NATSEM PRELIMINARY BUDGET ANALYSIS 2016

An Enterprise Budget in Times of Mistrust

NATSEM Federal Budget Luncheon Event

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ABOUT NATSEM

For over 20 years NATSEM has been, and remains, one of Australia's leading economic and social policy research centres, and is regarded as one of the world's foremost centres of excellence for microsimulation, economic modelling and policy evaluation.

NATSEM was initially established at the University of Canberra in 1993 to develop microsimulation models for the Federal Government and to undertake broad social and economic modelling and research. A major modelling task was to develop STINMOD – a model of the personal income taxation and government benefits system.

The Federal Government heavily relies upon this model through Treasury, Social Services and Employment to understand how policy impacts on families – both example families (cameos) and the broad impacts on different socioeconomic groups across the country.

NATSEM undertakes independent and impartial research, and aims to be a key contributor to social and economic policy debate and analysis Australia-wide and throughout the world using expert economic modelling of the highest quality, and supplying consultancy services to commercial, government and not-for-profit clients. Through its research NATSEM is an active contributor to social and economic policy debate and its research receives extensive media and public attention.

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SIGHTING SHOTS – A PRECARIOUS CONTEXT

The 2016 Australian Budget has been launched at a time of significant uncertainty. The Australian economy is presently characterised by a modest growth rate of 2.5% (below the forecast level of the last budget), falling business and consumer confidence, a cooling housing market and an increasing budget deficit (estimated at $39 billion for 2015-16 according to the Budget Papers). In combination, this adds up to the emergence of worrying deflationary pressures and concern is rising over whether Australia's AAA international credit rating could be at risk. Moreover, the prospects of these pressures easing over the year are unlikely given that global markets continue to be unnerved by the longer-term prospects (however unlikely) of a British exit from the European Union and a Trump Presidency.

Against all of this, levels of trust in government and politicians in Australia are at the lowest level since 1993. Only 5% of Australians trust government, 74% exhibit a critical perspective, only 25% trust government ministers and satisfaction with democracy in Australia is now at its lowest level since 1996 (see: https://theconversation.com/now-for-the-big-question-who-do-you-trust-to-run-the-country-58723). While the Howard years provide evidence of a culture of contentment, 2007 to the present day has clearly been a period of profound citizen discontent with governments and politicians across the political spectrum.

In sum, these are capricious times for delivering a budget that will launch an election.

BIG IDEAS – THE ENTERPRISE BUDGET

The big ideas underpinning Budget 2016 have oscillated between narratives on whether the budget will "repair" the economy, help Australia to avoid "recession", "renew" the economy or whether it is "fair". This is crystallized in George Megalogenis's recent clarion call for the Turnbull government to achieve a "balancing act" between staving off recession and affecting a new politics of change and renewal. So how has the Turnbull government responded to this challenge? Budget 2016 is presented as an Economic Plan for Jobs and Growth. It introduces a series of measures outlined in a '*Ten Year Enterprise Tax Plan*'. Four themes are emphasized: 1) renewal through enterprise; 2) perceived improvements to the tax system to increase revenue; 3) fiscal consolidation; and; 4), fiscal stimulus. A classic cocktail for an enterprise budget aimed at fuelling what J.K. Galbraith has termed elsewhere the 'culture of contentment'.

The first theme refers to measures focusing on building an enterprise economy or what the Prime Minister Malcolm Turnbull has referred to "as responding to the challenges of the new economy" to ensure that the "spark of enterprise keeps burning and every policy of my Government is determined to encourage it" (https://twitter.com/TurnbullMalcolm/status/723408274171650048). These are measures geared towards boosting the enterprise economy in the run-up to the July election and include a range of tax concessions and other enterprise incentives and supports for corporates, start-ups and a more inclusive categorisation of "small business".

The second theme reflected the Treasurer's ambition to introduce a range of measures to improve the tax system to "make sustainable changes…so it can support the needs that are there in the future." This has included changes to superannuation, a modest tax cut for mid-high income earners, the prevention of bracket creep for middle-income earners and the tackling of tax avoidance by multi-national corporations.

The third theme expands on the fiscal consolidation measures initiated in the previous budget through additional cuts to the Australian public service (referred to as a "$1.4 billion efficiency dividend"), the termination of certain programs and delays in the inception of programs.

The fourth theme involves significant spending measures in defence, education, and infrastructure to further stimulate job creation.

