Fiscal outcomes in a time of increasing political spin and unanticipated economic change

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Some basic concepts and facts

The budget statements provide forecasts and projections.

In May 2017 the budget *forecasts* the 2016-17, 2017-18 and 2018-19 budget outcomes. Then *projects* budget outcomes for 2019-20 and 2020-21 assuming that the economy grows for these two consecutive years at above normal rates. Taxes increase above and expenditure increases below normal rates during *projection* period.

There are three taxes;
- individual income tax, about 50% of tax revenue
- indirect tax, about 30 %
- company tax, about 20%

Seem

The Overarching Issue

There is a long run tax crisis that governments will not face and tend to hide

The tax crisis requires a planned, consistent, believable and long run strategy to enable the community to accept possible solutions

This has not been happening. Too many minor diversions and emphasising policies or promises that do not seem to matter

Seem

Features of the Tax Crisis

Over the last decade governments have forecast -

I deficit will be closed primarily by tax increases

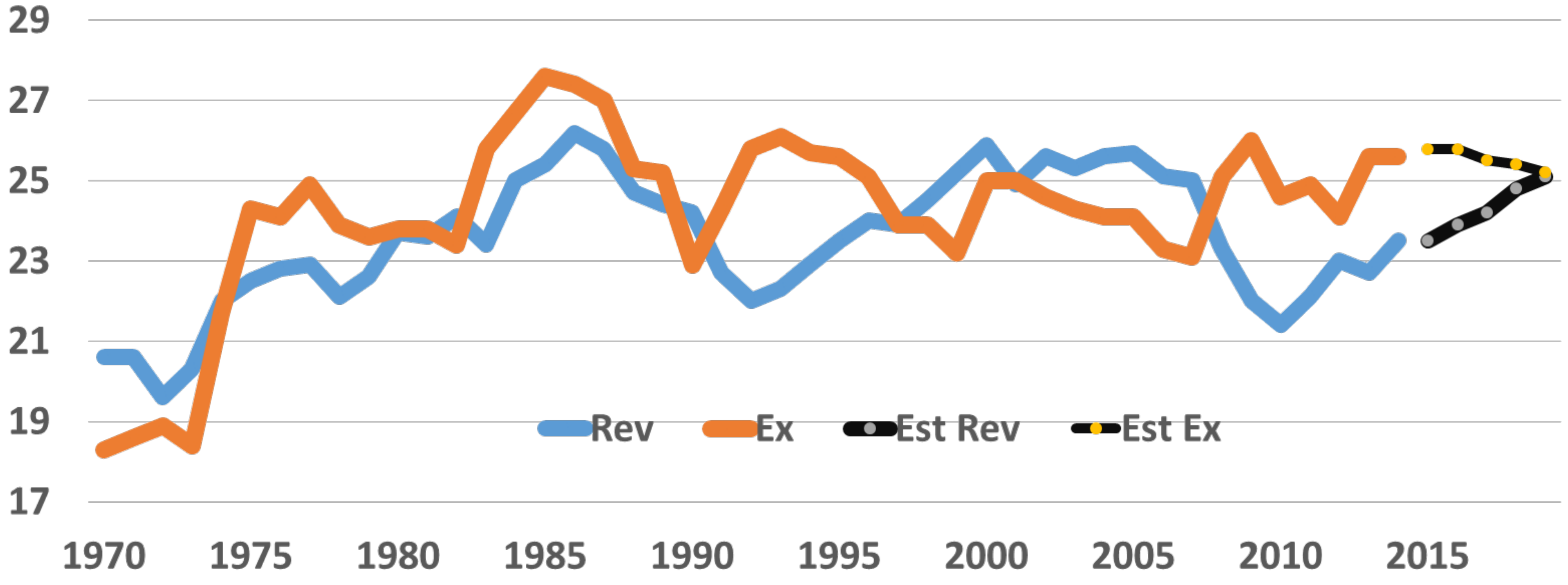
II deficit will be closed primarily during the ***projection*** period (two to three years after the budget year) when the economy is assumed, for two consecutive years, to grow at above the normal long term growth rate.

III deficit will be closed primarily by increases in personal income tax to reach their highest level over the last two decades

