

economic and political overview



2017



Economic and political overview 2017

About this publication

Economic and Political Overview 2017

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Page 24: (Top left) Prime Minister the Hon. Malcolm Turnbull, CEDA Event, Economic Address, August 2016. (Top right) Deputy Leader of the Liberal Party and Minister for Foreign Affairs, the Hon. Julie Bishop, 29 August 2016, AAP Image/Rick Rycroft. (Bottom left): Deputy Prime Minister and Leader of The Nationals, the Hon. Barnaby Joyce, CEDA event, State of the Nation, Canberra, June 2015. (Bottom right) Federal Leader of the Opposition and Shadow Minister for Indigenous Affairs and Aboriginal and Torres Strait Islanders, the Hon. Bill Shorten, CEDA event, State of the Nation, Canberra, October 2016.

Page 26: One Nation Leader, Senator Pauline Hanson, 19 November 2014, AAP Image/Dave Hunt.

Page 26: Nick Xenophon Team Leader, Senator Nick Xenophon, CEDA event, State of the Nation, Canberra, June 2015.

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Page 54: Federal Treasurer, the Hon. Scott Morrison, 19 December 2016, AAP Image/Lukas Coch.

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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 expanding 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 and sponsorship.

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committee for economic development of australia

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The content in the *2017 Economic and Political Overview* was up-to-date at the time of printing. Due to the dynamic current economic and political environment, it may not address the most recent developments.

CEDA's Economic and Political Overview event series takes place around Australia to coincide with the publication's release, and provides the latest analysis from the report authors as well as business and political leaders.

Foreword



Providing an economic and political overview for the year ahead is always difficult but given the tumultuous year that was 2016, this year's outlook is one of the most uncertain for many years.

However, that is why this year's CEDA *Economic and Political Overview* (EPO) is such an important document for political decision-makers and the business community. It again delivers reasoned analysis of the possible economic and political headwinds on the horizon and trends and projections.

It goes without saying that the political and economic consequences from 2016 will be felt throughout this coming year.

While internationally Brexit and the election of Donald Trump as US President dominated and continue to dominate the headlines, at home we had a Federal Election that delivered significant power to minor parties and independents, and a government that struggled to provide leadership and much-needed economic and social reform.

While the Federal Government managed to finish the parliamentary year by passing legislation that was generally of interest to their philosophical base, the New Year has already brought further instability following the focus on MPs' expenses, ministerial changes and the collapse of TPP.

How 2017 pans out for the Turnbull Government may well depend on its ability to urgently set-out a clear agenda and implement it. If they continue to falter on the tough decisions, they could face major problems.

From CEDA's December 2016 Big Issues survey we know the business community expects to see on the Federal Government agenda in 2017 policies that address the Federal Budget deficit, preparing for jobs of the future, and tax system reform. It will be interesting to watch these key areas as the year unfolds.

It will also be fascinating to watch the economic shifts in 2017. While the outlook is generally positive for Australia overall, results may be patchy across different jurisdictions. Recent inflation figures, growth in unemployment and international economic uncertainty make forecasting a profession not for the faint-hearted.

For example, in Sydney and Melbourne the perception seems to be that the economy is travelling well, but move outside these areas and there is growing concern over the economic outlook. Political implications are but one by-product of the two-speed economy.

In addition to the EPO's usual chapters that look at the broader economic and political outlook, this year's publication recognises the above uncertainties and also explores:

- Engaging communities in economic reform, the rise of populism and how politicians can make their message break through;
- Balancing the Federal Budget and if the government is making any progress; and
- The politics of budgets and why successive governments have failed to get the deficit under control despite decades of strong economic growth in Australia.

The Federal Government's path to returning the Budget to surplus still appears unrealistic. Having a Federal Budget surplus is important insurance that can provide some insulation if there are any major international or domestic economic shocks.

I would like to thank each of the authors for their contributions, with each providing important business intelligence and prescriptions for good public policy for the year ahead.

This year's five contributing authors are:

- Michael Blythe, Chief Economist and Managing Director, Economics, Commonwealth Bank of Australia;
- Katharine Murphy, Political Editor, *Guardian Australia*;
- Peter Martin, Economics Editor, *The Age*;
- Dr Anika Gauja, Associate Professor, Department of Government and International Relations, Sydney University; and
- Dr John Edwards, Visiting Fellow, Lowy Institute for International Policy and Adjunct Professor, Curtin University

As always, to coincide with the release of this publication, CEDA will be holding a series of EPO events across Australia during February and March to provide further analysis on the issues addressed in this publication. I look forward to seeing CEDA members at these events.



Professor the Hon. Stephen Martin
Chief Executive, CEDA

Economic overview



Michael Blythe



Michael Blythe is the Chief Economist and Managing Director of Economics at the Commonwealth Bank of Australia (CBA). His role encompasses monitoring, analysing and forecasting trends in the Australian economy and financial markets.

Mr Blythe also prepares a wide range of research material on matters of current interest and is a regular conference presenter and media commentator on major economic developments and themes. He and his team have consistently ranked in the top three for macroeconomic analysis advice in various industry polls.

He spent 13 years in various roles with the Reserve Bank of Australia (RBA), including a stint at the International Monetary Fund in 1988. From 1991 to 1995, he was the RBA's Senior Economist, providing economic analysis and policy advice. He joined the Commonwealth Bank in late 1995.

Rear view

It's fair to say that 2016 was another year of unrealised expectations from a macroeconomic perspective.

Global growth forecasts again went through a series of downgrades. The global economy expanded by a modest three per cent in 2016. Growth was sufficient to allow some progress in reducing unemployment, but insufficient to generate much in the way of inflation or income growth. Policy settings were eased further as a result. Negative interest rates became part of the policy lexicon. The exception was the US. The activity/inflation mix was robust enough to allow the Fed to take another small step on the road to monetary policy normalisation at year end.

However, the main drivers of growth uncertainty and market volatility were the "shocks" that defined 2016. The impact of Brexit in June and the election of President Donald Trump in November were events that will continue in 2017 and beyond.

The Australian economic story played out in much the same way. Growth and inflation rates both proved lower than expected. Unemployment fell by more than anticipated and policy settings were eased further. But the main domestic "shocks" were economic rather than political in nature (see Figures 1 and 2).

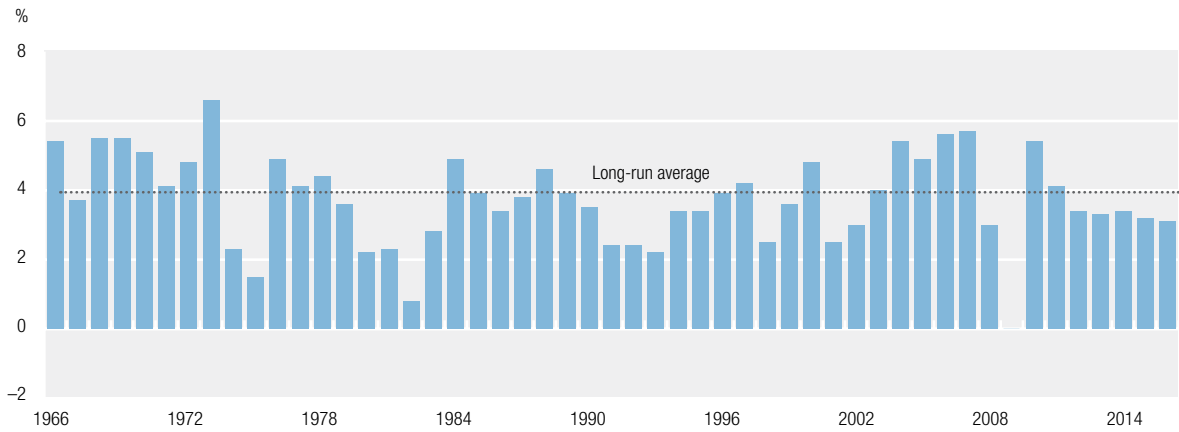
Is Australia's long-running expansion over?

An Australian economist's proudest boast is that we are now in our 26th year of continuous growth. This boast looks a little hollow after the surprise drop in Q3 GDP. Inevitably the debate about the risk of slipping into recession resurfaced at the end of 2016.

But the Q3 result should be seen as just a pothole along the way rather than the start of something more sinister:

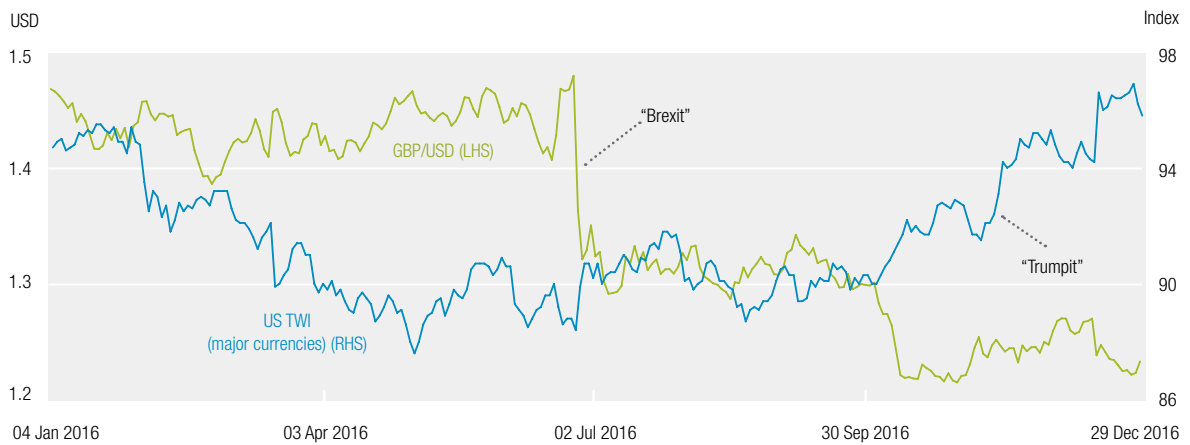
- The occasional weak spot is not unusual in long-running expansions.

FIGURE 1
World growth (annual change %)



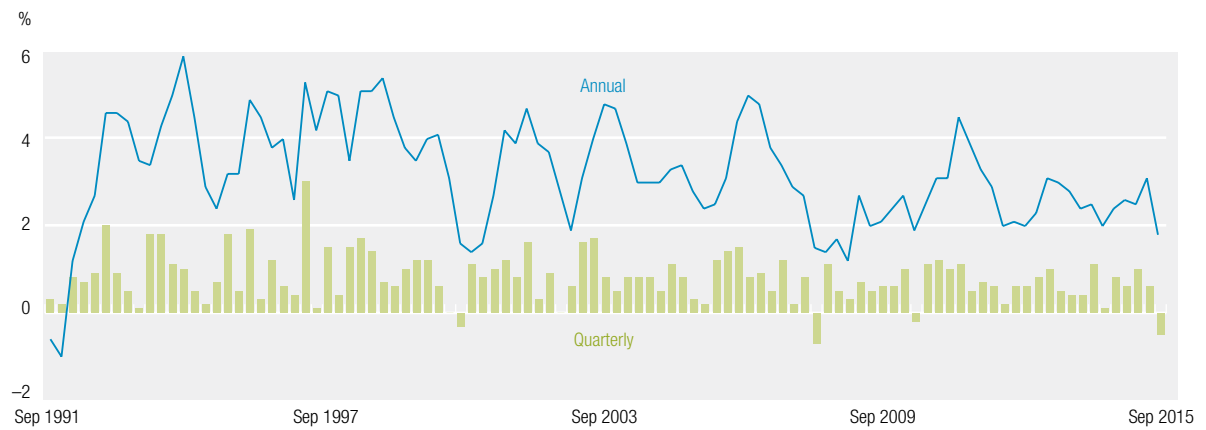
Source: IMF

FIGURE 2
FX markets in 2016



Source: Bloomberg

FIGURE 3
GDP (% change)



Source: ABS

- GDP growth rates are, mathematically, dominated by events around the turn of the quarter. So Q3 GDP growth reflected what was happening in June/July and the lengthy Federal Election campaign. The associated uncertainty depressed consumer and business activity.
- Adverse weather drove a large fall in construction. Mining production was also affected. These temporary factors will reverse (see Figure 3).

The baseline for 2017

We expect the economy to grow by 2.25 per cent in 2017. Such an outcome is broadly in-line with the average experience of the post-financial-crisis period (of 2.5 per cent per annum). And below our best guess at Australia's potential growth rate (which we put at 2.75 per cent per annum). It looks like another year of modest growth.

The year-average forecast conceals an improving trend during the year. Annual GDP growth should lift from two per cent at the end of 2016 to three per cent at the end of 2017.

As a result, we expect unemployment to grind lower during the year. Nevertheless, unemployment will remain a fair way from our full-employment estimate of five per cent. Wages growth should lift a little but is unlikely to threaten the low inflation backdrop.

Much of this economic trajectory sounds little different from recent years. Where things will change in 2017 is in the *nominal* economy. Higher nominal GDP growth on the back of higher commodity prices and a rising terms-of-trade will flow through to company profits and government tax revenues.

TABLE 1
Australia: CBA key forecasts

	2015 (actual)	2016 (forecast)	2017 (forecast)
Real GDP (%ch)	2.4	2.4	2.3
Unemployment rate (%)	6.1	5.7	5.6
Underlying CPI (%ch)	2.2	1.6	1.7
Wage Price Index (%ch)	2.3	2	2.2
Terms-of-trade (%ch)	-11.6	-0.7	5.8
Nominal GDP (%ch)	1.8	3.5	4.6
Current A/c deficit (\$bn)	78	48	27

Source: CBA data



“The year-average forecast conceals an improving trend during the year. Annual GDP growth should lift from two per cent at the end of 2016 to three per cent at the end of 2017.”

Higher commodity prices also point to a return to trade surpluses and a reduction in the current account deficit (see Table 1).

