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Pre-Budget Fiscal Outlook: a Quick Guide

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The 2017–18 Mid-Year and Economic and Fiscal Outlook (MYEFO) is the latest fiscal forecast released by the Government ahead of next week's Budget. MYEFO confirmed the Government's plan to return the Budget to surplus by 2020–21, an intention that is expected to be confirmed in the upcoming Budget.

MYEFO forecast that the budget balance is expected to increase from an estimated deficit of \$23.6 billion in 2017–18 to a surplus of around \$10 billion in 2020–21. The return to surplus is predicated on both increases in government receipts as well as restraining growth in government payments. Total government receipts were expected to grow from \$437.1 billion in 2017–18 (24.0 per cent of GDP) to a projected \$525.6 billion in 2020–21 (25.4 per cent of GDP). Over the same period, payments by the Australian Government were expected to increase in nominal terms from \$457.6 billion to \$515 billion, but to fall slightly as a percentage of GDP from 25.2 per cent in 2017–18 to 24.9 per cent in 2020–21.

Indications from [monthly budget reporting data](#) is that the fiscal position to date in 2017–18 is stronger than was forecast in MYEFO. Receipts to the end of March 2018 were \$5.3 billion higher than anticipated in MYEFO (including an additional \$1.8 billion from personal income tax, \$0.95 billion from company taxes and \$0.7 billion from GST) and total payments were \$2.7 billion lower than in MYEFO.

Commentators have speculated that this better-than-expected result will mean that next week's Budget will include upwards revisions in underlying revenue forecasts and downwards revisions in underlying expenses, giving the Government room to provide tax cuts, increase spending or project larger surpluses.¹

Receipts

Personal income tax is the largest source of government receipts, at just under half of all government receipts.² At MYEFO it was predominantly personal income taxes that were expected to drive the strong increases in government receipts, and ultimately fiscal consolidation, over the forward estimates period.

Improved macro-economic conditions, including stronger employment levels and an anticipated improvement in wages growth, would be expected to increase personal income tax receipt forecasts in the Budget. However, the Government has announced a few policies in advance of the Budget which will counteract this revenue growth. The Government has announced that due to a better fiscal position it no longer intends to increase the Medicare Levy to fund the National Disability Insurance Scheme.³ Further, in a recent speech, Treasurer Scott Morrison announced that the Government will implement personal income tax cuts, initially for low and middle-income

1. See, for example, Deloitte, '[Budget monitor: are the rivers of gold back?](#)'

2. Personal income tax includes capital gains tax paid by individuals.

3. S Morrison, 'Lower taxes for a stronger economy', [Address to the Australian Business Economists, Sydney](#), 26 April 2018.

earners.⁴ There have been reports in the media that these will be phased in over ten years to avoid affecting the projected return to surplus.⁵

The overall impact on personal income tax in the Budget will depend on the offsetting effects of these policy decisions (notably the size of the personal income tax cuts and how they are phased in) and the expected upward revisions in personal income tax receipts as a result of stronger macro-economic conditions.

Corporate tax receipts make up just under 20 per cent of government receipts and are also expected to contribute strongly to growth in receipts over the forward estimates period as a result of strong private sector investment and higher commodity prices.⁶

Indirect taxes are also likely to grow strongly over the forward estimates period on the back of increased GST receipts. However, GST is fully distributed to the states (net of administration expenditures) and is not expected to contribute to the Commonwealth's fiscal position in net terms.

Payments

Payments are presented in two different ways under the Government Finance Statistics framework:

- Presented on an **economic basis** - shows payments on the basis of economic purpose, such as transferring payments from the Commonwealth to other sectors, paying wages for public servants or purchasing goods and services.
- Presented on a **functional basis** - shows payments on the basis of the functions that Government performs; for example, payments for defence, health or education.

Both presentations are interesting because they provide a sense of what the Government is spending money on, and for what purposes.

The largest payment from the Budget (on an economic presentation basis) is **current transfers** between the Commonwealth Government and other sectors of the economy, which includes payments to the states and territories; the private sector; overseas entities; non-profit organisations; and subsidy payments and benefits—including payments to the aged; veterans; people with disabilities; families; the unemployed; students and vocational training. Current transfers are anticipated to account for \$280.5 billion of expenses, or 60 per cent of total expenses (15.4 per cent of GDP) in 2017–18, increasing to \$310.7 billion in 2018–19 (a slight decline to 15 per cent of GDP).

