

RUDD & SWAN

NO FRILLS BUDGET 2010

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Introduction: Swan's moment in the sun.

"Tonight we meet the highest standards of responsible economic management," said Federal Treasurer Wayne Swan as he delivered his third Budget speech to Parliament.

Sure the Treasurer has tickets on himself, but he's earned the right to crow a little.

What a difference a year makes.

"We do not easily forget this time last year, when we faced the grimmest set of global economic conditions since the Great Depression," said Swan.

The international economy remains in crisis, with last week's Wall Street drop and a crippled Greece propped up by the EU and the IMF.

By comparison, Australia's escape, relatively unscathed, seems near miraculous. It's not, but we're undeniably sitting pretty, writes Professor John Quiggin in *Crikey*: "The capacity to use monetary and fiscal policy in response to some unexpected future shock will be enhanced by a rapid return to budget surplus and neutral settings for monetary policy."

We boast our own set of vulnerabilities, the housing bubble being one, but for now, the giant economic gamble that the government took last year has paid off.

So what did Budget 2010 look like? Was it the "no frills" affair promised by Swan? Does it show the government to be fiscally responsible? Which sectors will benefit most from a sudden flow of extra cash? How will the government pay for it? Read on for the detail.

Budget 2010: it sure is a “budget” Budget.

Crikey Canberra Correspondent, Bernard Keane, writes:

Wayne Swan’s third Budget was billed as a “no frills” affair and the Treasurer has delivered in spades with another small reduction in the deficit and offsets for a range of mainly health-related initiatives. The only excitement is the central selling point for the government — a much faster return to surplus than forecast, with a small surplus now forecast for 2012-13, three years ahead of previously forecast.

But the lag from taxation receipts from a recovering economy means there will still be a \$40.8 billion deficit in 2010-11, before an expected \$34 billion surge in revenue in 2011-12 hits the Budget bottom line and accelerates the Government’s return to surplus.

As expected, the government has pumped even more money into primary health care — \$2.2 billion all up, in addition to the funding deal thrashed out with the states and territories at COAG. A new Renewable Energy Future Fund will also be established, partly funded by savings from the shelving of the CPRS, to pump more money into the renewables sector despite the slow rollout of previous big spending initiatives like the Solar Flagships program.

There’ll also be a simplified tax return system from 2012-13 and an array of small tax changes aimed at reducing compliance costs for small businesses and enhancing Australia’s credentials as a financial services centre. They include the establishment of a retail bond market and tax changes for foreign-owned banks to reduce their cost of capital and increase competition for local banks.

Otherwise, the sort of big-ticket spending items that traditionally form part of a pre-election budget are absent. Instead, this is a budget designed to convince Australians that Labor can be trusted to manage the recovery as well as it managed the GFC.

The Budget returns Australia to right where it was in 2008, before the GFC tore a hole in the government's economic plans. Returns literally — the government will spend 25.1% of GDP this year, the same as 2008, after the stimulus surge in spending last year that took spending to over 26% of GDP.

And like in 2008, the government has disappointed on the savings front, finding only \$1.4b in savings next year. It has claimed \$2.5b and \$30b over Forward Estimates, but much of that is the RSPT and tobacco excise increase rather than genuine cuts in expenditure — although the Government has moved to end the disgracefully generous treatment of locally-produced ethanol and achieved some big savings on pharmaceuticals.

The economic forecast that will drive the rapid return to surplus is fuelled by a 14.5% terms of trade surge — 3.75% GDP growth next year, rising to 4% in 2011-12 before dropping back to 3% in out years; unemployment will drop to 4.75% in 2011-12 and inflation will remain steady at 2.5%.

The story of this Budget, and like the Australian economy as a whole, is pretty simple: it's doing almost obscenely well compared to other western economies, and the GFC is increasingly looking like a momentary aberration from a long, resources-led period of high growth in a flexible, open economy. The government doesn't have to work too hard to keep that growth going, but it is a huge challenge to manage it sustainably. The government's tax package and this Budget are small steps toward that goal, though at least they're in the right direction.