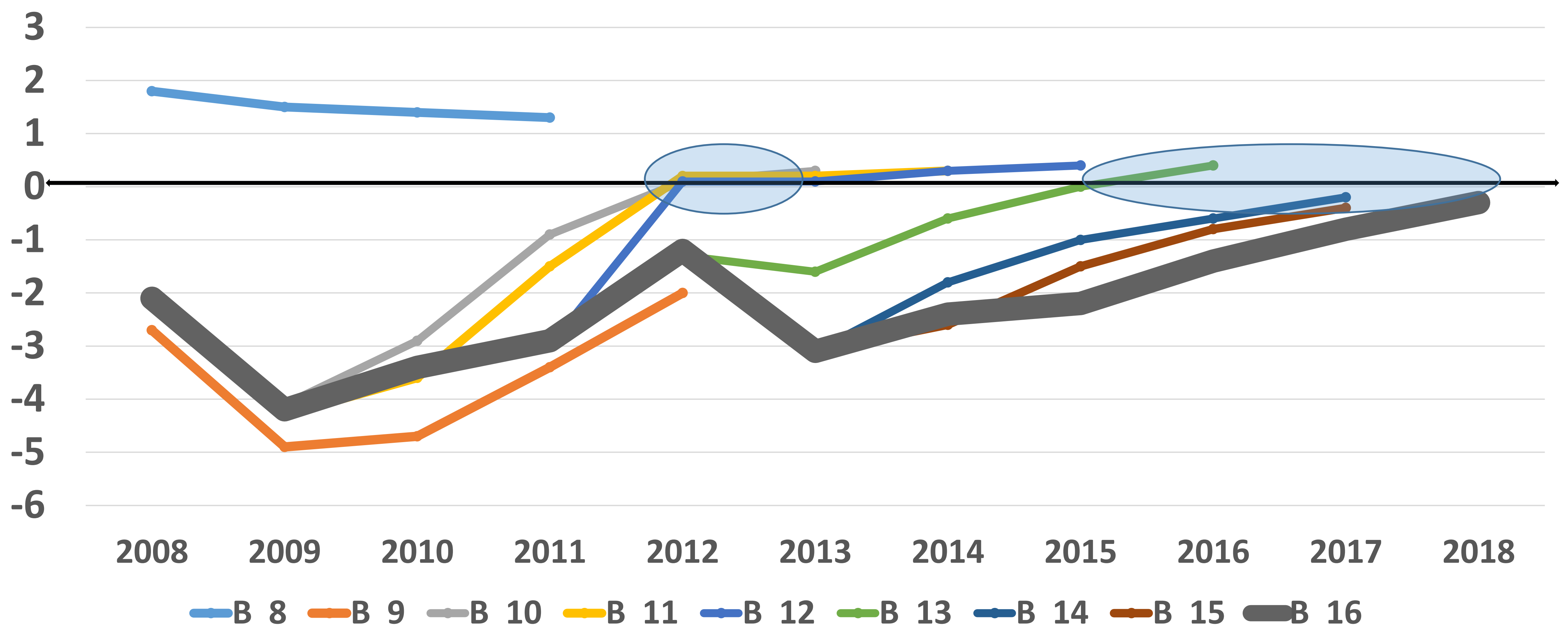
IV main revenue increase from 2015-16, however, will be from company tax

V tax revenue forecasts have been too optimistic

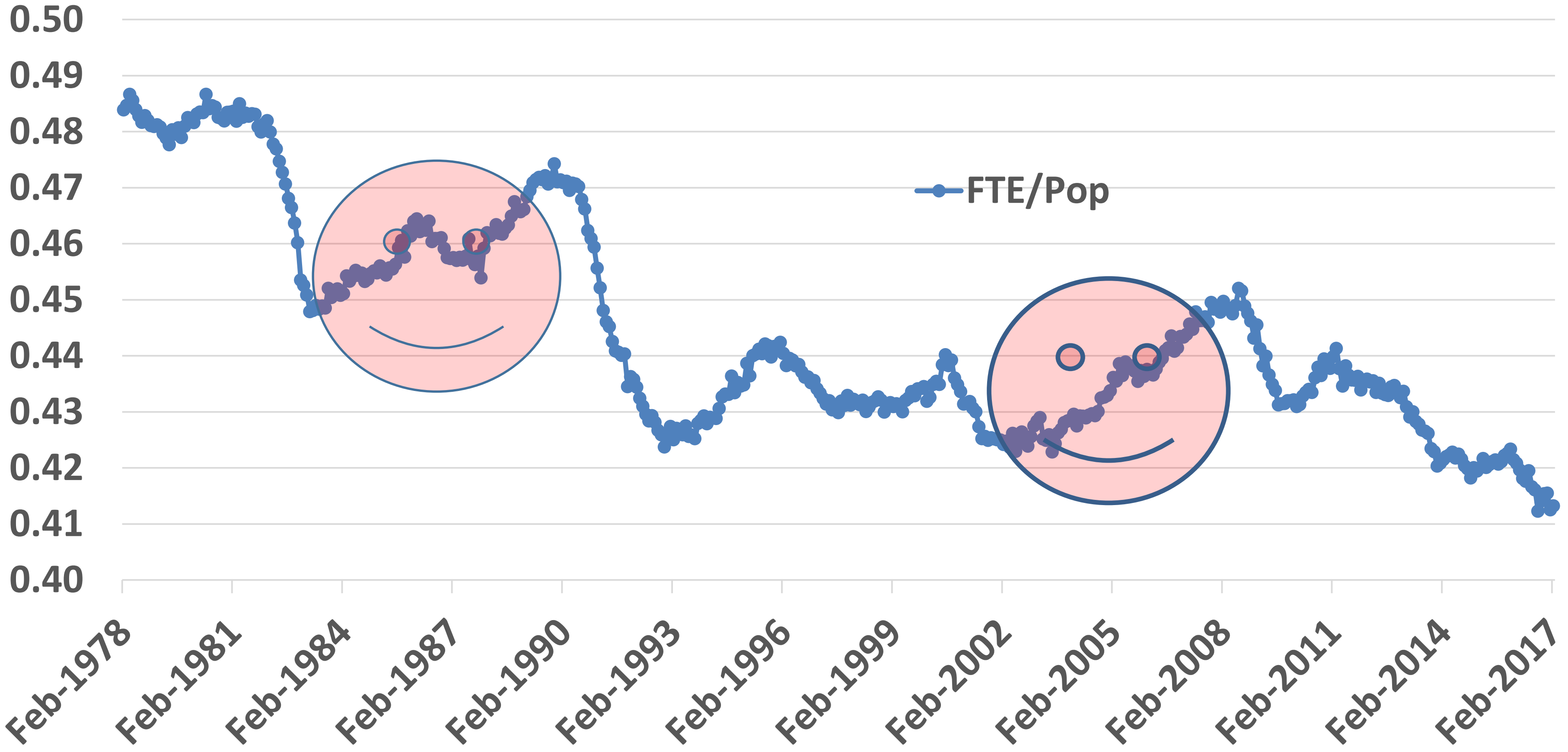
Australian Government Receipts and Payments as a Proportion of GDP 1970-2019



