>ceda

committee for economic development of australia

CEDA submission to the 2017-18 Federal Budget

>ceda

committee for economic development of australia

19 January 2017

Budget Policy Division

The Treasury

Langton Crescent

PARKES ACT 2600

Dear Sir/Madam,

In March 2016, CEDA launched a report, *Deficit to balance: budget repair options,* on how the Federal Government should repair the budget and return to balance in a realistic and politically-palatable manner.

This research report provides the Federal Government with an alternative to its current budget repair strategy and these recommendations are directly applicable to this year's Federal Budget.

CEDA's analysis of Budget 2016-17 and MYEFO 2016-17 has strengthened our scepticism around the Federal Government's current plan to return the budget to balance and our belief that the current fiscal position continues to pose a serious threat to the economy.

CEDA's position is that repairing the budget by the end of the forward estimates must be a priority for the Federal Government.

In order to achieve this goal, it is recommended that both revenue and expenditure measures must be considered, with particular focus on bringing revenue back to its long-term average.

A summary of the research rationale, methodology and recommendations, which provide a number of options for returning the Federal Budget to balance, may be found below. I have also attached the report.

Please do not hesitate to contact me should you require further information.

Yours sincerely,

Professor the Hon. Stephen Martin

Chief Executive

CEDA

1. About CEDA

CEDA – the Committee for Economic Development of Australia – is a national, independent, member-based organisation providing thought leadership and policy perspectives on the economic and social issues affecting Australia.

We achieve this through a rigorous and evidence-based research agenda, and forums and events that deliver lively debate and critical perspectives.

CEDA's membership includes 750 of Australia's leading businesses and organisations, and leaders from a wide cross-section of industries and academia. It allows us to reach major decision makers across the private and public sectors.

CEDA is an independent not-for-profit organisation, founded in 1960 by leading Australian economist, Sir Douglas Copland. Our funding comes from membership fees, events, research grants and sponsorship.

2. CEDA budget report

The CEDA report, *Deficit to balance: budget repair options*, was undertaken following concerns by the CEDA National Board about the persistence of the budget deficit despite a prolonged period of uninterrupted prosperity.

To oversee the recommendations, CEDA's Board formed the Balanced Budget Commission (the Commission) that drew together high level experts from government, academia and the private sector, consisting of:

- Paul McClintock AO (Chair)
- Professor the Hon. Stephen Martin
- Dr Rodney Maddock
- Dr John Edwards
- Angus Armour
- John Langoulant AO
- Su McCluskey
- Fabienne Michaux
- Terry Moran AC
- Helen Silver AO
- Dr Ian Watt AO
- Dr Mike Keating AC

>ceda
committee for economic development of australia

The aim of CEDA's report was to provide a pathway to balance the Federal Budget that is politically palatable and can gain community consensus. To achieve this outcome, the report is underpinned by two key budget repair principles.

BUDGET REPAIR PRINCIPLES

Under the guidance of the Commission, chaired by Paul McClintock AO, CEDA's National Chairman, the following budget repair principles were adopted.

1. Balance the budget by the end of the forward estimates

The first principle adopted was that the Budget should be balanced as soon as possible, bearing in mind the requirement to also sustain economic growth. Balance by the end of the then forward estimates (2018–19) was selected as the target.

The sooner the deficit is eliminated, the less the accumulation of debt and of the interest burden on future budgets; and the sooner Australia will improve its ability to respond to extreme events and shocks in the global economy.

2. Cap the tax-to-GDP ratio at 23.9 per cent.

The second principle was to identify an appropriate tax-to-GDP ratio by working within the revealed consensus evident in the policies of both the Coalition and the Labor Party when in office federally.

The average tax-to-GDP ratio for the period from the introduction of the GST in 2000-01 to the GFC in 2008-09 is 23.9 per cent.

A tax share of 23.6 per cent of GDP was used in the 2010 IGR under Treasurer Wayne Swan, and 23.9 per cent of GDP was the share used in the 2015 IGR under Treasurer Joe Hockey. A 23.9 per cent of GDP share was identified as the 'tax cap' in Treasurer Scott Morrison's December 2015 MYEFO and is still used today. Adjusting for the GST, a similar tax was used by Treasurer Peter Costello. In other words, a tax-to-GDP cap of 23.9 per cent was chosen as it is the consensus on both sides of politics.

Adopting a tax cap of 23.9 per cent by the end of the forward estimates, implies total receipts of 25.5 per cent as a share of GDP (tax revenue of 23.9 per cent plus non-tax revenue of around the long-term average of 1.6 per cent). To achieve balance, we therefore need to cap total payments at 25.5 per cent of GDP as well.

Under these parameters the Commission developed solutions to achieving a balanced budget by identifying alternative packages of measures that drew on policy statements of the major political parties. Each package includes:

- Both the spending and revenue sides of the budget.
- Being within an emerging consensus of the major parties, is reasonably fair, and assessed to be sufficiently acceptable that if enacted by a government of one major party, would be unlikely to be reversed by a succeeding government from the other major party.
- Being of sufficient magnitude to make a substantial difference to the deficit outcome, within the relevant time period.

The aim was not to increase revenue per se, but to return to the long-term average level of tax revenue as a share of GDP under the assumption that the long-term average already has community

(and political) support. At present, we are trending below that level and on current projections, we will not realistically achieve this level quickly enough.

SUMMARY OF OPTIONS

The CEDA report presents five illustrative packages which broadly fall within the perimeter of the Australian political debate.

On the revenue side of the equation, measures include higher indirect taxes, such as raising taxes on alcohol, luxury cars and tobacco, and reducing or removing taxation concessions, such as those available for superannuation and investment purposes.

The expenditure side includes measures such as reducing the size of budgetary assistance to industry, improving public sector efficiency and some measures to reduce health-related costs.

OPTION 1

Revenue			Expenditure		
Code	Description	$ billion	Code	Description	$ billion
a	Progressive superannuation contributions tax (15 per cent discount)	$6.9	o	Lower PBS drug prices	$1.6
b	Halve Capital Gains Tax discount	$3.6	p	Reduce budgetary assistance to industry by 10 per cent	$0.5
c	Cut fuel tax credit scheme by half	$3.3			
e	Raise taxes on luxury cars, alcohol and tobacco by 15 per cent	$2.3			
Total revenue		$16.1	Total expenditure		$2.1

Sources: See pages 31–33 for descriptions and sourcing of proposed measures.

OPTION 2

Revenue			Expenditure		
Code	Description	$ billion	Code	Description	$ billion
d	Marginal tax on superannuation contributions above $10,000	$8.5	s	Cut PHI rebate by 25 per cent	$1.8
b	Halve Capital Gains Tax discount	$3.6	t	Higher education efficiency dividend	$0.3
e	Raise taxes on luxury cars, alcohol and tobacco by 20 per cent	$3.1			
Total revenue		$15.2	Total expenditure		$2.1

Sources: See pages 31–33 for descriptions and sourcing of proposed measures.

>ceda
committee for economic development of australia

OPTION 3

Revenue			Expenditure		
Code	Description	$ billion	Code	Description	$ billion
f	Reduce capital gains by 75 per cent	$5.4	q	Improve public sector efficiency through reduced scope of activity (10,000 headcount reduction)	$2.0
c	Halve the fuel tax scheme	$3.3			
e	Raise taxes on luxury cars, alcohol and tobacco by 20 per cent	$3.1			
m	Remove negative gearing on all types of assets purchased after December 2015	$2.6			
l	Removal of PHI rebate exemption	$1.8			
Total revenue		$16.3	Total expenditure		$2.0

Sources: See pages 31–33 for descriptions and sourcing of proposed measures.

OPTION 4

Revenue			Expenditure		
Code	Description	$ billion	Code	Description	$ billion
f	Reduce Capital Gains Tax discount by 75 per cent	$5.4	r	Improve cost-effectiveness of treatments (Medical Benefits Schedule)	$2.1
e	Raise taxes on luxury cars, alcohol and tobacco by 20 per cent	$3.1			
l	Removal of PHI rebate exemption	$1.8			
g	Reduce industry tax concessions across the board by 25 per cent	$1.4			
j	Increase petrol tax by 10 cents per litre	$1.7			
k	Lift capital gains on super fund earnings to 15 per cent	$1.6			
Total revenue		$15.0	Total expenditure		$2.1

Sources: See pages 31–33 for descriptions and sourcing of proposed measures.

OPTION 5

Revenue			Expenditure		
Code	Description	$ billion	Code	Description	$ billion
i	Reduce work related tax deductions to raise $4b	$4.0	o	Lower PBS drug prices	$1.6
e	Raise taxes on luxury cars, alcohol and tobacco by 20 per cent	$3.1	p	Reduce budgetary assistance to industry by 10 per cent	$0.5
l	Removal of PHI rebate exemption	$1.8			
n	Reduce Capital Gains Tax discount to 40 per cent with no grandfathering	$1.7			
j	Increase petrol tax by 10 cents per litre	$1.7			
h	Continue the Budget repair levy	$1.4			
g	Reduce industry tax concessions across the board by 25 per cent	$1.4			
Total revenue		$15.1	Total expenditure		$2.1

Sources: See pages 31–33 for descriptions and sourcing of proposed measures.

Please refer to the report (Attached) pages 25 to 35 for a detailed list of each package and assumptions.

3.CEDA contact details:

Professor the Hon. Stephen Martin
CEDA Chief Executive
stephen.martin@ceda.com.au
(03) 9652 8401

Sarah-Jane Derby
Senior Economist
sarah-jane.derby@ceda.com.au
(03) 9652 8425

Roxanne Punton
Director, External Affairs
roxanne.punton@ceda.com.au
(03) 9652 8424

March 2016

Deficit to balance: budget repair options

The report of the CEDA Balanced Budget Commission

ceda
committee for economic development of australia

Deficit to balance: budget repair options

The report of the
CEDA Balanced Budget Commission

ceda
committee for economic development of australia

About this publication

Deficit to balance: budget repair options
© CEDA 2016
ISSN: 0 85801 303 7

The views expressed in this document are those of the authors, and should not be attributed to CEDA. CEDA's objective in publishing this research is to encourage constructive debate and discussion on matters of national economic importance. Persons who rely upon the material published do so at their own risk.

