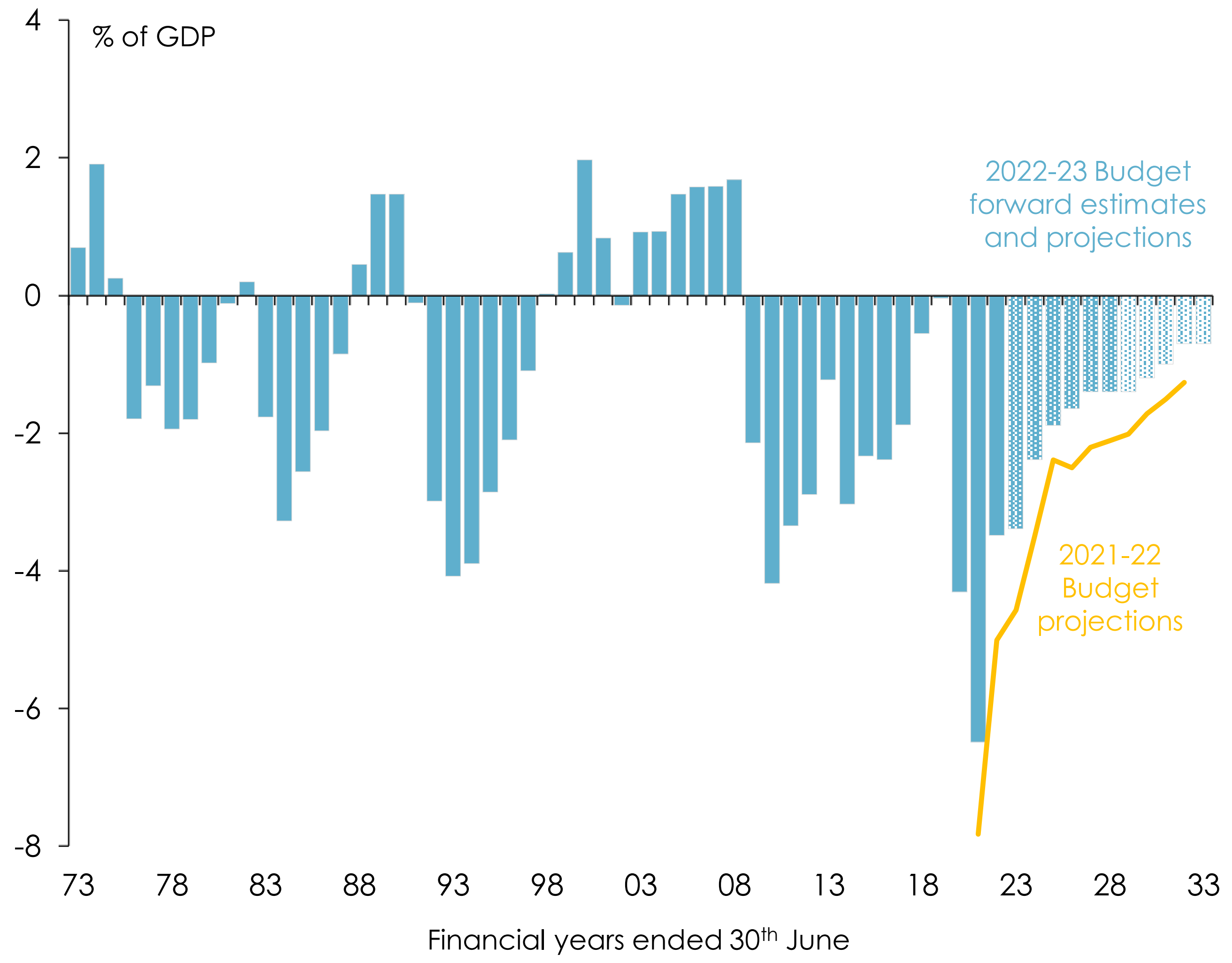
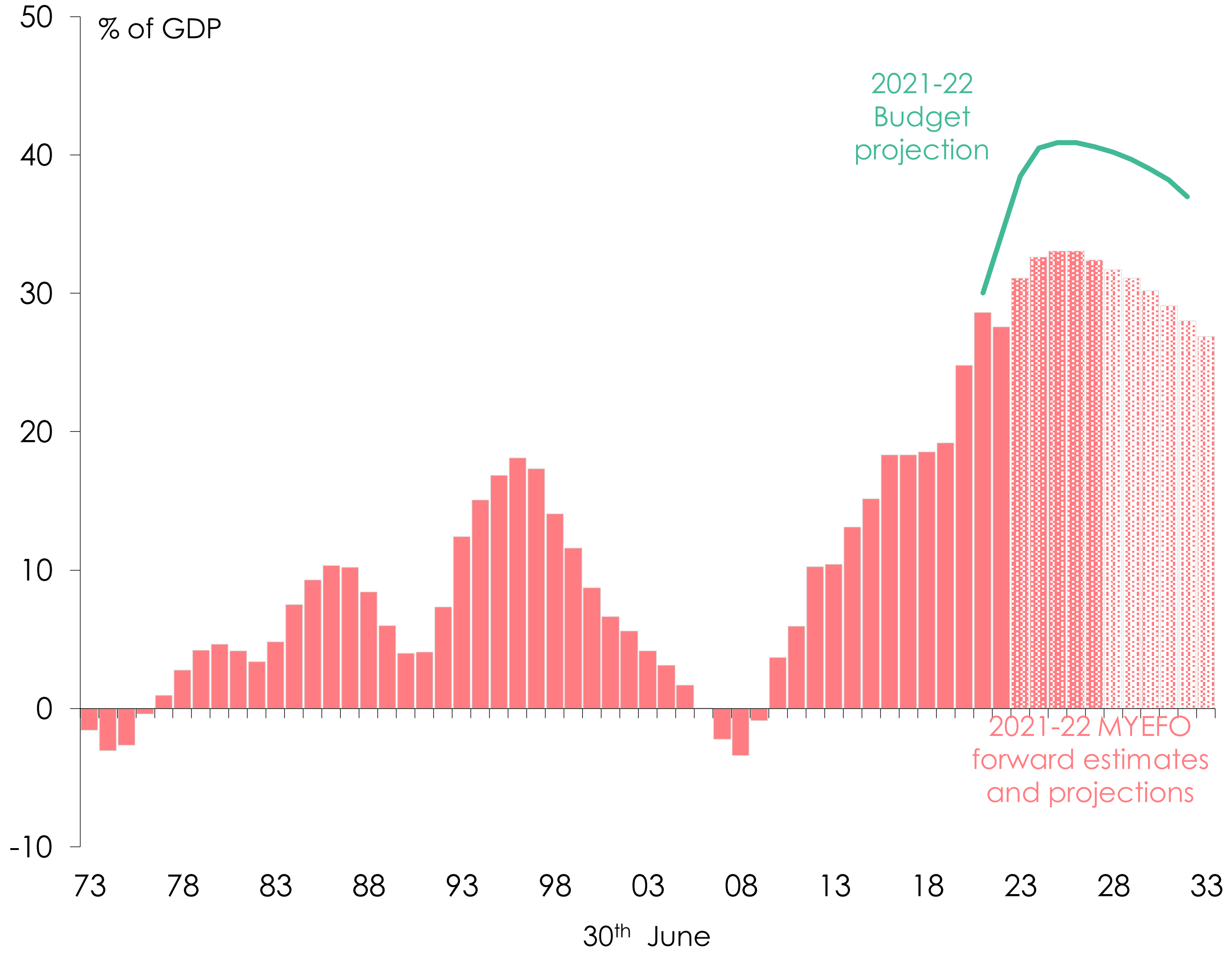
The medium-term deficit and debt projections are also improved – although the Government has no plans to return the budget to surplus