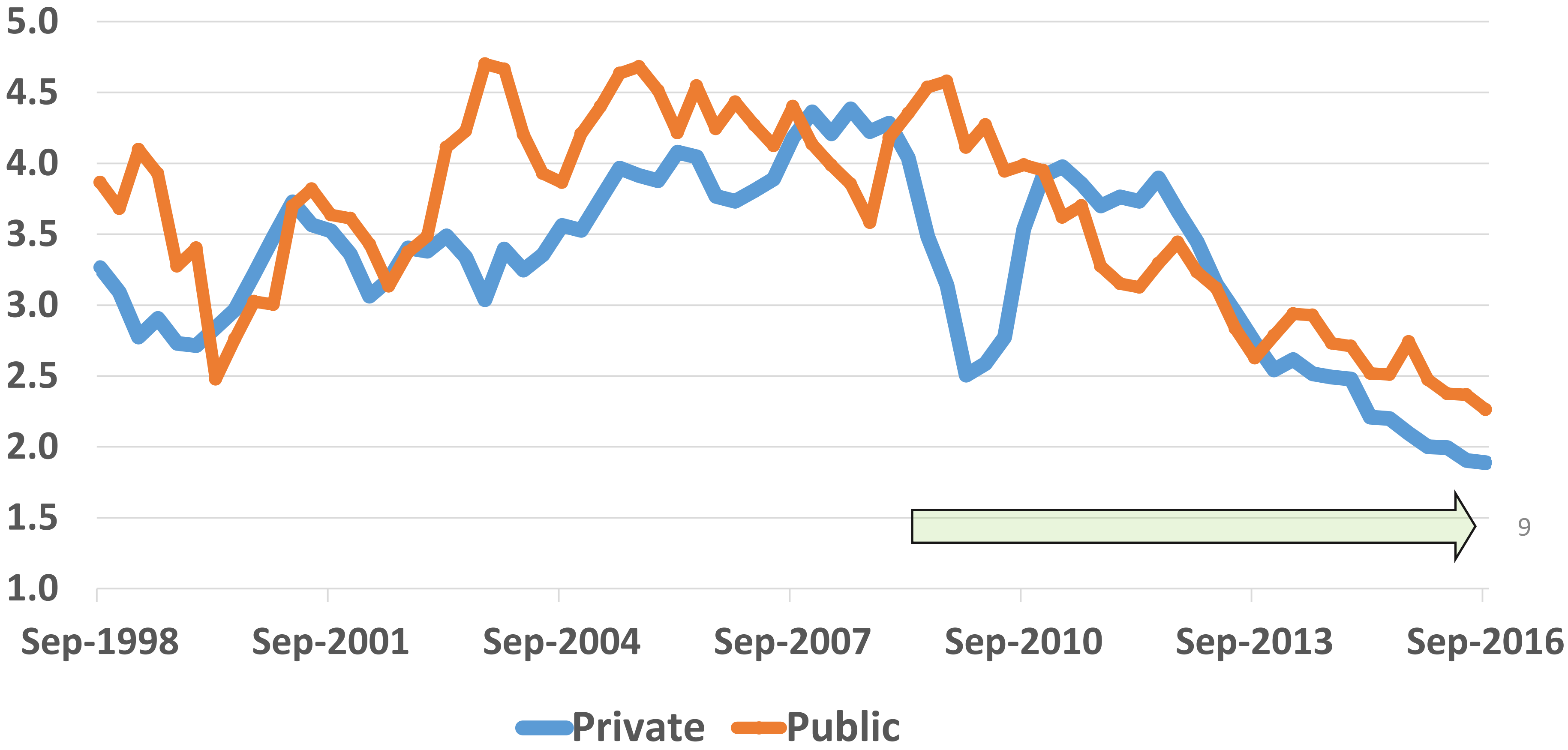
Budget Actual and Forecast Outcomes/GDP
Each budget from 2008-2009