The largest payment in the Budget (on a functional presentation basis) is **social security and welfare** (including pensions), at around 35 per cent of total government payments. These payments are forecast to increase from around \$164 billion in 2017–18 to \$187.4 billion in 2020–21, maintaining at around nine per cent of GDP.

Other categories that exceed one per cent of GDP, and make up a total of 11.3 per cent of GDP, include intergovernmental transfers (3.5 per cent), health (4.2 per cent), education (1.9 per cent) and defence (1.7 per cent). The remaining 21 categories account for the residual 5.4 percentage points of GDP. These payments are expected to stay relatively stable as a percentage of GDP over the forward estimates period.

4. Ibid.

5. P Coorey, '[Income tax cuts loaded for 10 years](#)' *Australian Financial Review*, 26 April 2018.

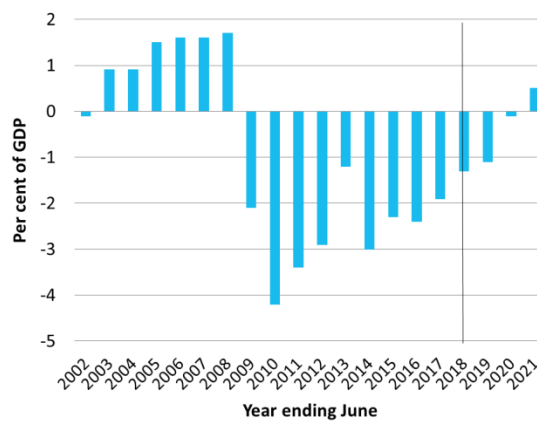
6. Inclusive of capital gains tax paid by companies.

Key fiscal charts

The Budget is expected to be back in surplus by 2020–21, which will be the first Budget surplus since 2006–07.

MYEFO projected an improvement in the fiscal position from a deficit of \$23.6 billion in 2017–18 (1.3 per cent of GDP) to a surplus of \$10 billion (0.5 per cent of GDP) in 2020–21.

Figure 1: underlying cash balance (% of GDP)



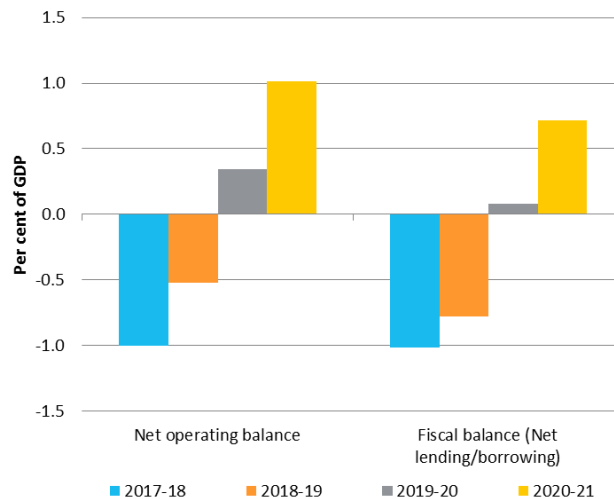
Other measures of fiscal balance provide insight into the impact of Government on the economy.

The net operating balance (NOB) measures the sustainability of the Government's fiscal position and is an indication of the sustainability of the level of government services. In the short term the NOB is in deficit by 1 per cent of GDP.

The fiscal balance (FB) approximates the contribution of the Australian general government sector to the current account balance in the balance of payments. In the short term the FB is in deficit by 1 per cent of GDP.

Both measures are expected to improve over the budget cycle.

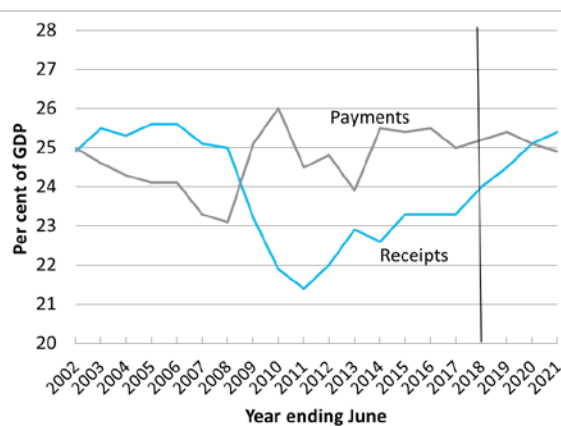
Figure 2: fiscal balances (% of GDP)



Achieving a surplus depends on closing the gap between payments and receipts.