Growth headwinds easing

It should be easier for the economy to grow in 2017 because the commodity-related headwinds are easing while the commodity tailwinds are still blowing.

i. Commodity prices and incomes

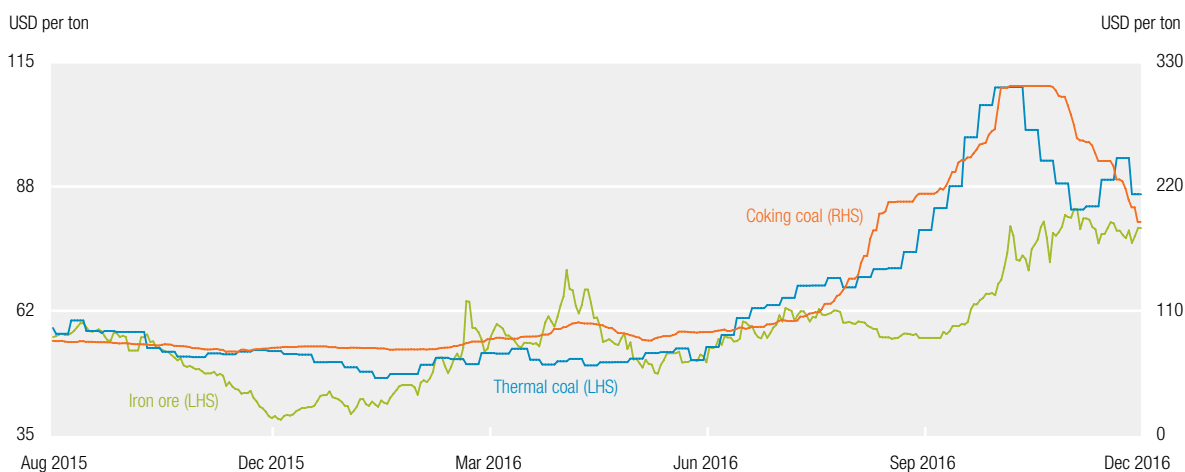
The spectacular turnaround in commodity prices in 2016 is changing the Australian income dynamic. Higher prices mean faster income growth. The income risks hanging over the economic outlook are much lessened as a result.

The income turn also plays into the debate about Australia's AAA rating. The initial beneficiary of higher commodity prices will be company profits. An improvement in government revenues should follow. This improvement could buy some time from the rating agencies.

The rating agencies also worry about the size of the current account deficit. The deficit is an indication of our reliance on tapping the savings of the rest of the world and exposure to global funding markets. But higher commodity prices saw a return to trade surpluses and a reduction in the current account deficit at the end of 2016.

The demand-supply balance in most commodity markets did improve in 2016. The Chinese economy, for example, proved stronger than expected. Global commodity supply grew at a much slower pace. There were some cutbacks in unprofitable production.

FIGURE 4
Bulk commodity prices



Source: Bloomberg

However, this improvement in fundamentals is not enough to support the extraordinarily high prices attained by coal and iron ore in 2016. There will be some give back in 2017 (see Figure 4).

ii. A global reflation cycle?

The more intriguing possibility for 2017 is that commodity price risks are tilting to the upside. There are indications of a global reflation cycle.

Global growth remains subdued. But global industrial production is lifting. Some of the headwinds facing the industrial production cycle are

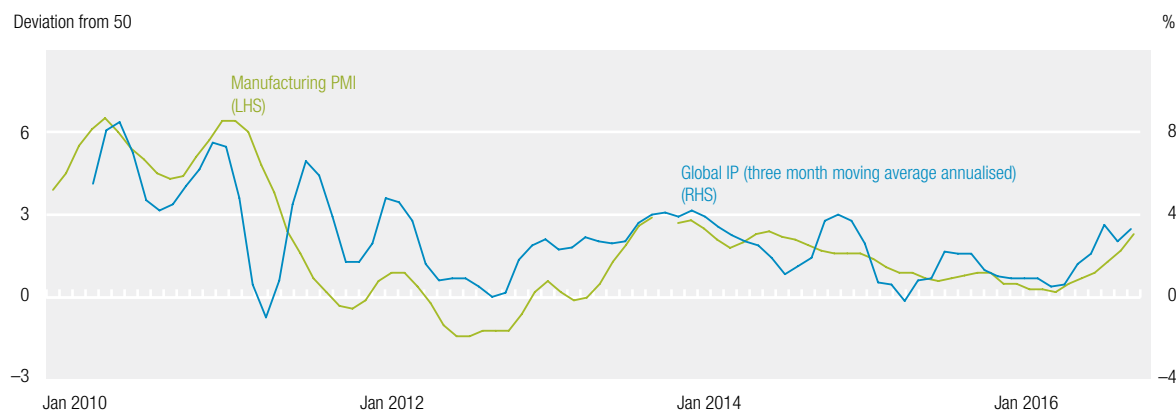
easing. Global balance sheet repair, for example, is well advanced. Fiscal policy has edged in an expansionary direction. President Trump is set to give US infrastructure a major boost. Chinese policymakers have concluded that “good economic work in 2017 is of great significance”, indicating a pro-growth political backdrop.

Consistent with this trend, the deflation in Chinese producer prices since 2012 that restrained global inflation appears to be over. China could potentially “export” inflation to the rest of the world (see Figure 5).



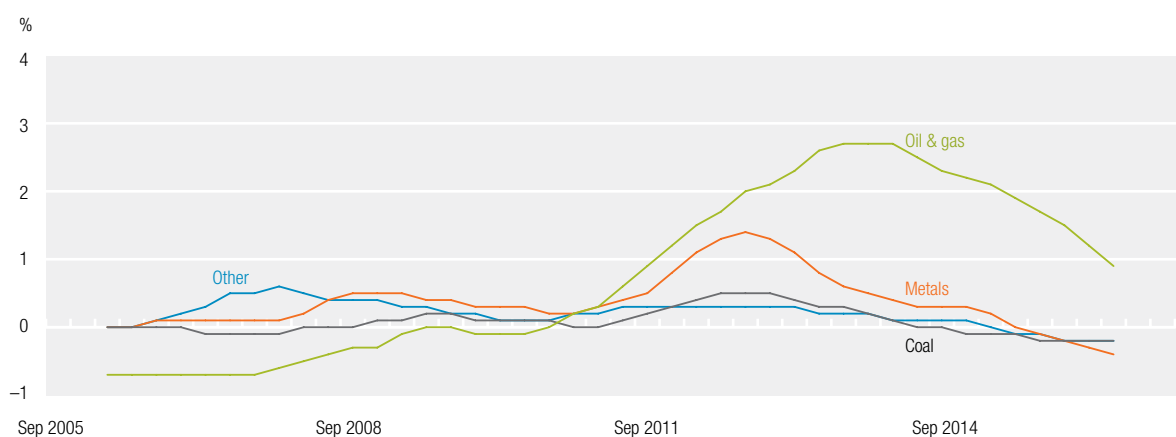
“The spectacular turnaround in commodity prices in 2016 is changing the Australian income dynamic. Higher prices mean faster income growth.”

FIGURE 5
PMI's and global IP



Source: IMF

FIGURE 6
Mining capex relative to normal (rolling annual % of GDP)



Source: CBA calculations

iii. The mining capex cliff and jobs

We have never been concerned about the GDP growth or job loss implications of falling mining capex. Our view was that the problem would largely be “exported”.

The mining capex boom was an import intensive one. About half of LNG capex, for example, went on imports. So in GDP growth terms there is an automatic 50 per cent offset to falling capex from lower imports. Half the pain is being “exported” to those countries making the capital goods. And, of course, rising resource exports as we transition to the production phase are helping.

We are “exporting” job losses as well. The specialised workers on 457 visas are moving on to the next big project and New Zealanders are returning home. Fly-in fly-out workers are losing their jobs in remote

mining areas, but they are becoming unemployed in Sydney and Melbourne where they live, and that is where the new job creation is occurring.

Growth tailwinds blowing

The expansion in mining capacity is driving a boom in resource exports. And there is plenty more to come.

Beyond resources, the financial conditions backdrop remains accommodative. Interest rates and the AUD are low and access to credit is relatively easy. The interest rate and currency sensitive parts of the economy are benefitting, including in surprising areas like manufacturing.

Growth tailwinds lessening

Some growth tailwinds will lessen in 2017. Residential construction, for example, ran at a record pace in 2016, but the contribution to GDP growth will wane in 2017.

Some 225,000 dwellings were commenced in 2016. This outcome was similar to the record starts in 2015 and well above the 155,000 commencements generally regarded as normal for Australia. Two years of record construction means that the cycle is very mature.

Some of the fundamentals supporting the boom are also easing back. Population growth has slowed, the stock of unsatisfied demand has now largely been met, rising prices have reduced affordability and regulatory action is weighing on foreign investor interest.

Emerging fears of oversupply mean that the residential construction pipeline is not refilling. A significant amount of residential development sites are for sale. And there is potential for these sites to be re-tasked to aged care, hotels and education facilities. So we may still get the construction activity – but classified as non-residential instead.

“Some 225,000 dwellings were commenced in 2016. This outcome was similar to the record starts in 2015 and well above the 155,000 commencements generally regarded as normal for Australia.”



The renovations share of activity is currently unusually low and the leading indicators are pointing up. There is scope for renovations activity to prolong the building boom.

The risks from any slowdown in residential construction are accentuated by the large second-round effects on other parts of the economy. Retailing and state government revenues are beneficiaries of building booms.

Where will growth come from?

A perennial concern when discussing the outlook is where the growth will come from and where the new jobs will be. The year ahead will be no different. The main drivers should be:

i. Resource exports

The ramp up in LNG exports plus the residual benefits from higher iron ore and coal production will contribute up to one per cent to Australian GDP growth each year for the next couple of years (see Figure 7).

ii. Infrastructure

The stock of economic and social infrastructure relative to the size of the economy is at levels last seen in the 1970s. There is a need to rebuild that stock. The added benefits are that such spending can boost activity in the short-term by lifting aggregate demand and in the longer-term by raising productivity. The need to take some of the pressure off monetary policy and the option to take advantage of the exceptionally low borrowing costs only adds to the case.

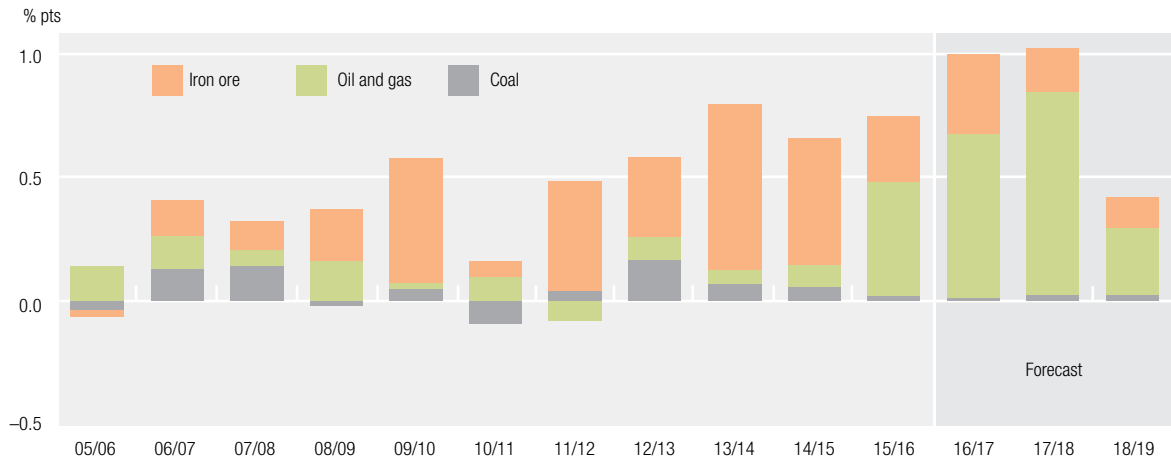
The flow is finally turning. The round of State Budgets for 2016–17 reveals a substantial increase in planned infrastructure spending, and actual spending is now moving higher.

We expect largely infrastructure-related public spending to contribute around 0.5 per cent per annum to GDP growth (see Figure 9).

iii. Agriculture

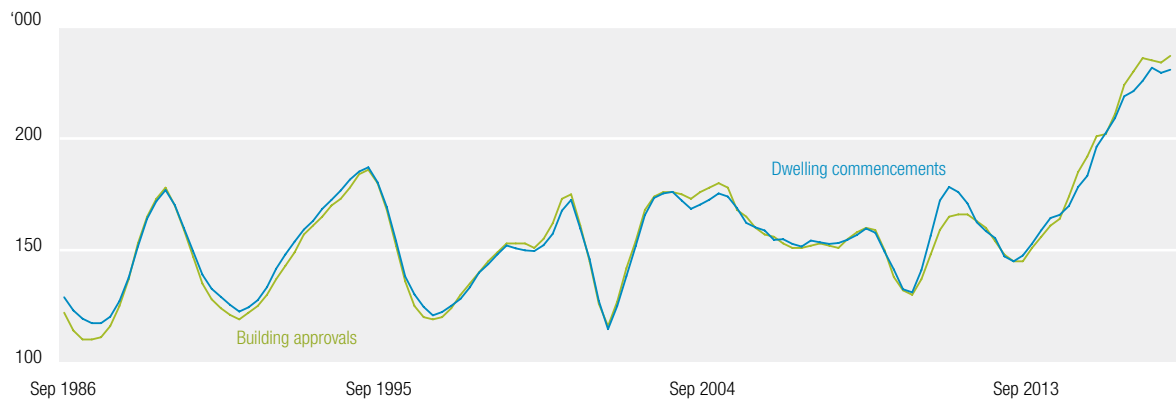
Favourable weather conditions have sharply boosted agricultural production prospects. The Government forecasting agency, The Government forecasting agency, ABARES, puts winter crop production at a record 52.4 million tonnes in 2016–17 (up 32 per cent on the previous year). Previous farm production booms have added 0.4 per cent to GDP growth. Rural exports should also lift significantly.

