

Commentary on the Federal Budget 2006

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Outline

- Budget Aggregates
- Expenditure
- Revenue
- Macroeconomic Forecasts

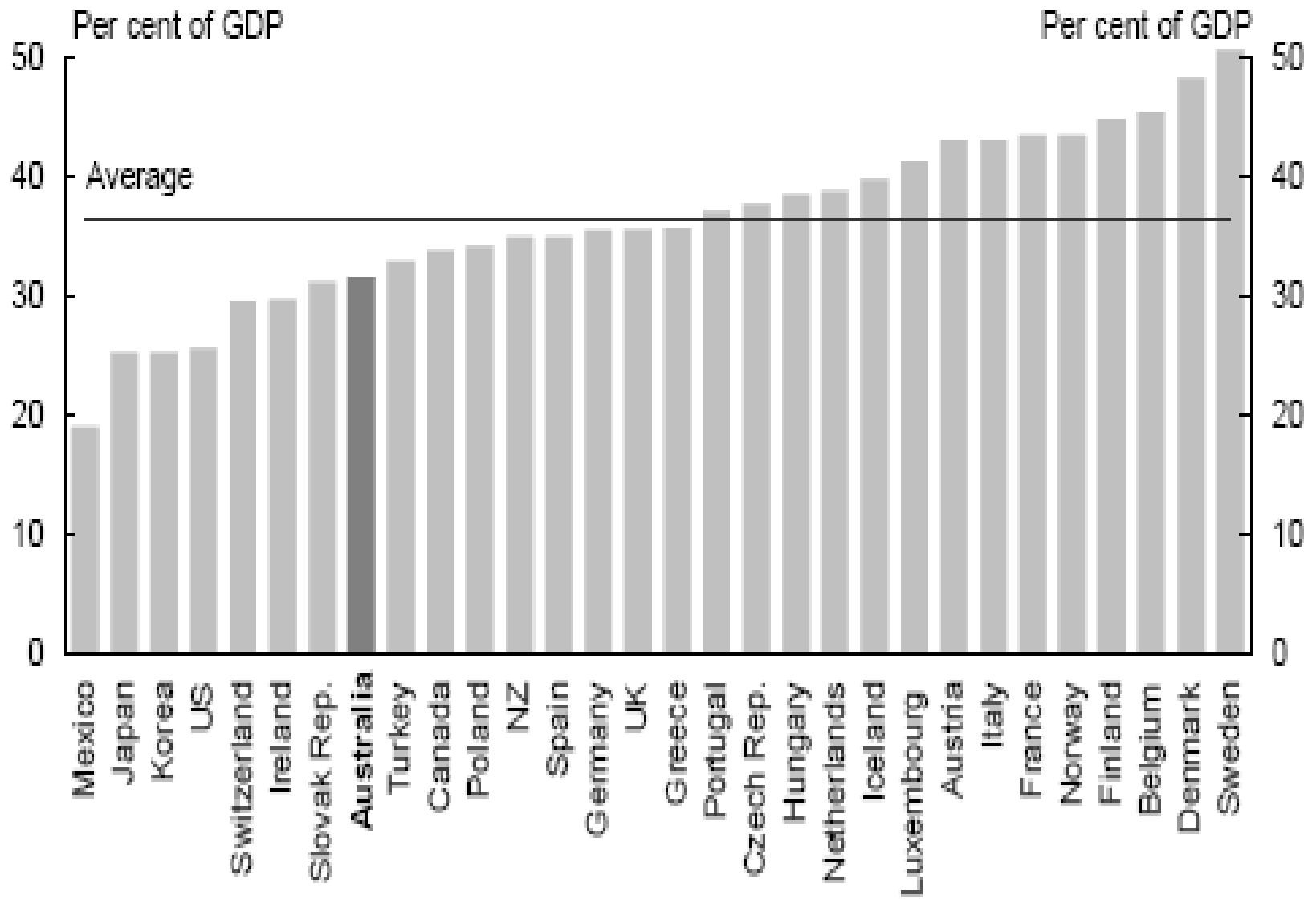
Table 1: Australian Government general government sector budget aggregates^(a)

	Actual	Estimates		Projections		
	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Revenue (\$b)	206.6	222.9	231.7	240.7	252.1	265.6
Per cent of GDP	23.1	23.3	23.0	22.9	23.0	23.0
Expenses (\$b)	195.7	206.0	219.7	230.6	240.9	252.6
Per cent of GDP	21.9	21.6	21.8	21.9	22.0	21.9
Net operating balance (\$b)	10.9	16.8	11.9	10.1	11.2	13.0
Net capital investment (\$b)	0.1	0.9	1.6	0.2	0.6	0.0
Fiscal balance (\$b)	10.8	16.0	10.3	9.9	10.6	13.0
Per cent of GDP	1.2	1.7	1.0	0.9	1.0	1.1
Underlying cash balance (\$b)(b)	13.6	14.8	10.8	10.6	11.2	12.0
Per cent of GDP	1.5	1.5	1.1	1.0	1.0	1.0
Memorandum item:						
Headline cash balance (\$b)	12.5	13.5	37.5	10.7	11.4	12.3

(a) All estimates are based on Government Finance Statistics (GFS) standards, but with goods and services tax (GST) revenue collected on behalf of the States and Territories netted off revenue and expenses.