Strong growth in receipts is expected to be the main driver of fiscal consolidation over the forward estimates period. Growth in payments is expected to be constrained over the forward estimates period.

Figure 3: receipts and payments (% of GDP)



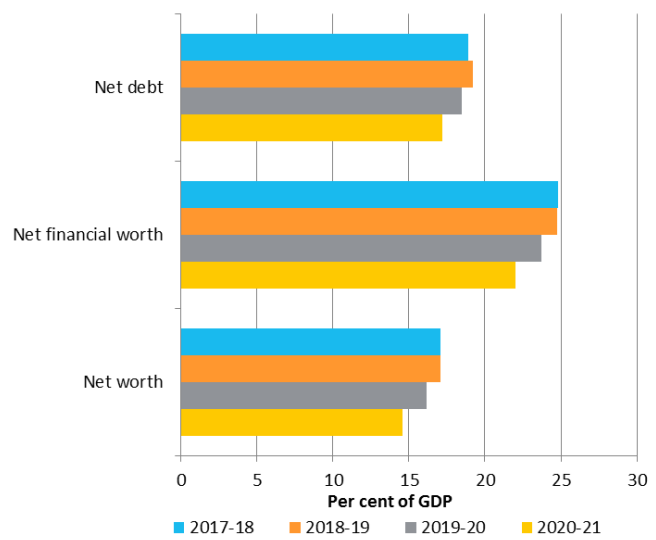
Deficits will contribute to gross borrowing, which are offset by investments. Net debt is how these differences are measured.

Net debt will sit at \$343.8 billion in 2017–18, or around 18.9 per cent of GDP. Relatively lower deficits, or actual surpluses will moderate the net debt result.

The difference between all assets and all liabilities is measured by net worth. On current settings, the Australian Government has more liabilities than assets, and has a negative net worth of \$310.7 billion, equivalent to 17.1 per cent of GDP.

The difference between financial assets and liabilities is measured by net worth. On current settings, the Australian Government has more financial liabilities than assets, and has a negative net financial worth of \$451.3 billion, equivalent to 24.8 per cent of GDP.

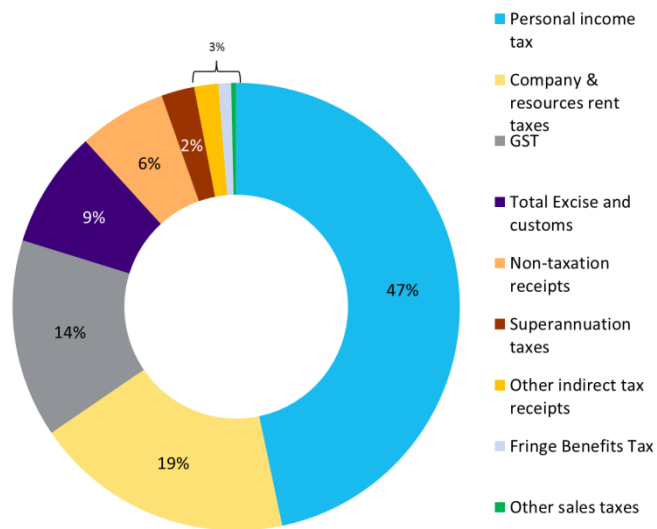
Figure 4: net debt (% of GDP)



Personal income taxes (including capital gains tax (CGT) paid by individuals) account for just under half of government revenues.

A total of 19 per cent comes from taxes on companies (including CGT and resource rent taxes).