In the upcoming financial year (2016-2017), the Commonwealth government is expected to collect total revenue of just over $416.9 billion dollars, which is around 24.2% of the size of the economy (% of GDP) and an increase of 5.2% from last year's total revenue. This is equivalent to around $26,000, or nearly 17 weeks of full-time work with an average wage for everyone in the working age population (age 15 and 64). On the expenditure side, the Commonwealth government is expected to spend $451 billion dollars over the next financial year, a 4.4% increase compared with last year. This translates to an expected fiscal deficit of $37.1 billion dollars (2.2% of the GDP), raising the total government net debt to $326 billion dollars, which is about 18.9% of GDP.

Let's look at these measures now in a little more detail.

A SNAPSHOT OF BUDGET OUTCOMES

And the winners are …

- Middle income earners will benefit from tax cuts to the tune of $6 per week. This measure will reduce the marginal rate of tax on incomes between $80,000 and $87,000 from 37% to 32.5% which means those above $87k retain the full saving of $7k*.045= $315 per annum. The income tax measures (which are pretty modest) have been introduced to prevent bracket creep (where wage inflation pushes people into higher tax brackets).
- Women on low incomes could benefit from a Low Income Superannuation Tax Offset (LISTO).
- Young job seekers under the age of 25 will be able to access *The Youth Jobs Path* which will provide them with job hunting skills and internships during which they will earn an additional $100 per week on top of their existing allowance.
- Australian corporates will benefit from company tax cuts from 30% to 27.5% (2016) and 25% (2017). This will affect about 870,000 registered companies with more than 3.4 million employees.
- Small businesses (with a turnover threshold increase from $2 million to $10 million) will benefit from a tax cut to 27.5% from the 2016-17 income year. The threshold will then be progressively increased to ultimately include all companies at 27.5% in the 2023-24 income year.
- Medium-sized businesses (with an annual turnover below $10 million), get a tax break from 28.5% to 27.55%.

And the losers are…

- Australians with large superannuation funds – given the introduction of a $1.6million superannuation transfer balance cap.
- Pensioners – $1.2 billion has been stripped from aged care.
- Australia's aid dependents as the Foreign Aid budget has been cut by $224 million leaving foreign aid at a record low.
- The Australian Public Service which has to find $1.2 billion of efficiency savings.
- Multi-national companies engaged in tax avoidance – $3.7bn is expected to be generated from this measure over 4 years and will create 1000 ATO jobs.
- Smokers due to increases in tobacco excise to equivalent customs duties through four annual increases of 12.5% per year from 2017 until 2020.
- Universities in two ways – Cuts to universities announced by the Abbott/Hockey partnership that did not get through the Senate are included in this budget. This is a $2 billion "saving" starting with a $100 million cut in the next year, increasing to half a billion for each of the following two years, and nearly $800 million a year by 2020. Moreover, no deregulation package for student fees emerged in the budget.

WHAT HAVE BEEN THE KEY CHANGES TO SUPERANNUATION?

Significant post-budget attention has focused on superannuation. The concessional contribution limit has reduced from $30,000 to $25,000, and, the income limit for concessional superannuation contributions has reduced from $300k to $250k. Moreover, a lifetime time non-concessional cap has been introduced but that is likely to affect very few Australians. It is noteworthy that only about 1~2% of the general population makes a more than $25k pre-tax contribution to superannuation. However, as Figure 1 and Charts 1 and 2 suggest there is a substantial group of "about-to-retire" Australians, who are catching up on the super contribution thus hitting the threshold.