Full-time Employment/Population 15+ years



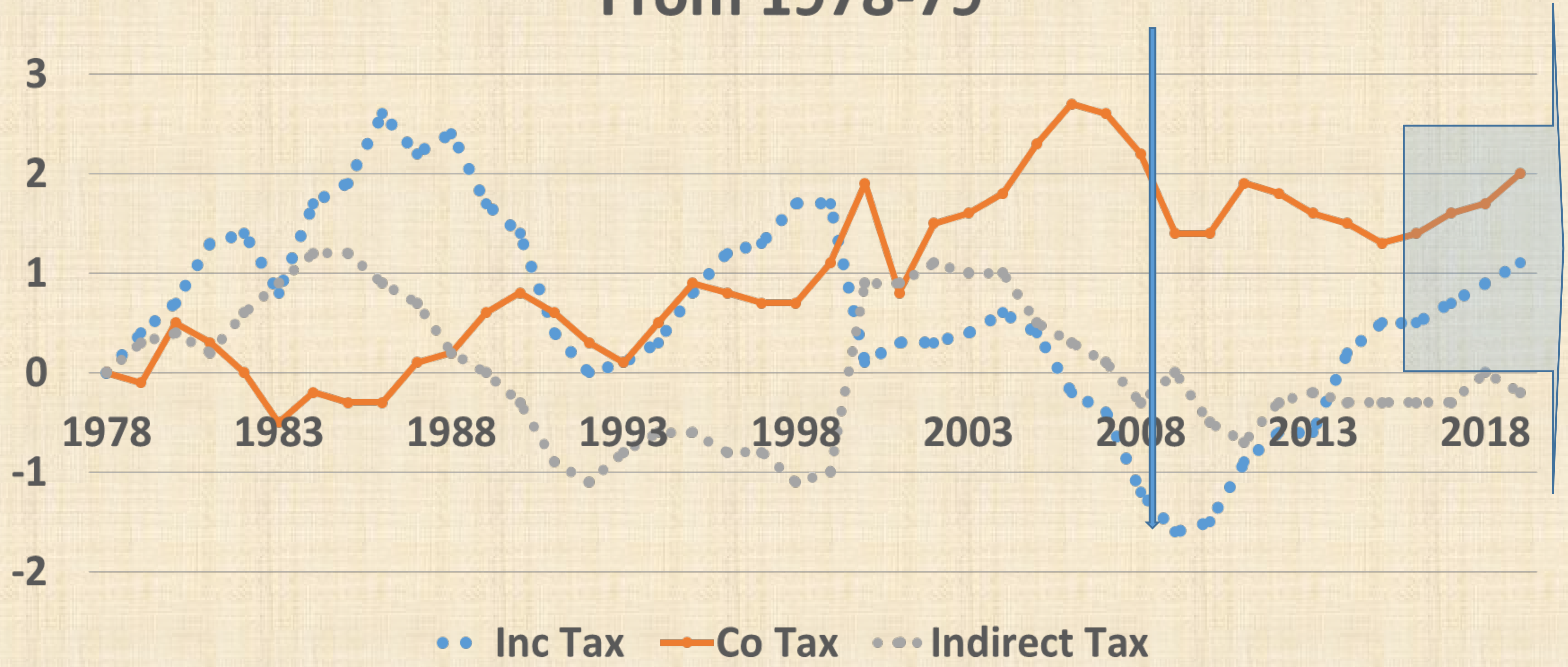
Annual hourly wage increase 1997-2016



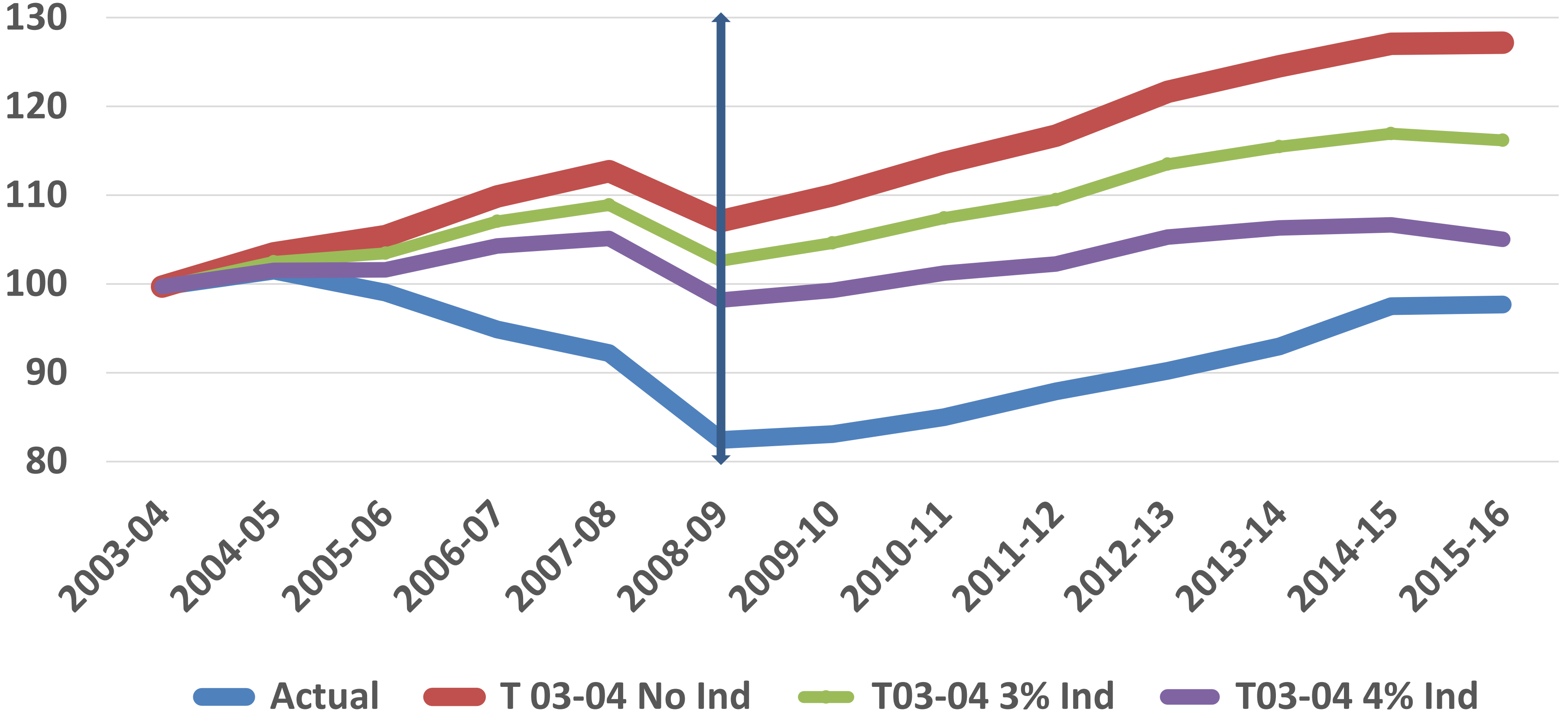
How did we get into this low tax revenue situation?