Design Robyn Zwar Design

Photography
Page16: 2015–16 Budget Papers, 11 May 2015, Lukas Coch, AAP Image
All other images: iStock Photo Library.

About CEDA

CEDA – the Committee for Economic Development of Australia – is a national, independent, member-based organisation providing thought leadership and policy perspectives on the economic and social issues affecting Australia.

We achieve this through a rigorous and evidence-based research agenda, and forums and events that deliver lively debate and critical perspectives.

CEDA's membership includes 700 of Australia's leading businesses and organisations, and leaders from a wide cross-section of industries and academia. It allows us to reach major decision makers across the private and public sectors.

CEDA is an independent not-for-profit organisation, founded in 1960 by leading Australian economist Sir Douglas Copland. Our funding comes from membership fees, events and sponsorship.

CEDA – the Committee for Economic Development of Australia
Level 13, 440 Collins Street
Melbourne 3000 Australia
Telephone: +61 3 9662 3544
Fax: +61 3 9663 7271
Email: info@ceda.com.au
Web: ceda.com.au

>ceda
committee for economic development of australia

contents

Forewords 4
Professor the Hon. Stephen Martin, Chief Executive, CEDA
Paul McClintock AO, National Chairman, CEDA

CEDA Balanced Budget Commission 6

Section 1: A grave fiscal problem 8

Section 2: Forming the Commission 10

Section 3: Principles of the Commission 12

Section 4: The problem to 2018–19 16

Section 5: Beyond forward estimates 19

Section 6: Projections and assumptions 22

Section 7: Options for closing the gap 24

Sources and descriptions 31

Appendix A: Treatment of measures 34

Bibliography 36

Acknowledgements 38

forewords

Professor the Hon. Stephen Martin, CEDA Chief Executive

This unique CEDA report is a product of a decision by CEDA's Board last year that persistent Federal Budget deficits, with no genuine end in sight, were a significant and urgent issue that must be addressed to ensure Australia maintains its economic stability and strength.

CEDA's Board subsequently formed a Balanced Budget Commission that drew together high level experts from government, academia and the private sector.

The scope of the Commission was to develop a menu of options that would be fiscally and politically palatable and offer genuine solutions for returning the Federal Budget to balance as soon as possible, with a target for balance to be achieved by 2018–19.

The report that follows sets out why CEDA decided to tackle this issue, its urgency and the process adopted by the Balanced Budget Commission in developing the menu of options for repairing the Federal Budget.

I would like to thank CEDA Chairman Paul McClintock AO for leading the Balanced Budget Commission, CEDA Board Members Dr John Edwards and Dr Rodney Maddock for their significant contribution to this project, and of course the Balanced Budget Commission members. In addition, I would also like to thank the Parliamentary Budget Office for their assistance.

This is a unique CEDA report, very different from what has been produced in the last five years. I hope it will be a useful resource for those interested in good public policy and options for returning the Federal Budget to balance.

Paul McClintock AO, CEDA National Chairman

No economic problem in Australia is graver than the persistence of large budget deficits. The particularly concerning aspect is that we have had continuous deficits, eight years in fact, during a sustained economic expansion.

The CEDA Board and Balanced Budget Commission have undertaken this report because all agree that there is an urgency to balance the Federal Budget and that the longer deficits continue the greater the difficulty in returning to surplus.

Prolonged deficit penalises today's youth and future generations, who will end up paying for current spending despite Australians being wealthier than they have ever been.

In addition, as a player in the global economy, running a large deficit means we have no buffer when we experience unexpected economic shocks and political choices to insulate and boost our economy become limited.

Even in prosperous times, deficit and the resultant interest on debt narrows government spending choices by reducing the Budget pool and diverting money that could otherwise be spent on delivering services and infrastructure.

Successive governments have promised to return the Budget to surplus but this is yet to eventuate.

The current discourse about Australia's fiscal position has been caught in the politics of tax reform. This piece of work is about getting back to balance as quickly as possible using long run averages as the basis. Once this obstacle is overcome, the national conversation on structural reform can be reset and progress.

In providing examples of revenue and expenditure changes to balance the Budget, the Commission's aim was to show it is achievable.

While which specific measures are selected will ultimately be the choice of the Government of the day, the Commission has been very conscious to ensure options are realistic and politically palatable.

I hope this report provides an insightful and valuable contribution to refocusing public discourse on returning the Federal Budget to balance as soon as possible.

Balanced Budget Commission

In 2015 CEDA set up a high-level expert Balanced Budget Commission to guide and oversee this report. The people selected have significant experience working on economic policy and include eminent former public servants and other experts in the field from across the private sector and academia.

Balanced Budget Commission Chairman

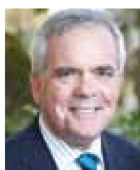
CEDA National Chairman
Paul McClintock AO

Balanced Budget Commission members

Business Council of Australia Principal Adviser
Angus Armour

Reserve Bank of Australia Board Member
Dr John Edwards

Former Secretary, Department of Prime Minister and Cabinet; Former Secretary, Department of Finance; Former Secretary, Department of Employment and Industrial Relations; Visiting Fellow at the ANU
Dr Michael Keating AC



Westpac WA Chairman; former WA Department of Treasury Under Treasurer
John Langoulant AO

Monash University Adjunct Professor in Economics; Victoria University Vice Chancellor's Fellow
Dr Rodney Maddock

CEDA Chief Executive
Professor the Hon. Stephen Martin

Harper Review of Competition Policy panel member
Su McCluskey

Standard & Poor's Ratings Services Australian Country Head
Fabienne Michaux

Former Secretary, Department of Prime Minister and Cabinet; Former Secretary, Victorian Department of Premier and Cabinet
Terry Moran AC

Allianz Australia Chief General Manager Workers Compensation; Former Secretary, Victorian Department of Premier and Cabinet
Helen Silver AO

Former Secretary, Department of the Prime Minister and Cabinet; Former Secretary, Department of Finance
Dr Ian Watt AO

Secretariat of the Commission

CEDA Senior Economist
Sarah-Jane Derby

CEDA Chief Economist
Nathan Taylor

one

a grave fiscal problem

Despite a quarter century of prosperity, the Australian Government is now in the eighth year of continuous and substantial fiscal deficit. Consecutive governments have forecast a return to surplus but this is yet to eventuate and appears unlikely on current forecasts. Spending growth is expected to continue to be faster than the growth of the economy as a whole, resulting in rising interest debt levels unless action is taken now.

Australia is now in its 25th year of uninterrupted economic expansion. During this period output has more than doubled, living standards have increased by more than half, and household wealth has increased to more than five times the level it had reached when the long expansion began at the end of 1991.

Even today, with sharply lower commodity prices than a few years ago and falling investment in mining, Australia's output growth is still above that of most other advanced economies, and not far below Australia's average growth for the last decade. The unemployment rate has trended down over the last two years, while the proportion of Australians participating in the workforce has increased.

Despite this quarter century of prosperity, the Australian Government is now in the eighth year of continuous and substantial fiscal deficit. The Federal Budget anticipates deficits to continue for at least another three years.

In every previous Australian government deficit episode since the Budget was brought back into balance after the exceptional spending of World War II, deficits have arisen from economic contractions. Not so now. According to the recent Treasury Mid-Year Economic and Fiscal Outlook (MYEFO), the deficits in the 10 years to 2018–19 as cumulative shares of Gross Domestic Product (GDP) will be substantially bigger than the run of deficits arising from either the recession of 1982–83 or the recession of 1990–91 – and not far short of the total deficits accumulated in both recessions, again compared to GDP. By 2017–18, according to the Parliamentary Budget Office, net Commonwealth debt as a share of GDP will exceed the previous peak reached in 1995–96.[1] Even this bleak projection assumes relatively favourable economic and fiscal circumstances.

The current deficit is only part of the problem of Australian Government finances, and in some respects not the most serious part. On current Government projections the deficit is righted by 2020–21. However, even if Australian Government tax revenue is brought up to its historical share of GDP, the deficit will soon reappear – and continue to widen – because Government spending growth is expected to be faster than the growth of the economy as a whole.

The average share of tax to GDP in the years between the introduction of the GST in 2000–01 and the GFC in 2008–09 was close to 23.9 per cent. This is consistent with the ceilings adopted by both Coalition and Labor governments. As the Treasury's 2015 Intergenerational Report showed, on currently legislated programs and taking into account announced policy changes that do not require legislation, Government spending will increase faster than nominal GDP. With tax revenue constrained to grow at the same rate as GDP, the deficit will inevitably widen.

By 2054–55, the Intergenerational Report shows the deficit will have increased from a projected base of close to zero to six per cent of GDP. Of that deficit, two thirds will be accounted for by interest payments on Government debt. These projections do not include the additional spending proposals in the recent Defence White Paper.

The projection embodied in the Intergenerational Report assumes continuous economic growth. This means slow growth or a significant recession would result in an even worse outcome.

two

forming the Commission

Troubled by the persistence of large fiscal deficits during a prolonged period of prosperity, and concerned that deficits were likely to persist for decades if not resolved urgently, CEDA's National Board agreed in 2015 to form a Balanced Budget Commission to examine genuine options for balancing the Federal Budget.

Concerned by Treasury projections showing deficits would continue accumulating indefinitely on current policies unless taxes increase in lockstep with increased spending, and by the likelihood that continuous deficit will erode Australia's economic strength and political choices, CEDA's Board discussed the problem at a meeting in September 2015.

The CEDA Board noted that:

- While running deficits in recessions was warranted, in running continuous deficits during sustained economic expansions the government was utilising private savings that could otherwise support productive investment.
- The Government was financing current consumption at the expense of future generations, which would pay not only part of the bill for today's government spending but also the interest accumulated on that bill.
- The longer the deficits continued, the greater the debt accumulated and the higher the interest bill as a share of government spending.
- Accumulating debt narrows the range of spending and revenue choices open to governments. It also restricts the flexibility of government to respond to economic downturns.
- Every additional year of deficit makes the return to balance more difficult.