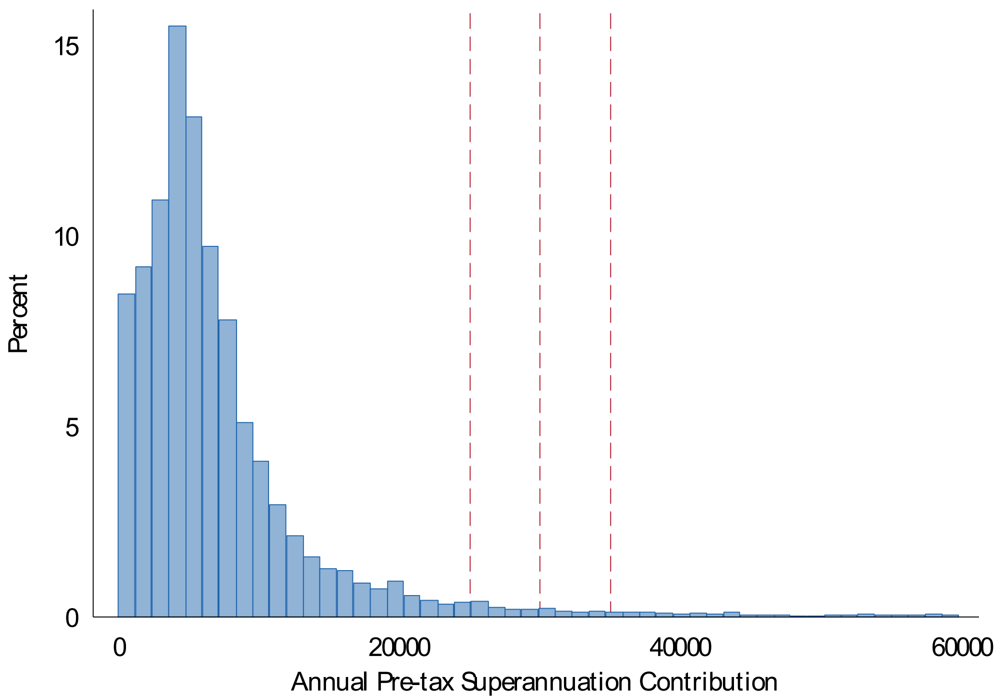
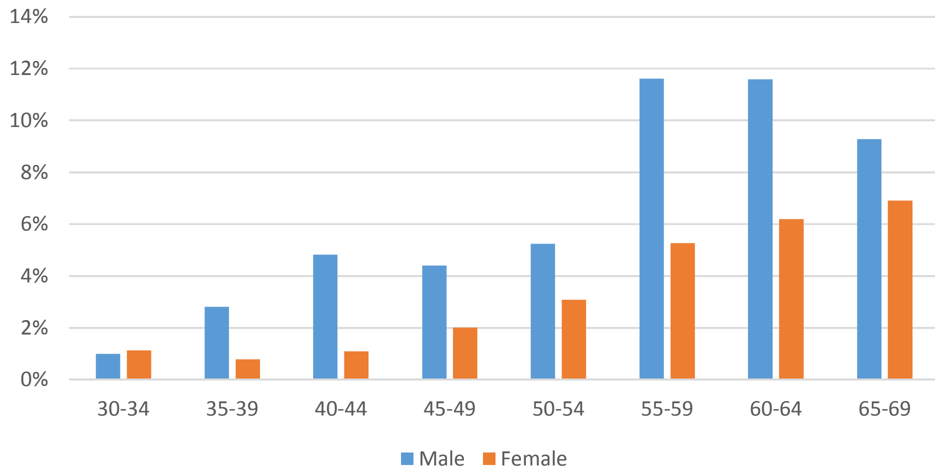


Figure 1: Annual Pre-tax Superannuation Contribution (the three red lines are $25K, $30K and $35K)

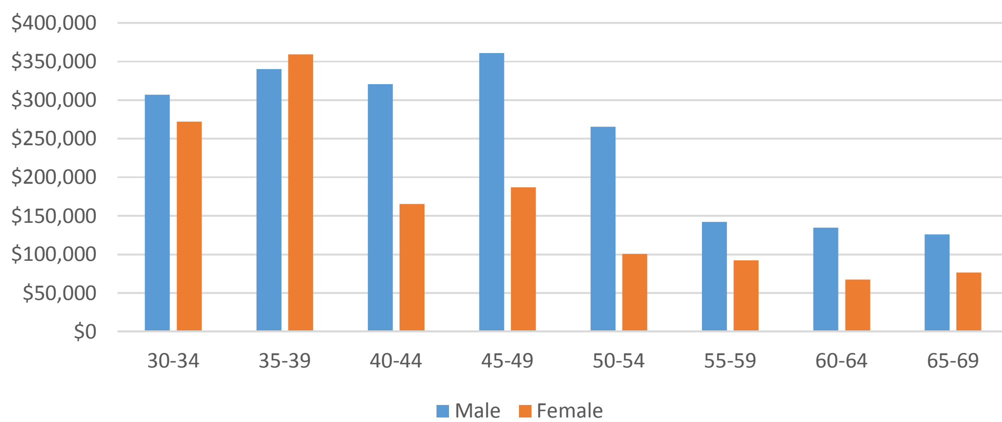
The measure will likely affect close to 9% of the 55 to 70 years old workers as they transit to retirement. While some of these contributors are high income earners, historical data suggests that many people close to the retirement age might have a high proportion of their salary sacrificed, especially in the case of women between 50 and 70 years old, where the median gross earning of those who contribute more than $25,000 annually is around $80,000.

