ACTU
australian council of trade unions

Budget Briefing

May 2014

Harsh Budget to change Australia for the worse

Key points

- Young unemployed without income support for 6 months per year
- 16 500 public sector jobs to go, with more through privatisation
- Super Guarantee increase delayed four years
- Redundancy entitlements less protected when employers go bust
- Cuts to indexation for many welfare payments
- Temporary levy for highest income earners
- Family payments cut
- PPL scheme survives, capped at $50 000 over 6 months, not means tested
- New $7 GP payment & higher co-payment for prescription drugs
- Big cuts to funding for health and education, particularly beyond 2017-18
- Uni fees to rise, HELP (HECS) debt to attract real interest rate, repayment threshold cut
- A range of industry assistance programs will be cut or axed
- Tools for Your Trade program to help apprentices to buy their tools will be abolished, new loan scheme created
- Twice yearly fuel excise indexation will be reintroduced
- Company tax to be cut, MRRT & carbon price abolished
- Union royal commission to cost $53.3 million

This briefing examines key budget measures for working people, followed by an assessment of the economic and fiscal outlook. The list of budget measures is far from exhaustive, and is not ranked in order of importance. The analysis is preliminary.

Young unemployed will be on their own

Young unemployed people will be completely on their own for the first six months of unemployment, with no income support from government. After those first six months, people will have to work for the dole, a scheme that does not work to help people find real jobs. After the six months of work for the dole, people will be on their own again, with no income support. 'Young' means people under 30.

There are a few exceptions from the rule, including people who have a partial work capacity due to disability, single parents, and principal carers of children. Contrary to some press reports, it does not appear that all parents will be exempted.

The six month waiting period will be reduced for young people with a prior work history. One month will be discounted from the waiting period for each year of full-time work a person has completed in the past (pro-rata for part time/casual work).

This is a breathtakingly harsh, punitive measure that will not help people find work.

Public sector jobs slashed

In his Budget speech, Joe Hockey announced that "16 500 staff will leave over the next three years without compromising frontline services." The absurd proposition that 16 500 workers could lose their jobs without affecting services is not substantiated by any evidence. To the contrary, vital agencies and programs will cease to operate, or have their funding cut.

The Budget show that 7 336 jobs will be cut in the coming financial year, 2014-15. The job losses – including in major agencies like the ATO – will be spread right across the country. $35.5 million will be cut from the ABC, the Australia Network will be closed, $8 million go from SBS, and CSIRO will lose a large number of workers, contrary to the Coalition's promises in opposition.

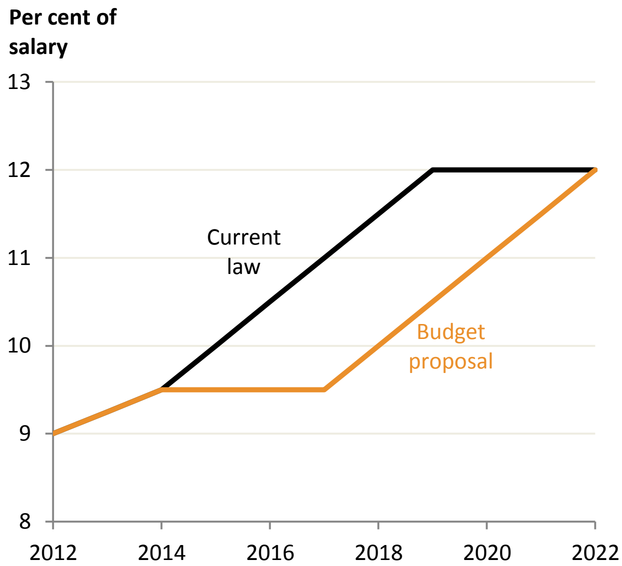
The Royal Australian Mint, Defence Housing Australia, and several other agencies will be privatised. The 16 500 job loss figure does not include jobs lost through these privatisations.

Super Guarantee increase delayed

The increase in the superannuation guarantee will be delayed for four years. It will rise from 9.25% to 9.5% on 1 July this year, and then will remain at 9.5% until 2018, rather than rising each year as had been planned.