The CEDA Board concluded that there is no economic problem in Australia graver than the persistence of large deficits now and for decades to come.

However, the CEDA Board concluded that while the problem was serious and would only increase if not addressed, there were solutions well within the usual boundaries of the Australian political contest of the last two decades.

The CEDA Board noted that there was a strong community consensus, shared by the two major political parties, that the Australian Government Budget should be brought back into balance. There was also a consensus, evident in the past conduct and statements of both Labor and Coalition governments, that tax revenue as a share of GDP should average no more than 24 per cent of GDP, or a little less.

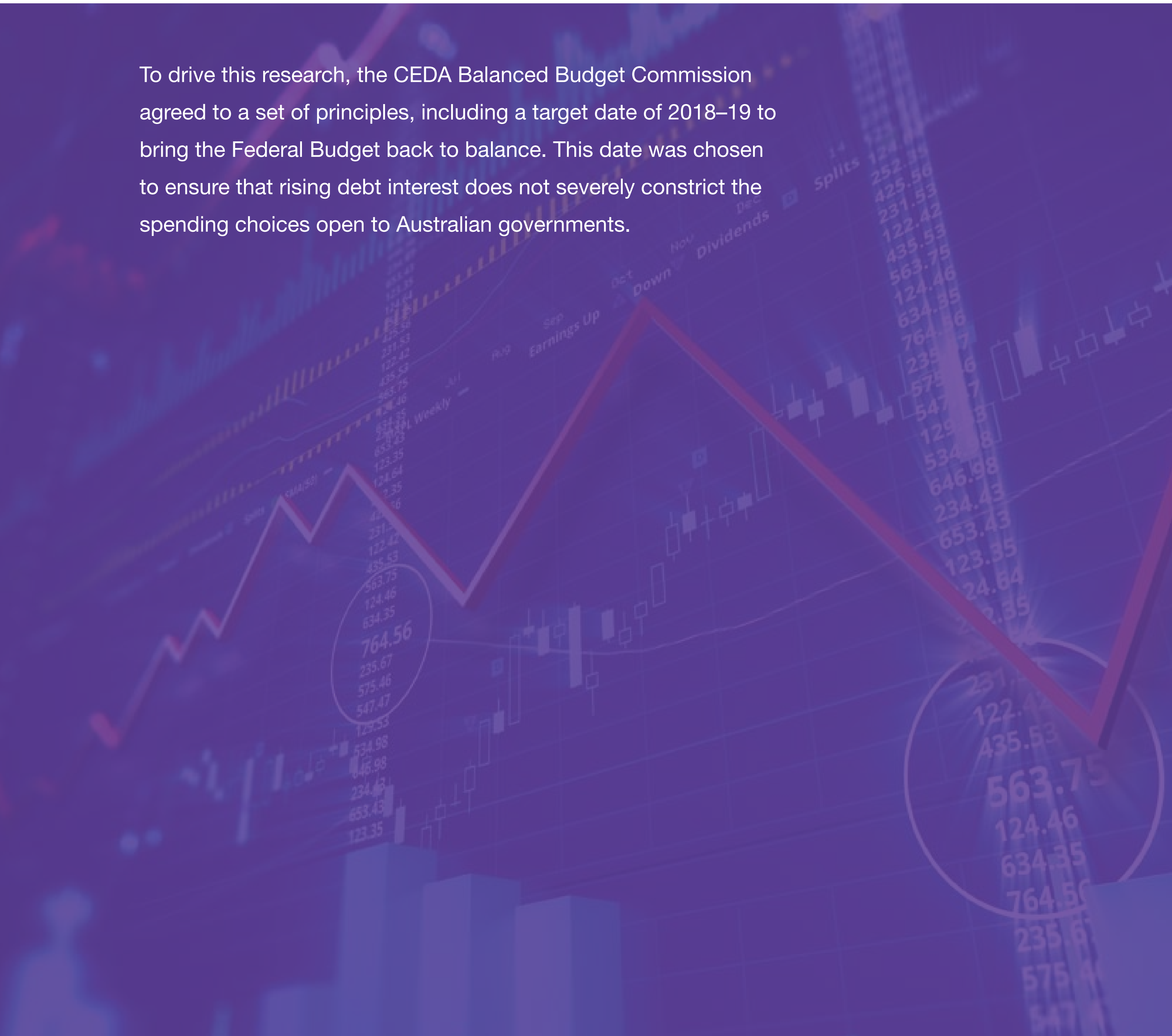
There was no community or party consensus that would permit tax revenue to rise indefinitely to match indefinitely rising Australian Government spending, compared to GDP. This then implied a consensus on the limit on the average share of Australian Government spending as a share of GDP, if the Budget was to be in balance on average. The CEDA Board also recognised that as a non-partisan organisation with wide membership in business and government and a long history of public policy engagement, CEDA was positioned to identify solutions which would meet wide community approval.

The CEDA Board resolved to ask a range of experts to join a CEDA Balanced Budget Commission under the chairmanship of CEDA's National Chairman, Paul McClintock AO.

The purpose of the Commission would be to reboot a locked debate about fiscal alternatives by examining a range of solutions that would, given the seriousness of the problem, be found in practice to be broadly acceptable. To focus the issue most clearly the CEDA Board separated out the fiscal balance issue from the issue of changes in the tax mix and the issue of policies to stimulate productivity and economic growth. In the CEDA Board's view, failure to clearly distinguish between these three important challenges hinders action to meet any of them.

three

principles of the Commission



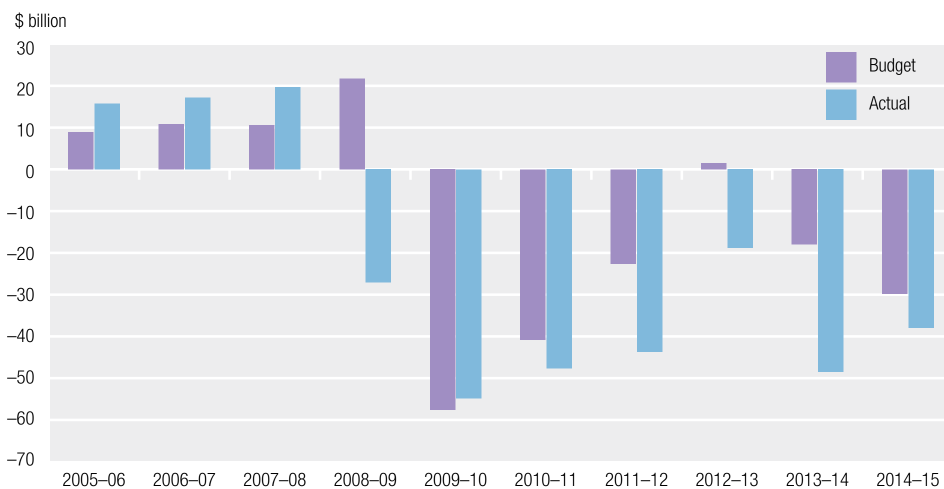
To drive this research, the CEDA Balanced Budget Commission agreed to a set of principles, including a target date of 2018–19 to bring the Federal Budget back to balance. This date was chosen to ensure that rising debt interest does not severely constrict the spending choices open to Australian governments.

At its first meeting in November 2015 the Commission agreed that the deterioration in the Australian Government's fiscal position poses serious issues not only for the sustainability of government finances and for Australia's credit rating, but also for Australia's capacity to offset unfavourable global economic influences and for the range of political choices open to Australians. The Commission found that the fiscal deterioration did not appear to be exaggerated, or the projections alarmist. On the contrary, the Commission observed, for each and every fiscal year since 2008–09 the actual deficit has been revealed to be worse than expected, and in most cases considerably worse.

As shown in Figure 1, governments' forecasts of the Budget position have been consistently different from the actual positions, and since the GFC, the final budget outcomes have been far worse than predicted.

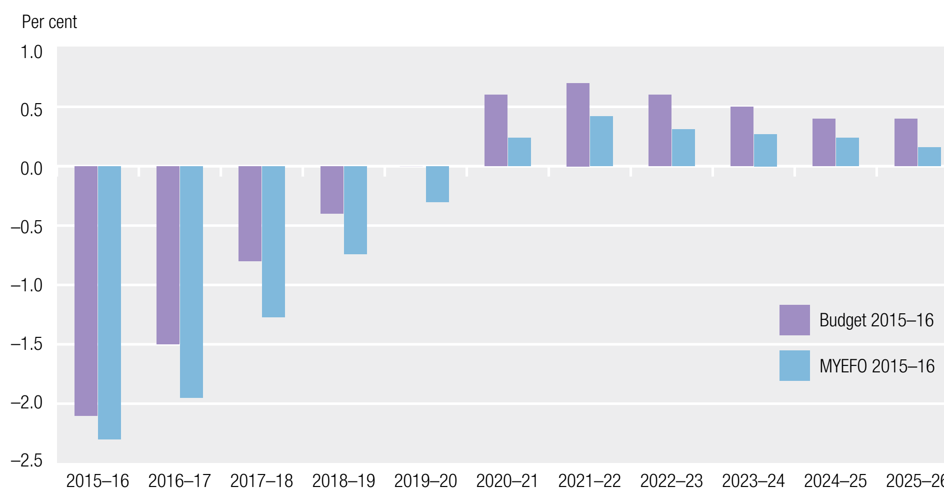
The December 2015 MYEFO, for instance, predicted a larger deficit than the May Budget did and pushed out the return to surplus by a year, despite being released only six months after the Budget, as shown in Figure 2.