Chart 1: Proportion of workers affected by the superannuation concessional contribution cap



Source: NATSEM's estimates based on ABS and ATO data using STINMOD+

Chart 2: Median gross earnings of those who make more than $25,000 pre-tax super contribution



Source: NATSEM's estimates based on ABS and ATO data using STINMOD+

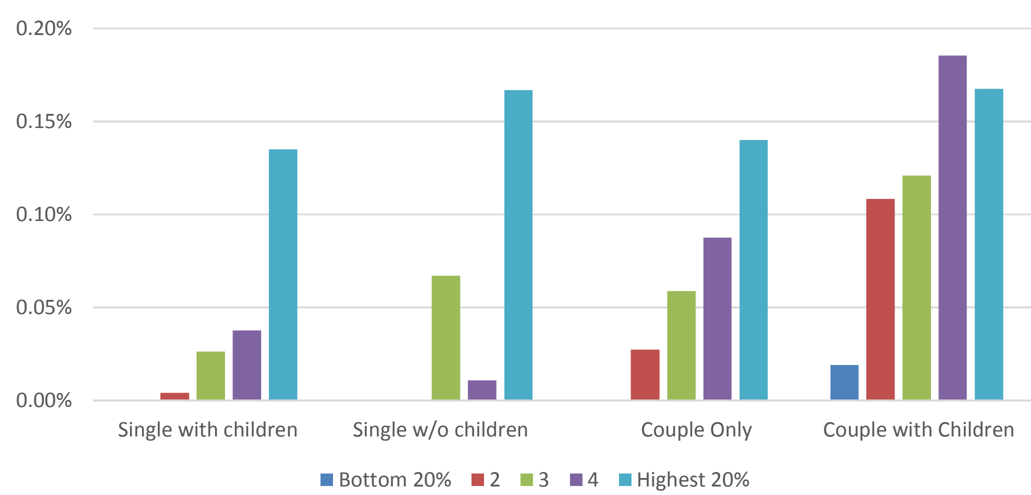
The stricter contribution rules mean that it is likely that this budget measure will catalyse behavioural change to the superannuation contribution pattern.

WHAT HAS HAPPENED TO INCOME TAX?

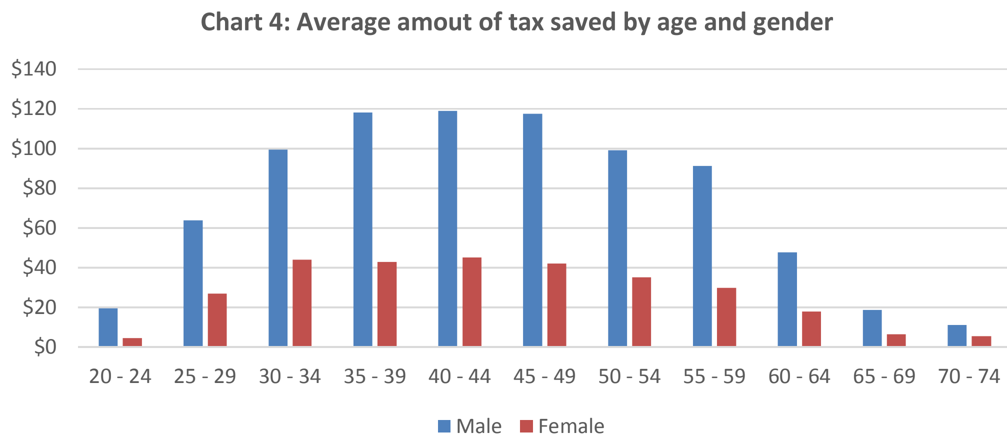
Very modest changes have been made in this area. Middle income earners will benefit from tax cuts to the tune of $6 per week. This measure will reduce the marginal rate of tax on incomes between $80,000 and $87,000 from 37% to 32.5% which means those above $87k retain the full saving of $7,000*.045= $315 per annum. The income tax cut is given to anyone with a taxable earning above $80,000. The Medicare levy low-income threshold has also increased, which effectively reduces the tax for low income groups. Although middle income earners are likely to experience a marginally higher disposable income, the overall effect is partially reduced when taking into account the potential extra superannuation contribution tax.