What was the role of structural change, recession and taxation policy?

Change of Tax Revenue/GDP From 1978-79



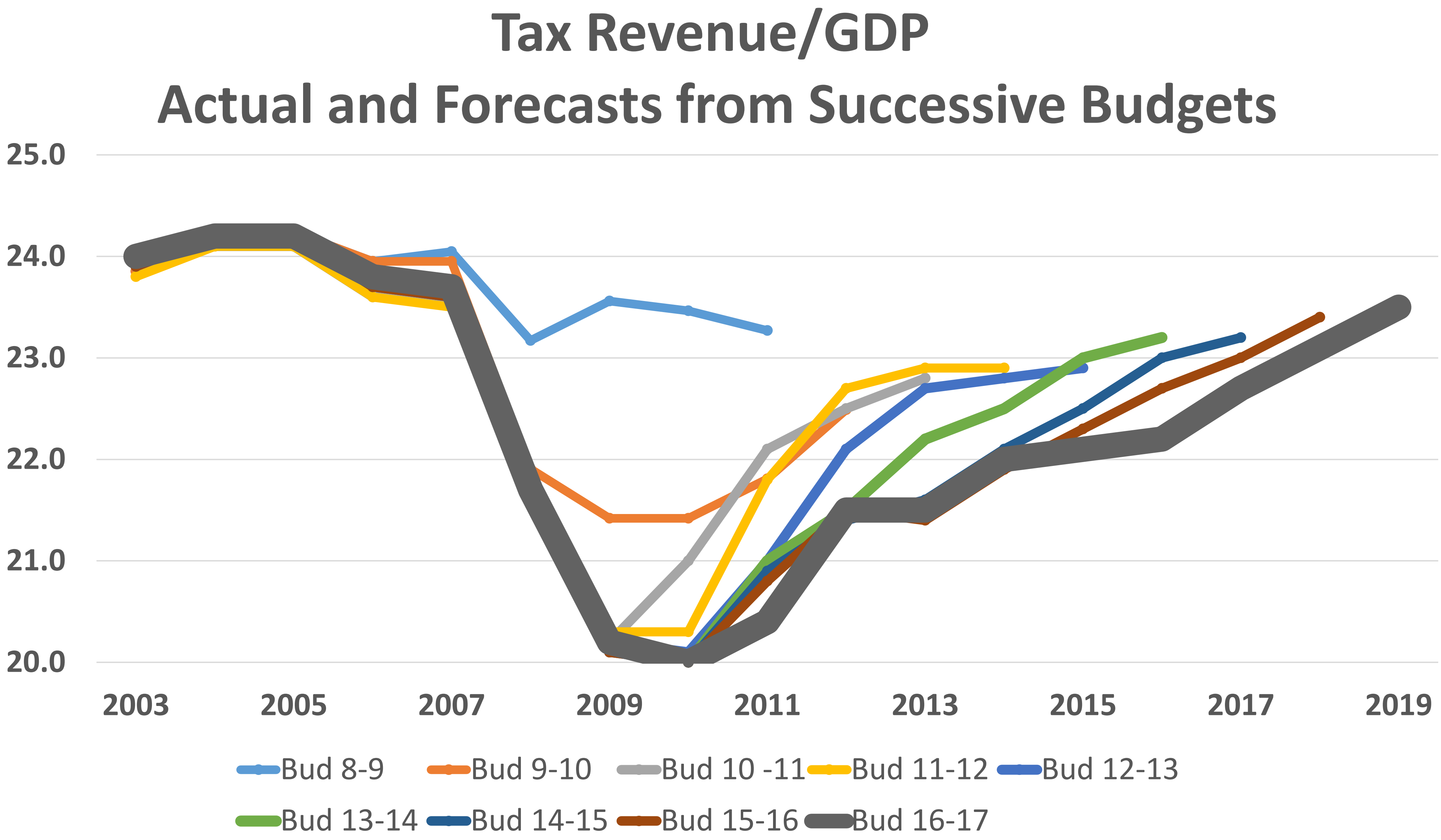
Actual and Simulated Personal Income Tax/GDP with different tax indexation rules 2003-04 =100



- The changing actual tax/GDP ratio is dominated by the large tax changes before the GFC. It was the Costello tax cuts rather than the GFC that created the large short fall in personal income tax.
- Costello tax cuts reduced personal income taxes by almost 30 per cent compared to a no indexation no schedule change: a huge series of tax cuts, which have not yet been clawed back
- Why did Costello do this?
- A comparison of 4% indexation and no indexation indicates the importance of bracket creep.
- A 4 per cent indexation rule applied to the 2003-04 schedule would have left the personal income tax/GDP ratio more or less constant over the 2003-2016 period