The S Word.

Crikey Canberra Correspondent, Bernard Keane, writes:

For the government, there's only one number that counts in this Budget — 3. That's the number of years within which the government will return to surplus, and the number of years early it's returning the Budget to surplus and the number that will be trumpeted by Wayne Swan and the prime minister from now until the election.

As a statement of the government's economic credentials to an electorate feeling temporarily jaded of Kevin Rudd and all his works, it is a fairly powerful statement.

The mind-boggling array of health spending in the Budget will impress even the harshest critic of the government health reform plan, but that's now yesterday's theme. Health reform is done and dusted. There's more funding for renewable energy and training, and efforts to encourage the development of Australia as a global financial sector. But this is all about economic credibility — to wit, that the government has it, and the opposition does not, that the government can be trusted, but Tony Abbott is a risk.

While the 2010-11 deficit of \$40.8b still looks painfully high for a government battling an opposition obsessed with debt'n'deficits, in truth the Budget leaves the opposition with little room to move. The deficit will shrink dramatically in 2011-12, fuelled by a surge in tax revenue, putting the government within touching distance of a balanced budget years ahead of originally estimated. The opposition's charges of incurring Greek levels of debt will look problematic given Swan will be presenting a surplus before the election after this.

There's a faint air of unreality about the rapid return to fiscal rectitude. Not so much from the figures themselves — as John Quiggin shows in *Crikey* today, an even quicker return to surplus is quite plausible — as from how they were achieved. They have mainly been built on the back of Treasury's mid-GFC gloom proving too pessimistic (you'll recall, of course, they were criticised for being too optimistic), a mining boom and a series of accounting changes and tax rises. On the other hand, apart from its health spending, the government has exercised some restraint to bank the surge in revenue, and has extended its commitment to a spending cap of 2% beyond the return to surplus, until the surplus reaches 1% of GDP.

It's called fiscal discipline without political risk, and this government has proved very good at it, avoiding controversial large spending cuts in favour of keeping growth in spending down.

Swan's lock-up press conference showed exactly where the government wants the emphasis in this Budget to lie — he spent nearly all of it discussing the return to surplus and the government's fiscal discipline, before dashing through the spending highlights at the end. And as if to demonstrate just how pre-election budgets have changed, Swan found himself under attack from journalists suggesting the conservatism of the Budget was a pre-election ploy.

Swan repeatedly insisted that the Budget had not been crafted with an election in mind. He might have been lying, but judging by the Budget itself, you could never tell.

Budget backs Opposition into a corner.

UQ economics professor and *Crikey* Budget boffin John Quiggin writes:

Last year's Commonwealth Budget represented a huge, and, for the most part, successful economic gamble. The gamble last year was that a big budget deficit would yield an economic stimulus sufficient to outweigh the associated increase in public debt and provide a basis for sustainable economic growth in the future.

As the Treasurer's speech points out, the Australian economy has recovered strongly at a time when the US and European economies are only marginally stronger than at the depths of the recession. Public debt is now projected to peak at 6 per cent of GDP, compared to a developed world average of more than 80 per cent. The government's claims as strong economic managers have a fair bit of credibility.

This year's Budget is a political gamble; that the government can win re-election based on that credibility, without offering any significant electoral sweeteners. The government doubled down on this gamble with the series of backflips and repudiated promises in the leadup to the Budget, motivated largely by the desire to achieve an early return to surplus. The political price for these backflips, most notably the indefinite deferral of the CPRS, has been steep, and it's far from obvious that the Budget will provide any offsetting bounce.

The government's rhetoric also precludes anything extravagant in the way of election promises. Given that the projected surplus is only \$1 billion, there room to move. Anything new has to be fully offset, or else justified by a further upward revision in estimates of the net position.