(b) Excludes expected Future Fund earnings from 2005-06 onwards.

Chart A1: Total tax burden for OECD countries, 2003^(a)



Summary

- Revenue/Expenditure as a proportion of GDP
 - stable.
 - future reform? Unlikely:
 - OECD comparison – not much room to budge;
 - electoral cycle.
 - Revenue neutral reform is possible (and could be highly beneficial)
- Budget surplus.
 - moderately contractionary.
 - RBA and business cycle – this budget doesn't place upward pressure.
 - as a proportion of GDP stable.

Summary: Aust vs OECD

- Weighted vs unweighted average.
 - Weighted average: flow of funds and people.
 - The (relative) tax rates in larger economies are more important in terms of their impact on flows.
 - Unweighted average: qualitative comparison of the impact of different revenue/expenditure levels.
 - Each data point is equally important.
- Revenue-neutral reform.
 - Simplification: remove deductions/lower rates.
 - Reporting requirements for small/medium taxpayers.
 - Reweighting: increase indirect, lower income (politically feasible?)

Table 3: Estimates of expenses by function

	Estimates		Projections		
	2005-06	2006-07	2007-08	2008-09	2009-10
	\$m	\$m	\$m	\$m	\$m
General public services	13,033	13,809	14,658	15,091	15,455
Defence	15,802	17,871	17,955	18,078	19,013
Public order and safety	2,804	3,288	3,328	3,370	3,450
Education	15,622	16,633	17,041	17,606	18,353
Health	37,620	39,838	41,991	43,635	45,459
Social security and welfare	88,372	91,756	95,807	99,991	103,788
Housing and community amenities(a)	2,321	2,790	3,028	2,831	2,914
Recreation and culture	2,669	2,627	2,549	2,513	2,534
Fuel and energy	4,013	4,804	4,958	5,290	5,304
Agriculture, forestry and fishing(a)	2,412	2,300	1,942	1,588	1,331
Mining, manufacturing and construction	1,847	2,085	2,030	2,048	2,038
Transport and communication	3,104	3,552	4,023	4,166	2,649
Other economic affairs	5,101	5,618	5,560	5,496	5,595
Other purposes	13,269	12,781	15,692	19,408	25,311
Total expenses	206,018	219,730	230,556	240,910	252,592

(a) There has been some reclassification of expenditure that was previously reported under the natural resources development sub-function (agriculture, forestry and fishing) to other primary functions.

Summary

- Big increases:
 - Defence (13.1 percent, \$2 billion)
 - Public order and safety (17.2 percent, \$400m)
- Big ticket items:
 - Health (5.9 percent, \$2 billion)
 - Education (6.5 percent, \$800 million)
 - Social security and welfare (6.2 percent, \$5 billion – **Transfer**)
- Reductions:
 - Recreation and culture (-2.7 percent, -\$70m)
 - Agriculture, forestry and fishing (-4.7 percent, -\$100m)

Table 1: Total Australian Government general government revenue

	Actual	Estimates		Projections		
	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Total taxation revenue (\$b)	194.1	208.1	217.2	228.1	238.7	249.5
Real growth on previous year(%)	6.2	2.6	1.9	3.3	3.7	3.4
Per cent of GDP	21.7	21.8	21.5	21.5	21.6	21.6
Non-taxation revenue (\$b)	12.5	14.8	14.5	14.6	15.3	16.2
Real growth on previous year(%)	-0.8	13.5	-4.2	-0.2	4.1	3.3
Per cent of GDP	1.4	1.5	1.4	1.4	1.4	1.4
Total revenue (\$b)	206.6	222.9	231.7	240.7	252.1	265.6
Real growth on previous year(%)	5.8	3.2	1.5	3.1	3.8	3.4
Per cent of GDP	23.1	23.3	23.0	22.9	23.0	23.0

Personal Tax Rates

Current tax thresholds Income Range		New thresholds 1 July 2006	
0-6,000	0	0-6,000	0
6,001-21,600	15	6,001-25,000	15
21,601-63,000	30	25,001-75,000	30
63,001-95,000	42	75,001-150,000	40
95,001	47	150,001+	45