This will reduce the retirement savings of working Australians at a time when they're being told they'll have to work for longer, with the pension age rising to 70.

Figure 1: Superannuation Guarantee rate



Source: Budget 2014-15, ACTU.

Workers' entitlements less protected

The previous government legislated a scheme called the Fair Entitlements Guarantee (FEG), while ensures that workers will be paid their redundancy entitlements if their employer goes out of business. This Budget puts a cap on the entitlements that workers will receive. Rather than receiving the redundancy entitlements set out in a collective agreement, workers will receive only the minimum legal redundancy entitlements in the National Employment Standards. Redundancy payouts will be capped at 16 weeks' pay.

With the manufacturing industry in particular facing difficulties, many workers will be worried about receiving their entitlements if their employer goes bust. This Budget measure makes their entitlements less secure.

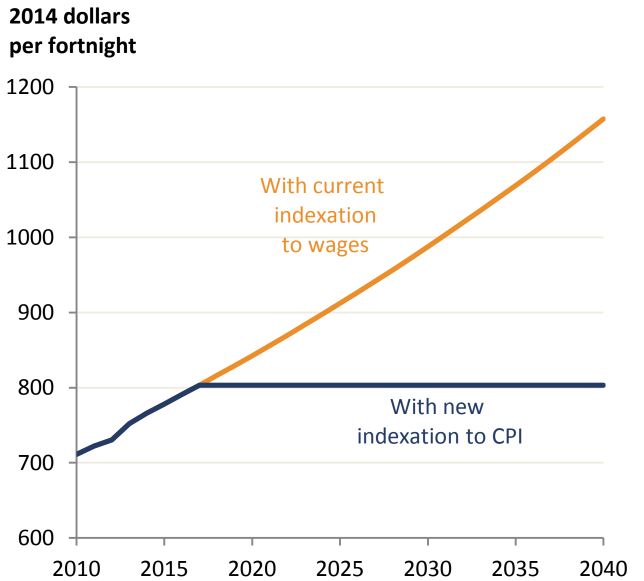
Pension indexation to be cut

Pensions currently rise in line with wages growth. This is an important feature of the system – indexation to wages means that pensioners don't fall further behind typical community living standards over time.

This Budget announces an end to this arrangement. Instead, pensions will rise only in line with the Consumer Price Index (CPI). 'Pensions' include the Age Pension, Disability Support Pension, Carer Payment and Veterans' Affairs pensions. All of these will be tied to the CPI from 1 September 2017 and will no longer keep pace with wages growth. The indexation for Parenting Payment Single will also be cut to the CPI, but that will happen from 1 July this year.

The ACTU projects that this will mean that, in inflation-adjusted 2014 dollars, pensions will be around $200 per fortnight lower in 2030 than they would have been if the existing indexation arrangements had been retained.

Figure 2: Projected effect of indexation change to pension



Source: ACTU projections. Historical payment rates from the DSS Guide to Social Security Law, Section 5.2.2.10. CPI from ABS 6401. Projections assume CPI inflation of 2.5% and nominal wages growth of 4.1%, consistent with IGR 2010.

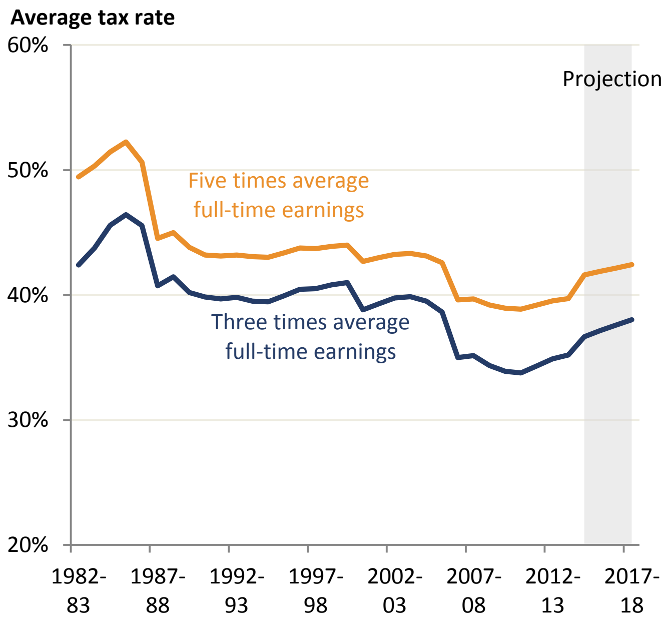
The cut to indexation rates won't be too noticeable at first, but over time the consequence will be that people reliant on pensions will fall far behind typical community living standards. The number of people living in relative poverty is sure to rise as a result.