There are a few options remaining. The Henry Review provides a wide range of policy options in addition to the handful of measures adopted in the budget (in addition to the Resource Rent Tax, the budget implemented Henry's recommendation for concessional treatment of interest income). Some of Henry's measures would increase revenue and provide funding for new initiatives.

Equally, the Budget presents the Opposition with some nasty political problems as the election approaches. Tony Abbott has dissipated any credibility he might have had with a series of policy thought bubbles. The most notable was the announcement of a generous parental leave scheme, to be financed by a levy on big business, in direct contradiction of his rhetoric about Great Big New Taxes. So far, the political cost has been modest. But he cannot afford any holes in the accounting for his election platform.

Abbott now has to decide whether to match the government's pledge of a return to surplus by 2012-13. Like the government, the opposition has no room to move, in net terms, if this target is to be met. But the position is worse than that for the coalition. The government's projection includes the revenue from a range of measures the opposition has pledged to reject, including the means test on the private health insurance rebate, the tobacco tax and the resource rent tax. In the absence of a backdown on these measures, the opposition has to find big expenditure cuts just to break even.

The result is not one to inspire enthusiasm. But we ought to be grateful that we are facing these problems, and not those of the US, UK and eurozone.

Where will the savings come from?

Crikey Canberra Correspondent, Bernard Keane, writes:

The Government has been on a spending spree since last November, splurging \$30b over Forward Estimates, but has offset nearly all of it with \$28b worth of savings and tax increases, according to Budget papers. This year and in 2010-11, the Government will spend approximately \$4.2b in net terms – but expects to come out \$544m ahead in the long run.

When it comes to savings, however, the Government is relying heavily on two new taxes — the RSPT, although that only fully kicks in in the last year of Forward Estimates, so it plays no role in the return to surplus, and the tobacco excise, which while hypothecated to health spending, frees other revenue up that would otherwise be required for health purposes (for the problems of this sort of earmarking of revenue, advocates should Google “hypothecation” and “fungibility”).

Together, those two furnish \$17b of the \$30b of “savings” identified over Forward Estimates in the Budget.

Greater GST compliance is forecast — with remarkable accuracy — to also yield \$1.1b.

The only true, big-ticket savings in the Budget are PBS reform, which yields nearly \$1.3b and which, along with changes to the new Community Pharmacy Agreement (\$480m) represents the hard work of Nicola Roxon and her bureaucrats; a fortuitous, but apparently legitimate, change in national accounts methodology affecting the foreign aid budget (\$1b), cuts to the Green Car program (\$200m, and the Rudd Government’s first anti-protectionist decision) and some fiddles to superannuation concessions to yield over \$800m.

These superannuation fiddles — the Government played the same trick last year — tend to fly beneath the radar (they are listed separately in the Budget documents to look more innocuous) but are a lucrative source of revenue for a Government otherwise unwilling to seriously reform our absurdly generous

superannuation-related tax concessions, on the basis that it doesn't want to keep tinkering with super.

There's also nearly \$400m from changes to the taxation arrangements applying to companies that split and merge.

And Martin Ferguson has belatedly responded to the Government's own internal review of the Howard-era ethanol excise arrangements (including the outrageous Manildra-inspired tariff on overseas-produced ethanol) by phasing out the tariff and implementing a energy-based taxation regime for fuel.

The Government's ditching of the CPRS has also saved it a total of \$3b over Forward Estimates, but only in accrual terms; in cash terms between now and 2010-11 to 2013-14 it only amounts to \$415m (the reason Wayne Swan was so adamant the expenditures allocated to the CPRS in MYEFO weren't available for spending in the Budget; it turns out he was correct); with departmental savings, the government has redirected \$650m from the CPRS to new renewable energy fund.

But the real heroes of return to surplus will be personal income tax and company tax receipts, which are expected to surge as a proportion of GDP. Personal income tax will lift from this year's low of 9.5% of GDP up to 9.8% next year then 10.2% in 2011-12, and company tax will lift from 4.1% of GDP to 4.7% and then 5.2%, delivering a \$34b revenue increase in 2011-12.