FIGURE 1
BUDGET BOTTOM LINE – UNDERLYING CASH BALANCE (UCB)



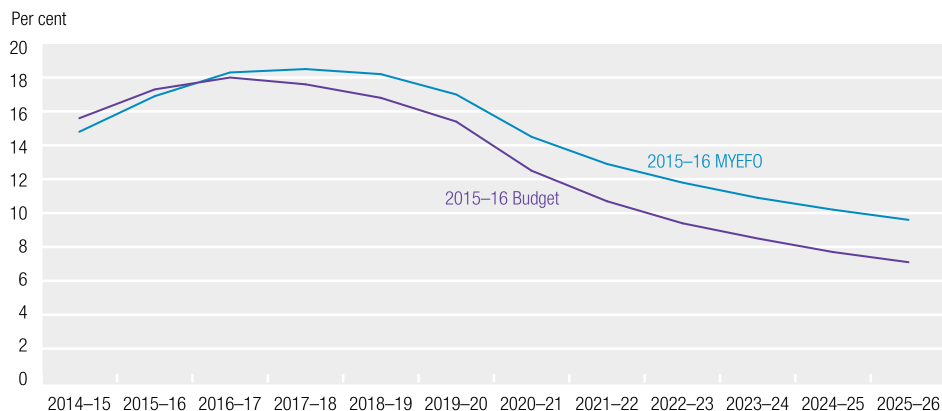
Source: Federal Budget papers (various years)

FIGURE 2
FORECASTS OF THE BUDGET BOTTOM LINE (UCB AS A SHARE OF GDP)



Source: Federal Budget (2015) and MYEFO (2015)

FIGURE 3
NET DEBT AS SHARE OF GDP



Source: MYEFO 2015–16

The Commission agreed that bringing the Budget back into balance could not be long delayed before rising debt interest constricted the spending choices open to Australian governments. For example, delaying the return to surplus by one year in the December 2015 MYEFO projections led to an estimated 2.5 percentage point rise in net debt by 2025–26 to an estimated 9.6 per cent of GDP as shown in Figure 3.

The Commission observed that while Treasury projects a return to balance by 2020–21, it also projects that most of the gap will be closed by higher personal income tax revenue. The December 2015 MYEFO looks to the deficit declining from 2.3 per cent of GDP in 2015–16 to 0.7 per cent of GDP in 2018–19. Of this change, 1.6 per cent of GDP – just short of two thirds, is projected to be contributed by personal income tax, projected to increase from 11 per cent of GDP today to a little over 12 per cent in 2018–19 (and thereafter continue to increase, compared to GDP). At over 12 per cent, personal income tax revenue would be higher as a share of GDP than at any time since the GST was introduced to rebalance the tax base, and only half a per cent of GDP less than the share before the change.

The projected one fifth increase in personal income tax revenue from 2015–16 to 2018–19 is a growth rate much faster than the projected growth of wages, employment and incomes. The Commission was sceptical that a budget-balance plan so dependent on markedly higher average rates of tax on wages and salaries, and on today's base, will meet with electoral approval, or have any very great chance of being realised.

The Commission adopted several principles for its work. The first principle was that the Budget should be balanced – and as fast as possible, bearing in mind the requirement to also sustain economic growth. This is because the sooner the deficit is eliminated, the less the accumulation of debt and of the interest burden on future budgets. In addition, the sooner the deficit is eliminated, the sooner Australia will improve its flexibility to respond to extreme events in the global economy.

Balance by 2018–19 was selected as the target. In choosing the target the Commission assumes that economic growth continues in line with the Treasury and RBA forecasts. Commission members were conscious that if economic circumstances were markedly less favourable over the next two years, budget balance might have to be postponed.

The second principle was to work within the revealed consensus evident in the conduct and declaratory policies of both the Coalition and the Labor Party when in office federally.

Governments of both colours have adopted a tax share of GDP of around 23.9 per cent as the maximum average that would be sustainable. After adjustment for the GST a similar number was used in the 2002 and 2007 Intergenerational Reports under Treasurer Peter Costello. A tax share of 23.6 per cent of GDP was used in the 2010 Intergenerational Report under Treasurer Wayne Swan, and 23.9 per cent of GDP was the share used in the 2015 Intergenerational Report under Treasurer Joe Hockey. A 23.9 per cent of GDP share is identified as the 'tax cap' in Treasurer Scott Morrison's December 2015 MYEFO. This is markedly above the 22.3 per cent share expected in 2015–16 but close to the average tax share of the first decade of the century. Non-tax revenues typically run at 1.6 per cent of GDP, giving an average expected revenue ceiling of 25.5 per cent of GDP.

Governments of both major parties have avowed an intention to produce balanced budgets on average, and also to contain the tax share of GDP.

If the Australian Government Budget is to be on average balanced and tax is not to exceed 23.9 per cent of GDP, it follows that Australian Government spending should be limited to an average of 25.5 per cent of GDP. This is below the projected share for 2015–16, though not markedly.

The Commission's principles evoke the 'trilogy' commitments of the Hawke government, the Howard government's Medium Term Budget Strategy, the declared Budget principles in the Rudd and Gillard governments, and principles embodied in statements issued by the Abbott and Turnbull governments. In all cases these governments have declared an objective of a budget balance 'over the cycle' or 'on average', with a limit on the tax ratio to GDP and therefore a limit to Government spending as a share of GDP.

The Commission resolved to illustrate solutions to achieving a balanced budget by identifying alternative packages of measures that would over time balance the budget, both by the last year of the current forward estimates (2018–19), and in the long term.

In addition it was agreed the packages would:

- Include both the spending and revenue sides of the budget.
- Fall within an emerging consensus of the major parties, be reasonably fair, and be assessed to be sufficiently acceptable that if enacted by a government of one major party, they would be unlikely to be reversed by a succeeding government from the other major party.
- Be of sufficient magnitude to make a substantial difference to the deficit outcome, within the relevant time period.

The Commission noted that the community consensus on government taxing and spending constraints applied also to the states and local government. However, while there have been year-to-year variations, state and local government income and spending, and the total of their capital and consumption spending, have been fairly stable as shares of GDP over recent decades and are now close to the long run averages. While the Australian Government deficit is large and projected to persist, the most recent Parliamentary Budget Office projections show the state and local government sector as a whole close to balance.

four

the problem to 2018–19

The Commission’s task was to find $2 billion in spending cuts and $15 billion in revenue enhancements to achieve a balanced budget in 2018–19.

The Commission has adopted the December 2015 MYEFO as the base case in its projection of the short term fiscal challenge. That document projects that the deficit will contract from 2.3 per cent of GDP this year (2015–16) to 0.7 per cent of GDP in 2018–19.

As was true of the Rudd and Gillard governments and the Abbott government, the Turnbull government expects much of the projected deficit reduction to be brought about by increasing revenue. As the Treasurer Scott Morrison remarked on 17 February, 2016 “most of the work bringing the Budget back to balance over the next few years is actually being done by revenue”.

Of the deficit contraction of 1.6 percentage points projected over the period, just short of one percentage point is provided for by revenue increases as a share of GDP, and 0.6 percentage points by reducing spending as a share of GDP.

Almost all the revenue increase as a share of GDP arises because personal income tax revenue is projected to increase markedly faster than output, employment and incomes over the projection period. It follows that in the absence of measures to broaden the base of personal income tax or to increase indirect tax, much of the revenue increase projected in the MYEFO arises from employees paying a higher share of their income as income tax.

The MYEFO projections include the impact of measures not yet legislated, some of which have already been rejected by the Senate and some won’t be implemented for other reasons. Most of these measures are savings on the spending side. While it has not been possible to precisely estimate the impact of these measures, they appear to total in the order of $5.6 billion in 2018–19, or 0.3 per cent of projected 2018–19 GDP.

The Commission decided its packages should be sufficient to produce a zero deficit in 2018–19 on currently projected economic parameters, spending and revenue, after netting out the impact of measures which may not be implemented. To the extent they are implemented, the deficit challenge will be less.

Finding one per cent of GDP

As a result, the Commission’s task for the forward estimates period was to identify broadly acceptable packages which amount to a little less than one per cent of GDP in 2018–19.

In the MYEFO projections, tax revenue in 2018–19 will be 23.1 per cent of GDP and spending as a share of GDP will be 25.3. The spending totals include savings measures which may not be implemented. Assuming they remain unimplemented, spending would be 25.6 per cent of GDP.

Using its rules of a tax limit of 23.9 per cent of GDP and a spending limit of 25.5 per cent of GDP, the packages selected by the Commission aim to cut spending by 0.1 per cent of GDP and increase tax revenue by 0.8 per cent of GDP.

It is worth noting that the MYEFO projections estimate that non-tax revenue will be 1.7 per cent of GDP in 2018–19. This is 0.2 per cent of GDP above the average outcome in the Commission's baseline. However, the non-tax revenue includes 0.2 per cent of GDP from net Future Fund earnings, which until 2020–21 are subtracted from receipts before calculating the deficit.

In 2018–19 dollar terms, the Commission's task has been to find $2 billion in spending cuts from the MYEFO outcome in that year, and $15 billion in revenue enhancements.

The revenue task is particularly challenging. However, the Commission observes that if Budget balance is attained in 2018–19 with tax at 23.9 per cent as a share of GDP, personal income tax scales and rates could thereafter be adjusted to cap the increase in average tax paid and in personal income tax as a share of GDP. This means 'bracket creep' can be eliminated after 2018–19, under the Commission's program.

Without Budget balance, the personal income tax contribution to revenue will continue to increase. This is evident in projections by the Parliamentary Budget Office, and in material presented by the Treasurer in his 17 February 2016 National Press Club Address and associated Treasury projections.

The Commission has identified a range of illustrative packages which it judges fall broadly within the perimeter of the Australian political debate. They are depicted in Section Seven.

Neither CEDA nor the Commission endorse any particular package as the preferred option. Any package or mix of elements from them will close the deficit.

Individual Commission members and CEDA Board members have their own preferences between the options, as will be true of the wider community. But all options are well within the contemporary conversation on tax and spending choices, and all will achieve the objective of resolving this grave problem.

five

beyond forward estimates

Even if a balanced Budget is achieved by 2018–19, longer term projections in the 2015 Intergenerational Report show that on currently legislated programs, Australian Government spending is likely to resume increasing faster than GDP.