FIGURE 7
Bulk commodities (contribution to GDP growth)



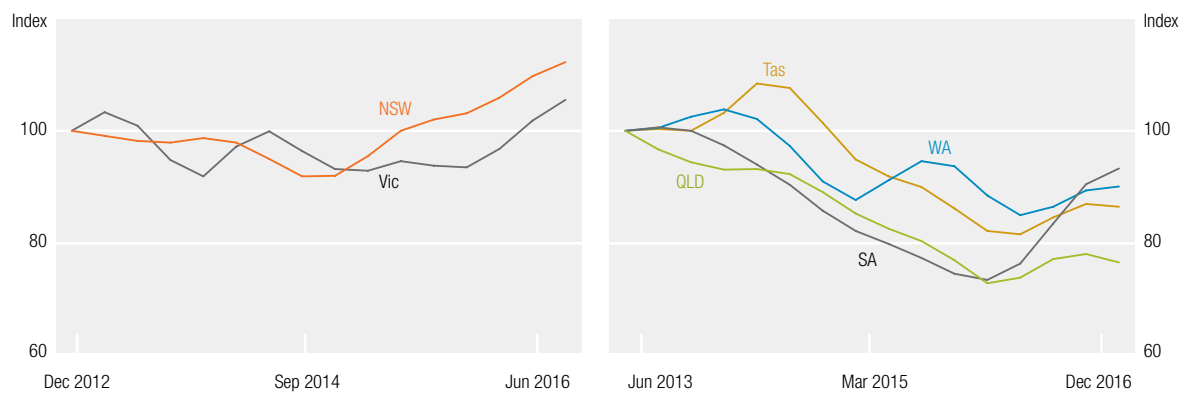
Source: CBA/ABS/DIST

FIGURE 8
Dwelling construction (rolling annual total)



Sources: ABS

FIGURE 9
State public capex (trend, December 2012=100)



Sources: ABS

iv. Asian incomes

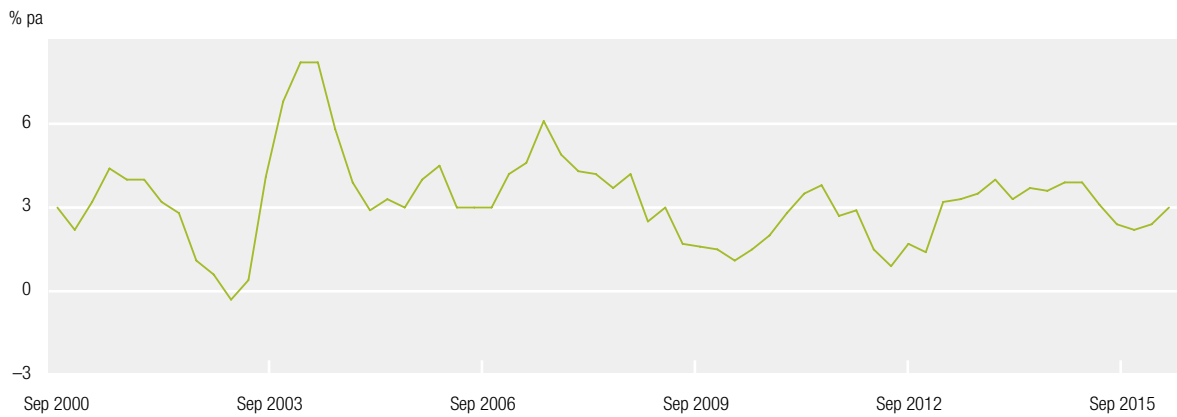
While economic growth rates have slowed, Asian incomes have continued to grow at a fair clip. There are plenty of growth opportunities for Australia if we have the wit to grasp them. Sectors such as food, education, tourism, consumer durables, health and financial services should benefit.

Education and tourism already rank in our top five exports. That part of the Australian economy exposed to the Asian income story is, on our

estimates, growing at three per cent per annum, well above overall GDP growth running at 1.8 per cent per annum.

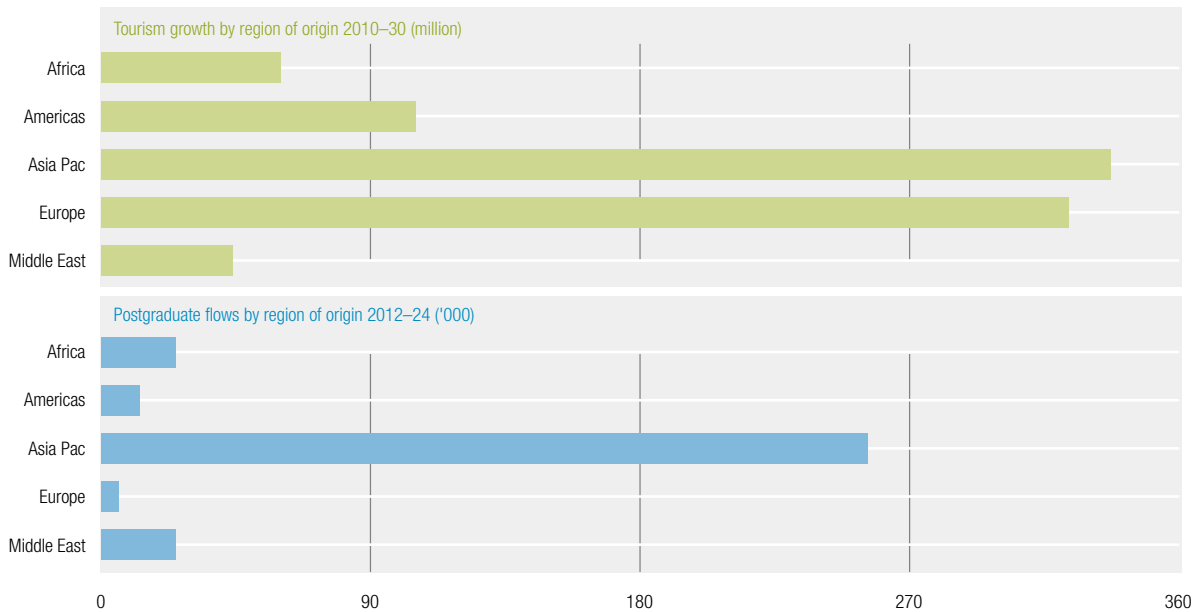
Tourism and education also highlight the potential *upside* in the Australian growth story. The UN World Tourism Organisation, for example, projects global tourism flows to grow by 869 million between 2010 and 2030. The Asia-Pacific region is expected to be the largest source of growth of outbound tourists (see Figure 11).

FIGURE 10
Asian income growth proxy (Australian GDP exposed to Asian income growth)



Sources: ABS/CBA

FIGURE 11
Global tourism and education flows (projected growth)



Source: UNWTO/British Council

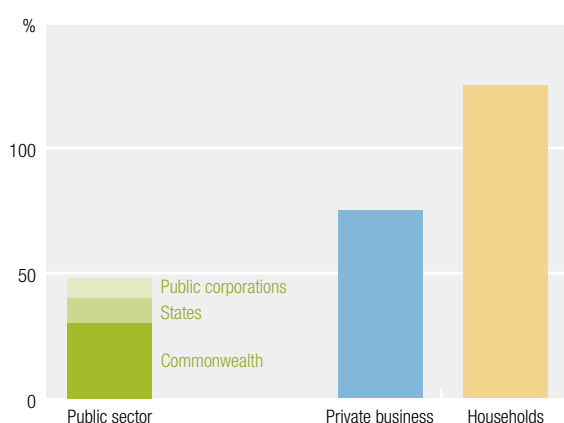
What's needed?

There are a range of growth drivers to support economic activity. But there are other areas where change could help. They relate to the government, non-mining business and the consumer.

i. Governments need to lose their fear of debt

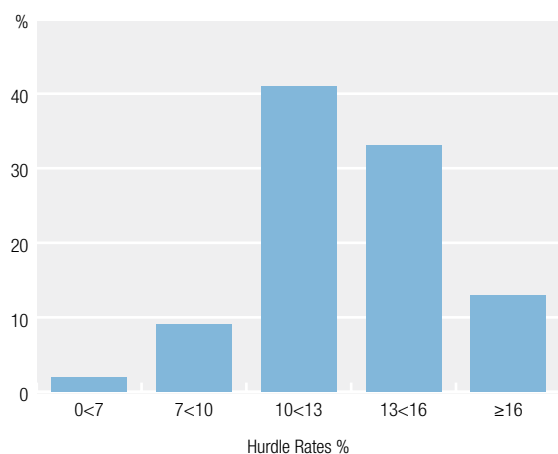
The lift in infrastructure spending is being constrained by the preference to finance spending through selling existing assets and using some of the proceeds to repay debt. There is nothing wrong with asset recycling. But we are not necessarily using all of the firepower available. Nor are we satisfying the demand for Australian infrastructure investments from sovereign wealth funds, pension funds and the like.

FIGURE 12
Australian gross debt in 2016 (% of GDP)



Source: Treasury

FIGURE 13
Hurdle rates for investment decisions, share of firms



Source: Deloitte CFO Survey, RBA

The Organisation for Economic Co-operation and Development estimates that Australia has significant fiscal space (the gap between actual debt and the market tolerance for debt). This space is up to 20 per cent of GDP. Debt financing is also an effective way to share the costs of long-life assets with the users.

The focus on keeping Australia's AAA rating is part of the debt aversion mindset. But the benefits of that rating are increasingly less clear. AAA is a rare commodity. The number of AAA sovereigns fell from 19 in 2010 to 12 in 2016. Borrowing costs for those sovereigns that were downgraded are lower than when they were AAA. AA is the new AAA from an investor perspective.

ii. Businesses need to adjust their expectations

Australian businesses remain reluctant to invest despite a set of fundamentals that would generally favour rising capex.

There are a range of factors that business cite to explain the reluctance. The restraint in labour costs means that labour is favoured relative to capital as an input into the production process. The skew in economic growth towards services with a lower capital intensity pushes in the same direction. The global backdrop and the policy environment remain uncertain, encouraging a wait-and-see approach.

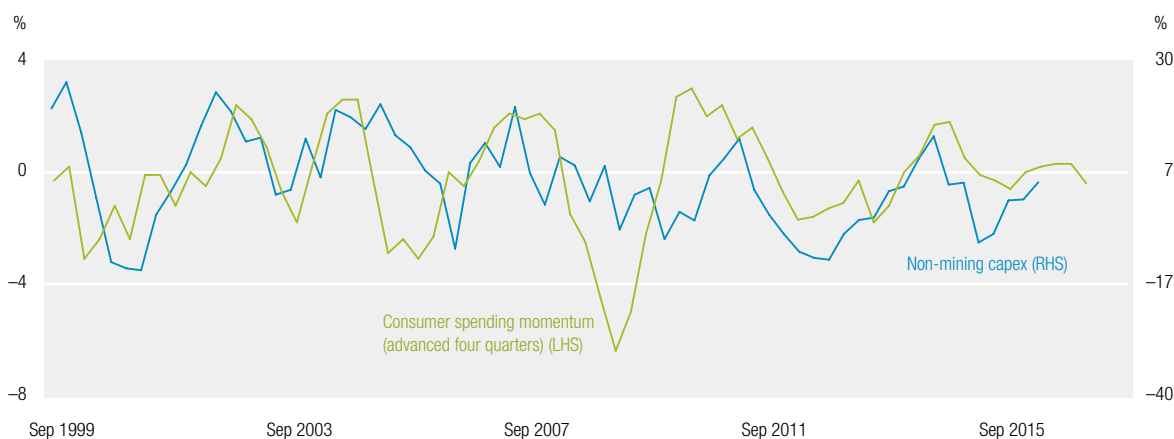
These are all reasonable responses. However, what looks unreasonable is the high hurdle rates of return used for evaluating projects. Surveys show that typical hurdle rates are 10–16 per cent. Such rates look unrealistically high in a low inflation, low yield, low return environment. Not surprisingly, many projects fail to meet the hurdle and capex suffers. Business need to adjust their expectations to the new reality (see Figure 13).

iii. Consumers need more income and the confidence to spend

Consumer spending has grown by 2.7 per cent per annum on average in the post-financial-crisis period, down from four per cent per annum pre crisis. The step down partly reflects a more cautious consumer, but the main driver is the extended weakness in household income growth.

Looking ahead, subdued wages growth is set to persist. Wages growth is contained by rising underemployment, low inflation expectations and elevated job security fears. And other influencers of disposable income growth – tax cuts, social benefit increases and interest rate cuts – are off the policy agenda.

FIGURE 14
Capex and the consumer (annual % change)



Sources: ABS

The ability of policymakers to change the income story may be limited. But they used to exert a fair amount of influence on labour incomes through the centralised wage fixing system. A return to a centralised system is not desirable. But some sort of national wage increase would deliver additional spending power to the group most likely to use that benefit.

Japan is an interesting case in point. Bank of Japan Governor, Haruhiko Kuroda has called on business to lift wages to help stimulate the economy and help in the pursuit of the two per cent inflation target.

In the end, though, if consumer spending is going to run ahead of incomes again then the gap must be filled. This requires households to cut their saving rates further. Or find some alternative methods of financing.

Households could, for example, take advantage of the huge increase in housing wealth over the past three years (up by A\$1.4 trillion over the period). Or they could tap some of the large deposit balances sitting in mortgage offset accounts (household deposits are up by A\$236 billion). But households will need to feel their job prospects are secure before accessing these financing options. The health of the labour market is the key to the consumer story.

The mathematics of the labour market involve working age population growth running at 284,000 per annum. With a labour force participation rate of around 64.5 per cent, more than 183,000 new jobs will be required in 2017 to place downward pressure on unemployment.

So jobs growth needs to run at 1.5 per cent per annum or 15,000 per month. The good news is that leading indicators from the business surveys and job vacancies suggest these outcomes are achievable.

Some ongoing domestic challenges

The high levels of household debt and the housing market drivers behind that debt are perennial favourites in the risk debate. This year will be no exception.

The 2016 calendar year ended with the RBA debating the balance between “the benefits of lower interest rates in supporting growth and achieving the inflation target with the potential risks to household balance sheets”.