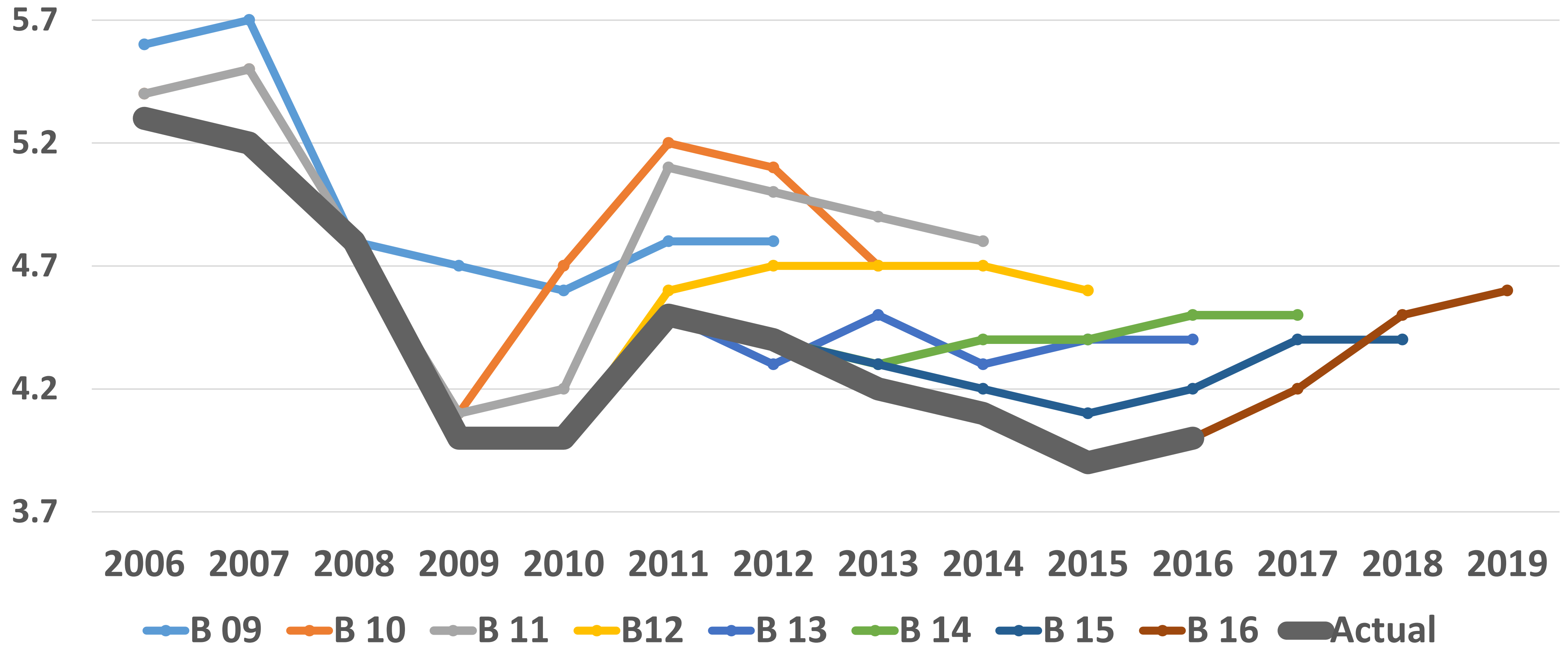
II Why have we been in deficit for such a long time?

- The tax forecasts were always too optimistic and suggested that economic recovery would solve the tax shortfall
- Government has been too optimistic for nine years and this probably diverted attention from the long run game
- What caused nine years of over prediction of tax revenues– nine years of unanticipated surprises!, no learning! governments misdirecting their focus?
- The ***personal income tax problem*** was largely created by Costello tax cuts.
- But there has also been a large problem of ***company tax shortfalls.*** Does this indicate the long drawn out recession or is it a results of the passing of the mineral boom? The tax shortfalls are in mining and finance.


Tax Revenue/GDP
Actual and Forecasts from Successive Budgets
25.0
24.0
23.0
22.0
21.0
20.0
2003
2005
2007
2009
2011
2013
2015
2017
2019
Bud 8-9
Bud 9-10
Bud 10 -11
Bud 11-12
Bud 12-13
Bud 13-14
Bud 14-15
Bud 15-16
Bud 16-17

- There has also been large falls in the indirect tax/GDP ratio which has returned to pre GS T levels. The GST no longer provides additional tax revenue to underpin the personal tax cuts

