FEDERAL BUDGET

2012/13

Wednesday 9 May, 2012

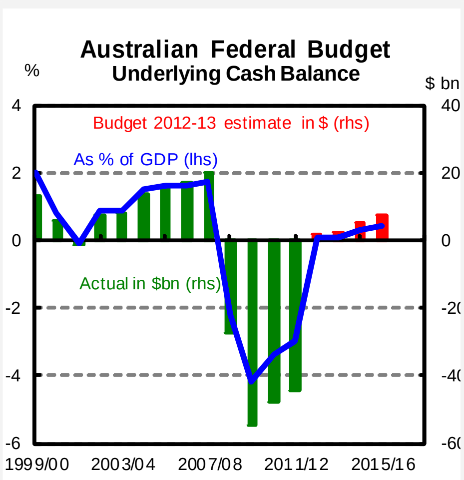
The Commonwealth Government is a significant part of the Australian economy. In 2012-13 it expects to raise $369 billion in revenue and spend around $368 billion.

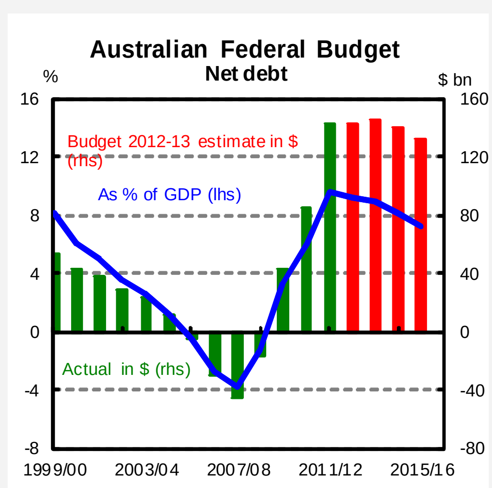
The bulk of its spending goes towards social security and welfare payments, health, education and defense.

During the global financial crisis of 2008-2009 government revenue was far less than initially anticipated as collections of company tax and personal income taxes fell. At the same time, spending on welfare payments increased and the government launched a stimulus package in order to avoid a recession.

While a recession was averted, the government was left with a significant Budget deficit. The 2012-13 Budget seeks to move from a large deficit to a small surplus with the hope that the surplus can grow in 2013-14 and onwards.

On paper, at least, it has succeeded. In this report we examine the changes to spending and revenue that produce the surplus plus some of the assumptions behind the figures.





Spending

In the face of weak economic growth and the impact of carbon pricing, the government has decided to provide low income families with support. It has also revamped its Education Tax Refund with the aim of getting cash into the hands of low income consumers more quickly. In 2012-13 this combined spending amounts to $0.6 billion with further spending in 2013 to 2016.

The introduction of a National Disability Insurance Scheme is to be applauded. However in 2012-13 only $83.9 million will be spent. The remainder of the $1.02 billion promised will be spent in 2013-14 and beyond.

In 2012-13, $84.4 million will be spent on dental health programs with the remainder of the promised $0.5 billion occurring in the following three years.

Much was made of the 'loss carry-back' for small business and it will be welcomed by some. However, of the $0.7 billion expected to flow to small business, only $6.7 million will occur in 2012-13. Access to the program is restricted to businesses with less than $2 million in turnover.

Similar comments apply to the government's reforms to aged care. Of the $1.5 billion allocated to building an aged care system for the future, only $48.8 million will be spent next financial year.

The government's spending initiatives are being financed by increases in revenue and are outlined in the section below.

Revenue

Total receipts are expected to increase from $330 billion in 2011-12 to $369 billion in 2012-13. Income tax receipts are expected to increase, reflecting an expected pick up in economic growth from 3.0% in 2011-12 to 3.25% in 2012-13. Additional revenue also reflects an increase in receipts from the resource rent tax from $1.5 billion in 2011-12 to $7.2 billion in 2012-13. The introduction of the carbon pricing mechanism also adds $4 billion of revenue in 2012-13.

