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Introduction

The Australian government uses the Federal Budget to implement its plan for government spending (G) and government receipts (T) for the coming financial year. Underpinning this plan is a fiscal strategy which influences:

- resource allocation
- income distribution
- the level of economic activity.

There are three possible budget outcomes:

- a deficit budget, \( G > T \)
- a surplus budget, \( T > G \)
- a balanced budget, \( G = T \).

In recent years the government has run budget deficits due to the need to stimulate the economy, as a result of the Global Financial Crisis and the sovereign debt issues in Europe. These events led to a decline in incomes and therefore government tax revenue. They also led to higher government spending on welfare, sustained budget deficits and increased government debt. Figure 1 shows the trends in the budget outcomes over the last 30 years. During periods of recession (1982-83, 1993-94) and slow economic growth (2000-01, 2007-08) budget deficits increased to deal with the problems of insufficient aggregate demand and increasing levels of unemployment.

In the periods following the economic slowdowns, tightening of fiscal policy and increased economic growth rates have led to the budget returning to a surplus. As can be seen from Figure 1, the current plan is also to return the budget back to a surplus in the next few years.

The impact of budget deficits since 2007-08 has led to an increase in the Australian Government’s Net Debt (Figure 2). By 2006-07 the Australian Government had no debt. The subsequent budget deficits have increased the Australian Government’s Net Debt to 18.6% of GDP in 2017-18, but this is still much lower than most other industrial nations (Figure 3).

**Figure 1:** Australian Government Budget Balance as a %age of GDP

**Figure 2:** Public Sector Net Debt as a percentage of GDP

**Figure 3:** Selected Industrial Nations Public Sector Net Debt as a %age of GDP (2017)

**Source:** IMF (2018)
Fiscal Strategy

The previous section examined the overall fiscal strategy in recent decades. This section will consider the fiscal strategy associated with the current budget. The fiscal strategy relates to what the government is actually trying to achieve in the 2018-19 Budget and its subsequent budgets. Because the Federal Budget is a plan of what the Australian Government expects to achieve, it does not mean that it will be achieved. In the 2014-15 Budget Papers, the Federal Liberal Government, stated that they were aiming to achieve a budget surplus, with a fiscal balance of $1 billion dollars in 2017-18 as shown in Table 1. This did not occur.

<table>
<thead>
<tr>
<th>Table 1: Australian Government Budget Aggregate 2012-13 to 2017-18</th>
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<td><strong>Year</strong></td>
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<tr>
<td>-----------</td>
</tr>
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<td>2016-17</td>
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<td>2017-18</td>
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The 2018-19 Budget Papers announced that the Federal Government was projecting that the Budget would now return to a surplus in 2020-21.

The Government would normally achieve this reduction in the budget deficit by increasing the level of government revenue and reducing the level of government expenditure. As can be seen in Table 2, the government is aiming to reduce the underlying cash deficit from an estimated $18.2 billion (1.0% of GDP) in 2017-18 to $14.6 billion (0.8% of GDP) in 2018-19. This is to be achieved despite an increase in government expenditure from 25.1% of GDP in 2017-18 to 25.4% of GDP in 2018-19. The main factor reducing the budget deficit therefore has to be government revenue, which is expected to increase from 24.3% of GDP in 2017-18 to 24.9% of GDP in 2018-19.

An alternative measure of the budget deficit/surplus is known as the Fiscal Balance. This is the accrual accounting measure of the Underlying Cash Balance, discussed above. The Fiscal Strategy in the 2018-19 budget is to reduce the overall fiscal balance from a deficit of $13.4 billion in 2017-18 to $7.4 billion in 2018-19. This will be further reduced in the coming budget to achieve a surplus of 0.2% of GDP in 2019-20.

The Government is aiming to reduce the budget deficits over the next 2 years by increasing the level of government revenue and reducing the level of government expenditure (Table 2). If we compare the budget figures with those projected for 2018-19, we see that the budget deficit is much bigger than projected in Table 1. Table 1 projected a surplus of $7.4 billion in Table 2 projects an underlying cash deficit of $14.5 billion. In terms of the fiscal balance, it has increased from a surplus in Table 1 to a deficit of $7.4 billion in Table 2. These figures show the difficulty of accurately predicting budget outcomes.