Company Tax/GDP
Actual, Forecast and Projection
Budget 09-10 to 16-17

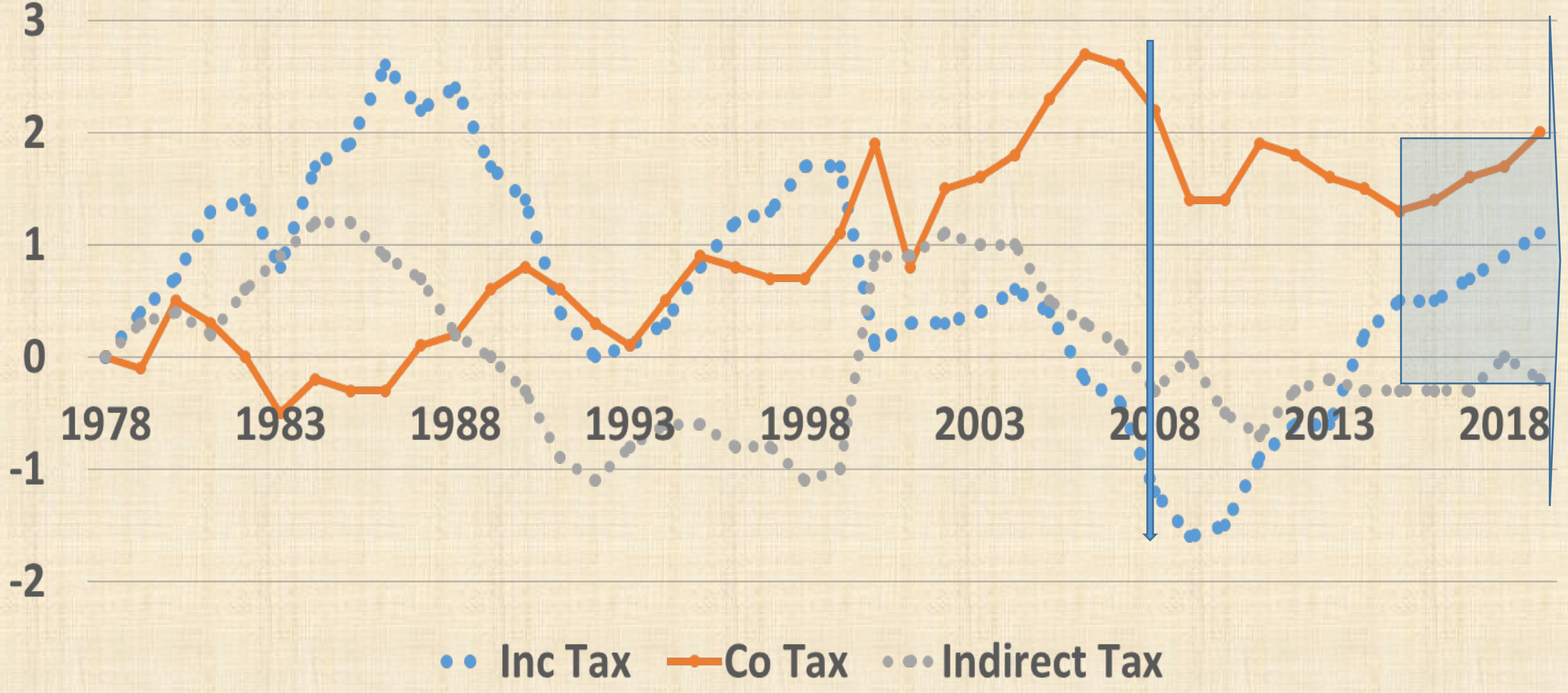


How will a budget balance be achieved?

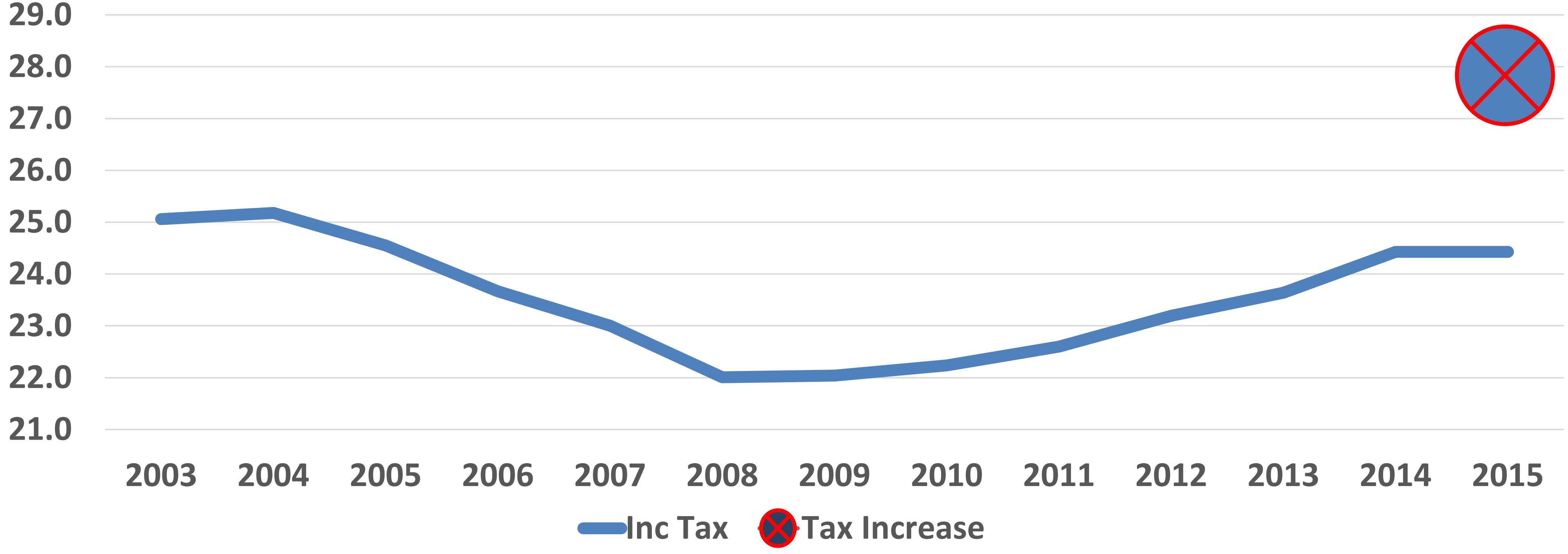
The forecasts and projections imply

- **Personal income tax will continue to increase as a share of GDP through the operation of bracket creep. It will reach the highest level for two decades**
- **Company tax receipts will reverse their downward trend and begin to increase. From 2015 they will be a major source of increased tax revenue**