Under the Commission's recommended program, the deficit will be met in 2018–19. But the longer term projections in the 2015 Intergenerational Report show that on currently legislated programs, Australian Government spending is likely to resume increasing faster than GDP.

If tax revenue is held to a limit of 23.9 per cent of GDP and non-tax revenue averages 1.5 per cent of GDP, the deficit will soon reappear.

A reappearing deficit

Projecting spending as currently legislated, the March 2015 Intergenerational Report depicts the deficit reappearing from early next decade, if tax is held to 23.9 per cent of GDP.

The Intergenerational Report projects that on current policies the deficit will rise from close to zero in 2021–22 to six per cent of GDP in 2054–55. At that point spending would be 31.2 per cent of GDP, well above the consensus identified by the Commission.

The Commission agreed it was not sensible to adopt an inflexible rule on what Australian Government spending should be as a share of GDP in three or four decades time. However, the Commission noted that if spending was permitted to grow faster than GDP over prolonged periods, either the deficit would continue to widen or the tax share of GDP would have to be continuously increased.

It also noted that of the projected 2054–55 deficit of six percentage points of GDP, nearly two thirds is public debt interest. The outcome illustrates the destruction of political choices and economic flexibility caused by the continuous accumulation of deficits.

Limiting debt interest

If spending savings are introduced sufficiently early, the public debt interest will be limited to the interest on debt accumulated by the time balance is reached in 2018–19 under the Commission's program. This debt interest is projected in MYEFO to be 0.7 per cent of GDP in 2018–19. So long as the Budget then remains in balance (or in surplus) and nominal GDP increases, this share of GDP will decline each year.

If, as projected by the 2015 Intergenerational Report, nominal output increases by 5.25 per cent each year over 40 years, nominal GDP would be more than seven times bigger in 2054–55 than in 2014–15, while the amount of net interest would be unchanged from 2018–19. In 2054–55 it would be less than one tenth of one per cent of GDP – a trivial share.

Even if nominal output growth is markedly slower than projected by the Treasury in the Intergenerational Report, net public debt interest would still be very small in 2054–55 if the budget is balanced from 2018–19.

The Intergenerational Report projects that under currently legislated policies, but excluding public debt interest, the deficit will be half a per cent of GDP by 2035, growing to 2.4 per cent of GDP by 2049–50.

By way of illustration, the Commission observed that the projected deficit would be eliminated by the adoption of a broadly acceptable package of spending measures that would by 2035 amount to at least half a per cent of GDP, accumulating to 2.4 per cent of GDP by 2054–55.

This is a challenging but not insuperable task. Increasing the pension age to 70, for example, would take projected spending much of the way towards savings of this order.

Legislated measures and policies

The Intergenerational Report spending projections path selected by the Commission as its baseline includes currently legislated measures and those policies announced by the Government to March 2015 that did not or will not require legislation.

For example, it includes the announced program of cuts to foreign aid and the announced change to the formula for support for hospitals. It also includes funding for the National Disability Insurance Scheme (NDIS), agreed by both major parties. But it does not include the Abbott government's proposed changes to the Age Pension eligibility age, to pension indexation, to school funding indexation, or to Medicare. All these require legislative change, which had not been made at the time the Intergenerational Report was published.

six

projections and assumptions

The Commission used an agreed set of assumptions for growth, tax mix changes and the treatment of investment to ensure options provided are rigorous and achievable.

The Intergenerational Report projections assume continued economic expansion, though at a somewhat lower rate than over the previous 40 years.

The Commission does not propose to run alternative scenarios. It notes that if the economic outcomes are not as favourable as assumed, the revenue outcomes and perhaps the spending outcomes will also be less favourable to budget balance.

Australia may decide to change its mix of taxes and expenditures, and change which level of government is responsible for which activities. Such changes may increase productivity or workforce participation or they may also improve the efficiency with which government services are delivered. Either would operate to increase the overall growth rate of the economy over the longer run. We do not address them here because they are unlikely to have any significant impact within our time horizon.

However, the Commission notes that to remove both spending and supporting revenue from the Australian Government budget for transfer to states will leave the nation's bottom line unchanged, though it would require an amendment to the revenue and spending shares assumed by the Commission. Merely passing a function to the states without accompanying revenue support would just transfer the spending problem to another jurisdiction.

We assume that any revenue neutral tax mix change leaves unchanged our rule of a 23.9 per cent of GDP tax limit.

Capital spending

The point is often made that government borrowing for investment can be a good use of debt, and hence capital spending should be treated differently to other government expenditure.

While recognising there are circumstances in which it is sometimes appropriate to finance major infrastructure projects off budget, the Commission also observed that Commonwealth capital spending should be subjected to the same rigorous scrutiny as other forms of spending, and savings made where possible.

In the Commission's view, major project spending should only be considered outside of the consensus cap on government spending to GDP where the project's returns will demonstrably and substantially exceed its costs.

seven

options for closing the gap

The Commission has identified a range of packages which fall within the perimeter of the Australian political debate. Any option or mix of elements from them will close the deficit.

THE TREASURY

This section provides illustrative examples of closing the budgetary gap based on the principles adopted by the Balanced Budget Commission.

Based on these principles, the urgent task of closing the gap boils down to devising strategies for raising an extra $15 billion in revenue and reducing expenditure by $2 billion in 2018–19.

Clearly there are a wide set of alternative ways to achieve balance. However, this section aims to set out examples which achieve the target while also balancing equity, incentive and macroeconomic concerns – practical solutions to the grave problem Australia faces. In each case we set out the measures which boost revenue, and those which reduce expenditure, and provide rationale for the choice. It is important to remember that the baseline is one in which a significant contribution is already being made by wage and salary earners through bracket creep in the income tax system.

We are not suggesting that these are the only strategies which might be used. Political parties will make their own calculations: our intent is to show that it can be done.

There is an important caveat: we have based the calculations on secondary sources and we have not built in consistently behavioural or macroeconomic changes which might result as taxes and expenditures are altered. The sources are indicated in each table and described in more detail on pages 31–33.

Option 1

Option 1 extracts two-thirds of its revenue from taxes on wealth and provides a basic sense of fairness to restoring the Budget balance. There will be some longer term consequences through changes to savings and investment behaviour although we do not expect these to be large. Superannuation contributions are compulsory so there are no issues of evasion of the impost. However, people may choose to direct their voluntary savings outside the superannuation system as a result.

Importantly the recommendation to halve the Capital Gains Tax discount will take much of the power out of negatively geared investment strategies as more of any gains made will be taxed. Just how the Capital Gains Tax rules might be changed and the extent to which pre-existing gains are treated, impacts the revenue uplift. The Parliamentary Budget Office has costed the elimination of the capital gains discount and its replacement by a system which only taxes real gains (discounting gains by the Consumer Price Index [CP]) to produce a net revenue uplift of just $1.1 billion in 2018–19.

During a period in which fuel prices have fallen sharply, a less generous treatment of fuel costs will have less impact than it might at other times. Fuel users have already had a reduction in their input costs which is likely to persist, so it is not inappropriate that industry make a contribution through this route to rebuilding the Budget. However, it is a tax on a business input with the mining industry, and to a lesser extent the agriculture sector, bearing the direct impact of the tax with consequences for employment and growth. Further, this measure can be considered in the absence of cost-reflective road pricing.

The rise in other taxes which is indicated goes some way towards restoring the contribution those taxes used to make to government revenue but which have been run down over the last decade. This broad taxation category contributed revenue equal to 3.2 per cent of GDP in 2004–05 but only 2.3 per cent in 2014–15. The case for raising the sin taxes (alcohol and tobacco) has been argued before but there are also clear anomalies which should be addressed such as the availability of wine tax rebates for New Zealand producers and for bulk wines. There is likely to be some behavioural impact so revenue generated will be less than suggested, but we doubt it would be so large as to reduce overall revenues below our target of $15 billion.

Overall the impact may appear regressive but that depends on the starting point chosen: the indirect increases may appear regressive relative to last year but not when compared with a decade ago. The increase in superannuation taxes also offsets this tendency.

On the expenditure side, the reduced payments for PBS drugs could have some cost in terms of which drugs are provided to consumers in Australia but much of the cost would fall on international drug companies.

A further source of revenue gain introduced in this option involves the government reducing the scope of the tax concessions it provides to industry. The Productivity Commission's estimate of net assistance to industry in 2013–14 was $9.7 billion. About half of that was in the form of tax concession and half budgetary assistance. This amount could be reduced by 10 per cent to assist with the Budget repair task.

OPTION 1
IMPACT ON UNDERLYING CASH BALANCE

Revenue			Expenditure		
Code	Description	$ billion	Code	Description	$ billion
a	Progressive superannuation contributions tax (15 per cent discount)	$6.9	o	Lower PBS drug prices	$1.6
b	Halve Capital Gains Tax discount	$3.6	p	Reduce budgetary assistance to industry by 10 per cent	$0.5
c	Cut fuel tax credit scheme by half	$3.3			
e	Raise taxes on luxury cars, alcohol and tobacco by 15 per cent	$2.3			
Total revenue		$16.1	Total expenditure		$2.1

Sources: See pages 31–33 for descriptions and sourcing of proposed measures.

Option 2

Option 2 provides a different mix of policies to achieve a similar outcome.

Once again superannuation and Capital Gains Tax drive the bulk of the revenue uplift. The justification is similar to that discussed above although this formulation captures more revenue – with a short term revenue boost for the government but a reduced pool of savings available in the longer term.

The other significant source of revenue lies with a range of specific taxes. The contribution of this tax category has fallen over the last decade as discussed above. The tax increase illustrated in this example is larger than in the previous case.

The wealth taxes (superannuation, capital gains and luxury cars) are likely to have their greatest immediate impact on people at the upper end of the income distribution, while the sin taxes (alcohol and tobacco) tend to impact lower in the income distribution.

On the expenditure side, the proposal is to decrease the size of the private health insurance rebate by 25 per cent. According to third party sources, this would not have a substantial influence on the number of people purchasing private health insurance as they are more significantly motivated by the Medicare levy surcharge (the 1.5 per cent surcharge for those earning over an income threshold) and the lifetime cover policy (which applies a loading to insurance rebates based on the age at which it is purchased). This package would also apply a higher education efficiency dividend.