Table 2: Australian Government Budget Aggregate 2016-17 to 2021-22

<table>
<thead>
<tr>
<th>Year</th>
<th>Actual</th>
<th>Estimate</th>
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<td>2021-22</td>
<td>$118.5</td>
<td>$128.5</td>
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Source: Australian Government 2014-15 Budget Papers, Budget Overview

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Budget Measures

At the time of writing this article the 2018-19 Budget has not been passed through Federal Parliament. There is considerable opposition to sections of the Budget which may lead to some of the plans to be amended or rejected totally. The ability of the government to achieve its budget objectives has been restricted in recent years by the Senate. The Liberal Government does not have the majority of seats in the Senate, so some policies may be rejected or amended. This article will discuss what was actually proposed in the Budget Papers and the effect that those proposals are likely to have on income inequality and resource allocation. It should be noted that a number of the policy changes will not take effect till 2020 or later. The government anticipates that the economy will be on a stronger growth path by then and the effects of moving to a surplus will not push the economy into recession.
It should be remembered, when considering why the government chooses various policy options, that an election is expected during the 2018-19 fiscal year, so very immediate political factors also influence budget decisions.

**Plans for Government Revenue 2018-19 Budget**

Total revenue for 2018-19 is expected to be $486.1 billion, an increase of 6.6% on estimated revenue in 2017-18. The growth in government revenue has resulted from increased income tax revenue (equivalent to $13.3 billion since December 2017), as a result of employment growth. In addition, higher than expected iron ore, coal, and oil prices have all boosted company tax revenue and contributed to a reduction in the budget deficit. Figure 4 shows the main sources of government revenue in the 2018-19 Budget. The following sections will discuss the main changes that have been proposed in regards to taxation revenue in the 2018-19 Budget.

Figure 4: Sources of Revenue 2018-19 Budget
Source: Australian Government 2018-19 Budget Papers, Budget Overview

1. Changes to Taxation Policies

   a) Changes to Income Tax

   The main change to income tax introduced in the 2018-19 Budget is a three step plan for personal income tax reform from 2018-19 to 2024-25.

   The first step will occur in 2018-19 when the Government will reduce taxes for low and middle income earners. The plan involves over 10 million low and middle income Australians receiving up to $530 in tax relief for the 2018-19 income year. The top threshold of the 32.5 per cent tax bracket will be further increased to $90,000 from 1 July 2018, having already been increased from $80,000 to $87,000 in 2016-17 (Australian Government 2018).

   The second step is designed to be introduced from 2022-23 when the benefits of the Step 1 tax offset will be locked in by increasing the top threshold of the 19 per cent tax bracket from $37,000 to $41,000 and increasing the low income tax offset from $445 to $645. In this second step the top threshold of the 32.5 per cent bracket will be further increased to $120,000, ensuring that the average income earner remains in this middle tax bracket (Australian Government 2018).

   Step 3 of the tax cuts involves reducing the number of tax brackets from 5 to 4. From 1 July 2024, the personal income tax system will be simplified by abolishing the 37 per cent tax bracket entirely, reducing the number of tax brackets from five to four. Australians earning more than $41,000 will only pay 32.5 cents in the dollar all the way to the top marginal tax rate threshold. The top marginal tax rate of 45 per cent will only apply to incomes above $200,000 (Australian Government 2018).

   There is a need for personal income tax reform. As individual incomes rise, most people will be paying more income tax. As people’s incomes rise they pay a greater proportion of any income gains in tax and their tax payments increase over time. This is known as ‘Bracket Creep’ or ‘Fiscal Drag’. Income tax rates should be regularly adjusted to reflect rises in money wages to prevent an increased tax burden especially on lower and middle income earners. Figure 5 shows the likely implications of leaving the income tax schedule the same.

   Figure 5: Taxation Scenarios 2016-17 to 2028-29
   Source: Australian Government 2018-19 Budget Papers, Budget Overview

   Without income tax reform, tax revenue would rise from around 22% of GDP 2016-17 to over 25% of GDP by 2028-29. The government in this Budget has set a cap on taxes as a percentage of GDP at below 23.9%.

   One issue with the tax reforms is that the Liberal Government wants the 3 steps of the reform to be agreed to as a package in 2018-19. This is likely to face some level of opposition in the Senate.

   b) Squeeze on Tax Deductions and Tightening of Tax Avoidance

   The Australian Tax Office will be funded to cut down on the people of over-claiming work expenses and rental losses. This is expected to raise $1.1 billion of additional
There will also be a new $10,000 limit for cash payments for goods and services from July 1 2019. The Government will also divert more funds to crack down on the ‘black economy’, hoping to raise an extra $1.9 billion in revenue. The Government will also have the Tax Office crack down on illicit tobacco smuggling. This is expected to raise $3.6 billion over 4 years (Australian Government 2019).

c) Cuts to Company Tax
The Government has legislated tax cuts for around 3.3 million small and medium Australian businesses with annual turnovers up to $50 million, as part of the Ten Year Enterprise Tax Plan. This Plan has also increased the unincorporated small business tax discount rate from 5 % to 8 % (up to a cap of $1,000). This rate will increase to 16 % by 2026-27.