'Medium-term' projections of the 'underlying cash balance' and net debt

'Underlying' cash balance



Net debt



Source: Australian Government, 2022-23 *Budget Paper No. 1, Statement No. 3* and Statement No. 10, 29th March 2022.

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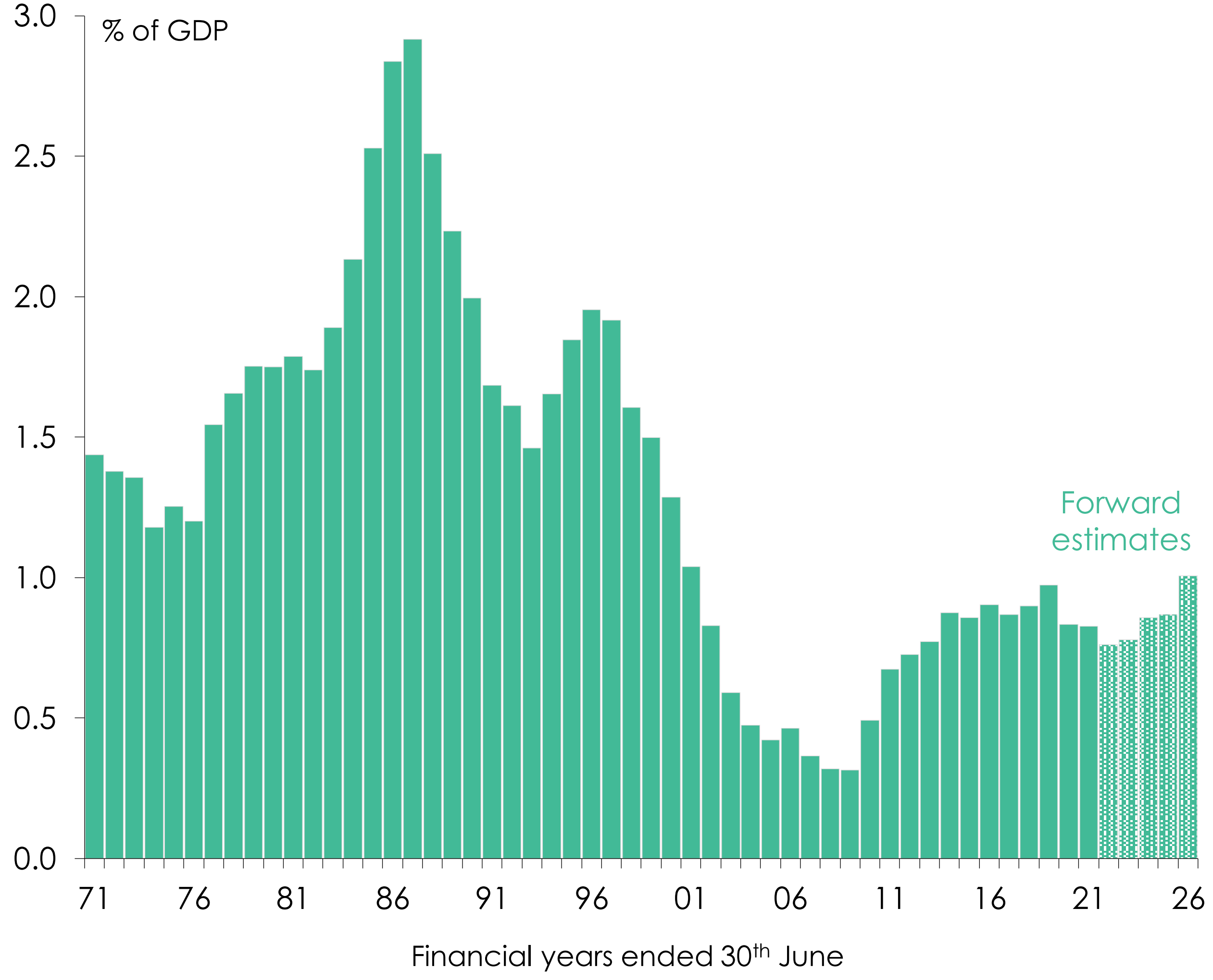
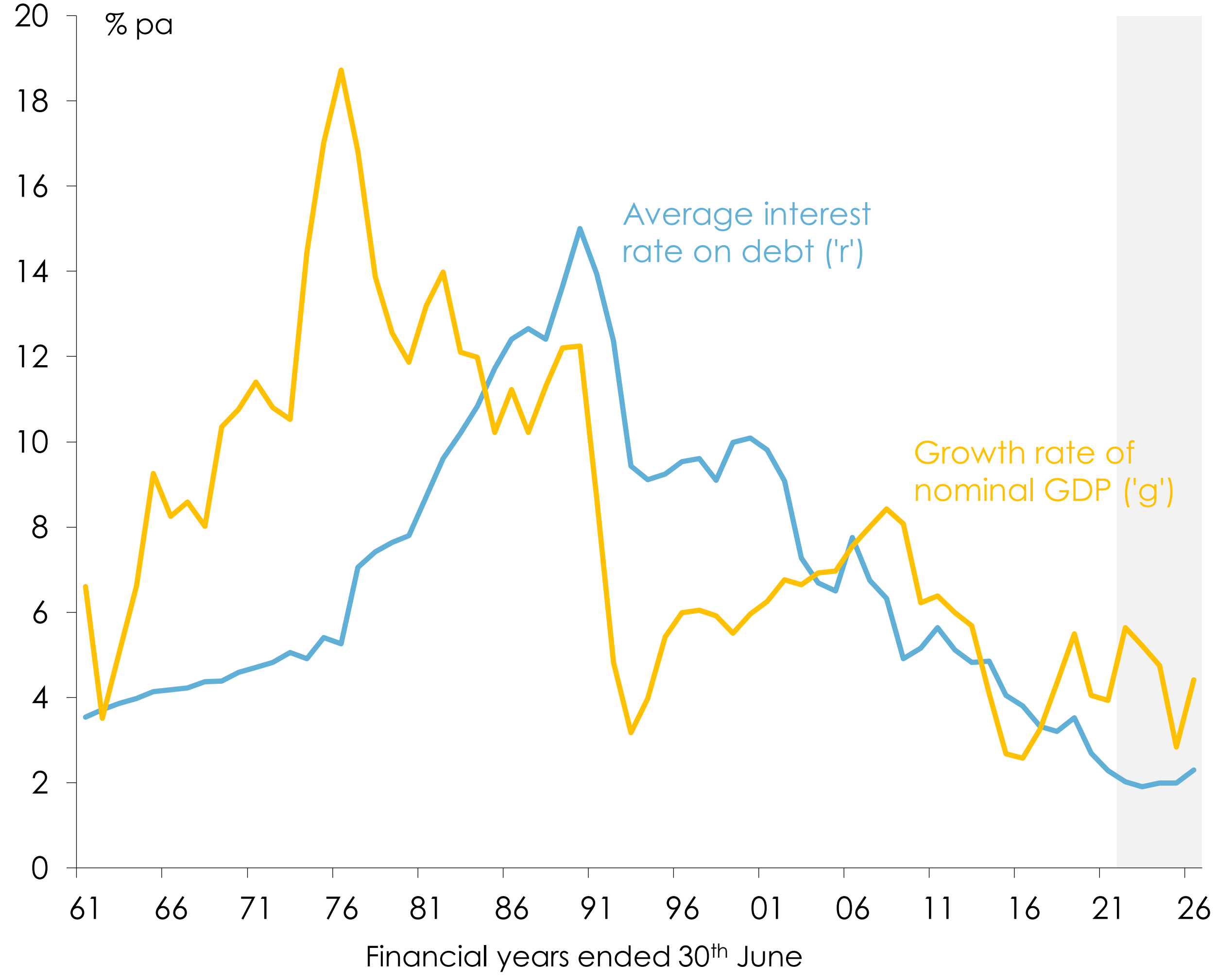
The Government can comfortably service its historically high levels of debt as long as interest rates are lower than the rate of economic growth