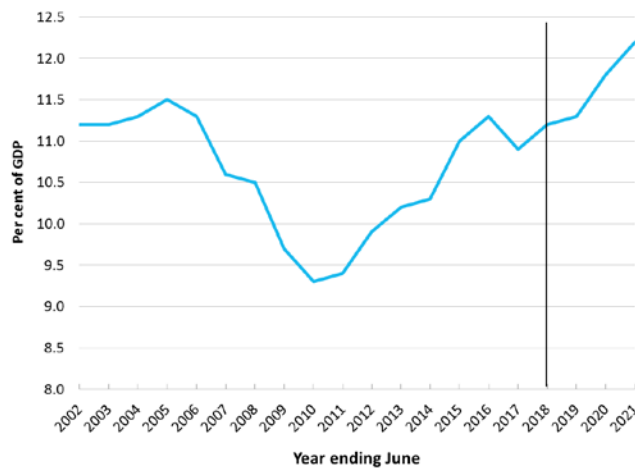
Figure 5: government receipts (% of revenue)



Personal income tax receipts were anticipated to grow to their highest level as a proportion of GDP since 1999–2000 on the back of strong employment and better wages growth.

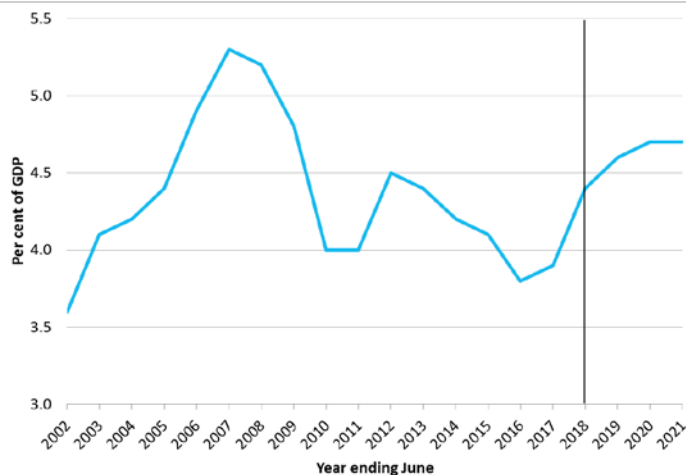
The Budget is expected to include measures which deliver cuts in personal income tax rates over the next decade and reverse the Government’s previous policy to increase the Medicare Levy.

Figure 6: personal income tax (% of GDP)



Corporate income tax receipts were anticipated to grow to their highest level as a proportion of GDP since 2008–09 on the back of strong non-mining investment, increased corporate profitability and higher commodities prices.

Figure 7: corporate income tax (% of GDP)

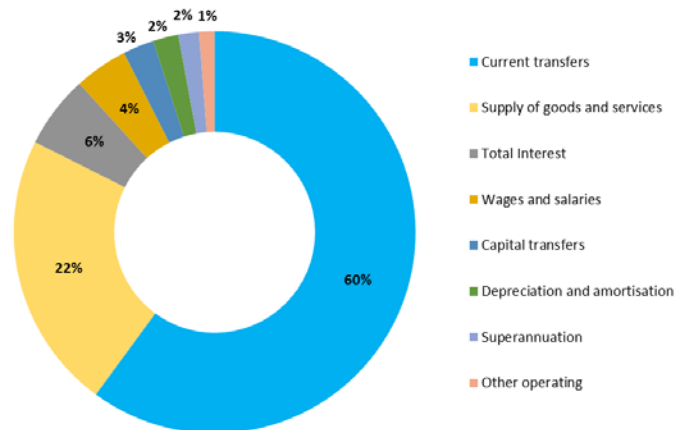


Current transfers account for 60 per cent of total payments. Many of these payments are made under special appropriations.

Supplies and services account for 22 per cent of payments. These include payments to suppliers, contractors and consultants, operating leases, health care payments and indirect personal benefits.

The ten largest individual payment categories are wages and salaries; supply of goods and services; indirect personal benefits; government debt interest; current transfers to state and territory governments; transfers across multiple jurisdictions; subsidy expenses; assistance to the aged; assistance to people with disabilities; and assistance to families with children.