Deficit levy

There will be a small increase in the top marginal tax rate. Effectively the top tax rate will rise by 2 percentage points. This rate affects income over $180 000, or approximately the top 3% of income earners.

This 'Temporary Budget Repair Levy', as it's known, will apply only from 1 July 2014 until 30 June 2017, raising $600m in the coming financial year. This increase comes after very large tax cuts in the 2000s that disproportionately benefited high-income earners. The ACTU projects that a person earning three- or five-times the average full-time wage will still pay a lower tax rate in 2017-18 than someone who earned three- or five-times the average full-time wage in 2005-06.

Figure 3: Estimated and projected average tax rate over time



Source: ACTU estimates and projections based on historical tax scales, ABS 6302. 'Average tax rate' is the income tax liability (including Medicare Levy, additional NDIS levy & Temporary Budget Repair Levy) as a proportion of gross income.

The levy is temporary, unlike many of the measures that will affect low- and middle-income earners, which will have compounding effects over time.

Family payments reduced for many

Family Tax Benefit Part B (FTB-B), which is paid to single-income families, will be significantly tightened. It will now only be paid to families with incomes below $100 000 per year (down from $150 000). The more serious change is that FTB-B will now only be paid to parents of children younger than 6. A small payment ($750 per year) for low-income single parents with children aged between 6 and 12 will partly offset the loss of FTB-B for some families.

The income test will also be tightened a little for Family Tax Benefit Part A (FTB-A), which is paid to low- and middle-income families based on household income. The payment rates for both FTB-A and FTB-B will fall in real terms over the next two years, as their indexation will be 'paused'. This means that inflation will reduce the real value of payments between 1 July 2014 and 1 July 2016. The FTB end-of-year supplements will also be cut immediately and will cease to be indexed, which mean a reduction of $1.2 billion in payments over four years.

Paid parental leave scheme

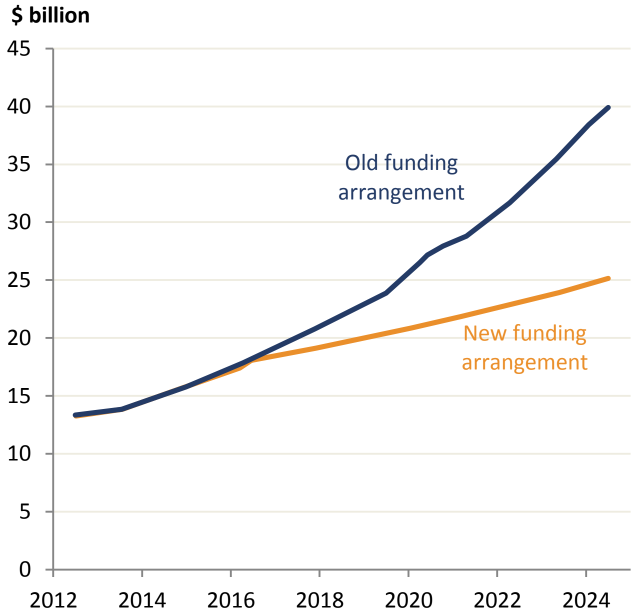
The Government will proceed with its paid parental leave scheme. The payment will be capped at $50 000 over six months, although eligibility is not means tested, so very high income parents will still receive the $50 000.