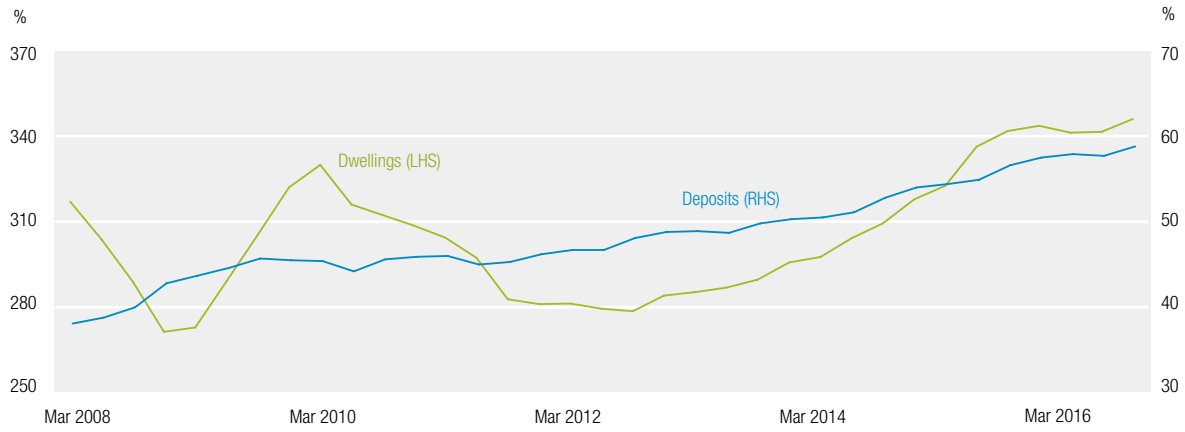
From that perspective there will be a level of concern given signs of a reacceleration in investor interest in the housing market. And with the resilience in national dwelling price growth as earlier signs of a slowdown recede.

The debate needs to acknowledge that balance sheets have two sides. Household debt has grown more quickly than incomes – so the debt:income ratio has increased. But household assets have grown more quickly than debt – the debt:asset ratio is well below recent peaks.

High levels of investor interest in the housing market should be seen as a rational response to the environment created by central banks. From an investor perspective, for example, term deposit rates are below rental yields. And the tax benefits are appealing.

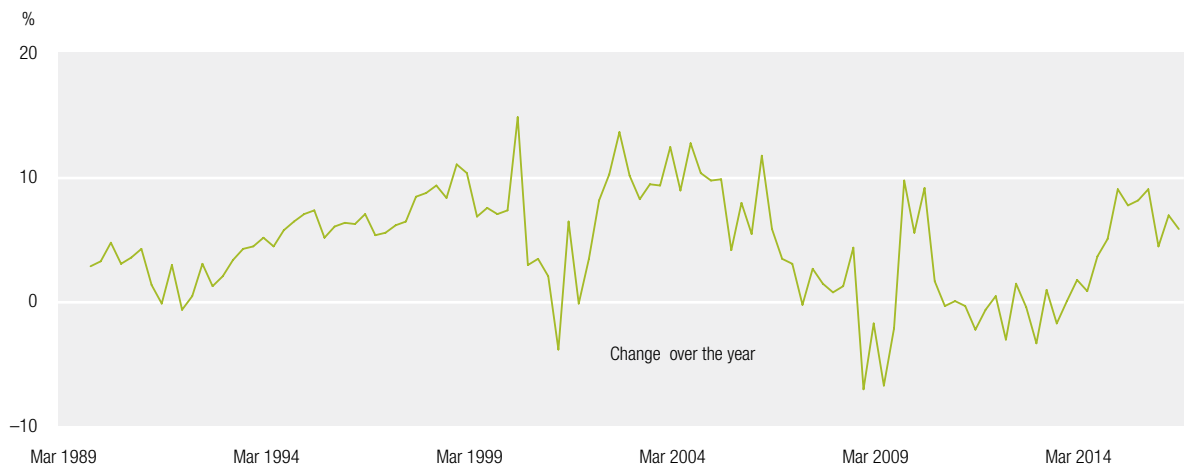
Growth in investor loans outstanding is comfortably below the 10 per cent per annum guideline imposed by the banking regulator, APRA, in 2015. But any ramping up of policymaker concerns would see the debate about macroprudential tools resurface in 2017.

FIGURE 15
Household assets (% of GDP)



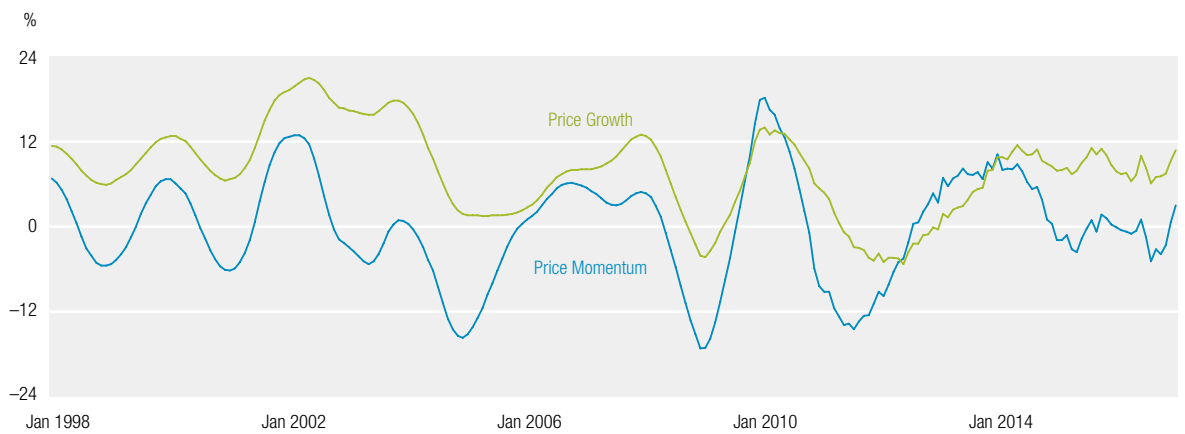
Sources: RBA/ABS

FIGURE 16
Change in household debt (% of household disposable income)



Sources: RBA

FIGURE 17
Dwelling price momentum (eight capital cities)



Sources: CoreLogic

There are some protective buffers. Households have built up mortgage offset accounts and accelerated repayment of principal. Banks have tightened lending standards – the share of high loan to valuation ratio (LVR) lending (>80 per cent), for example, has fallen significantly.

The usual triggers for exposing problems in the housing market or crystallising household debt issues are higher interest rates and higher unemployment. Neither of these triggers seem imminent.

None of this is to say that Australian dwelling prices cannot fall. They have. Prices fell in some market segments in 2016. And some segments are at risk in 2017. But these falls reflect specific housing market factors rather than broader macroeconomic trends.

The price issue for 2017 relates to the large pipeline of new construction activity. RBA estimates point to a sizeable addition to the supply of inner-city apartments in Brisbane, Melbourne and Sydney.

Any imbalance between demand and supply brings with it the risk of lower prices. But the imbalance may prove to be short-lived and not an ongoing threat. Strong population growth in Sydney and Melbourne will help. As will the growing need for student accommodation. And, as noted earlier, emerging fears of oversupply mean that the residential construction pipeline is not refilling.

The inner-city apartment market is also exposed to any reduction in foreign investor interest. The



“The lift in infrastructure spending is being constrained by the preference to finance spending through selling existing assets and using some of the proceeds to repay debt.”

Chinese authorities appear to be further tightening the screws on capital outflows from China. And some state governments have increased stamp duties on foreign purchases of Australian real estate.

Will inflation be an issue in 2017?

Inflation measures running below the bottom of the RBA’s two to three per cent target band were a feature of 2016. This trend is set to continue in 2017. A return to the target band seems unlikely before 2018. And it is easier to see downside risks than upside surprises in the near term. Potential sources of downside inflation pressures include falling business input costs, restrained labour costs and falling import prices.

Complacency is always dangerous. So it is worth thinking about what could put some *upside* risk into the inflation story.

Domestically, higher gas prices reflecting supply constraints are a risk. And the end of the commodity downturn could remove some of the cyclical restraint on labour costs.

Globally, upside inflation pressures could come from the Trump policy package and with the end of the export of deflation from China. The Trump agenda also favours a stronger USD and a weaker AUD as a result. A falling AUD would put some upward pressure on import costs – both for consumers and business (see Figure 19).

The RBA in 2017

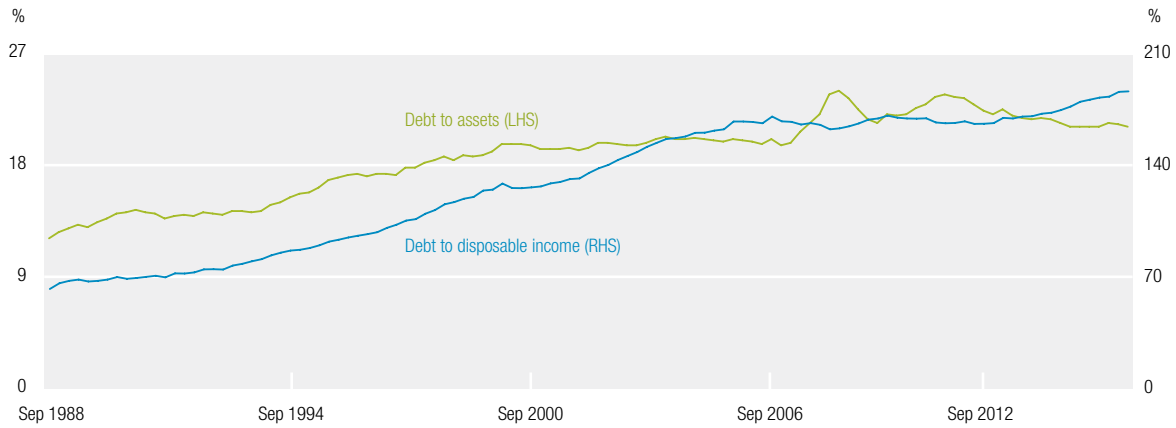
It is difficult to imagine further rate cuts given resurgent commodity prices and uncomfortably high house price growth. The need for the RBA to play the role of policymaker-of-last-resort has also eased. The AUD is at levels assisting the economy, the Fed is on the move and infrastructure spending is taking some of the load.

Equally, the incipient debate about rate rises looks premature. There are some residual downside risks to inflation in 2017. There were some disappointing GDP growth numbers in Q3 2016, and progress in winding back unemployment has slowed to a crawl.

The RBA has recently elevated the importance of financial stability in the policy equation. The “least bad” policy option may be to tolerate longish periods of below target inflation without responding if the broader economic picture looks okay and when there are risks with going too hard to get inflation back into the target range.

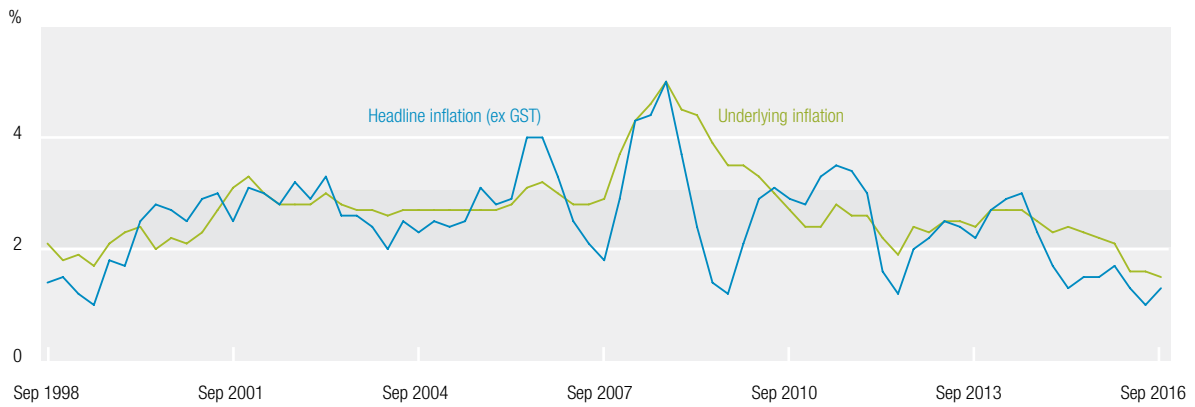
We expect the cash rate to remain at 1.5 per cent during 2017 and into 2018 (see Figure 20).

FIGURE 18
Household finances



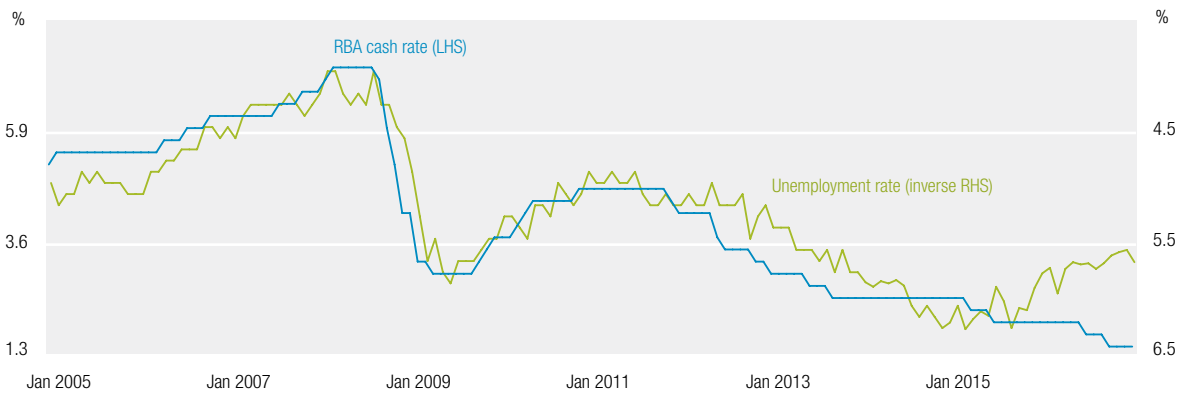
Sources: RBA

FIGURE 19
Consumer prices (annual % change)



Source: ABS

FIGURE 20
Cash rate and unemployment



Sources: ABS/RBA

Global risks and issues

Growth outcomes matching our global economic forecasts would provide an essentially benign backdrop for Australia. But there are many risks. They revolve around the fluid geopolitical backdrop and rising financial imbalances.

i. Geopolitics

There is a strong vein of global disillusionment – part economic, part other – that can influence economic trajectories and drive financial markets. A significant group feel they are missing out.