OPTION 2
IMPACT ON UNDERLYING CASH BALANCE

Revenue			Expenditure		
Code	Description	$ billion	Code	Description	$ billion
d	Marginal tax on superannuation contributions above $10,000	$8.5	s	Cut PHI rebate by 25 per cent	$1.8
b	Halve Capital Gains Tax discount	$3.6	t	Higher education efficiency dividend	$0.3
e	Raise taxes on luxury cars, alcohol and tobacco by 20 per cent	$3.1			
Total revenue		**$15.2**	**Total expenditure**		**$2.1**

Sources: See pages 31–33 for descriptions and sourcing of proposed measures.

Option 3

Option 3 considers a range of revenue enhancements which do not start with big tax increases on superannuation. The main contribution comes from a larger reduction in the Capital Gains Tax discount and an increase in fuel and other indirect taxes. The appropriate level of capital gains discount is not clear. However, if the discount is to compensate people for nominal capital gains (i.e. gains that simply reflect inflation rather than real returns), then the current low inflation rate suggests we do not need to provide a big discount.

Negative gearing has re-emerged in the policy debate and a change is incorporated in this package. The costing of the negative gearing proposal comes from the Parliamentary Budget Office and relates to all purchases and purchases by any entity. A narrower scope, for example a restriction to housing, would make a smaller contribution to revenue.

The distributional impact of this package is less clear. The large reduction in Capital Gains Tax revenue, the higher fuel taxes and the reduction in industry tax concessions will all have their direct impact on capital and investment as will the total elimination of negative gearing. This may slow future growth with broad longer term consequences.

On the expenditure side, the case for further public sector efficiency gains is perennially popular outside Canberra albeit it is difficult to achieve. However, our measure includes an increase in the annual efficiency dividend, similar to what was applied in 2012–13, as well as a freeze in recruitment to achieve the desired expenditure reductions. The most effective way is for the Commonwealth to reduce the range of activities it undertakes, certainly at least by reducing overlap with the states.

OPTION 3
IMPACT ON UNDERLYING CASH BALANCE

Revenue			Expenditure		
Code	Description	$ billion	Code	Description	$ billion
f	Reduce capital gains by 75 per cent	$5.4	q	Improve public sector efficiency through reduced scope of activity (10,000 headcount reduction)	$2.0
c	Halve the fuel tax scheme	$3.3			
e	Raise taxes on luxury cars, alcohol and tobacco by 20 per cent	$3.1			
m	Remove negative gearing on all types of assets purchased after December 2015	$2.6			
l	Removal of PHI rebate exemption	$1.8			
Total revenue		**$16.3**	**Total expenditure**		**$2.0**

Sources: See pages 31–33 for descriptions and sourcing of proposed measures.

Option 4

The current fuel tax scheme is designed to reduce the cost of fuel tax for road freight to an assessed road user charge and to eliminate tax costs for off-road use (especially by mining industry and remote hospitals etc). An alternative approach to fuel taxation for our purposes would be to increase the petrol tax by 10 cents per litre. This would raise about $1.7 billion in 2018–19 and is included in this option. The impact would be more directly on consumers.

To reach our revenue target one further option would be a tax on the capital gains of superannuation funds of 15 per cent, so that both their income and their capital gains would incur the same rate. The Tax Expenditures Statement suggests this would generate about $1.6 billion.

The expenditure reductions have a narrower impact. They are expected to reduce waste to the extent that procedures are being paid for through the Medical Benefits Schedule which is out of date or inappropriate. As such the change represents a high-quality efficiency gain.

OPTION 4
IMPACT ON UNDERLYING CASH BALANCE

Revenue			Expenditure		
Code	Description	$ billion	Code	Description	$ billion
f	Reduce Capital Gains Tax discount by 75 per cent	$5.4	r	Improve cost-effectiveness of treatments (Medical Benefits Schedule)	$2.1
e	Raise taxes on luxury cars, alcohol and tobacco by 20 per cent	$3.1			
l	Removal of PHI rebate exemption	$1.8			
g	Reduce industry tax concessions across the board by 25 per cent	$1.4			
j	Increase petrol tax by 10 cents per litre	$1.7			
k	Lift capital gains on super fund earnings to 15 per cent	$1.6			
Total revenue		$15.0	Total expenditure		$2.1

Sources: See pages 31–33 for descriptions and sourcing of proposed measures.

Option 5

It is also possible to increase revenue by imposing a large number of narrower policies.

An option which has not been debated much recently is the deductibility of work related expenses. The Australian Taxation Office lists the total amount of work related tax deductions as $31 billion for the tax year 2012–13. Extrapolating this with nominal GDP at about five per cent per year, means that Australians will claim $40 billion in tax deductions in 2018–19. A tightening of the criteria for eligible deductions could add $4 billion to revenue. Since deductions are more valuable to higher paid employees, limiting deductions will probably have a relatively (but slight) progressive impact.

The option also follows a different strategy with respect to capital gains, reducing it to the rate suggested in the Henry Tax Review of 40 per cent. It also builds in the extension of the Budget repair levy.

OPTION 5
IMPACT ON UNDERLYING CASH BALANCE

Revenue			Expenditure		
Code	Description	$ billion	Code	Description	$ billion
i	Reduce work related tax deductions to raise $4b	$4.0	o	Lower PBS drug prices	$1.6
e	Raise taxes on luxury cars, alcohol and tobacco by 20 per cent	$3.1	p	Reduce budgetary assistance to industry by 10 per cent	$0.5
l	Removal of PHI rebate exemption	$1.8			
n	Reduce Capital Gains Tax discount to 40 per cent with no grandfathering	$1.7			
j	Increase petrol tax by 10 cents per litre	$1.7			
h	Continue the Budget repair levy	$1.4			
g	Reduce industry tax concessions across the board by 25 per cent	$1.4			
Total revenue		**$15.1**	**Total expenditure**		**$2.1**

Sources: See pages 31–33 for descriptions and sourcing of proposed measures.

Sources and descriptions

Revenue raising measures				
Code	Description	Expected revenue raised ($ billion)	Description	Source*
a	Progressive superannuation contributions tax (15 per cent discount).	$6.9	This measure would tax pre-tax contributions in a more progressive way, by making the incentive a flat 15 per cent. In other words, the progressive rate charged will be the difference between the marginal income tax rate and 15 per cent. For example, for someone in the $37,000–$80,000 income bracket the marginal tax rate on their superannuation contributions would be 17.5 per cent or the difference between the marginal tax rate of 37 per cent and 15 per cent.	Deloitte (2015)
b	Halve the Capital Gains Tax (CGT) discount.	$3.6	This measure would reduce the CGT discount from 50 per cent to 25 per cent.	PBO and Greens (2015b)
c	Cut the fuel tax credit scheme by half.	$3.3	Fuel tax credits provide organisations with a credit for the excise or custom duty that apply to fuel they use in capital equipment (including heavy vehicles). This measure would reduce the credit by 50 per cent.	PBO (2015b), Grattan (2013)
d	Marginal tax on superannuation contributions above $10,000.	$8.5	This measure would remove superannuation tax concessions for contributions above $10,000 annually. In other words, marginal income tax rates would apply to contributions above that level. At the current minimum compulsory Superannuation Guarantee rate of 9.5 per cent, a worker would need to earn over $105,000 a year to be affected.	Grattan (2013)

* For full reference information refer to the bibliography on page 36.

Revenue raising measures… continued				
Code	Description	Expected revenue raised ($ billion)	Description	Source*
e	Raise taxes on luxury cars, alcohol and tobacco by either 15 or 20 per cent.	$2.3–$3.1	Table 3.10 of MYEFO (2015–16) details the revenue raised from taxes on luxury cars, alcohol and tobacco. Not accounting for behavioural change, CEDA calculated the amount that could be raised by increasing these taxes by either 15 or 20 per cent.	MYEFO (2015–16)
f	Reduce the Capital Gains Tax (CGT) discount by 75 per cent.	$5.4	This measure would reduce the CGT discount by 75 per cent and (presumably) grandfather negative gearing for all asset classes at the same time.	PBO and Greens (2015b)
g	Reduce industry tax concessions across the board by 25 per cent.	$1.4	This measure would reduce the level of assistance provided to industry and is calculated based on Table A.7 of the Productivity Commission's latest Trade and Assistance Review.	PC (2015b)
h	Continue the Budget Repair Levy.	$1.4	This would continue the existing Budget Repair Levy. The figure is extrapolated from the current figure.	Treasury (2015d)
i	Reduce work related tax deductions.	$4	Reduce claimable work related tax deductions.	Freebairn
j	Increase petrol tax by 10 cents per litre.	$1.7	The 2015–16 Budget Papers estimate that a 38 cents a litre tax on petrol will yield $7 billion in 2018–19. It is assumed that a 10 cents increase in the fuel tax would generate an additional $1.7 billion.	Treasury (2015d)
k	Lift capital gains on superannuation fund earnings to 15 per cent.	$1.6	This is estimated from the 2015 Tax Expenditures Statement, Table C2.	Treasury (2016)
l	Removal of Private Health Insurance (PHI) rebate exemption.	$1.8	The PHI rebate is exempt from income tax. This measure would remove the exemption.	Treasury (2016)
m	Remove negative gearing on all types of assets purchased after December 2015.	$2.6	This measure would remove negative gearing on all asset types purchased by any entities with grandfather arrangements.	PBO & Greens (2015b)
n	Reduce Capital Tax (CGT) discount to 40 per cent with no grandfathering.	$1.7	This measure would lower the CGT discount from 50 per cent to 40 per cent.	PBO & Greens (2015b)

* For full reference information refer to the bibliography on page 36.