If we consider the broadening of the tax bracket, together with the increased Medicare exemption threshold, no one is likely to be adversely affected as the amount is very minor. NATSEM estimates that these measures will affect less than 1/3 of the families in terms of their disposable income and the average change to disposable income will only be around 0.1%. These estimates exclude the increased spouse tax offset option for the superannuation contribution although the majority of the Australians do not make post-tax contributions and the offset will be limited as the lower income group tends to contribute less towards super and has a lower tax rate.

Chart 3: Average increase in disposable income by family type



If we look at the age and gender distribution of the change, the proposed measure generally benefits the middle age male population most as their income level has reached the threshold for tax cuts. Given the lower average income level, women on average receive a lower level of benefit, as shown in Chart 4.



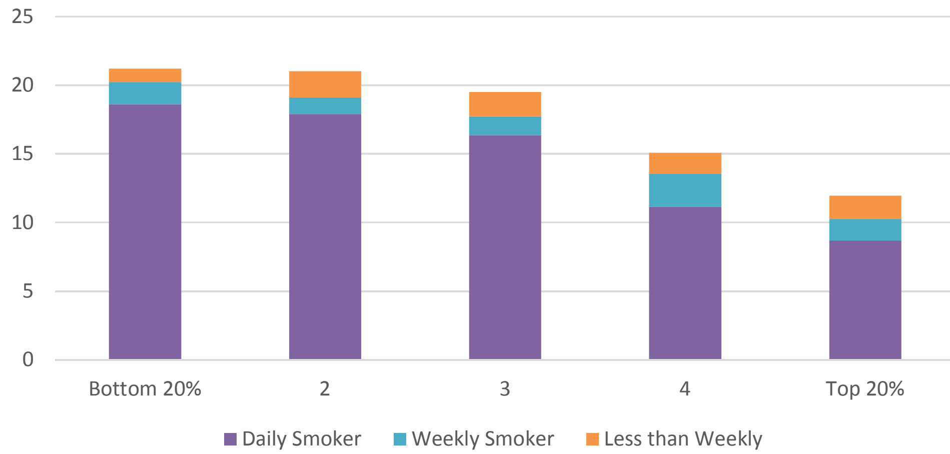
The combined effects from both the superannuation and the income tax system change translate to a minor reduction of tax for some households but the highest income group will experience an increased tax due to the reduced concessional super contribution limit. At the family level, most families will experience a small tax cut, but households with the highest 20% equivalised disposable income [1] can expect a small increase in the total tax payable on average. It should be noted, as the budget measures this year tend to affect very high income earners more, the differences within the top 20% can be large. The deficit repair levy does not affect this particular analysis as it will not be removed until 1 July 2017.

TOBACCO

Another measure that affects a significant proportion of households is the increase in tobacco excise. Using the latest data from The Household, Income and Labour Dynamics in Australia Survey (HILDA, 2015) – a more recent source of data compared with the figures in the budget paper – around 17% of the adult Australian population are daily or casual smokers. The budget measure of raising tax will adversely affect 1 in 5 households in Australia who consume tobacco, and have a median weekly expenditure of around $60 on tobacco products. Such measures will likely affect poorer households more than the top earning ones as the prevalence rate of smoking is higher compared with the richer households. However, the behavioural response (to stop smoking) may have a positive impact on the affected households in the long term due to improved health status.

[1] OECD-modified equivalence scale is used where household head has a weight of 1, each additional person 15 years or older has a weight of 0.5, and 0.3 for each child under 15 years.

Chart 5: Prevalence of Smoking by Income Level (18+)



WHAT ABOUT THE DEFICIT?

The deficit, in theory, is to be tackled through fiscal consolidation, revenue raising tax measures (some of which we have already alluded to) and a growth agenda including export trade deals. For the Treasurer this is about getting "expenditure as a share of the economy to 25.3% and the deficit reduced to 0.7% from 2.4% by the end of the current budget and forward estimates period" to be achieved by "saving more than we are spending" and "reducing taxes more than we are increasing taxes".