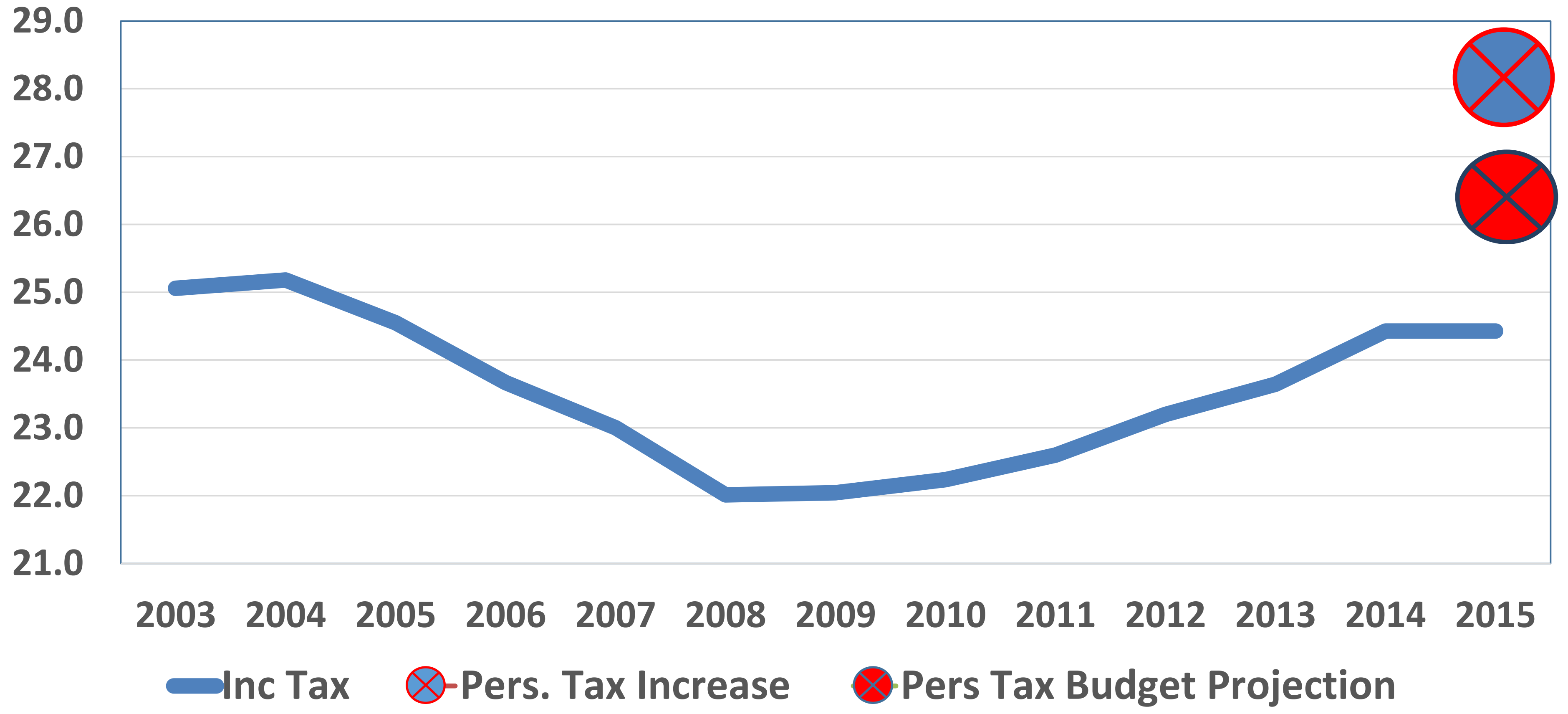
Change of Tax Revenue/GDP From 1978-79



Personal Income tax/Taxable Income Current Deficit instantly closed by Personal Income tax increase only



Personal Income tax/Taxable Income Current Deficit instantly closed by (i) Personal Income tax increase (ii) Personal Income tax Budget Projection



The End

Budget Outcomes, Estimates, Projections: Accrual Basis

Treasurer			**Swan**	**Hockey**	**Hockey**	**Morrison**			
	11 to 12	**12 to 13**	**13 - 14**	**14-15**	**15-16**	**16-17**	**17-18**	**18-19**	**19-20**	**Four Year Change**
Revenue										
Swan	*22.9*	23.7	**24.3**	24.5	24.8	**25.2**				**0.9**
Hockey		*23.6*	23.6	**24.0**	24.5	25.1	**25.5**			**1.5**
Hockey			23.6	23.9	**24.5**	24.8	25.4	**25.9**		**1.4**
Morrison				*23.7*	24	**24.2**	24.9	25.5	**25.9**	**1.7**
Expenses										
Swan	*25.6*	25.1	**24.9**	24.8	24.4	**24.4**				**-0.5**
Hockey		*25.1*	26.2	**25.4**	25.2	25.3	**25.3**			**-0.2**
Hockey			26.2	26.2	**26.2**	25.9	25.7	**25.8**		**-0.4**
Morrison				*26.0*	26.1	**26.2**	25.7	25.8	**25.7**	**-0.5**
Fiscal Balance*										
Swan	*-3*	-1.3	**-0.8**	-0.4	0.3	**0.6**				**0.6**
Hockey		*-1.5*	-2.8	**-1.6**	-0.7	-0.4	**0.1**			**0.1**
Hockey			-2.8	-2.5	**-2.0**	-1.3	-0.5	**-0.2**		**-0.2**
Morrison				*-2.5*	-2.4	**-2.2**	-1	-0.5	**-0.1**	**-0.3**