Opinion

Will the budget be a requiem for economic responsibility?

If Josh Frydenberg eschews more pump-priming and makes tough fiscal choices to help drive investment and productivity, Tuesday night could be the Treasurer's finest hour.

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May 9, 2021 – 1.42pm

The federal budget on Tuesday night will be a requiem to the one-time robustness of Australia's medium-term macroeconomic frameworks, both fiscal and monetary.

It is sobering to think that just 18 months ago Treasurer Josh Frydenberg was on the brink of delivering a budget surplus. Reserve Bank of Australia governor Philip Lowe had ruled out using unorthodox monetary policy. C'est la vie.

Both the Treasurer and RBA governor can be congratulated for helping the national economy ward off much of the adversity associated with the coronavirus tragedy. It also seems their policy mix has created a mini-boom on the other side. But there is a long-term price to be paid for all the necessary remedial action.

Josh Frydenberg: will the federal budget be a funeral dirge for the economic rigour and responsibility of the 1980s and 1990s? **Alex Ellinghausen**

Policy is continuing to fuel the 30-year, tax concession-fuelled boom in east coast residential real estate. This has combined with the unprecedented global monetary expansion of the US and other majors (ex-China) to support stockmarket reflation and resurgence.

Only the real economy and productivity can create permanent wealth, as Milton Friedman espoused. Presumably the current exuberance will end in a thumping crash as soon as the markets see there is no pot of gold at the end of the dogecoin rainbow: October 1987; July 1997; March 2000; October 2007; February 2020; and coming soon. This time is not different.

Meanwhile Treasurer, Australia's net debt is on the rise. Macroeconomics projects Australia's national (Commonwealth and state) net debt and unfunded superannuation liabilities will surpass 77 per cent by the end of the forward estimates, building on a ratio of household debt to GDP in excess of 100 per cent. This combined risk is unprecedented.

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Macroeconomics forecasts a federal budget deficit of $177 billion (9 per cent of GDP) in the current year (2020-21), and $88 billion (5 per cent of GDP) in the budget year (2021-22). Moreover, we project deficits in excess of $50 billion in each year of the forward estimates.

More troubling, macroeconomics projects structural deficits above $60 billion over the forwards, built on terms of trade (commodity prices) well in excess of pre-China-boom historical averages.

Self-provision in retirement

When Vale comes back online in Brazil in 2022, the federal budget is sunk. Still even if our terms of trade remain temporarily elevated, it also seems that the budget deficit will not narrow much either after the budget year because the stage three announced personal tax cuts are coming in 2024-25.

Treasurer Frydenberg will no doubt use his budget speech to attempt to position the Morrison government [ahead of the looming federal election.]

He will play down big spending pressures such as population ageing, residential aged care, future submarines and global warming. OK, but let's also hope he eschews any further pump-priming, especially given it seems the worst impacts of the shock are behind us.

The 2021-22 budget should be judged by its ability to drive strong and sustainable business and dwelling investment, and by its propensity to propel the creation of new productive capacity including necessary social housing.

Top of our reforms list would include:

First, encouraging greater self-provision in retirement living and care options. This can be achieved by reforming the pension and aged care means tests to allow the sale of the family home with proceeds set aside to manage retirement living without tax penalty.

Under the current means tests, retirees have no incentive to sell their home to fund their own retirement living and aged care arrangements. Many sales and the appropriate lifestyle right-sizing are being prevented.

The idea is to dedicate the sale proceeds to right-sizing accommodation options (private dwellings, retirement villas or aged care options), with remaining proceeds (up to a reasonable limit) dedicated to managing longevity by investing the balance in a special purpose retirement living superannuation account with a 30:70 asset mix.

These accounts should be specifically dedicated to meeting new retirement living and care needs if and when more intensive care services are required.

Second, investment-enhancing tax reforms. Our tax system needs to target the barriers to more efficient asset use and investment levels by replacing company taxes and stamp duties with a cash-flow tax and land taxes.

Third, restructuring of the national electricity grid. The east coast grid needs to cope with the ever-increasing levels of intermittent power generation. Solution: follow Nobel-prize-winning financial economist Harry Markowitz' principle of diversification – don't put all your eggs in one basket.

Embrace a broad mix of least-cost renewable generating technologies and storage options. That will include some that look totally infeasible or entirely too risky. In the absence of a carbon price, this is the best way to insure against technological obsolescence and costly group think surrounding “populist” options.

Fourth, paring back the $70 billion in property tax concessions afforded to mum and dad property investors to fund an ongoing annual construction of 15,000 new community-owned homes. These dwellings could then be offered for sale to tenants via low-cost loans and shared equity, such as Keystart in Western Australia. Perhaps a role for the superannuation funds?

Looking at our four proposals, each would barely affect federal (or state budgets), but all could significantly and speedily affect business and dwelling investment by way of the private sector.

So we wish that federal budget night will not be funeral dirge for the economic rigour and responsibility of the 1980s and 1990s, but Treasurer Frydenberg’s finest hour.

Stephen Anthony is chief economist at Macroeconomics.

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