TABLE 2
CBA global growth forecasts

	2015 %ch	2016 %ch	2017 %ch
World	3.2	3.1	3.2
United States	2.6	1.6	2.9
Japan	1.1	1.0	0.9
Eurozone	1.9	1.6	1.7
United Kingdom	2.2	1.9	1.6
Canada	0.9	1.2	2.1
China	6.9	6.8	6.8
India	7.3	7.2	7.0

Sources: CBA data

The need for the benefits of economic reform to carry everyone forward is nicely demonstrated by the World Bank’s elephant curve (so named for its shape, see Figure 21). The chart ranks the world’s population from poorest to richest. It shows income growth for each rank between 1988 and 2008.

Most cohorts saw respectable income growth over the period. But there was a significant group around the 70–90 percentile (where advanced economy middle income earners sit) that went nowhere. This group not surprisingly feel left behind and not inclined to support the status quo.

The bottom line is that trust in government has declined sharply. And unexpected political outcomes have almost become the norm.

There are plenty of potential flashpoints in 2017. They include the Trump presidency (January 2017), the official start of Brexit negotiations (perhaps March 2017) and a range of European elections as well.

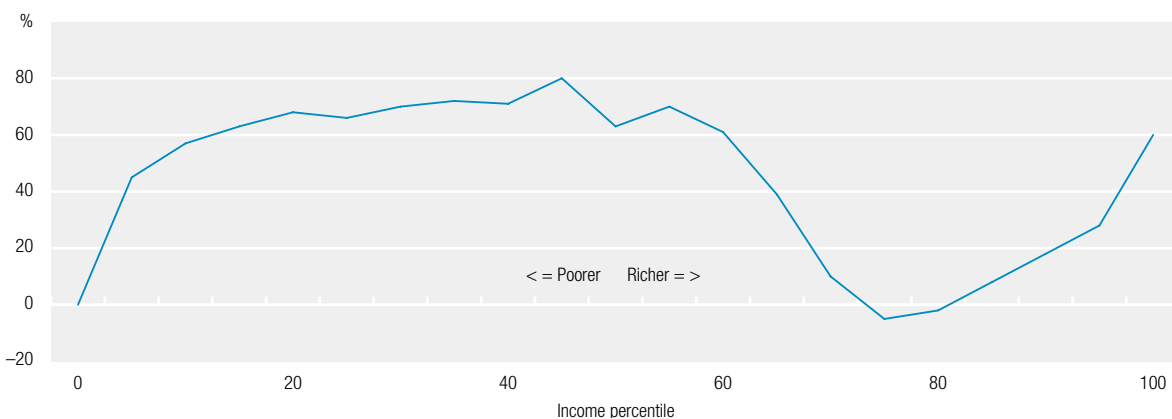
ii. President Trump

The general consensus is that the Trump agenda will be:

- Stimulatory for the US economy as taxes are cut and infrastructure, military and other spending is ramped up; and
- Inflationary for the US economy as growth strengthens, labour supply growth slows and tariffs rise.

Higher ongoing inflation rates will probably see the Fed move a little faster in “normalising” US interest rates. A number of Fed Governors have suggested that the Fed may need to lift US interest rates more aggressively in 2017.

FIGURE 21
Income growth (per capita household income: 1988–2008)



Source: World Bank

“The general consensus is that the Trump agenda will be stimulatory for the US economy as taxes are cut and infrastructure, military and other spending is ramped up...”



Interest rate pressures could be compounded by the expansion of US government debt. The Tax Policy Centre sees the Trump tax cuts alone adding US\$7 trillion to Federal debt.

So the competition for funds in sovereign debt markets, corporate bond markets and bank funding markets will be more intense. Borrowing costs will be higher.

The Trump trade policies would be in the firing line. Punitive tariffs against some countries would invite a response. The outcome would be contractionary for global trade as trade barriers rise. Nobody really wins in a trade war. Trade costs rise and trade flows fall for all.

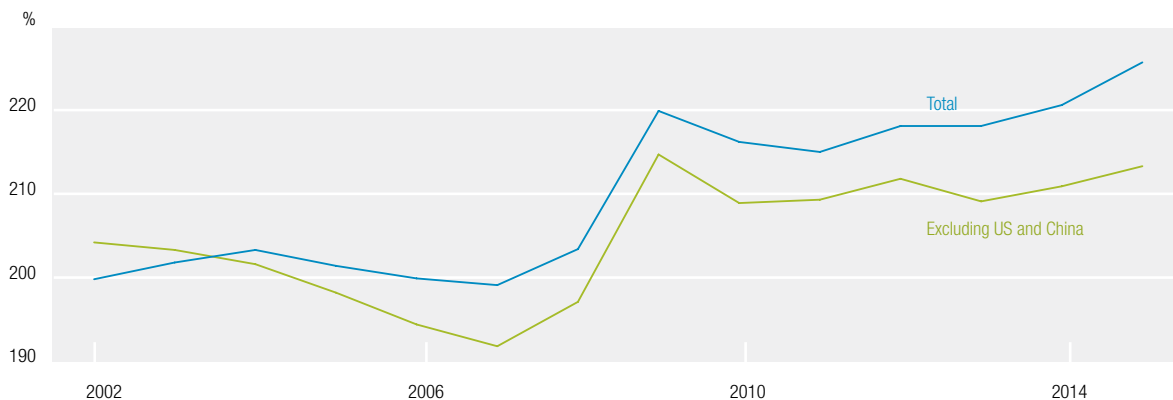
Trade restrictions mean that economic growth becomes more about domestic economic activity, and everyone wants a lower currency to protect home markets. Currencies become another potential flashpoint.

iii. Extreme monetary policy settings

Extreme policy settings – zero/negative rates, quantitative easing (QE) – have been in place for a very long time and behaviours have changed as a result.

One outcome is a significant increase in debt. The International Monetary Fund estimates that global gross debt stands at 226 per cent of global GDP.

FIGURE 22
Global gross debt (% of GDP)



Sources: IMF

Or some 26.5 ppts higher than in the pre-Lehman's period. The flip side of rising debt is credit provision. The experience is that rapid growth in credit over short time periods brings with it financial system risks. And recent history highlights just how damaging financial system problems can be.

Large credit-to-GDP gaps are early warning indicators of banking crises or financial distress. On those metrics, the Chinese financial system looks the most exposed of the major economies (see Figure 23).

When assessing risks to the Chinese financial system there are two points to note. The foreign currency component of Chinese debt is small (about four per cent of the total). And Chinese policymakers have exceptional firepower they could bring into play.

iv. Brexit

Brexit was something of a non-event after the initial confidence shock and market reaction. It is, of course, early days. The actual exit negotiations are yet to commence. The end of March 2017 start date for triggering Article 50 is uncertain.

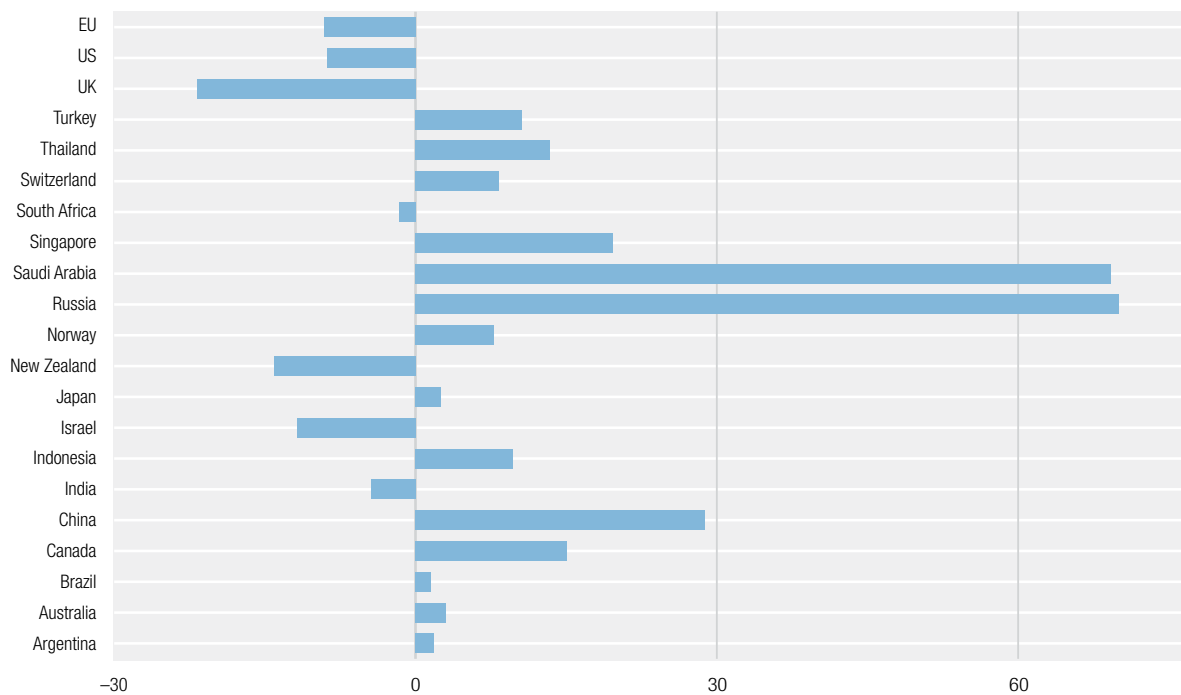
It will certainly be a lengthy process. The EU track record on negotiating complex agreements is poor. We still expect that heightened uncertainty will eventually dampen UK capex, higher inflation will squeeze

“Brexit was something of a non-event after the initial confidence shock and market reaction. It is, of course, early days.”



real wages and consumer spending, and unemployment will rise. And there is potential for a flow on into Europe as well.

FIGURE 23
Credit-to-GDP gap (% deviation from long-run trend, Q1 2016)



Source: BIS



“We think USD strength is the main currency theme for 2017. Most currencies will weaken against the USD as a result.”



TABLE 3
CBA interest rate forecasts

	Mar 2017	Jun 2017	Sep 2017	Dec 2017
Cash rate	1½	1½	1½	1½
3-yr bonds	1.8	1.85	1.95	2
10-yr bonds	2.6	2.75	2.85	2.9
AU 3-10 curve	80	90	90	90
AU-US 10yr spd	35	25	20	15
Fed funds	¾	1	1	1¼
US 10-yr bonds	2.25	2.5	2.65	2.75

Source: CBA data

TABLE 4
CBA Exchange Rate Forecasts

	Mar 2017	Jun 2017	Sep 2017	Dec 2017
vs USD				
AUD	0.75	0.74	0.72	0.71
EUR	1.05	1.02	1	0.98
JPY	117	120	122	124
CNY	7.05	7.1	7.14	7.2
vs AUD				
JPY	87.8	88.8	87.8	88
EUR	0.71	0.73	0.72	0.72
GBP	0.61	0.62	0.64	0.65

Sources: CBA data

Financial markets in 2017

The Trump election win was something of a game-changer in financial markets. Bond yields are higher and the USD is stronger. These trends were evident before the US Presidential election. But we now see these trends as continuing in 2017.

Rising US yields will filter through to the Australian curve. With the RBA on the sidelines, the Aussie curve should steepen but spreads to the US should narrow.

We think USD strength is the main currency theme for 2017. Most currencies will weaken against the USD as a result.

A stronger USD means the AUD will weaken. We put the AUD at US\$0.71 at the end of 2017. But the RBA is on hold, commodity prices are higher and the current account deficit is narrowing. So we also expect the AUD to outperform the EUR, GBP and JPY.

The views in this article are those of the author and should not be attributed otherwise.

Political overview



Katharine Murphy



Katharine Murphy has worked in the Federal Parliamentary Press Gallery since 1996. She is currently Political Editor of *Guardian Australia*. She has worked at *The Australian Financial Review*, *The Australian* and *The Age*. Ms Murphy is an award winning journalist, who pioneered daily political live blogging in Australia for Fairfax Media and *Guardian Australia*.

She contributes a quarterly essay for *Meanjin*, and appears regularly on radio and television, contributing to ABC metropolitan radio stations and Radio National, ABC TV's Insiders program, Sky News, and current affairs programs such as the Ten Network's *The Project*. She is a director of the National Press Club in Canberra and is Adjunct Associate Professor of Journalism at the University of Canberra. She has lived in Canberra for more than 20 years.

Introduction

Disruption and disaffection is the new normal in democratic politics in western democracies, and Australia is no exception.

Prime Minister Malcolm Turnbull endured a turbulent 12 months in 2016, and his Coalition Government ended the political year trailing in the opinion polls. The parliamentary year of 2017 looms littered with substantial policy and political challenges. Economic conditions are fragile, low wages growth has squeezed households, the budget remains in structural difficulty, and the increasing vote for independents and micro parties tells us the electorate is fatigued and disillusioned with major party politics. There is also the wildcard of a new, unknown president in the White House, casting a long shadow across international affairs.

Turnbull was under acute political pressure from the moment he returned from his Christmas break. His government will need to do what it failed to do convincingly over the course of 2016 – articulate a coherent policy and political strategy to address Australia's challenges, and connect with the voting public. This imperative is not only about turning around a patchy performance over the past 12 months, but an investment in restoring public confidence in the capacity of major party politics to govern in the national interest.

Looking back at 2016: an election year

2016 was a gruelling year in federal politics, dominated by an eight-week double dissolution election campaign held in mid-winter. Turnbull and his treasurer, the Hon. Scott Morrison, went straight from delivering their first budget, to the election battle arena.

The Coalition's election campaign was highly unusual, containing very few new policy announcements, and the Coalition's conversation with voters turned on the main budget initiatives – a cut in the corporate tax rate from 30 per cent to 25 per cent, to be phased in over 10 years, a tax cut for workers earning more than A\$80,000, and changes to superannuation tax concessions for the wealthy.

Turnbull ran a largely positive campaign, emphasising the importance of job creation, new investment and innovation. Labor declared the Coalition Government's agenda was trickle-down economics, and the focal point of the Opposition's campaign was government services, including schools funding and universal health care.

The poll was the first double dissolution election held in Australia since 1987, and the government changed the voting rules for the Senate just prior to the campaign in an effort to reduce the presence of micro parties in the upper house elected on a tiny percentage of the vote.