Tax receipts however, have been revised downwards over the budget period since estimates were published in the Mid-Year Economic and Fiscal Outlook. In 2012-13, tax receipts (excluding GST) have been downgraded by $3.2 billion, although Treasury's growth forecast remained unchanged for 2012-13. The revisions largely reflect downgrades to company and superannuation taxes amid weaker profitability in businesses outside of the resource sector and sluggish asset price growth. Further, the growth driver of the economy, business investment, predominantly within the mining sector, is given investment-related tax deductions and therefore reduces overall tax receipts.

Other downward revisions include resource rent tax receipts. For 2012-13, there was a $850 million downgrade in resource rent taxes due to weaker coal prices and an upward revision to the Australian dollar.

GST revenue has been downgraded by $3.0 billion in 2012-13, as a result of a softer outlook for consumption and this will affect the bottom line for State budgets.

New policy decisions have partly offset the declines in revenue by $2 billion in 2012-13. The most notable measure is abandoning the decision to lower the company tax rate from 2012-13. This measure increases tax receipts by $300 million in 2012-13 and $4.6 billion over the five years from 2011-12. Additional revenue of $580 million in 2012-13 has also been found by deferring an increase in the concessional contributions cap for over 50s with superannuation balances below $500,000 to 1 July 2014 from 1 July 2012.

Economic Parameters

The economic forecasts are broadly similar to those of the Reserve Bank (RBA) published in last week's Statement on Monetary Policy.

The Australian economy is forecast to grow at "around trend" over the next two years. The drivers of growth are expected to be business investment, led by the resources sector and exports (despite a forecast decline in the terms of trade and expectations for the Australian dollar to remain high).

Economic growth in 2011-12 is forecast to be 3.00%. Economic activity is then expected to accelerate with GDP growth of 3.25% expected in 2012-13, before slowing back to 3.00% growth in 2013-14, according to the Budget forecasts. Although the forecast for economic growth in 2011-12 looks somewhat ambitious, the forecasts for the Budget year 2012-13 look reasonable and the forecasts for 2013-14 appear on the conservative side of the RBA's estimate.

Headline inflation is expected to be 3.25% through the year to the June quarter 2013, which includes a ¾ of a percentage point boost from the introduction of the carbon price. Inflation is then expected to ease to 2.50% through the year to the June quarter of 2014, in the middle of the RBA's 2-3% target band. The inflation forecasts appear reasonable compared to those of the RBA and while higher than our own, would still give the RBA room to cut interest rates further, if necessary, if the impact of the carbon price is removed from the calculations.

The Budget forecasts the unemployment rate to rise from its current rate of 5.2%, to 5.5%

in 2012-13 and 2013-14, before easing back to 5.0% in 2014-15.

The Budget forecasts assume (as is standard practice) that interest rates "move broadly in line with market expectations". Markets are currently pricing in 75 basis points of interest rate cuts, which would take the RBA's cash rate to 3.00%.

	Forecasts (% Change on Previous Year)			Projections
	2011/12	2012/13	2013/14	2014/15
Real Gross Domestic Product (GDP)*:				
Budget	3.00	3.25	3.00	3.00
RBA Statement on Monetary Policy	2.75	3.00-3.50	3.00-4.00	-
Our Forecast	2.80	3.10	3.50	-
Unemployment Rate (%, June Quarter)**				
Budget	5.25	5.50	5.50	5.00
RBA Statement on Monetary Policy	-	-	-	-
Our Forecast	5.30	5.50	5.50	-
CPI (Headline) ***				
Budget	1.25	3.25	2.50	2.50
RBA Statement on Monetary Policy	1.25	2.50-3.50	2.00-3.00	-
Our Forecast	1.25	2.80	2.50	-

*Real GDP forecasts are year average. **The unemployment rate is for the June quarter. *** Through the year growth rate to the June quarter

Conclusions

From a macro-economic perspective the 2012-13 Budget will place a drag on the economy as government revenue increases but the effects of this will be softened by extra funding for consumers.

The government is hoping for economic growth of 3.25% in 2012-13. While this forecast is reasonable, it is open to risk. Current economic growth is below this pace and the Budget itself is contractionary. The government is clearly hoping the RBA will step into the breach.

The move towards surplus is appropriate policy. While the cash handouts will help families in the short term, they do not address the fundamental issues of coping with structural change. A reduced company tax rate would have assisted the process of change but this has been directed predominantly towards consumers with some assistance given to small business.

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The Detail