Health care

Standard GP consultations and out-of-hospital pathology and imaging services will be subject to a new $7 co-payment. The revenue from this payment will go to a new medical research fund. People will also pay more for medicine, with the co-payment under the Pharmaceutical Benefits Scheme to rise from $36.90 to $41.90 from July 2015, on top of the normal CPI indexation in January.

There will be large reductions in funding to the states for public hospitals. There will be a reduction of $1.8 billion over the next four years, but much bigger cuts after that. The cuts beyond 2017-18 will come from the Commonwealth cutting indexation on hospital funding. The change will mean around $15 billion less federal funding per year for hospitals by 2024-25.

Figure 4: Federal funding for hospitals

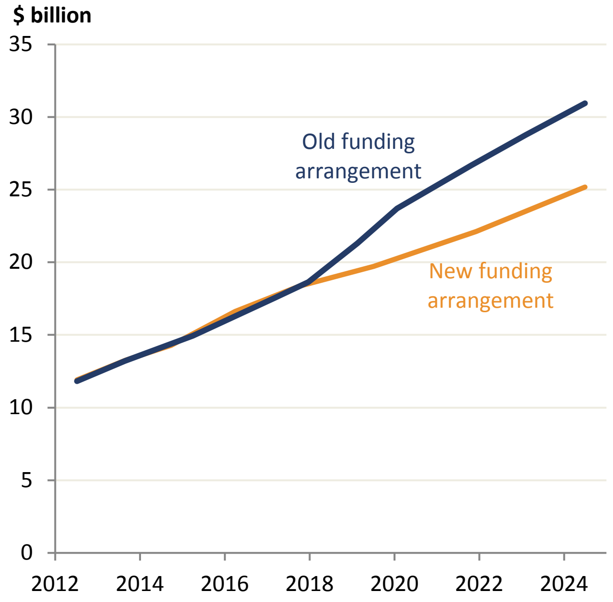


Source: Budget 2014-15 Overview, p.7.

School education

Federal funding to the states for school education will also be cut. Similar to the cut for hospital funding, the cut for school funding comes through a reduction in indexation beyond 2017. The change will see school funding reduced by over $5 billion per year by 2024.

Figure 5: Federal funding for schools



Source: Budget 2014-15 Overview, p.7.

Higher education fees up

The Budget includes big changes to fees for higher education. The caps on university fees will be removed from 2016, which will mean that fees (particularly at elite universities) will rise, perhaps by a large amount. Students' HELP (formerly known as HECS) debts will no longer just be indexed at the CPI – instead, they'll rise in line with the interest rate on government debt, which is typically around 6%. This means that the real burden of student debt will rise over time, which has not been the case in the past. Students will also have to begin repaying their debts from a lower level of income.

Industry assistance and innovation

A range of industry assistance programs will be cut or axed, including more than $800 million in funding to the automotive industry, and the axing of the Australian Renewable Energy Agency and Carbon Capture and Storage Flagships Programme. The CSIRO, Australian Nuclear Science and Technology Organisation and Australian Institute of Marine Science will have their funding cut by almost $150 million over four years.

Apprentices

The Tools for Your Trade program of financial incentives to apprentices to buy their tools will be abolished, cutting $914 million from support for apprentices. It will be replaced with a loans program for apprentices, similar to higher education loans, which must be repaid .

Fuel tax to rise

Twice yearly fuel excise indexation will be reintroduced, in line with inflation. The fuel excise has been frozen at 38.1 cents a litre since 2001.

Company tax

The government will go ahead cutting the company tax rate by 1.5% to 28.5% from July next year, and will proceed with the repeal of the Minerals Resource Rent Tax and the price on carbon.

Royal commission into trade unions

The Royal Commission into trade unions will cost $53.3 million over two financial years. The report is due by the end of 2014.