Published opinion surveys during the campaign suggested the contest was very tight, and the polls proved to be an accurate barometer of voter intentions. After looking for a period like it might have to govern in minority, the Coalition prevailed at the close of the count. Malcolm Turnbull would govern with a one-seat majority in the House of Representatives.

Turnbull had gone to the voters in search of a personal mandate in order to consign the controversial Abbott prime ministership to history, but the election result was considerably less emphatic than he had hoped, which has made his post-election governing environment more complex and difficult.

The Hon. Tony Abbott did not leave the parliament at the 2016 election, and was returned as the member for Warringah for another term. The former prime minister has made it clear he wants to return to Cabinet, but thus far, Turnbull has resisted those entreaties.

Despite the changes to the Senate voting rules that were designed to dilute micro party influence, the government also went backwards in terms of Senate representation as a consequence of the 2016 election.

The new Senate

The newly elected Senate contained a bigger cross-bench than the previous parliament. The One Nation party returned as a force in federal politics, returning four Senators to Canberra, including Pauline Hanson as party leader; and the South Australian independent Senator Nick Xenophon formed a minor party called the NXT, which secured three Senate spots and one lower house seat.

Former broadcaster Derryn Hinch secured a spot in the new chamber. A number of crossbench Senators were also returned in the mid-year poll. Tasmanian Jacqui Lambie (initially elected as a Palmer United Party senator before parting ways with that group in the 44th parliament) returned to Canberra, alongside the Liberal Democratic Party Senator David Leyonhjelm and the Family First Senator Bob Day.

Two Senators – Day, and a One Nation representative, Rod Culleton – subsequently faced difficulties. Day’s multi-million dollar construction business was placed into liquidation after the election, and the Family First Senator departed from politics soon after.

As he exited his political life in Canberra, it emerged that Day was also facing questions about whether he was actually eligible to run for the Senate in the first place because of an issue involving his electorate office in Adelaide. The concerns related to a possible financial interest in the building housing his electoral office, which potentially triggered Constitutional questions. Culleton also faced eligibility questions because of legal actions predating his arrival on the federal political scene.

As at January 2017, both cases have been referred to the High Court for deliberation. The ultimate outcome of both cases will affect both the Senate numbers and the power-broking dynamics in the upper house.

The One Nation bloc has already suffered internal turbulence, with a public break down in the relationship between Hanson and Culleton culminating in Culleton quitting the micro party in December, and declaring his intention to sit as an Independent.



“Despite the changes to the Senate voting rules that were designed to dilute micro party influence, the government also went backwards in terms of Senate representation as a consequence of the 2016 election.”

“Apart from managing the complexities of the Senate, the Prime Minister faces an enormous challenge managing his Coalition colleagues.”



Internal dynamics

Apart from managing the complexities of the Senate, the Prime Minister faces an enormous challenge managing his Coalition colleagues. Recent political history tells us leadership changes undertaken within terms of government have consequential effects, and create the conditions for ongoing instability within governments.

In addition to personality conflicts, there are significant ideological and factional differences within the contemporary Liberal Party. The party room in 2016 spans a spectrum from small “l” liberal moderates to hard line conservatives.

Turnbull also has to govern in coalition with the National party, with an independently minded leader in Deputy Prime Minister, the Hon. Barnaby Joyce. As a consequence of the strong One Nation showing at the election, Joyce and the Nationals are now in direct competition with One Nation for votes in the regions, particularly in Queensland, and Queensland is one of the most important battlegrounds in any Federal Election. The Nationals have already begun to flex their muscle on hot button issues in the regions, like control of gun ownership.

There is also the potential for further fracturing. For some months, the South Australian Liberal Senator Cory Bernardi has been foreshadowing the creation of a grassroots conservative movement

to try and offset some of the gains the progressive left has made in field campaigning. The Coalition in the 2016 election found itself outgunned in marginal electorates by progressive activists – the trade union movement, and groups like GetUp – whose local campaigns helped Labor and the Greens during the long campaign. Bernardi’s Australian Conservatives movement may be simply an activist entity, or the positioning may foreshadow a more profound split in right wing politics over the course of 2017.

Adding to those fault lines is the continuing presence of Abbott in the parliament. The former prime minister has made it plain that he intends to speak out on issues he feels strongly about unless he is returned to the Cabinet or the ministry, where he would be bound by government positions.

At the close of the 2016 political year Abbott was out of favour with conservative colleagues, with some of his public interventions post-election being seen as over reach. But the former prime minister remains adept at traversing fault lines within the government.

Since winning back the leadership in 2015, Turnbull has tried to stabilise the internal conflicts by exhibiting a consensus model of leadership. He’s made some significant concessions to the conservative wing of his party, and that dynamic has maintained internal equilibrium within the government more often than not.

“Turnbull also had to deal with a plebiscite on marriage equality, that was ultimately defeated by the Senate, an attempt to quarantine renewed discussion within government ranks about existing protections in the Racial Discrimination Act, and the ultimate resolution of the backpackers tax...”



Both Turnbull and the Opposition Labor leadership are attentive to the trends, but neither of the major parties has yet developed a clear response to the conditions that voters would be able to readily identify. Political strategies in response to these trends remain nascent as we begin the new parliamentary year.

Apart from the manifest complexities of managing hostile voter sentiment, and managing competition from political insurgencies outside the major party system, the Turnbull Government is yet to establish a strong sense of identity and mission in the post-election period.

The last six months of 2016 were about forming government, which took an extended period of time as a consequence of the closeness of the count; and about settling legacy issues, like passing the double dissolution triggers for the election – the Australian Building and Construction Commission and the Registered Organisations Bill – two pieces of industrial legislation totemic for the Liberal Party base, but of limited interest to ordinary voters.

Turnbull also had to deal with a plebiscite on marriage equality, that was ultimately defeated by the Senate, an attempt to quarantine renewed discussion within government ranks about existing protections in the Racial Discrimination Act, and the ultimate resolution of the backpackers tax, which

dragged out to the last parliamentary week of 2016, and saw an outbreak of pure brinkmanship in the new Senate.

The latter half of 2016 was about clearing the political decks for a new political year, not about exhibiting a clear sense of purpose, either politically or in a policy sense. In the six months following the election, immediate problem solving trumped coherence and political narrative.

Looking ahead to 2017: the economy, budget management and participation

GDP figures released for the September quarter of 2016 underscored the fragility of the Australian economy. In seasonally adjusted terms, the economy shrunk 0.5 per cent in the September quarter, which was the second biggest drop in 25 years. Measured on an annual basis, Australia has chalked up the weakest growth we've seen since the Global Financial Crisis.

Having campaigned on a jobs and growth platform, the government will enter the 2017 political year under pressure about the state of the economy, and under pressure about the imperative of fiscal repair, with ratings agencies hovering in the wings.

The government produced the Mid-Year Economic Forecast in late December, which showed deficits had increased over the forward estimates by A\$10.3 billion as weaker wages growth and profits growth hit revenue collections.

The treasury forecast said the deficit would narrow from A\$36.5 billion in 2016–17 to A\$10 billion by 2019–20. A projected return to surplus is outside the four-year estimates period. Net debt was forecast to peak at 19 per cent of GDP by 2018–19. Commodity prices have improved, but not sufficiently to offset weaker growth in aggregate wages and non-mining profits over the four-year budget cycle.

There was considerable speculation during December about whether the ratings agencies would downgrade Australia's AAA rating given the fiscal outlook, and given the complexities of the parliament making budget repair difficult. In the end, they cooled their heels, but two agencies, S&P Global Ratings, and Moody's suggested close monitoring would continue into 2017.

S&P said it remained "pessimistic about the government's ability to close existing budget deficits and return a balanced budget by the year ending 30 June 2021". Moody's said the government's fiscal metrics were in-line with AAA rated sovereigns, but the agency predicted budget deficits "will be somewhat wider for longer than currently projected" and it would be "challenging" to achieve the revenue collections and expenditure restraint outlined in the forecast.

In an interview to close out the 2016 parliamentary year with *Guardian Australia*, Turnbull said the government would press ahead in the new year with its planned company tax cuts for big business despite opposition from the Senate. Turnbull indicated the government was hopeful the incoming Republican President Donald Trump would follow through with an election promise to cut the US

corporate tax rate from 35 per cent to 15 per cent – he argued that would help the Coalition in Australia make the economic competitiveness case for cutting the company tax rate.

The Coalition Government's plan is to lower the Australian company tax cut progressively from 30 per cent to 25 per cent over 10 years, at a cost to the budget of A\$48.2 billion. Even if that succeeds, the Australian rate would still be 10 percentage points higher than the US rate if Trump implements his pre-election policy.

While the government may be able to shift one of the key Senate blocs in the new year by offering enticing trade-offs – Nick Xenophon, for example, is interested in persuading the government to come back to the table on emissions trading for the electricity sector – the politics of implementing an expensive tax cut for big business is fraught, with low wages growth continuing to squeeze households, and widespread community concern about profit shifting, avoidance and evasion by big firms.

Community perceptions that big companies don't pay enough tax are not helped by tax transparency data, released by the Australian Taxation Office, which indicates more than 35 per cent of Australia's largest public companies and multinational firms paid no tax in Australia during the last financial year.

In his final interview for the year, the Prime Minister said the government would also pursue reforms to childcare policy early in 2017 – an agenda that has been stalled in the Senate. Turnbull argued reforms to childcare would boost participation by women in the economy.

The Prime Minister also signalled the government would look at policies to improve the affordability of housing in the major cities. Turnbull continues to argue affordability is largely a function of limited supply, which is a state issue, not a federal issue, but he argued in December: "Housing affordability is a very central issue in our thinking."



"S&P said it remained 'pessimistic about the government's ability to close existing budget deficits and return a balanced budget by the year ending 30 June 2021'."



The freedom agenda: race and rights

Almost immediately post-election, Turnbull faced a re-run of a debate about the Racial Discrimination Act that had flared during the Abbott years. Conservatives, led by Bernardi, forced renewed political debate about section 18C of the RDA by bringing forth a private members bill that would remove the words “insult” and “offend” from the legislation.

The Bernardi proposal attracted widespread support among Coalition Senators – sufficient support to trigger agreement from Turnbull to send the issue to a parliamentary inquiry by the Joint Committee on Human Rights. That inquiry will play out over the first months of 2017. Government MPs are split between the group that would water down the existing protections and another group that favours an administrative change to processes overseen by the Australian Human Rights Commission to allow vexatious complaints to be dismissed at an earlier stage.

The last 12 months also saw the government’s proposed marriage equality plebiscite fail in the parliament, but this is unlikely to be the end of the debate over marriage equality. Advocates will continue to pressure the government to allow a free vote in the parliament. Some Liberal MPs are privately supportive of a free vote, and the push in favour of a parliamentary resolution to the issue is likely to build over the course of 2017 – creating a political challenge for the Prime Minister, who has to bridge the government’s conservative and moderate wings.

Climate change and energy regulation

The Coalition’s Direct Action policy will be reviewed over the course of 2017. The policy, implemented by the Abbott Government after the repeal of Labor’s clean energy policy in 2013, has been widely criticised as being inadequate.

Over the course of 2016, the Turnbull Government signed Australia up to the Paris international climate agreement, which requires Australia to reduce emissions by 26–28 per cent below 2005 levels by 2030. The Paris target builds on Australia’s 2020 target of reducing emissions by five per cent below 2000 levels.

Australia’s Chief Scientist Alan Finkel is one of a number of experts who have argued the Direct Action policy will not allow Australia to meet its Paris targets. In a report handed to the Council of



“In early December, Energy and Environment Minister, the Hon. Josh Frydenberg, outlined the terms of reference for the review of the Direct Action policy, which will be conducted in house, and report later in the year.”



Australian Governments in December, Finkel said: “While the electricity sector must play an important role in reducing emissions, current policy settings do not provide a clear pathway to the level of reduction required to meet Australia’s Paris commitments.”

In early December, Energy and Environment Minister, the Hon. Josh Frydenberg, outlined the terms of reference for the review of the Direct Action policy, which will be conducted in house, and report later in the year.

In unveiling the Direct Action review, Frydenberg initially left open the idea it would consider the desirability of establishing an emissions intensity trading scheme for the electricity sector – a form of carbon trading. The signal was consistent with expert advice from a range of sources that a trading scheme would allow least cost abatement consistent with Australia’s international climate change commitments.

Reopening a debate about carbon pricing would always be a highly contentious development in Coalition ranks, given that issue had led to the downfall of Turnbull as opposition leader in 2009, and the Coalition had prosecuted an aggressive and successful political campaign against Labor's carbon "tax".

As soon as Frydenberg had signalled preparedness to countenance an intensity scheme for electricity, internal critics within the Coalition, including Abbott, issued voluble protests. Within the space of a couple of days, Turnbull ruled out consideration of any form of carbon tax or emissions trading – comprehensively pre-empting the review, and closing off a significant policy option for the government.

Notwithstanding this development, the terms of reference for the review allow stakeholders to make



“Trump has indicated no interest in the economic dimension of the Obama Administration’s pivot to the region – the Trans Pacific Partnership – but he’s indicated interest in stepping up the US military presence in the region...”

broad-ranging submissions about the desirability of reforms on climate policy and energy regulation, and a number of stakeholders will use the review to argue in favour of carbon trading as a mechanism to help Australia lower emissions. It will be interesting to see whether or not the arguments made through the review have any impact on the government's position.

While containing the scope of the Direct Action review, the government may face more internal unrest about climate change policy in 2017.

A number of conservative MPs have laid the ground for arguing that Australia should withdraw from the Paris international climate agreement if America pulls out once Trump takes office in January 2017. If Trump withdraws from the Paris agreement, conservative politicians will make the case that Australia should follow suit.

During the presidential election race, Trump signalled opposition to the Paris agreement, but post-election comments suggest he may be rethinking that stance.

Foreign policy

The election of Donald Trump was a consequential development for the world. Leaders, including the Australian Prime Minister, are watching and waiting to see whether the new American president conforms with some of his strident undertakings during the presidential race, or whether he becomes more pragmatic and less confrontational in office.