In terms of fiscal consolidation, $1.2 billion of efficiency savings will be affected to the Australian public service and a range of programs have been terminated including in aged care, asset recycling, and carbon tax compensation program. The biggest spending cut is actually a diversion of funds already in the Social Services portfolio to save money for the future of the National Disability Insurance Scheme. Moreover, *The Youth Jobs Path* is to be paid for through changes to *Work for the Dole.*

New jobs will be grown through new spending measures introduced in:

- **Defence** – the government has already announced a $50 billion submarine contract with Adelaide reaping the benefits in terms of economic stimulus and additional jobs are to be created in cyber security and .
- **Education** – the states have been given an extra $1.2 billion for schools between 2018 and 20 (although the investment is still Gonski-Light).
- **Infrastructure** – further infrastructural investment has been announced with new funding for roads and a Brisbane to Melbourne rail link.
- **Regulation** – ASIC the corporate watchdog will receive an additional $127 million to help it ensure the integrity of the banking system (a counter to Labor's pledge to introduce a Royal Commission).
- **Welfare** – through *The Youth Jobs Path.*

- And, 1000 new ATO jobs to investigate multi-national companies suspected of engaging in tax avoidance.

However, we need to remember that the government has only managed to shave $2 billion off the deficit and some of these policy instruments remain unproven.

But there is no change (despite pre-budget speculation) on:

- the revenue side of the Budget; ideas that had been in the public domain before the budget that did not translate into budget measures include: GST (goods and service tax) will remain at 10%; no measure will be introduced to alter current negative gearing arrangements to raise revenue; and, no measure will be introduced to allow states to raise their own income taxes. The only changes to the personal income tax scale is a $7000 increase in one threshold level and the removal of the high income “budget repair” levy. Or,

- the expenditure side, areas that had been under political discussion but failed to be included in specific new initiatives include deregulation of the higher education sector (but the sector will face cuts), investment in new environmental and renewables, and efforts to produce “the 30 minute city”.

BUT IS IT FAIR?

Unsurprisingly given the ideological complexion of the Coalition, the budget still overloads opportunity towards the top end of town. Although our analysis shows that in contrast with the last budget the combined effects from both the superannuation and the income tax system change translate to a minor reduction of tax for some households but the highest income group will experience an increased tax due to the reduced concessional super contribution limit. Moreover, Turnbull and Morrison have learned from the Abbott-Hockey budgets and have introduced no punitive measures that scapegoat particular groups in Australian society with the exception of what has been termed the “Google crackdown” on multi-national companies and smokers.

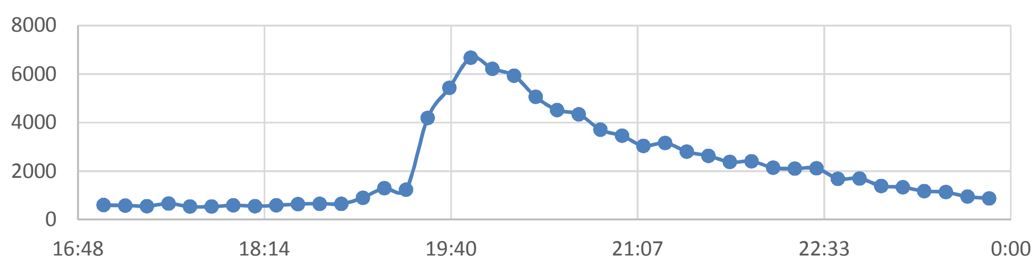
It is also unsurprising, given that there is an election on the horizon, that there are few *big* losers from this budget (with the evident example once again of the Australian Public Service and probably by implication Canberra) when compared with the last budget. However, concerns will be expressed regarding the government’s contention that they’re not increasing tax as it is a difficult one to square with the evidence and some of the assumptions underpinning the government’s growth forecasts may prove problematic.

HOW DID THE SOCIAL MEDIA REACT TO THE BUDGET 2016 SPEECH?

The annual budget speech is one of the most significant events on the Australian political calendar. The budget speech and budget reply constitute the contrasting narratives from the government and opposition regarding where the country is, its challenges and opportunities, and how the major parties aim to confront those challenges. But how did the public react in social media? This year, NATSEM monitored the twitter discussions during the budget speech and have some intriguing findings.