Figure 8: government economic payments (% of total)



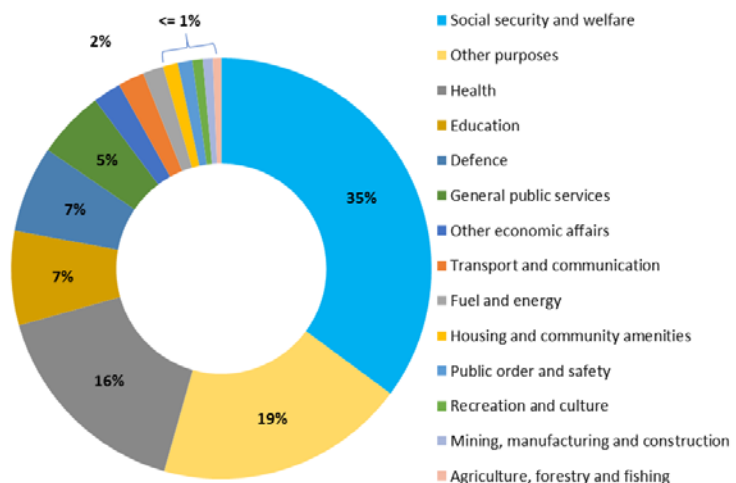
In terms of functions, social security and welfare account for 35 per cent of expenses.

The next largest single category is health, accounting for 16 per cent.

The category 'other purposes' accounts for 19 per cent, but this includes items such as public debt interest superannuation interest and the transfer of goods and services tax to the states.

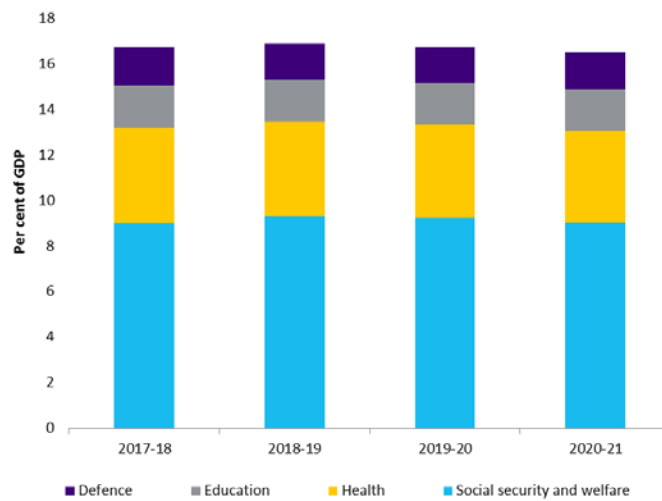
The ten largest individual functional expenditures are social security and welfare; health; GST transfers; education; defence; public debt interest; transport and communication; superannuation interest; fuel and energy; and financial and fiscal affairs.

Figure 9: government functional payments (% of total)



The largest areas of functional expenditure by the Commonwealth Government are social security and welfare, health, education and defence. These are expected to remain relatively stable as a percentage of GDP over the forward estimates period.

Figure 10: government payments (% of GDP)

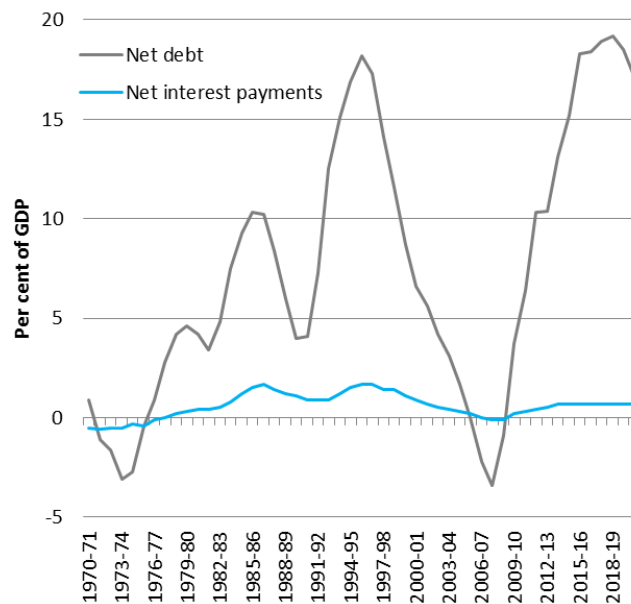


Increases in net debt affect net interest payments which are measured over the long-term in budget papers.

Net interest payments are around \$13.4 billion in 2017–18, equivalent to around 0.7 per cent of GDP. This is the highest level since 2001–02, consistent with net debt sitting at a peak of 18.9 per cent of GDP.

Net interest payments are equivalent to around \$478 per capita.

Figure 11: net interest payments(% of GDP)



Source: [2017–18 Mid-Year Economic and Fiscal Outlook](#)

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