With such a surge in taxation receipts, it only needs a Government to sit on spending in order to start building surpluses. And that's exactly what this Government is doing.

Health gets another boost.

Crikey Editor Sophie Black writes:

On top of the spending already announced under Rudd and Roxon's health reforms under the COAG agreement, the 2010 Budget invests a further \$2.2 billion over four years in health and hospital reform, across three broad platforms:

Access to GPs: \$355.2 million over three years for 23 new GP Super Clinics and 425 facility upgrades and \$417 million to enhance after hours services and to establish Medicare Locals across the country, responsible for identifying service gaps in local areas and improving co-ordination of primary care, hospital and aged care services.

Training and support for nurses: \$523 million over four years to train and support nurses:

Including \$390.3 million over four years to improve financial support for nurses in general practices to help expand their role in primary care, particularly in prevention and chronic disease management

\$128.4 million over four years for training and education incentive payments for nurses and personal care workers in aged care; to allow rural nurses to take leave; to build nursing careers in aged care; and to evaluate nurse practitioner models in aged care.

E-health: \$466.7 million over two years from 2010-11 to establish the "key national components" of a personally controlled Individual Electronic Health Record (IEHR) system, an online system that enables health care providers to access and use an individual's health care record when and where it is needed, with consent, with a view to modernising health system to "boost patient safety, make it easier to navigate the health system and slash waste and duplication." Commencing in 2012-13.

This takes the total investments to \$7.3 billion over five years to support the National Health and Hospitals Network.

Big ticket items already announced as part of Rudd's COAG agreement include:

- * Government will provide \$1.6 billion over four years to provide funding for at least 1,300 additional beds for sub-acute services (announced 20 April 2010) as part of the COAG communique and is subject to States and Territories committing to and establishing an agreed number of new sub-acute beds each year to receive payment from the Commonwealth.

- * \$625.3 million over four years to reduce waiting times for elective surgery in public hospitals, announced 12 April 2010. Of this, \$300 million will be provided to the States and Territories in 2010-11 to help reduce elective surgery backlogs, with a further \$350 million available in reward payments for those States and Territories that meet the announced targets, under a National Partnership Agreement.

There are also some interesting reforms to the Pharmaceutical Benefits Scheme and the Repatriation Pharmaceutical Benefits Scheme (RPBS) worth noting: changes will be made to the way Formulary 2 (F2) medicines are priced:

"F2 medicines are those listed on the PBS and RPBS that currently attract a statutory price reduction when a single brand medicine becomes subject to direct competition, usually when a patent expires.

Pricing of F2 medicines will be reduced firstly by strengthening price disclosure and secondly, by implementing three statutory price reductions."

From October 1 this year all F2 medicines will be subject to price disclosure and according to Treasury estimates, these measures will provide savings of \$1.9 billion over five years.

A billion to border security.

Crikey Editor Sophie Black writes:

The government has put its money where its mouth is when it comes to backing its increasingly hardline rhetoric on border security, flagging \$1.2 billion to “enhance and strengthen Australia’s border and aviation security.”

There’s spending flagged across airport security, detention centre upgrades, a new passport issuing system and continuing co-operation with Indonesia to manage “irregular migration flows in the region.”

Initiatives include \$143.8 million for capital funding for additional immigration detention facilities and \$119.3 million over four years for the improvement of facilities, infrastructure and services on Christmas Island.

There’s also a further emphasis on the coastal guard — replacing “ageing Bay Class patrol boats with new enhanced vessels of longer patrol times over greater distances” and “\$15.7 million over two years for the continued lease of the Ashmore Guardian patrol vessel from 1 July 2011 to 30 June 2013”.

The ship will be used primarily for apprehension of “illegal foreign fishers; monitoring environmental compliance; and countering people smuggling operations.”