These tax cuts began in 2016-17. Companies with an annual turnover of less than $10 million had their tax rate cut to 27.5 % – the lowest level in over 50 years. This lower corporate tax rate was extended to companies with an annual turnover of less than $25 million in 2017-18 and will extend to companies with an annual turnover of less than $50 million from 1 July 2018 (Australian Government 2018).

d) No increase in the Medicare Levy
The Government will keep the Medicare Levy at 2% instead of increasing it to 2.5% as previously planned. This will cost the Government an estimated $12.8 billion in revenue from 2017-18 to 2021-22.

Plans for Government Expenditure 2018-19 Budget
Total expenses for 2018-19 are expected to be $488.6 billion, an increase of 4.2 % on estimated expenses in 2017-18. Figure 6 shows the main areas of government spending in the 2018-19 Budget. The following sections will discuss the main changes that have will occur in regards to government expenditure in the Budget.

Figure 6: Areas of Government Expenditure 2018-19 Budget
Source: Australian Government 2018-19 Budget Papers, Budget Overview
Similar to the changes in tax, some areas have had reductions in the levels of spending and some areas have had increases. Again, many of these decisions seem more politically driven than driven by economic theory.

1. Cuts to Government Expenditure

a) Tightening Social Security and Welfare Payments
Social security and welfare is the largest component of government spending, with $176 billion estimated to be spent in 2018-19. The Government will save $299 million over three years from 2019-20 by extending fraud detection and debt recovery activities. The extended debt recovery activities will focus on high value debts and individuals who are no longer receiving welfare payments. In addition, welfare recipients will have their payments suspended or cancelled if they have outstanding warrants for indictable criminal offences.

The Government also expects to save a further $203 million over five years from 2017-18 by increasing the waiting period to four years for newly arrived migrants to access certain welfare benefits from 1 July 2018.

b) Cuts to Foreign Aid
Foreign Aid will be cut a further $140 million over the next 4 years.

2. Increases in Government Expenditure
At a time where economic theory would suggest that there should not be increases in government spending, there are, a large number of areas of increased spending. The Government is relying on taxation revenue to pay for the increased levels of expenditure.

a) $24.5 Billion for Infrastructure
The Budget proposes $24.5 billion for new nationally significant transport projects and initiatives that benefit people and businesses in every State and Territory. It includes funding for existing projects such as the Melbourne to Brisbane Inland Rail project and the Western Sydney Airport announced in last year’s Budget. These form part of the Government’s $75 billion transport infrastructure investment over the next decade. In 2018-19 this will involve a $3.5 billion roads expenditure package, including $1.5 billion for the Northern Australia Package, $400 million for the Tasmanian Roads Package, $100 million for the NSW and ACT Barton Highway Corridor Package and $1.5 billion for future national priorities (Australian Government 2019).

b) Assistance for the Aged
The More Choices for a Longer Life Package includes
online interactive health checks for 45 and 65 year olds across key areas of skills, finances and health. It should enable people to plan ahead and get the most out of their longer lives and have the flexibility to remain in the workforce if they choose.

The Package also attempts to improve the quality of care and safety in aged care services. Support for the mental health of older Australians will be boosted while helping them to remain in their homes and connected to the community. Some 14,000 additional home care packages will be funded for older people with high-level needs, providing subsidised assistance for activities such as showering and dressing, meal preparation, transport and mobility (Australian Government 2018).

c) Medicare Guarantee Fund

Funding for the Medicare Benefits Schedule (MBS) and the Pharmaceutical Benefits Scheme (PBS) has been guaranteed through the Government legislated Medicare Guarantee Fund. For 2017-18, $34.4 billion has been credited to the Fund. A further credit of $35.3 billion will be made to meet estimated MBS and PBS expenditure for 2018-19.

This Budget includes $1.4 billion for new and amended listings on the PBS, including medicines to treat spinal muscular atrophy, breast cancer, relapsing-remitting multiple sclerosis and a new medicine to prevent HIV.

The Government is also encouraging the greater use of generic drugs which would reduce costs.

d) Increased Funding for Hospitals and Health Care

A new public hospital agreement will deliver more than $30 billion in additional funding between 2020-21 and 2024-25 — a 30 % increase over the previous five years.

The Government will provide support for Australians with mental illness, including providing $33.8 million to Lifeline Australia to enhance its telephone crisis services and funding for beyondblue and the Way Back Support Service. In addition, the Government will spend $77.9 million on infant and maternal health for the first 2000 days of a child’s life. It is hoped this will lead to lower obesity and reduced reliance on healthcare later in life.

e) Support for Indigenous Australians

Indigenous Australians will receive $550 million over 5 years from 2018-19 to address their remote housing needs in the Northern Territory.

f) Repairing the Great Barrier Reef

The Government is providing more than $500 million over the next 5 years to secure the future of the Great Barrier Reef through improving water quality, combating crown-of-thorns starfish and conducting scientific research.
Winners

High-tech research - The budget included an extra $1.9 billion over 12 years on research “infrastructure” for industries, including healthcare, manufacturing and agriculture.