To start off, we looked at the popularity of the word "budget" on Twitter. We monitored the number of tweets with the keyword. As shown below, more than 90,000 tweets posted between 5pm and midnight on the 3rd of May contain the word “budget”, and there are more than 600 tweets per minute on this topic when the Treasurer's speech started. While some of these tweets may not be entirely related to the Australian budget given the global reach of Twitter, the spike in communications around the start of Treasurer Morrison’s speech is unmistakable and largely driven by communications about the Australian budget.

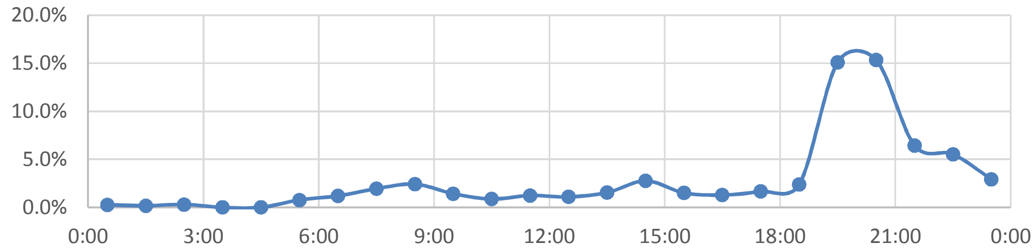
Figure 2: Number of tweets with keyword "Budget"



Source: Twitter.com, collected by NATSEM, data points are showing the number of tweets within each 10 minutes interval.

To get a sense of the overall interest in the budget by social media users we analysed Twitter’s stream of tweets produced in Australia. Though these data do not encompass all tweets produced in Australia, we have no indication that these data deviate from a relevant representative sample of tweets across Australia. More than 15% of the tweets produced in Australia on 3 May 2016 between 7 and 9 PM contain the word “budget”. This shows a great interest of the general public in this major political event and mirrors the trends we see in the global data from Twitter.

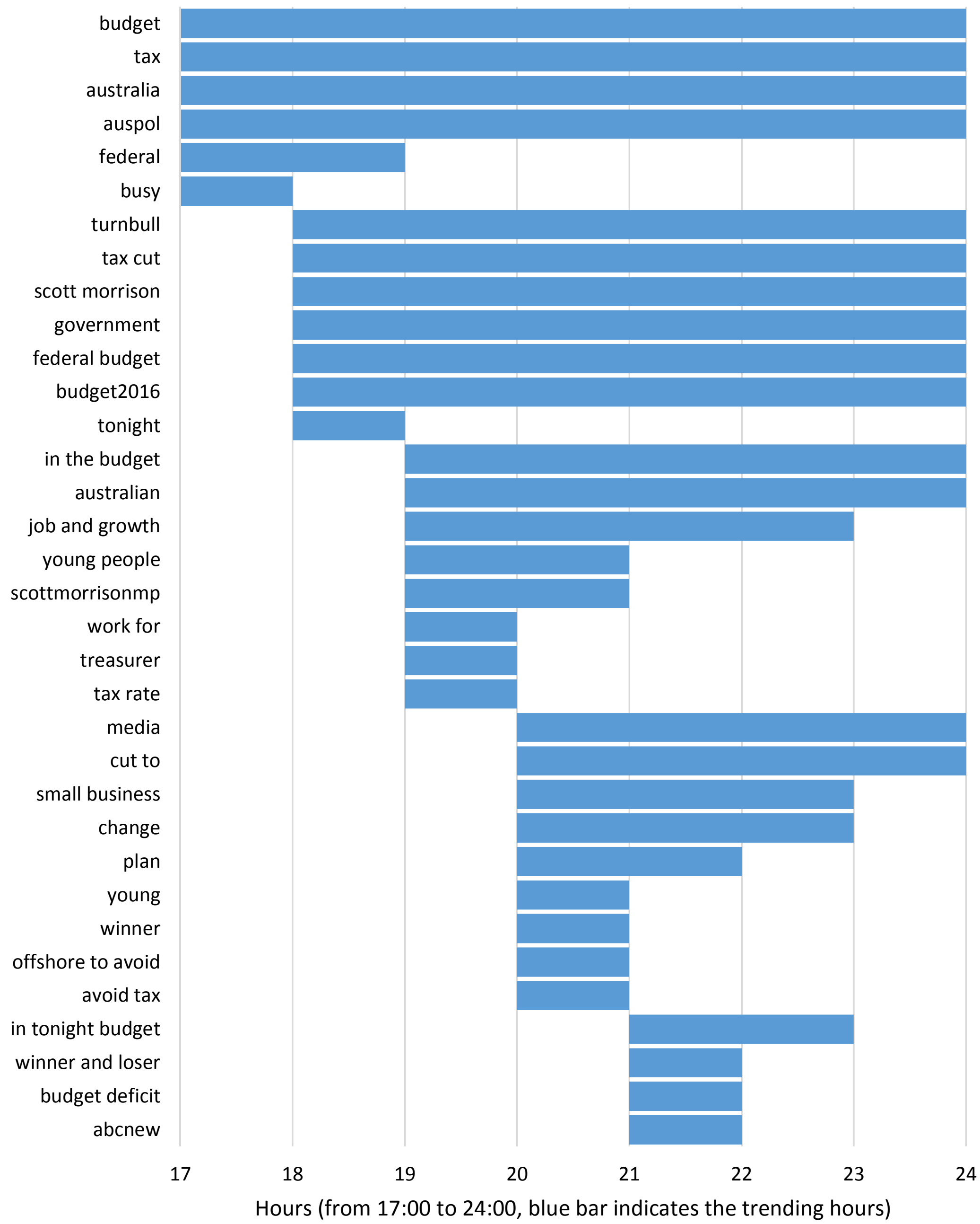
Figure 3: Percentage of tweets in Australia with "budget"