Economic and fiscal outlook: sluggish growth, sea of red

Economic outlook

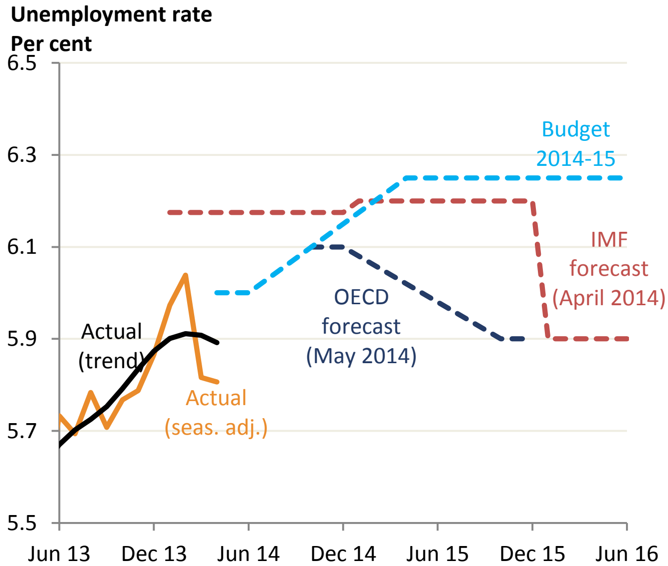
The Australian economy is going to keep growing at less than its trend pace for the next three years, with unemployment rising to 6.25% by June next year and remaining there for the following year. Wages growth will remain sluggish, 2.75% this year and 3% for each of the next two years, and employment growth won't be strong enough to keep up with population growth. By June 2015, just 60.5% of the population aged 15 and over will be in work, the lowest employment-to-population ratio since 2004.

That's the pessimistic outlook set out in this year's Budget. Not much has changed in the outlook since the new government's mini-budget (MYEFO) late last year. For the very near term, the Budget forecasts are in line with the RBA's latest forecasts – both expect real GDP growth of 2.75% this financial year. But the Budget is a little more pessimistic than the RBA about what will happen in the next financial year, 2014-15, with the RBA forecasting growth of 2.75% (the midpoint of its forecast band) while the Budget forecasts only 2.5%.

It looks like the economic forecasts in this year's Budget might be a little pessimistic. Recent data about the economy and the labour market in particular has been positive. It's always noisy, but the signs have been good – the unemployment rate has fallen, employment growth has picked up, job advertisements and vacancies have started to recover. Retail trade and housing construction have finally picked up in response to low interest rates, bringing the long-anticipated 'rebalancing' in economic activity away from mining activity. Despite all this, the Budget envisages unemployment rising for the next year at around the same pace that it was growing in late 2013.

This is a fair bit more pessimistic about the outlook for jobs than some other recent forecasts, particularly from the OECD. The OECD's *Economic Outlook*, issued just a few days ago, envisages 6.1% unemployment by the end of this year, but a fall next year to 5.9% by the end of 2015.

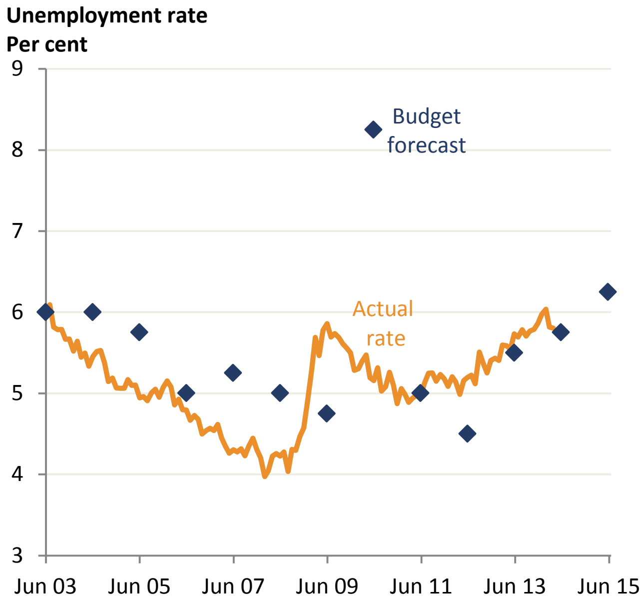
Figure 6: Actual unemployment rate and forecasts



Source: ABS 6202, IMF WEO database April 2014, OECD *Economic Outlook* Annex Table 13, Budget 2014-15. Note that IMF forecasts are year averages; OECD forecasts are for the Dec quarter; Budget forecasts are for June quarter.