Trump campaigned as an isolationist, but there was a departure in that rhetoric when it came to the Asia Pacific. Trump has flagged a US naval expansion into our region, a posture the Republican discussed with Turnbull after he won the election. Trump has indicated no interest in the economic dimension of the Obama Administration's pivot to the region – the Trans Pacific Partnership – but he's indicated interest in stepping up the US military presence in the region as part of efforts to contain Chinese assertiveness.

If the US delivers on the early signal, there could be consequences for the Australian Government, not simply the discomfort of being sandwiched between our most important strategic ally and our largest trading partner, but practically. It could mean more assertive requests from Washington for Australia to participate in naval exercises in the disputed South China Sea, or requests to host personnel and American military assets on Australian soil.

“Labor’s early disposition has been to maximise Turnbull’s political difficulties... But there have also been signs of cooperation between the major parties.



The Labor Party

Labor rolled into the opposition after the turbulence of the Rudd/Gillard period with a disposition to rebuild internal party unity, and a desire to rework the party’s economic policy offering in order to be competitive at the 2016 election contest. Labor performed reasonably strongly during the Federal Election, with some bold economic policies, like reducing negative gearing and capital gains tax concessions, and campaigning on the party’s traditional areas of social policy strength – health and education.

Labor’s solid performance at the election was sufficient to allow the Hon. Bill Shorten to continue on as party leader without challenge, although post-election, there have been some internal wobbles.

The left faction decided to try and remove a key Victorian powerbroker and Shorten ally, the Hon. Kim Carr, from the opposition frontbench. The attempt to dump Carr from the frontbench failed, but saving Carr’s position in the shadow ministry required considerable intervention by Shorten. The Labor leader also lost another key internal ally, the Victorian right wing Senator, the Hon. Stephen Conroy, who retired from politics abruptly in September.

A stability pact between Carr and Conroy was an important institutional component underpinning Shorten’s leadership, maintaining factional harmony in Shorten’s home state, but the Labor leader has entered new territory after Conroy’s departure and the attack on Carr by the national left. Internal controversy deepened when Shorten chose to replace Conroy with Kimberley Kitching, a long time right wing factional ally, but a controversial figure in Labor ranks. The trade union royal commission in 2014 made adverse findings about Kitching and referred her for possible prosecution.

How these internal tensions play out will be an interesting political story over the course of 2017.

Labor’s early disposition has been to maximise Turnbull’s political difficulties by outbreaks of tactical opposition in the parliament, and practical opposition to some of the government’s policy agenda.

But there have also been signs of cooperation between the major parties. They combined to pass a modified version of the Coalition’s superannuation reforms late in 2016, and also combined on a budget repair bill that contained A\$6 billion worth of savings measures.

The views in this article are those of the author and should not be attributed otherwise.

The politics of budgets in 2017



Peter Martin



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Introduction

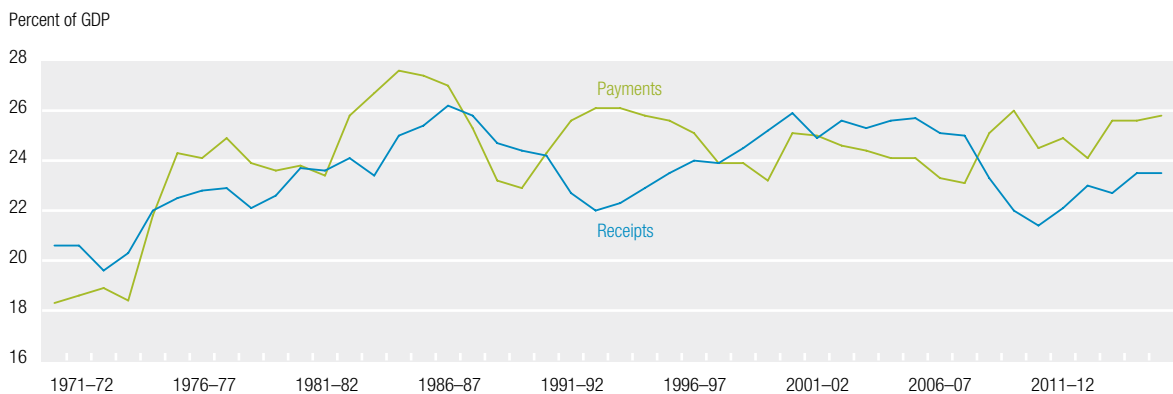
Suddenly, politics matters.

It's been a long while since it's had much effect on the economy (apart from in extraordinary times, such as the delivery of cash splashes during the Global Financial Crisis). And until recently it didn't have much effect on the Federal Budget balance. The extraordinary story of the last half a century of Commonwealth budgets is that most of the time they've more or less taken care of themselves, whatever the politics.

Professor Bob Gregory of the Australian National University has produced a graph of government spending and receipts (mainly taxes) going back to the start of the 1970s, which is when the series published with the budget begins (see Figure 1).

It shows that the size of government shot up dramatically in the 1970s. Before then the Commonwealth collected and handed back around 20 per cent of GDP. By the early 1980s it was 25 per cent. Astoundingly, in little more than a decade we went from funnelling one-fifth of the dollars we earned through the Commonwealth government to one-quarter.

FIGURE 1
Australian Government receipts and payments as a proportion of GDP



Source: 2016-17 Budget Paper 1, Statement 10

We did it because we wanted to spend in entirely new fields including lone parent pensions, disability pensions and Medibank. Once we had, we couldn't go back (although former Prime Minister the Hon. Malcolm Fraser succeeded in briefly turning back Medibank before it was reinstated as Medicare) and most of us didn't want to. What's remarkable from today's standpoint is how easily we were able to do it.

Revenue vs. spending

In those days revenue had a way of automatically catching up with spending. Not immediately, but within a couple of years of each extra bout of new spending, revenue bounced up toward it. And that's how it was for the next four decades: whenever spending ran ahead of revenue or revenue ran ahead of spending, it wasn't long before the two moved back into sync.

Until the Global Financial Crisis.

Professor Gregory's graph changes in 2008. Revenue collapsed in the crisis and spending exploded. But instead of getting back together as would have happened in the past, the two lines have stayed separate and have run more or less in parallel ever since.

Company tax isn't responding as it once would have, partly because some companies have become more skilled at avoiding it, and partly because of the enormous expenses run up expanding mines,

which will weigh down taxable profits way out into the future.

Far from helping, the proposed cuts in company tax rates would make things worse, making it up to A\$8 billion per year harder to balance the budget when they are fully phased in, as the Treasury's own modelling and modelling commissioned by the Treasury makes clear.

More importantly, personal income tax isn't responding as it used to.

Inflation, wages and taxes

Until recently we could rely on high inflation to push a greater proportion of each pay packet into higher tax brackets, automatically lifting the tax take each year. If the government wanted more revenue, it simply had to wait. If it wanted less, it could cut tax rates.

In the 1970s wages grew at a blistering pace of 12 per cent per year. In the 1980s it was 10 per cent, and even in the 1990s it was four per cent.

But today it's just two per cent, a touch less in the September quarter of 2016. Despite the Treasurer's oft-expressed concern about bracket creep, there's scarcely any of it.

So needing to actually take action in order to bring the budget back into balance, what has the government done?

For the most part, next to nothing. It has acted as though it wouldn't need to.



“We wanted to spend in entirely new fields including lone parent pensions, disability pensions and Medibank. Once we had, we couldn't go back...”



“It’s often said that insanity is doing the same thing over and over again and expecting a different result. In this case it’s continuing to forecast a lift in revenue, and when it doesn’t happen, forecasting it again.”



Repeating the same mistakes

Former Treasurer the Hon. Wayne Swan’s 2012 budget predicted that over the course of four years receipts would climb from 23.8 per cent of GDP to 24.2 per cent. A year later he conceded that his starting point would lower, 23.5 per cent of GDP. But he still predicted an increase to 24.4 per cent, this time over the following four years.

A year later still the starting point was much the same, but former Treasurer the Hon. Joe Hockey said the takeoff would be over the following four years as revenue climbed from 23.6 to 24.9 per cent of GDP. A year further on the takeoff was delayed again. They were going from 24.0 to 25.2 per cent. And then in 2016 Treasurer the Hon. Scott Morrison pushed things out by another year, saying they were going to climb from 23.9 to 25.1 per cent.

For half a decade now the starting point hasn’t much changed, nor has the endpoint, it’s just been pushed out a year at a time.

It’s often said that insanity is doing the same thing over and over again and expecting a different result. In this case it’s continuing to forecast a lift in revenue, and when it doesn’t happen, forecasting it again.

The late-December 2016 mid-year budget update continued the pattern. The starting point was worse, 23.3 per cent of GDP, yet the projected end point was much the same, 24.8 per cent.

Acting with inefficiency

The action it has taken has been wilfully ineffectual. The December update boasted of budget repair measures totalling A\$22 billion in 2016. That’s A\$22 billion over four years of forward estimates in which spending will total A\$1.9 trillion. It’s 1.1 per cent.

But most of those budget repair measures have been spent on new programs, many of them on election promises. The net budget saving is A\$2.5 billion, which is 0.13 per cent of the projected spending over the next four years. As a means of closing the gap, it’s not even a rounding error.

Just when they are needed, our government and the political system are paralysed. But they weren’t going to be.

For a brief hopeful moment in 2014, the Coalition’s Commission of Audit opened all sorts of possibilities. The fast-growing cost of the age pension was to be tackled by indexing it to the consumer price index rather than average male earnings until it hit a new lower benchmark related to average total earnings (male and female) and stayed there. In his first budget Hockey announced a more extreme version that would have lifted the pension only in-line with the consumer price index forever. He failed to sell it and went on holidays, returning to discover the Senate couldn’t see why it was needed.

The Commission recommended widening the pension means test to include part of the most important asset would-be pensioners own: the value of their homes above A\$750,000 for couples and A\$500,000 for singles. That was too much for Hockey, as was lifting the superannuation preservation age so that it moved in line with the pension age, a recommendation pushed by the Business Council of Australia and now the Productivity Commission that would have saved A\$6 billion per year.

He was prepared to lift the pension age, so that it would eventually reach 70 by 2035, but, disgracefully, Labor wouldn’t back him even though he would be merely linking the pension age to life expectancy as Labor had when it lifted it to 67 by 2025. It’s one

of the so-called zombie measures, still presented in each budget but not passed by the Senate because it can't see the gravity of the problem.

In the lead-up to Hockey's 2015 budget, then Prime Minister the Hon. Tony Abbott essentially endorsed the Opposition's approach by all but declaring the budget crisis over. From here on budgets would be "pretty dull and pretty routine".

"Under Labor the budget was completely out of control, under us it's manageable," he told Macquarie Radio's Neil Mitchell. "There's still more to do, but it's a manageable situation."

To Prime Minister, the Hon. Malcolm Turnbull's credit, his government introduced mild measures to dial back some of the exceptionally generous superannuation tax concessions showered on high income earners. To his even greater credit, Labor Finance Spokesman, Jim Chalmers succeeded in persuading his party not to block them on the spurious ground that they were retrospective. They are not. They don't reach back and tax income earned accrued in the past.

Facing opposition

Super was the exception. Labor outrageously opposed the reintroduction of fuel excise indexation, even though without it the effective tax rate on petrol would continue to shrink because it would remain set at cents per litre rather than cents per dollar. More extraordinarily still, the Greens opposed it after a party room brawl that those concerned about the environment and the budget lost.

The government went ahead and introduced it by regulation anyway, daring Labor and the Greens to disallow the change and have the takings handed back to the oil companies.

When in a welcome moment of honesty Education Minister, the Hon. Simon Birmingham conceded there was a limit to what the Commonwealth could spend on schools and said it might get more bang for its buck if it wound back its spending on overfunded private schools and directed it to those in need, Labor's the Hon. Tanya Plibersek continued to maintain that no school should be worse off.

Almost every other good idea that stood a chance of bringing the budget back into balance has been vetoed by either the government or the Senate.

In March 2016 CEDA produced five options made up of different mixes of measures including having the capital gains tax discount (saving A\$3.6 billion over four years and much more over time), disallowing negative gearing for newly acquired assets

(A\$2.6 billion and much more over time), halving the fuel tax credit scheme predominantly used by the mining industry (A\$3.6 billion), lifting petrol excise by 10 cents per litre to make up for the years it was unindexed (A\$1.7 billion), cutting the private health insurance rebate by 25 per cent (A\$1.8 billion), taxing the private health insurance rebate (A\$1.8 billion) and cutting industry tax concessions by 25 per cent across the board (A\$1.7 billion).

It could have added winding back the cost of Australia's extraordinarily expensive submarine building program. At A\$56 billion for 12 submarines (A\$4.6 billion each) the contract with the French builder is more than twice the A\$20 billion fixed price offered by a German firm which would have also built in Adelaide.



"In a welcome moment of honesty Education Minister, the Hon. Simon Birmingham conceded there was a limit to what the Commonwealth could spend on schools and said it might get more bang for its buck if it wound back its spending on overfunded private schools..."



“The so-far unclosable gap between spending and income is costing A\$12.4 billion per year in interest payments.... that’s more than the government spends on universities (A\$9.7 billion per year), more than it spends on unemployment benefits (A\$10.5 billion) and more than it spends on the Pharmaceutical Benefits Scheme (A\$10.8 billion).”



Momentarily unconcerned with the need to rein in the deficit, the Prime Minister declared in Adelaide in April that he was “determined that every dollar we spend on defence procurement as far as possible should be spent in Australia”.

When the government acts as if value for money no longer matters and it can always find more of the stuff, Labor and the Senate feel emboldened to act the same way.

Priorities and frugality

What’s needed is to dramatise the state of the budget by levelling with the public about how bad things are. Gregory’s graph would be a start.

The so-far unclosable gap between spending and income is costing A\$12.4 billion per year in interest payments. By way of comparison, that’s more than the government spends on universities (A\$9.7 billion per year), more than it spends on unemployment benefits (A\$10.5 billion) and more than it spends on the Pharmaceutical Benefits Scheme (A\$10.8 billion).