Expenditure reducing measures				
Code	Description	Expected expenditure reductions ($ billion)	Description	Source*
o	Lower Pharmaceutical Benefits Scheme (PBS) drug prices.	$1.6	The PBS is expected to cost the Government about $12 billion a year in 2018–19. This measure would adopt price cuts that reflect the price of manufacturing generic drugs on expiry of pharmaceutical patents.	Grattan (2013), CEDA (2013), PBO (2015a)
p	Reduce budgetary assistance to industry by 10 per cent.	$0.5	Based on Productivity Commission estimates of industry assistance and is calculated based on Table A.7 of the Productivity Commission's latest Trade and Assistance Review.	PC (2015b)
q	Improve public sector efficiency through an increase in the efficiency dividend and a reduction in Commonwealth activity.	$2.0	This measure includes cutting staff by 10,000 over two years via a freeze on recruitment and increasing the efficiency dividend to three per cent.	Budget (2014), PBO (2013), ABS (2015a)
r	Improve cost-effectiveness of Medicare Benefits Schedule (MBS) treatments.	$2.1	This measure would reduce the cost of the MBS by about $2 billion in 2018–19. The MBS is expected to cost the government about $25 billion in that year. Measures could include reducing procedures and tests with limited clinical benefit or deemed to be unsafe and always using the most cost-effective options.	Grattan (2013), PBO (2015c), ABC 4corners (2015), PBO (2015a)
s	Cut the Private Health Insurance (PHI) rebate by 25 per cent.	$1.8	This measure would reduce the PHI rebate by 25 per cent.	Grattan (2013), PBO (2015a), MYEFO (2015)
t	Higher education efficiency dividend.	$0.3	This measure would apply efficiency dividends of two per cent in 2016 and 1.25 per cent in 2017 to all grants provided under the Higher Education Support Act 2003 (HESA) with some minor exceptions.	PBO (2015b), Budget (2013)

* For full reference information refer to the bibliography on page 36.

Appendix A: treatment of measures

This appendix contains the assumptions made about which savings measures are included in the Budget and current forward and medium term estimates, as well as a comment on some uncertain measures.

The table below provides a list of significant unlegislated measures.

Table A1: Net impact on the underlying cash balance

Estimated significant unlegislated measures	2018–19 ($million)	Forward estimates ($million)
Family payment reform	$2161	$4261
Higher education reform	$1415	$3198
Pharmaceutical Benefits Scheme – increase in co-payments and safety net thresholds	$447	$1191
Maintain eligibility thresholds for Australian Government payments for three years	$384	$1139
Increasing the age of eligibility for Newstart Allowance and Sickness Allowance	$211	$615
Other measures	$958	$3045
Total	$5576	$13,448

It includes new measures announced in late 2015 that replace previously-announced measures that looked unlikely to pass in the Senate. It also adjusts previously announced measures to account for the delay in passing legislation and adds any new significant savings measures.

Some unlegislated measures are currently not going ahead at all in their current form, including the deregulation of higher education university fees and maintaining eligibility thresholds for government payments. Other measures include policies such as ceasing the large family supplement payment and the proportional payment of pensions outside Australia.

Most unlegislated measures would lead to Budget savings if passed but some would cost the Budget. For example, the Family Payment Reform package includes concessions such as a rise in some types of payments in order to justify cuts to others. The figures reported here refer to the net savings impact.

There are also a number of other measures in MYEFO 2015–16 which may fall victim to public and other pressures. For example, the removal of bulk-billing incentives for pathology services, aligning bulk-billing incentives for diagnostic imaging services with those applying to General Practitioner (GP) services and reducing the bulk-billing incentive for magnetic resonance imaging (MRI) services have already faced public backlash.

Programs in the recently announced National Innovation and Science Agenda may also be at risk if the budgetary problem worsens. The policy included a reversal of previously-made cuts such as those made to the Commonwealth Scientific and Industrial Research Organisation (CSIRO). However, we have not attempted to include this in a scenario.

For the purpose of this report, the assumptions for uncertain expenditure items such as the NDIS and schools funding are the same as those used by the Government. Federal NDIS funding is assumed to amount to approximately $20 billion by the end of the forward estimates.

Schools funding assumes Gonski funding in addition to normal funding until 2017, after which time funding is indexed to inflation and student numbers.

Hospital funding assumes real spending per person to be constant after 2017.

Bibliography

References

ABC 4corners 2015, Wasted, http://www.abc.net.au/4corners/stories/2015/09/28/4318883.htm

Australian Bureau of Statistics (ABS) 2015, Cat 6302.0 Average Weekly Earnings, Australia May 2015

Budget papers, http://budget.gov.au/index.htm

CEDA 2013, Healthcare: Reform or ration, http://www.ceda.com.au/research-and-policy/research/2013/04/15/healthcare2013

Centre for Independent Studies 2013, Emergency budget repair kit, https://www.cis.org.au/publications/target30/emergency-budget-repair-kit

Creighton and Owen 2015, $6 billion boost to hit home from pension reform, The Australian, http://www.theaustralian.com.au/national-affairs/treasury/6bn-boost-to-hit-home-from-pension-reform/news-story/31549fafef51df183edf8f68cbb638a7

Deloitte 2015, Shedding light on the debate: Mythbusting tax reform, http://www2.deloitte.com/au/en/pages/tax/articles/tax-reform-debate-mythbusting-perspective.html

Edwards, J 2015, Tony Abbott's new budget strategy — and how Bill Shorten will respond, http://insidestory.org.au/tony-abbotts-new-budget-strategy-and-how-bill-shorten-will-respond

Fraser, J 2015, Australia's budget pressures — the view from Treasury, http://grattan.edu.au/wp-content/uploads/2015/05/575_transcript_budget2015.pdf

Freebairn, J, Income Tax Reform: Base Broadening to Fund Lower Rates, https://www.melbourneinstitute.com/downloads/conferences/archive/s6c/john-freebairn-p.pdf

Grattan Institute 2013, Balancing budgets: Tough choices we need, http://grattan.edu.au/wp-content/uploads/2014/03/801_Balancing_Budgets.pdf

Grattan Institute 2014, Controlling costly care: a billion-dollar hospital opportunity, http://grattan.edu.au/wp-content/uploads/2014/03/806-costly-care.pdf

Grattan Institute 2015, Fiscal challenges for Australia, http://grattan.edu.au/report/fiscal-challenges-for-australia/

Grudnoff, M 2016, CGT main residence exemption: Why removing the tax concession for homes over $2 million is good for the budget, the economy and fairness, http://www.tai.org.au/content/capital-gains-tax-main-residence-exemption, The Australia Institute

Independent Economics 2014, Economic impact of selected macroeconomic shocks, http://www.aph.gov.au/~/media/05%20About%20Parliament/54%20Parliamentary%20Depts/548%20Parliamentary%20Budget%20Office/Reports/03-2014%20The%20sensitivity%20of%20budget%20projections%20to%20changes%20in%20economic%20parameters/IE%20report%2023Sept2014.pdf?la=en

Ingles D & Stewart M 2015, Superannuation tax concessions and the age pension: a principled approach to savings taxation, https://taxpolicy.crawford.anu.edu.au/files/uploads/taxstudies_crawford_anu_edu_au/2015-12/m_stewart_d_ingles_retirement_income_final.pdf

McMorrow, JF 2014, The 2014 Commonwealth Budget: Ending the schools funding 'unity ticket', https://www.nswtf.org.au/files/2014_06june_16_mcmorrow_research.pdf

MYEFO 2015-16, http://budget.gov.au/2015-16/content/myefo/html/index.htm

Parliament of Australia 2015b, Higher Education and Research Reform Bill 2014, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Fbillhome%2Fr5396%22

Parliamentary Library 2015, Budget Review 2015-16, http://www.aph.gov.au/library/budgetreview

PBO 2013, Costing — Outside the caretaker period, http://d3n8a8pro7vhmx.cloudfront.net/australianlaborparty/pages/1375/attachments/original/1377734203/PBO_APS_minute.pdf?1377734203

PBO 2015a, 2015-16 Budget: medium-term projections, http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Budget_Office/research_reports/2015-16_Budget_-_medium-term_projections

PBO 2015b, Unlegislated measures carried forward in the Budget — September 2015 update, http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Budget_Office/Chart_packs

PBO 2015c, Medicare Benefits Schedule: Spending trends and projections, http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Budget_Office/research_reports/Medicare_Benefits_Schedule

PBO 2015d, Response to request for budget analysis — outside of caretaker period, http://www.aph.gov.au/~/media/05%20About%20Parliament/54%20Parliamentary%20Depts/548%20Parliamentary%20Budget%20Office/Reports/PBO%20response%20%20request%20for%20budget%20analysis%2027022015.pdf?la=en

PBO 2015e, Goods and Services Tax: Distributional analysis and indicative reform scenarios, http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Budget_Office/research_reports/Goods_and_Services_Tax

PBO 2015f, The sensitivity of budget projections to changes in economic parameters: Estimates from 2014-15 to 2024-24, http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Budget_Office/research_reports/The_sensitivity_of_budget_projections_to_changes_in_economic_parameters

PBO & Greens 2015a, Reforming Negative Gearing, http://scott-ludlam.greensmps.org.au/sites/default/files/negative_gearing_initiative.pdf

PBO & Greens 2015b, The case for capital gains tax reform, http://scott-ludlam.greensmps.org.au/sites/default/files/cgt_factsheet.pdf

Productivity Commission 2015a, Housing decisions of older Australians, http://www.pc.gov.au/research/completed/housing-decisions-older-australians

Productivity Commission 2015b, Trade and Assistance Review 2013-14, http://www.pc.gov.au/research/ongoing/trade-assistance/2013-14

Treasury 2015a, Tax Expenditure Statement 2014, http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/TES-2014

Treasury 2015b, 2015 Intergenerational Report, http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/2015-Intergenerational-Report

Treasury 2015c, Tax Expenditure Statement 2015, http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/TES-2014

Treasury 2015d, 2014-15 Commonwealth Budget, Part 1: Revenue Measures, http://www.budget.gov.au/2014-15/content/bp2/download/BP2_Revenue.pdf

Treasury 2016, Tax Expenditures Statement 2015, http://www.treasury.gov.au/PublicationsAndMedia/Publications/2016/TES-2015

Endnote

1. PBO Report 01/2016

Acknowledgements

CEDA would like to acknowledge the following members and individuals who contributed to CEDA's general research fund between 1 March 2015 and 1 March 2016.