The Budget concedes that its forecast for unemployment might be a bit pessimistic. In the coded language of these sorts of documents, it notes that "an improvement in job vacancies and advertisements in early 2014 indicates that there are upside risks," meaning that things might not turn out as bad as envisaged. If it turns out that they've been too pessimistic about the economy, then Joe Hockey will receive more tax revenue and spend less on welfare payments than they've budgeted for. It wouldn't be the first time that a Budget forecast for the unemployment rate has turned out to be too pessimistic, as shown in Figure 7.

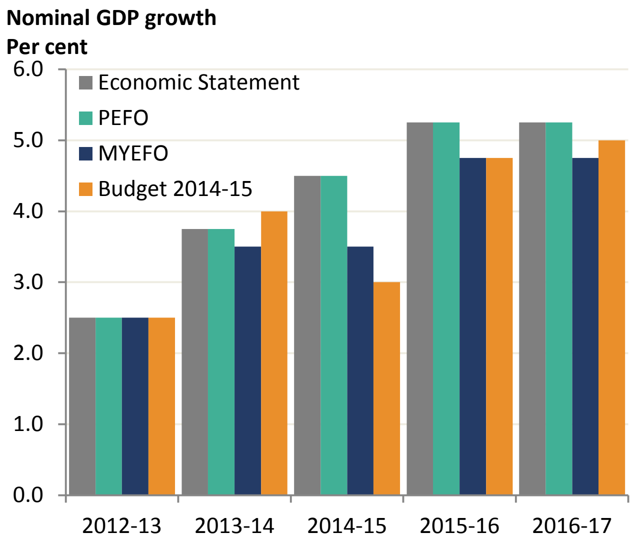
Figure 7: Unemployment rate and budget forecasts over time



Source: ABS 6202 and Budget papers (various years). Budget forecast for 2015 is from the 2014-15 Budget 2014 is from the 2013-14 Budget, and so on.

The Budget is also pessimistic about nominal GDP growth, which is a key determinant of the tax revenue the government takes in.

Figure 8: Nominal GDP growth forecasts



Source: Economic Statement 2013, PEFO 2013, MYEFO 2013-14, Budget 2014-15.

But what if it turns out the Budget is right? In that case, we'll have spent this entire decade of the 2010 operating with an economy smaller than its potential level – an 'output gap' in the language of economists. We'll have spent most of this decade with an unemployment rate well above 5%. That's an intolerable situation.

So either the economic forecasts are pessimistic, in which case the Budget balance will turn out to be much better than the Government is forecasting, or they're accurate or too optimistic, in which case we'll have an intolerable stagnation in economic activity.

Fiscal outlook

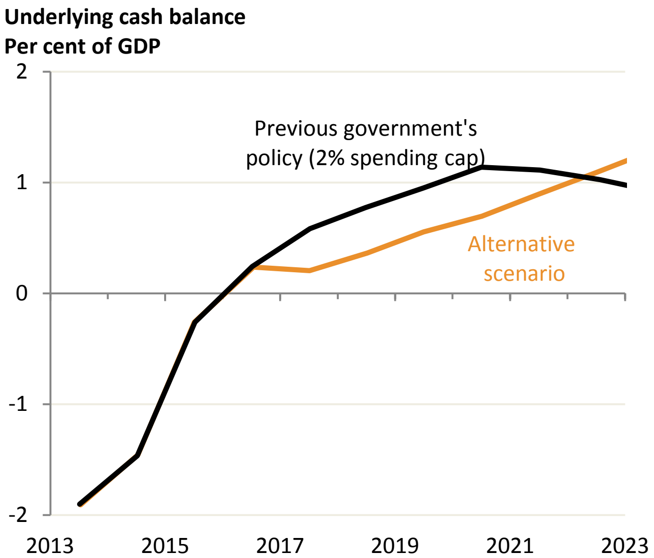
This wasn't supposed to happen anymore. Joe Hockey has followed a classic playbook since coming to office – find a budget black hole, blame it on your predecessors, then use this revelation to justify implementing an agenda more aggressive than you'd let on before the election. But this strategy wasn't supposed to be possible after the Howard Government passed the Charter of Budget Honesty into law.