Personal Tax Rates

New thresholds 1 July 2006		Effective new thresholds (tax offset) 1 July 2006	
0-6,000	0	0-10,000	0
6,001-25,000	15	10,001-25,000	15
25,001-75,000	30	25,001-40,000	34
75,001-150,000	40	40,001-75,000	30
150,001+	45	75,001-150,000	40
		150,001+	45

Personal Tax Rates

- Rates down, thresholds up.
 - Handing back bracket creep (index?)
 - Overall income tax take stable (11-12% GDP)
- Should top rate = corporate rate?
- The cost of reducing rates is higher for the lower rates.
- Income tax burden high – but overall burden is below average.

Table H2: Major categories of receipts as a proportion of gross domestic product (cash basis)^(a) (continued)

	Taxation receipts													Non-taxation receipts				
	Income tax								Other taxation receipts					Total	Interest	Dividends	Total	Total
	Gross	Gross	Refunds	Total	FBT	Super	Companies	PRRT	Total	Petrol &	Other	Customs	Total					
	ITW	other		individuals &		funds		income	other	fuel	excise	duty	other	tax	Interest	Dividends	Total	Total
%	%	%	individuals &	%	%	%	%	%	products	%	%	%	%	%	%	%	%	%
	individuals		w/holding				tax					tax	receipts		and	non-tax	receipts	
1998-99	11.9	2.2	1.7	12.8	0.5	0.6	3.4	0.1	17.5	1.8	0.4	0.4	5.7	23.2	0.1	0.8	0.9	24.1
1999-00	12.1	2.1	1.7	12.9	0.6	0.6	3.8	0.2	18.1	1.8	0.4	0.4	5.4	23.5	0.2	2.1	2.3	25.7
2000-01	10.9	1.9	1.6	11.2	0.5	0.7	4.6	0.3	17.3	1.8	1.0	1.0	3.9	21.3	0.2	1.9	2.1	23.4
2001-02	10.7	2.2	1.4	11.5	0.5	0.6	3.7	0.2	16.5	1.7	0.9	0.9	3.7	20.2	0.1	1.9	2.0	22.1
2002-03	10.7	2.2	1.5	11.5	0.4	0.6	4.2	0.2	16.9	1.7	1.0	1.0	3.7	20.6	0.1	1.8	1.9	22.5
2003-04	10.7	2.4	1.5	11.6	0.4	0.7	4.3	0.1	17.1	1.6	0.9	0.9	3.5	20.6	0.1	1.6	1.7	22.3
2004-05	10.9	2.5	1.5	11.9	0.4	0.7	4.5	0.2	17.7	1.6	0.9	0.9	3.4	21.1	0.2	1.6	1.8	22.8
2005-06 est	10.8	2.6	1.6	11.8	0.4	0.7	5.2	0.2	18.3	1.5	0.8	0.8	3.1	21.4	0.2	1.6	1.9	23.3
2006-07 est	10.3	2.7	1.7	11.2	0.4	0.6	5.6	0.2	18.1	1.5	0.8	0.8	3.1	21.1	0.3	1.4	1.7	22.9

(a) Figures up to and including 1998-99 are based on the old Commonwealth Budget Sector cash accounting framework. Figures from 1999-2000 are on an Australian Government general government GFS basis.

Superannuation

- Simplification
 - Should the cuts have been on contributions or money being taken out.
 - Difficult to model how people will behave in response to any particular set of cuts.
 - For example, the very strong default bias.
 - Should any of it be taxed?

Table 4: Australian Government general government revenue

	Estimates		Change on 2005-06	
	2005-06	2006-07	\$m	%
	\$m	\$m		
<i>Income taxation</i>				
Individuals and other withholding				
Gross income tax withholding	103,830	104,010	180	0.2
Gross other individuals	28,410	28,480	2,070	7.8
less: Refunds	15,350	16,790	1,440	9.4
Total individuals and other withholding taxation	114,890	115,700	810	0.7
Fringe benefits tax(s)	3,680	3,720	60	1.6
Superannuation funds				
Contributions and earnings	5,390	5,890	500	9.3
Superannuation surcharge	1,030	680	-350	-34.0
Total superannuation funds	6,420	6,570	150	2.3
Company tax	50,480	58,880	8,380	12.6
Petroleum resources rent tax	1,970	2,490	520	26.4
Income taxation revenue	177,420	185,340	7,920	4.5
<i>Excise and customs</i>				
Excise duty				
Petrol	7,280	7,310	30	0.4
Diesel	6,240	6,420	180	2.9
Other fuel products	220	450	230	104.5
Crude oil	330	470	140	42.4
Beer	1,730	1,780	30	1.7
Potable spirits	810	890	80	9.9
Tobacco	5,290	5,320	30	0.6
Total excise duty	21,900	22,620	720	3.3