CEDA undertakes research with the objective of delivering independent, evidence-based policy to address critical economic issues and drive public debate and discussion. It could not complete its research agenda without the support of these contributions.

National

ABB Australia

ACIL Allen Consulting

Advisian

AECOM

AEMO

Allens

ANZ Banking Group

APA Group

Arup

Asciano

Ashurst

Austrade

Australia Post

Australian Catholic University

Australian Institute of Professional Education

Australian Rail Track Corporation

AustralianSuper

Bankwest

Beca

Broadspectrum

Bupa

Cardno

Chartered Accountants Australia and New Zealand

Clayton Utz

Commonwealth Bank of Australia

CPB Contractors

CSC

CSIRO

Deloitte

Empired

EY

G4S Australia and New Zealand

GHD

Google

HASSELL

Herbert Smith Freehills

HESTA

IBM

Jacobs

John Holland

Keolis Downer

KinCare

KPMG

Lendlease

McConnell Dowell

McKinsey & Company

Microsoft

Mitsubishi Australia

Navitas

Nous Group

Philips Electronics

PwC Australia

Reserve Bank of Australia

Rio Tinto

RSM

Santos

SEEK

Serco

Shell Australia

Siemens

South32

Stellar Asia Pacific

Stockland

Telstra

The University of Queensland

Transdev

Transurban

TRILITY

Uber

UniSuper

Westpac

WSP | Parsons Brinckerhoff

Australian Capital Territory

Aged and Community Services Australia

Australian Bureau of Statistics

Federal Department of Employment

Federal Department of Industry, Innovation and Science

Group of Eight Australia

University of Canberra

New South Wales

AGL Energy

amaysim

Australian Computer Society

Australian Institute of Company Directors

Australian Nuclear Science and Technology Organisation

Australian Payments Clearing Association

Barangaroo Delivery Authority

Bloomberg

BOC

BRI Ferrier

Business Events Sydney

Caltex Australia

CBRE

Phillip Isaacs, OAM

Greg Fackender

Talal Yassine, OAM

Anthony Sive

Cement Concrete and Aggregates Australia

Clean Energy Finance Corporation

Coal Services

Community Services & Health Industry Skills Council

Data61

Defence Housing Australia

Diabetes NSW

Edelman

EIG

Essential Energy

Export Finance and Insurance Corporation

Four Seasons Hotel Sydney

Fragomen

Gadens

Gilbert + Tobin

Healthdirect Australia

Holcim (Australia)

Hunter Valley Coal Chain Coordinator

IAG

Insurance & Care NSW (icare)

International SOS Australia

J.P. Morgan

JBA

Johnson & Johnson

Macquarie Group

Macquarie University

Maddocks

Mainsheet Capital

Marsh

McCullough Robertson Lawyers

National Insurance Brokers Association of Australia

Newgate Communications

NSW Department of Family and Community Services

NSW Department of Finance, Services and Innovation

NSW Ports

NSW Treasury Corporation

Plenary Group

Regional Development Australia Orana

Royal Bank of Canada

Snowy Hydro

Standards Australia

Swiss Re

Sydney Airport

Sydney Business School, University of Wollongong

Sydney City Council

Sydney Water

TAFE NSW Western Sydney Institute

TBH

The Benevolent Society

The BPAY Group

The Future Fund

The GPT Group

The Hay Group

The University of Sydney

Thorn Group

Transport for NSW

UGL

United Overseas Bank

University of Newcastle

University of Technology Sydney

UNSW Australia

UrbanGrowth NSW

Visa

Western Sydney University

Wollongong City Council

Northern Territory

Darwin Convention Centre

Queensland

Accenture Australia

Advance Cairns

AGL Energy

Arcadis Australia Pacific

Arrow Energy

Aurizon

Australian Sugar Milling Council

Baker & McKenzie

Bank of Queensland

BDO

Bond University

Brisbane Convention and Exhibition Centre

Brisbane Marketing

Burrell Stockbroking and Superannuation

Sue Boyce

Robyn Stokes

Churches of Christ in Queensland

City of Gold Coast

Clanwilliam Aged Care

Colin Biggers & Paisley

Community Services Industry Alliance

ConocoPhillips

Construction Skills Queensland

Data61

Energex

Ergon Energy

Ferrier Hodgson

Gadens

Griffith University

Hastings Deering

Honeycombes Property Group

Ipswich City Council

James Cook University

Law in Order

Local Government Association of Queensland

Logan City Council

Lutheran Community Care

MacroPlan Dimasi

McCullough Robertson Lawyers

Morgans

New Hope Group

NOJA Power

North Queensland Bulk Ports Corporation

Port of Brisbane

QGC

QIC

Queensland Airports Limited

Queensland Competition Authority

Queensland Department of Agriculture and Fisheries

Queensland Department of Energy and Water Supply

Queensland Department of Environment and Heritage Protection

Queensland Department of State Development

Queensland Department of the Premier and Cabinet

Queensland Department of Transport and Main Roads

Queensland Law Society

Queensland Resources Council

Queensland Treasury

Queensland Treasury Corporation

Queensland Urban Utilities

QUT

Robert Walters

Seqwater

South Burnett Regional Council

St Vincent de Paul Society

Stanwell Corporation

Suncorp Group

SunWater

Super Retail Group

The Star Entertainment Group

Toowoomba and Surat Basin Enterprise

Toowoomba Regional Council

Tri-Star Petroleum Company

UniQuest

Unitywater

University of Southern Queensland

University of the Sunshine Coast

Wiggins Island Coal Export Terminal

South Australia

Adelaide Airport

Adelaide Casino

Adelaide Convention Centre

BankSA

BDO

Business SA

Carolyn Grantskalns

City of Playford

Coopers Brewery

Flinders Ports

Flinders University

Funds SA

Health Partners

Hoshizaki Lancer

Life Without Barriers

NCVER

Philmac

RAA of SA

RiAus

SA Department of Health

SA Department of the Premier and Cabinet

Scotch College Adelaide

Shoal Engineering

South Australian Water Corporation

Southern Cross Care

Statewide Super

TAFE SA

University of South Australia

Tasmania

Aurora Energy

MyState

TasNetworks

University of Tasmania

Victoria

AusNet Services

Australian Red Cross

Australian Unity

Barwon Water

BASF Australia

Benetas

Bombardier Transportation Australia

Bravo Consulting

Cabrini Health

Care Connect

Janice Van Reyk

Alexander Gosling, AM

Citipower and Powercor Australia

City of Ballarat

City of Greater Geelong

City of Melbourne

Colin Biggers & Paisley

Competitive Energy Association

CSL

Data #3

Deakin University

Epworth HealthCare

Essential Services Commission

ExxonMobil

Fair Work Ombudsman

Fed Square

GlaxoSmithKline

Housing Choices Australia

IFM Investors

Independent Schools Victoria

Industry Super Australia

JANA Investment Advisers

Jo Fisher Executive

La Trobe University

MAI Capital

Medibank

Melbourne Water Corporation

Metro Trains Melbourne

Mitchell Institute

Monash University

Open Universities Australia

PGA Group

Phillip Island Nature Park

Pinnacle Group

Pitt & Sherry

Programmed Group

RMIT University

Royal Automobile Club of Victoria

RPS

Swinburne University of Technology

The Future Fund

The Smith Family

Toyota

Treasury Corporation of Victoria

United Energy and Multinet Gas

University of Melbourne

Victoria University

Victorian Department of Education and Training

Victorian Department of Environment, Land, Water and Planning

Victorian Department of Premier and Cabinet

VicTrack

Visa

Western Water

Wilson Transformer Company

Workskil

Western Australia

ATCO

Bendigo Bank

BP Australia

Brookfield Rail

CBH Group

Chamber of Commerce and Industry – Western Australia

Chevron Australia

City of Perth

ConocoPhillips

Curtin University

DORIC Group

Edith Cowan University

ExxonMobil

Georgiou Group

Griffin Coal

HopgoodGanim Lawyers

Independent Market Operator

INPEX

Jackson McDonald

LandCorp

Landgate

Lavan Legal

Main Roads, Western Australia

Murdoch University

Perth Airport

Programmed Group

Public Sector Commission

RAC of WA

SAP Australia

Silver Chain

South West Institute of Technology

The Chamber of Minerals and Energy of Western Australia

The University of Western Australia

WA Department of Agriculture and Food

WA Department of Commerce

WA Department of Finance

WA Department of Lands

WA Department of Mines and Petroleum

WA Department of Planning

WA Department of State Development

WA Department of Transport

WA Department of Treasury

WA Super

Wellard Group

Wesfarmers

Western Australian Treasury Corporation

National
Level 13, 440 Collins Street
Melbourne VIC 3000
GPO Box 2117
Melbourne VIC 3001
Telephone 03 9662 3544
Email info@ceda.com.au

New South Wales and the ACT
Level 14
The John Hunter Building
9 Hunter Street
Sydney NSW 2000
GPO Box 2100
Sydney NSW 2001
Telephone 02 9299 7022
Email info@ceda.com.au

Queensland
Level 17, 300 Adelaide Street
Brisbane QLD 4000
GPO Box 2900
Brisbane QLD 4001
Telephone 07 3229 9955
Email info@ceda.com.au

South Australia and the Northern Territory
Level 5
2 Ebenezer Place
Adelaide SA 5000
Telephone 08 8211 7222
Email info@ceda.com.au

Victoria and Tasmania
Level 13
440 Collins Street
Melbourne VIC 3000
GPO Box 2117
Melbourne VIC 3001
Telephone 03 9662 3544
Email info@ceda.com.au

Western Australia
Level 5
105 St Georges Terrace
Perth WA 6000
PO Box 5631
St Georges Tce
Perth WA 6831
Telephone 08 9226 4799
Email info@ceda.com.au

>ceda
committee for economic development of australia