Australian Government gross interest payments as a percentage of GDP



Average interest rate on Australian government debt vs growth rate of nominal GDP



Source: Australian Government, 2022-23 Budget Paper No. 1, Statement No. 3, Statement No. 6 and Statement No. 10, 29th March 2022.

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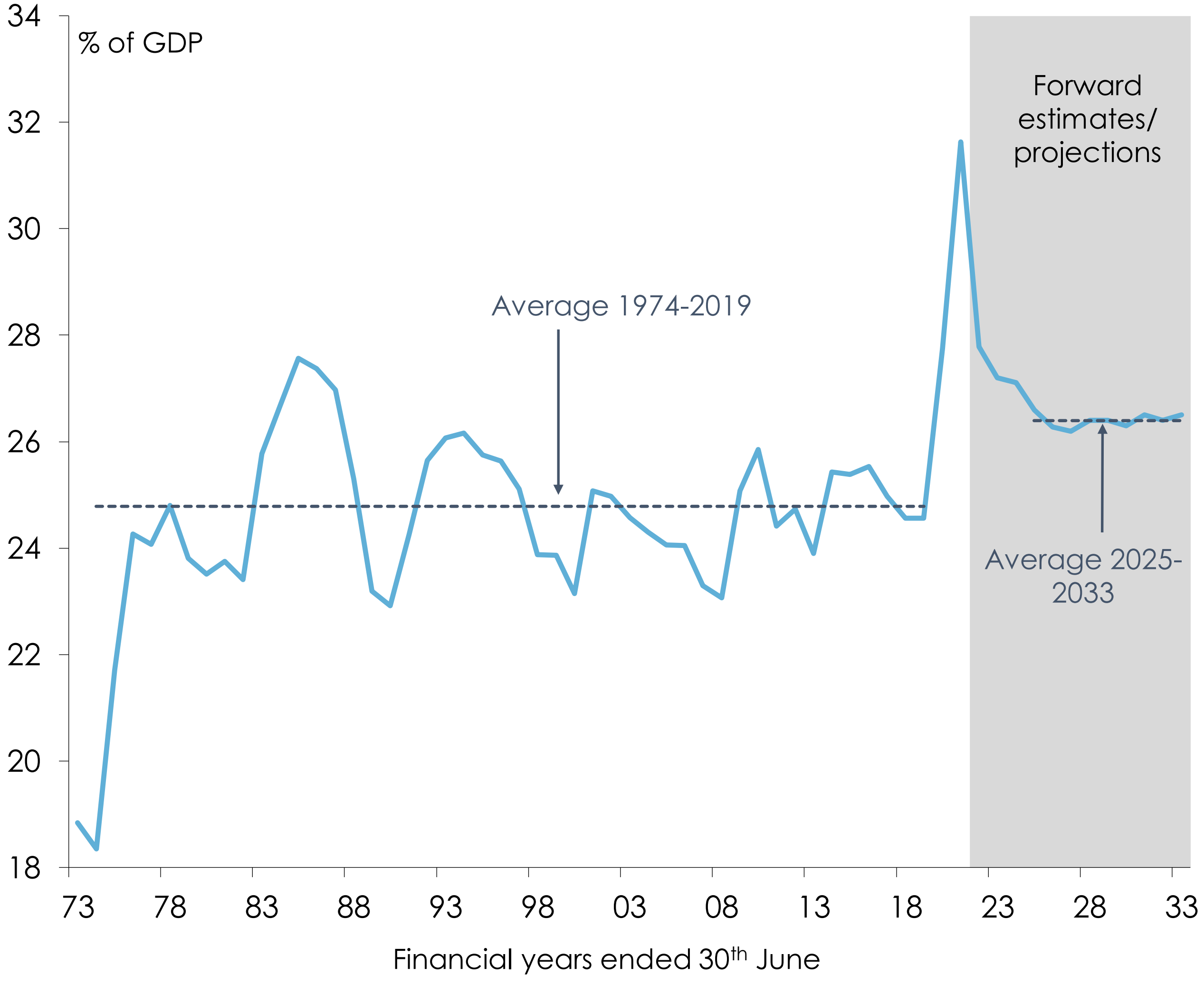
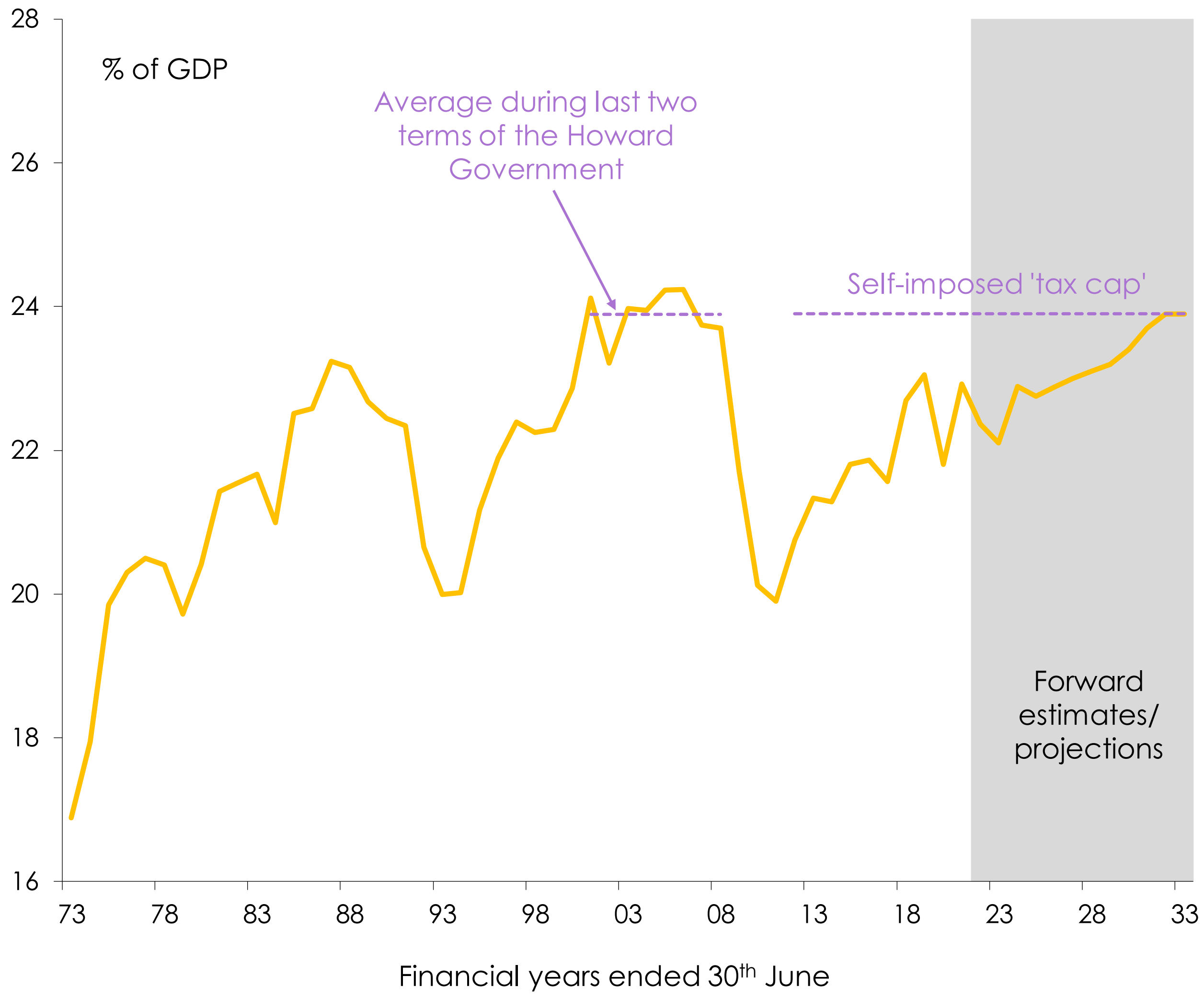
Ultimately, some future government is likely to have to bust the (quite arbitrary) 'cap' on tax revenue as a percentage of GDP

'Underlying' cash payments as a pc of GDP



Taxation receipts as a pc of GDP



Source: Australian Government, 2022-23 Budget Paper No. 1, Statement No. 3 and Statement No. 10, 29th March 2022.

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Important information

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