Customs duty				
Textiles, clothing and footwear	830	870	40	4.8
Passenger motor vehicles	1,258	1,300	42	3.3
Excise-like goods	1,810	2,160	350	19.3
Other imports	1,608	1,608	5	0.3
Less: Refunds and drawbacks	330	300	-30	-9.1
Total customs duty	5,171	5,638	467	9.0
Excise and customs revenue	27,071	28,258	1,187	4.4
Other taxation				
Wine equalisation tax	680	680	0	0.0
Luxury car tax	320	320	0	0.0
Agricultural levies	607	619	11	1.9
Other taxes	2,007	1,980	-27	-2.3
Other taxation revenue	3,594	3,599	-5	-1.0
Taxation revenue	208,085	217,157	9,072	4.4
Non-taxation				
Sales of goods and services	4,898	4,848	-52	-1.1
Interest received	2,388	3,717	1,330	55.7
Dividends	4,321	2,701	-1,621	-37.5
Other	3,173	3,241	68	2.2
Non-tax revenue	14,779	14,505	-274	-1.9
Total revenue	222,864	231,662	8,798	3.9

(a) See fringe benefits tax description in Appendix C.

Table 1: Domestic economy forecasts^(a)

	Outcomes(b)	Estimates	Forecasts	
	2004-05 year average	2005-06 year average	2006-07 year average	Four quarters to June 2007
Panel A - Demand and output(c)				
Household consumption	4.2	2 3/4	3	3
Private investment				
Dwellings	-1.5	-3	-1	2
Total business investment(d)	11.7	14	8	11
Non-dwelling construction(d)	7.7	14	6	8
Machinery and equipment(d)	15.4	15	9	13
Private final demand(d)	4.5	4 1/4	3 3/4	4 1/2
Public final demand(d)	4.3	3 1/4	3 1/4	2 1/4
Total final demand	4.4	4	3 1/2	4
Change in inventories(e)				
Private non-farm	-0.3	0	0	0
Farm and public authorities(f)	0.0	0	- 1/4	- 1/4
Gross national expenditure	4.1	4	3 1/2	4
Exports of goods and services	2.5	2	7	6
Imports of goods and services	12.0	6	7	9
Net exports(g)	-2.0	-1	- 1/2	-1
Gross domestic product	2.5	2 1/2	3 1/4	3 1/4
Non-farm product	2.6	2 3/4	3 1/4	3 1/2
Farm product	-0.5	-1	2	-1

Panel B - Other selected economic measures**External accounts**

Terms of trade	10.0	10	0	-1 1/4
Current account balance				
\$ billion	-57.6	-58 1/4	-62 1/2	
Percentage of GDP	-6.4	-6	-6 1/4	

Labour market

Employment (labour force survey basis)	3.0	2	1	1 1/4
Unemployment rate (per cent)(g)	5.3	5 1/4	5 1/4	5 1/4
Participation rate (per cent)(g)	64.0	64 1/2	64 1/4	64 1/4

Prices and wages

Consumer Price Index	2.4	3	2 3/4	2 1/2
Gross non-farm product deflator	3.9	4 1/2	2 1/2	2 1/4
Wage Price Index	3.8	4	4	3 3/4

(a) Percentage change on preceding year unless otherwise indicated.

(b) Calculated using original data.

(c) Chain volume measures.

(d) Excluding transfers of second-hand assets between the public and private sectors.

(e) Percentage point contribution to growth in GDP.

(f) For presentational purposes, inventories held by privatised marketing authorities are included with the inventories of the farm sector and public marketing authorities.

(g) The estimates in the final column are the forecast rates in the June quarter 2007.

Source: Australian Bureau of Statistics (ABS) cat. no. 5306.0, 5302.0, 6202.0, 6345.0, 6401.0, unpublished ABS data and Treasury.

Summary

- GDP forecast to grow at 3.25%
 - Reasonable, (last quarter – 3.1%) – but there is some risk.
- Terms of trade expected to plateau.
 - Consensus seems to be that this is reasonable – but again, there is some risk here.
 - Shouldn't overstate the extent to which minerals drive the economy.
- Labour market stability (low employment growth, stable unemployment)
- CPI low and stable, wages growth higher (the gap being expected productivity growth).

Summary

- Responsible budget.
 - Given the RBA's concerns, it plots a steady course.
- Moderate pork barrelling.
 - Much more next time.
 - The electoral cycle dimension to budgets.
Four years terms?
- Superannuation reform.
 - Reform needed elsewhere.