Under the Charter, we no longer have to compare the new government's numbers to the old government's numbers and work out for ourselves why they don't line up. Instead, the heads of the Treasury and the Finance Department are required to put out their own set of numbers, the Pre-Election Fiscal Outlook (PEFO), during the election campaign. This gives a neutral baseline against which we can assess the new government's figures. PEFO is the only set of budget forecasts that truly belong to the bureaucrats – all other documents (like the Budget) are issued by ministers.

The PEFO last year didn't contain a budget black hole. It didn't depict a budget emergency. In fact, the outlook in PEFO was remarkably close to the figures in the Economic Statement issued by Chris Bowen and Penny Wong just before the election was called. The public servants in PEFO projected the budget balance out for a decade. They found that the budget was on track, before the election, to return to surplus in 2016-17 and keep improving from there, eventually hitting a surplus of about 1% of GDP by 2023 with net debt approaching zero.

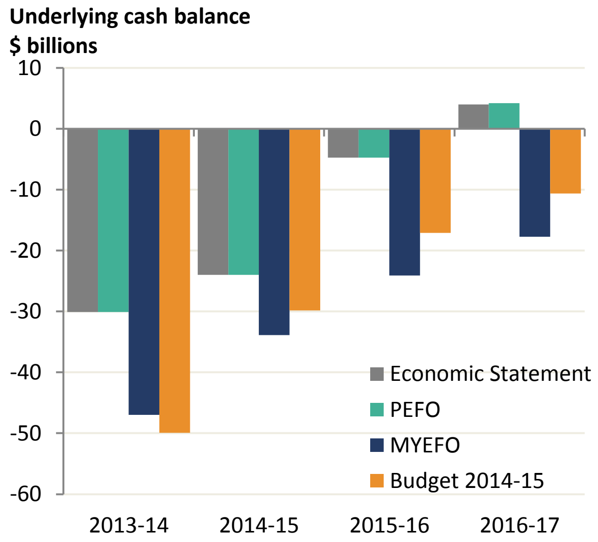
Some commentators have quibbled with these projections, suggesting that they're implausible because they adopt the previous government's policy of restricting real spending growth to 2% per year. This policy may well have been implausible, but PEFO didn't hinge on it. Instead, the public servants also showed what would happen to the budget if spending grew at its expected pace (instead of being restricted to 2% real growth) and revenue was allowed to grow. The result for the budget bottom line is much the same as under the previous government's policies.

Both of the scenarios – the first with the previous government's 2% spending growth cap and the second that reflects the underlying trend in spending and taxing – factor in big ticket items including DisabilityCare Australia (aka the NDIS) and the National Plan for School Improvement (aka Gonski).



Source: Pre-Election Fiscal Outlook 2013, Chart F3.

Despite the Charter and the neutral numbers in PEFO, Joe Hockey still played the budget black hole card, just as Peter Costello (in 1996), Paul Keating (in 1983) and John Howard (in 1975) had done before him. The new government's mini-budget (MYEFO) contained dramatically bigger deficits than the bureaucrats' PEFO projections, with no surpluses in sight. The worsened outlook was partly due to policy decisions taken by the new government (like scrapping the carbon and mining taxes and giving a large grant to the RBA), partly due to a change in the assumptions used for projections beyond the first two years of the forward estimates, and partly due to a slightly more pessimistic economic outlook. Hockey's first budget confirms this budget outlook, with budget deficits for years to come.



Source: Economic Statement 2014, Pre-Election Fiscal Outlook 2013, Mid-Year Economic and Fiscal Outlook 2013-14, Budget 2014-15.

For now, this sea of red ink is being used as the justification for deep cuts in spending and a few unpopular revenue-raising measures. But don't be surprised if, in a couple of years' time, the budget outlook is a lot rosier. That's the final step in the budget black hole strategy – show that you've brought home the bacon and balanced the books despite your predecessors' profligacy.