Losers

Companies “pushing the boundaries” on R&D tax claims - The government is cutting $2.4 billion from its research and development tax incentive scheme, to ensure the funding goes to genuinely innovative spending.

Older Australians - Some 14,000 additional home care packages will be funded for older people with high-level needs, providing subsidised assistance.

Indigenous Australians - Indigenous Australians will receive $550 million over 5 years from 2018-19 to address their remote housing needs in the Northern Territory.

Repairing the Great Barrier Reef - The Government is providing more than $500 million over the next 5 years to secure the future of the Great Barrier Reef.

Economic effects and economic outlook

The government’s fiscal stance refers to whether it is trying to increase growth (expansionary policy) or slow the rate of growth in the economy (contractionary policy). Budgets have a number of effects on the economy. Initially changes in government spending will affect the level of aggregate expenditure and aggregate demand and thus income in the economy. This change in the level of income will be magnified by the multiplier effect. If there is an increase in income this will generate economic growth and lead to higher levels of employment, while reductions in income will do the opposite. A reduction in taxation will have a similar effect to increasing government spending. It will increase income in the economy. An increase in the tax rate will reduce income, leading to a reduction in economic activity and higher unemployment.

The overall economic impact of the 2018-19 Budget relates to a reduction in the deficit by only $3.7 billion or 0.2 of GDP. In general, economic theory would suggest that this would act to lead to a small contraction in income and employment and slow down economic growth. It needs to be pointed out, however, that even though revenue is expected to rise by $30 billion (0.6% of GDP), much of this increase is likely to be caused by a growing domestic and global economy and higher commodity prices. In addition, company tax is anticipated to grow by $15 billion over the year; an increase of 22%. There is also a planned cut in income tax for low and middle income earners and a substantial rise in government expenses of $19.8 billion (0.2% of GDP).

Treasury has estimated that the spending on infrastructure has a multiplier of 4, suggesting that every billion dollars spent on infrastructure will grow the economy by four billion dollars, although this will be over a lengthy period of time (25 years). So the overall impact of the budget could be expansionary. This is supported by the Treasury’s economic estimates in Table 4. The table shows that economic growth and wage growth are expected to increase and the unemployment rate is expected to decline in 2018-19. Each of these outcomes would tend to increase government revenue in 2018-19 due to their impacts on the cyclical component of the budget deficit.

Table 4: Major Economic Parameters and Estimates

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Effects on income distribution

In regards to the impact of the 2018-19 Budget on income inequality, the National Centre for Social and Economic Modelling (NATSEM), at the University of Canberra, undertook economic modelling to measure the impact of the Budget on income inequality. As the 2018-19 Budget measures are planned to be implemented in multiple phases. NATSEM models the impact of the budget measures at each milestone (Figure 7). This includes Phase 1, 2018-19, when the low and middle income tax offset will be introduced and one of the tax thresholds will be adjusted. Phase 2, 2022-23, includes a change of the low income tax offset to replace the low and middle income tax offset, and further tax threshold changes will be implemented. Phase 3, 2024-25, will complete the last step of the personal income tax reform with the removal of the second highest tax bracket. Besides tax change, The NATSEM modelling, however, includes the Medicare levy change and the increased pensioner work bonus that were later dropped.
The NATSEM study shows that measures put in place for the upcoming financial year, 2018-2019, will mostly benefit middle income earners due to the changes in tax offset criteria. Lower income earners, however, will benefit less than middle income earners as they already pay no or little tax (Figure 7). In absolute terms, high income earners are most likely to benefit from the tax reform once it is fully implemented in 2024-25.

NATSEM (2018) suggests that although there are no significant losers under the 2018-19 Budget, a segment of the population will not benefit from any of the proposed measures. This includes pensioners with no income and the unemployed. They are among the most vulnerable people in Australia. The benefit of the measures primarily depends on the taxable income. Anyone earning less than $20,200 a year will receive no-benefit from the reforms. Figure 8 displays the impact of the reforms on various groups in Australia.

As was seen with recent budgets, overseas factors may still have a big impact on the actual budget outcome in 2018-19. Falling commodity prices and a rising Australian dollar would both work to worsen the size of the budget deficit. On the other hand, Treasury forecasts are projecting an improvement in commodity prices and the terms of trade along with stronger economic growth and a falling unemployment rate. Such an outcome would most likely improve the budget outcome.
Reference List


Australian Bureau of Statistics (various), *Employee Earnings and Hours*, Cat.No. 6306.0. Canberra.


Reserve Bank of Australia (various), *Reserve Bank Bulletin*, Canberra.


Websites