\$199.2 million has been flagged over five years for improved screening technologies, policing at airports and enhanced security procedures and \$100.8 million over six years to deliver a new passport issuing system.

In addition, \$69.4 million has been assigned over four years to introduce the biometric-based visa system (finger prints and facial images) for certain visa applicants in 10 overseas locations announced earlier in the year in the wake of the US Christmas Day security scare and to develop data sharing capabilities with partner countries.

And in perhaps further acknowledgement that the Christmas Island detention centre isn’t going to look any less crowded in the near future, \$18.9 million has been assigned over four years to upgrade existing onshore detention facilities

at Villawood, Port Augusta, and the Northern Immigration Detention Centre in Darwin.

In another nod to further solidifying the discourse with Indonesia over asylum seekers, \$32.9 million over four years has been assigned to “enhance Indonesia’s capacity to manage irregular migration flows in the region and reduce the number of irregular migrants seeking to enter Australia.” This funding will “support enhanced visa processes and accelerated refugee status determination in Indonesia.”

The government will also provide \$163.2 million over four years to “secure Australia’s northern waters against illegal foreign fishing.” The funding will “enable continuation of the apprehension, transfer, processing, detention, investigation and prosecution of illegal foreign fishers.”

And buried between Australian Customs and Border Protection Service and ASIO efficiencies, there’s a nod to the Australian Human Rights Framework: The Government will provide \$18.3 million over four years to “implement a new framework for the protection and promotion of human rights in Australia” through raising awareness in the community and the public sector “through targeted education initiatives.”

The government’s Emissions Trading Disaster.

UQ economics professor and *Crikey* Budget boffin John Quiggin writes:

The government’s politically costly decision to announce a series of backflips in the space of a few days, just before the Budget, seemed explicable only on the basis of a desire to find expenditure savings. The most prominent backflip, on the CPRS, seemed to fit this pattern, since Kevin Rudd’s announcement included the point that the ex-CPRS would not be included in the Budget. Surprisingly, though, senior government officials in the Budget lockup insisted that this was not the motive.

They argued, and the Budget papers state, that all the CPRS savings (at least in cash terms) had been reallocated to the Renewable Energy Future Fund, part of the expanded \$5.1 billion Clean Energy Initiative. Funding will be used to provide support for the development and deployment of renewable energy projects, including wind, solar and biomass.

The picture is not so clear in accrual terms. Because the CPRS involves the sale of “future vintage” permits to be used outside the forward estimates period, the associated cost to the Budget was much larger (by about \$2 billion) when measured in fiscal balance (accrual) terms. The savings from scrapping the scheme are correspondingly larger in those terms.

If the government’s story is right, Rudd’s announcement was a simple, but gigantic, political blunder. The government could have left the CPRS in Senate limbo, and announced the REFF as a contingency measure until it was passed. Instead, the government more or less explicitly caved in to the opposition, saying “The Government will not introduce the CPRS until after the end of the current commitment period of the Kyoto Protocol and only when there is greater clarity on the actions of major economies including the US, China and India.”

That said, the fact that scrapping what was, in essence, a revenue measure could save the government money shows what an appalling mess the CPRS had become by the time of the final compromise with Malcolm Turnbull. If there is one benefit from the government’s mishandling of this issue, it is the opportunity to start again from scratch.

In the meantime, it’s worth thinking about the Greens’ proposal for an interim carbon tax. If such a tax were levied on consumption (including imports) rather than production, there would be no need for the extensive compensation associated with the CPRS. And a tax levied at a low rate (\$10/tonne or even \$5/tonne) would be virtually invisible, helping to dispel the absurd panic over this issue.

In the context of a global agreement, an emissions trading scheme based on production makes more sense than the alternatives (for example, making carbon taxes internationally comparable is just about impossible in a world of floating exchange rates). But, given that such an agreement is some way off, a carbon tax might be the way to go.

Read more as the analysis unfolds at *Crikey's* [Budget 2010 page](#).