Source: Twitter.com, collected by NATSEM, data points are calculated based on the 60 minutes interval.

We also extracted the trending key words, hour by hour on tweets related to the budget. The phrase “tax cut” was a trending term one hour before the budget speech was delivered and remained so throughout the evening. This may be related to the widely reported information that the budget would contain a tax cut for both upper middle income earners and small businesses (a category which this budget also revises). As the specific nature of the cuts became clear, “cut to” became a trending phrase at 8 PM, persisting through the evening.

Chart 6: Selected trending keywords on twitter between 5pm and 12am



PARTING SHOT – WHO DO YOU TRUST TO RUN THE COUNTRY?

When the budget reckoning is over and Australian households have made marginal adjustments to their spending plans, one fundamental question will remain – *who do you trust to run the country*? Is this the right budget for uncertain times?

Typically elections are won by political parties that can demonstrate their capacity to manage the economy hence budget time provides government and opposition with an opportunity to pilot their key campaign messages and prove their credentials as the best managers of the Australian economy. The Morrison-Turnbull budget has certainly displayed a degree of fiscal responsibility and balance but without engaging in the radical adjustments required to transform Australia's economy. There was much kite flying of new policy in the run-up to budget and it is now clear that the Government decided to leave out the tough decisions that would require significant negotiation, particularly around what can be termed the devolution reforms – the series of reforms necessary to get federalism working in the national interest – City deals, tax reform powers for the states, as well as populist issues such as higher education deregulation.

So will this be enough this time around? Will Australians trust the government's narrative that this is an economic plan for jobs and growth when the budget will continue to be in deficit for the next four years? Will it trust some of the more contestable assumptions underpinning the government's growth forecasts and the contention that they're not increasing tax? Crucially, given what we said at the outset, are there sufficient trust building measures in this budget to reconnect government and the citizen and make them care once more? Or can the opposition win the war of ideas on economic matters – a significant challenge given its track record since 2007? We will see on 2 July.

APPENDIX: METHODS AND CAVEATS

The model used for estimating the impact of the 2016/17 budget reforms is a microsimulation model called STINMOD+. Microsimulation models apply the Commonwealth Government tax and transfer rules to data at the individual and household levels. This means complex government tax and transfer policies can be modelled, incorporating complex interactions between different policies. STINMOD+ is the successor of the original STINMOD model, widely used since the mid 1990's by the Commonwealth government agencies. The new model STINMOD+, has incorporated many new modelling techniques and has improved its methodology, efficiency and the maintainability of the original STINMOD model.

Data used in this work is derived from multiple sources, including ABS Survey of Income and Housing, Household Income and Labour Dynamics of Australia, ATO Taxation Statistics – Individual sample files, ABS Labour Force Survey and other statistics published by ABS. All numbers presented are preliminary 2016 estimates, assuming the increases in income and wealth are similar to recent years and may be subject to revisions. These estimates may be different from the actual characteristics of the population because of sampling and non-sampling errors in the microdata and because of the assumptions underlying the modelling techniques. The microdata used does not contain any information that enables identification of the individuals or families to which they refer.

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