And it’ll balloon as interest rates climb. Australia can easily borrow to service the debt (whatever its foreseeable credit rating) but the net interest bill from that borrowing has swelled from zero before the financial crisis to the size of funding the university sector or prescription medicines. It’s crowding out things that were once affordable.

The Treasurer has taken a small step towards acknowledging reality. On taking the job in September 2015 Morrison insisted he had “a spending problem, not a revenue problem”.

Asked by the ABC’s Leigh Sales whether he needed to tackle revenue as well as spending, he replied: “I’m not in that camp”.

These days he concedes he needs to do both. If he wants to be remembered well in history, he’ll explain why and explain that for the first time in half a century the government needs to take deliberate painful decisions in order to return the budget to balance. As a measure of good faith, he’ll revisit ideas previously ruled out by the Coalition such as more heavily taxing capital gains. And he’ll ask for the same from the Opposition. Abandoning its attachment to private schools would be a start, as would acknowledging that a quarter of a century after the introduction of compulsory superannuation, too many of us are getting the pension.

It’s what we expect of governments, and I’ve a hunch we would welcome it. It’d be great to think they were up for it.

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Engaging communities in economic reform



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She has received funding from the Australian Research Council and is the author of four books and numerous articles in international journals on democracy within political parties. Her most recent book, *Party Reform: The Causes, Challenges and Consequences of Organizational Change* has just been published with Oxford University Press.

At Sydney University she teaches courses on Australian politics, comparative democratic politics, political parties and political analysis.

Undertaking reform

Any process of reform, whether it involves social, institutional or economic change, is notoriously difficult to achieve. While a focus on strong leadership is crucial, it is not – of itself – enough. Rather, creating a successful pathway to economic reform involves understanding the interaction between leaders, policymakers and the broader political environment. For policymakers, this necessitates assessing the constraints, but also exploiting the opportunities created by the changing nature of political landscapes.

To undertake successful economic reform in 2017 and beyond we need to acknowledge that there is a widespread, global climate of disillusionment with traditional politics. However, this does not mean that citizens are uninterested in achieving change. Both individuals and organisations are finding new ways to engage with politics and debate. But, arguably, policymakers need to shift their orientations and expectations of how people want to participate in the process of reform to better connect with communities and stakeholders.

This chapter looks at a series of significant political changes in Australia and globally, and assesses what implications they have for policymakers and those seeking to advance an economic reform agenda. First, it examines the global rise of populism and the lessons Australia's political leaders can draw from it, before moving on to the domestic context. It then moves to briefly analyse the changing nature of how people are participating in politics, the importance of social media and the implications this has for our agenda-setters. Using data from the Australian Election Study (AES), this chapter examines the changing nature of voting in Australia, as well as some of the challenges produced by our current political institutions (in particular, the revolving door of party leadership) and what this means for our political leaders.

Based on analysis of recent events and the future trajectory of political change, the chapter concludes with a number of recommendations for enhancing the prospects of successful reform in the current political climate.

The global context of populism: learning from Europe and the United States

2016 was a year of unprecedented political upheaval across the world, but particularly in areas that Australians see as comparable to our own polity and society: Europe and the United States. In June, UK citizens voted to leave the European Union in the historic Brexit referendum, while in November, US voters elected Republican Party candidate Donald Trump to the presidency. Both these events represented seismic shifts to the established political order and are regarded by many commentators as symptomatic of a new era of populist-style politics.

In the last few years, populist parties such as the National Front (France), Forza Italia, the Five Star Movement (Italy) and Syriza (Greece) have emerged on both the right and left of politics, and populism has become an increasingly prominent style of politics throughout the world. It is a term that is used often and uncritically in the media, but one that needs to be seriously considered.

By pitting the interests of “corrupt political elites” against those of the “pure people”, pandering to the perceived demands of a disaffected population, and by constructing political decisions as a simple “us versus them” dichotomy,¹ populism is the exact opposite of good policy-making, which needs to be evidence-based, consultative and carefully considered.²

Many consider populism an ugly threat to democracy, but in fact there are several lessons Australian leaders and policymakers can learn from its global rise.

The first is that populist leaders and parties tend to have a better record in opposition than they do in government, particularly when it comes to policy reform.³ Research by Dutch political scientist Kristof Jacobs shows that these parties fail to implement their radical political reform agendas once in government, usually because it is not in their own self-interest to do so.⁴ This suggests that while populism may be a symptom of political disaffection, it is very unlikely to provide meaningful policy solutions.

The second lesson, stemming from comparative research conducted in the US, the Netherlands and Germany, is that populist parties are likely to experience greater success under certain conditions: if the media pays attention to their messages, and if established parties and politicians engage in debate with them.⁵ Because populist politics is not yet a mainstream practice in Australia, the key point to take away here is that populism can only really take hold if our leaders and media fuel its existence.

The third and perhaps most important lesson is while leaders must be critical of populist politics, policy-makers should not ignore the social and economic concerns that underpin it. Populist demands are always context specific and do not necessarily align with any particular economic policy approach or political ideology. While it is a goal shared with economic reformers to address problems such as the extent of state provision and welfare spending, unemployment, economic growth and income inequality, populist politicians have been particularly adept at highlighting these problems and how they relate to people’s own lived experiences. The issue for Australian leaders is not so much in identifying policy problems and prompts for reform, but in persuasively communicating longer-term policy visions in a way that individuals and communities can relate to.

Looking specifically at Australia, we know that economic issues matter. In 2016 voters’ positive perceptions of the state of the economy were at their lowest since the 1990 election: only 10 per cent of respondents to the 2016 Australian Election Study indicated that they felt the economy had improved in the previous year.⁶ Issues such as housing affordability and intergenerational equality are prominent in both traditional and social media channels. The challenge for policymakers is to communicate reforms in such a way that they extend beyond the abstract, to create an agenda for reform by connecting their policy vision to the experiences of individuals, businesses and communities.

But how can this be done? And what are the current characteristics of Australian politics that might hinder or help this process?



“Populist parties are likely to experience greater success under certain conditions: if the media pays attention to their messages, and if established parties and politicians engage in debate with them.”

The challenge ahead: responding to Australia's changing participatory landscape

Australian politics is changing, and this has ramifications for policy-making and reform agendas into the future. Many researchers who study political participation are sceptical of the ability of formal political institutions, such as parties and parliaments, to engage citizens today.⁷ For example, around one-quarter of young people failed to enrol to vote for the 2013 Federal Election. Party membership in Australia and overseas is at an all-time low. At the 2016 Federal Election, only 40 per cent of respondents to the Australian Election Study said that they routinely voted for the same party each election, a significant change from the 72 per cent who declared such an allegiance in 1967.⁸ Almost 20 per cent of voters said they had no allegiance to a particular party, the highest percentage since surveys began in 1967.⁹

Indeed, these sentiments were borne out in the 2016 Federal Election result, with a record high first preference vote for minor parties, both in the House of Representatives and the Senate.¹⁰

Moving away from the established political parties, citizens have turned to other political organisations to channel their participation, or to taking forms of direct action through participating in events like boycotts. For some researchers, these changing patterns represent the decline of political participation and engagement in society,¹¹ but for others they signify a diversification in citizenship norms and political participation away from fulfilling civic duties to more autonomous forms of participation, many of which are no longer focused on the formal institutions of the state.¹²

The primary changes that researchers in Australia and overseas have documented is that in contrast to traditional politics, where elections, governments, and formal political institutions are at the core of democratic participation, citizens now have weaker allegiances to government and choose to form loose networks for social and political actions, and to focus on lifestyle and issue-based politics.¹³

What opportunities does this bring for economic reform? The evidence suggests that communities and citizens are by no means disinterested in political debate, but that policymakers need to reach out to them in a more personalised way and focus on issues and outcomes rather than abstract policy visions and political ideologies. In this way, reformers who want to build coalitions of support can usefully learn from the communication and engagement



“The importance of the Internet, for both electoral and non-electoral participation, is paramount: international research has shown that young people in Australia are more likely to acquire political information online than their American counterparts...”



techniques of prominent advocacy organisations and the grassroots organising that is now being practiced by political parties in the US and UK,¹⁴ and which was used to some effect by the ALP in the 2016 Federal Election. The success of these organisations in mobilising participants for a cause (be it an issue or an election) rests on the ability of supporters and interested parties to personalise their engagement (on their own terms) and to connect with other like-minded individuals and communities.¹⁵

It is also important to understand the generational characteristics of political participation, and how this interplays with the ever-increasing importance of social media. In his research, Melbourne University Political Scientist, Dr Aaron Martin found that young and old citizens engage in politics differently – with younger citizens more likely to have signed a petition, undertaken a boycott of certain products, attended a demonstration and joined an online political forum.¹⁶ The importance of the Internet, for both electoral and non-electoral participation, is paramount: international research has shown that young people in Australia are more likely to acquire political information online than their American counterparts (more than 60 per cent used this forum for campaign news).¹⁷



“Leaders are faced with the difficult task of having to appeal to multiple audiences, but social media provides unique opportunities in engaging communities in a more direct and unmediated way.”



Sydney University Political Sociologist, Professor Ariadne Vromen, notes that the number of Australians “signalling their support for causes, donating money or joining petitions online, and interacting and building communities with like-minded others through blogs and social networking sites such as Facebook and Twitter” is increasing.¹⁸ Online participation is becoming more prominent, including signing online petitions (39 per cent of Australian Election Study respondents had indicated that they had done so in 2016, up from 12 per cent in 2004).¹⁹

Working with the way in which people participate in politics and how they perceive policy issues is key to pushing the agenda for economic reform in the current political climate, particularly when we think about the need to involve younger generations in the reform process. Leaders are faced with the difficult task of having to appeal to multiple audiences, but social media provides unique opportunities in engaging communities in a more direct and unmediated way. With the traditional media landscape rapidly changing, news agendas are being set in multiple arenas – both online and offline – and this new era of communication gives policymakers expansive opportunities to both encourage participation in reform processes, build consensus and bring together interested communities. Away from formal political arenas, leadership can (and must) come not only from governments and politicians, but also from experts, industry leaders, businesses, government agencies and key innovators.

What Australian voters think about economic issues

Building on the idea that we need to think outside the square of formal politics in engaging communities in reform, research suggests that elections and election campaigns are not necessarily the best vehicles to use to create a mandate for economic reform. Data from the Australian Election Study shows that since 1996 (when it was first tracked) economic voting is generally weak – that is, voters are more likely to vote according to their preferred party than on the basis of an evaluation of prospective economic performance or policy.²⁰ The salience of economic issues in election campaigns declines further when the economy is in good health,²¹ creating difficulties for establishing a structural reform agenda when everything appears otherwise well.

Despite these difficulties, the Australian Election Study data shed some light on how Australian voters think about economic policy, and in particular, the government’s role in influencing the economy, which are highly relevant to establishing a successful reform agenda.

Analysing the Australian Election Study data, Professor Timothy Hellwig and Professor Ian McAllister argue that Australian voters are, however, influenced by the extent to which they think parties and governments can exercise policy capacity. They expect strong and disciplined political parties,

but their vote choice depends on the extent to which they believe the government can exert some measure of control over the economy.²²

There are three implications that we can take away from this research. The first is the importance of unified and disciplined parties with a clear economic vision and capacity to achieve policy change, where developing consensus – both within the party and the parliament – is crucial.

The second is the necessity to emphasise the role that government policy has in shaping economic outcomes, particularly with reference to the impact of the global economic environment. There is a significant perception on the part of voters that the government has little capacity at all: for example, at the 2016 election, 69 per cent of Australian Election Study respondents felt that the government's actions did not make any difference to the financial situation of the country.²³ An economic reform agenda is not likely to gather public support if Australians are unconvinced that our leaders are able to exercise any control over the economy or meaningfully implement economic policy.

The third lesson, taking into account the decline of partisan attachments and the public's declining responsiveness to broad ideological cues, is that voters may well become more attuned to economic



“At the 2016 election, 69 per cent of Australian Election Study respondents felt that the government's actions did not make any difference to the financial situation of the country.”

performance and economic policy issues as shaping their vote choice in the future. This should be seen as a potential opportunity for the creation of a climate conducive to a debate on economic reform that transcends traditional partisan policy lines and ideological perceptions, provided that these issues are communicated in such a way the community can relate to them.

Political leadership and churn

In a previous CEDA publication, *Setting Public Policy*, Professor the Hon. Stephen Martin and Nathan Taylor outlined a series of leadership attributes crucial to policy-making success: having a strong set of values and a cohesive vision for the future of the nation; the necessity to undertake careful and detailed policy work to lay the foundations for reform, and the ability to instigate a meaningful process of communication and consultation.²⁴ These values remain just as crucial today, even if processes of communication and consultation gradually evolve.

However, as argued at the beginning of this chapter, strong leadership can be mediated by political forces and institutions, which present significant challenges for policymakers. Perhaps the greatest of these forces is desire to respond to the polls – to short-term shifts in public opinion. Nowhere is this more apparent than in the churn of party leadership.

Australian politics appears to have become so synonymous with leadership upheaval that major news agencies across the world have described Australia as the “coup capital of the world” and the prime ministership as a “revolving door”.

And it is true that the tenure of Australian party leaders is getting shorter, and challenges more common. In the 1960s, the average tenure of an Australian party leader was 10 years. By the 1980s this had declined to four years and in the period 2000–2012 it was just 2.4 years.²⁵ These figures illustrate the difficulties our political leaders face in implementing long-term economic visions.

But the problem is not exclusive to Australia. Looking at the figures across 13 established parliamentary democracies including Canada and the UK, the average length of a party leader's tenure declined from eight years in the 1960s, to just over three years in the period 2000–2012.²⁶ This suggests that while uniquely Australian factors, such as factions, might have a role to play in unseating leaders, broader systemic trends are also at play. As described above, the nature of politics is changing: citizens are less engaged with formal political institutions, social

media use and citizen reporting is on the rise, higher levels of education are producing more critical constituents, and loyal attachments to political parties are waning. The sum result may be that the role of party leader – in today's representative politics – is simply becoming more difficult.

But where Australia is different is in how it removes and selects its party leaders. Globally, political parties have been gradually shifting to more inclusive ways (in terms of the number of participants) of selecting their leaders.²⁷ In a comparative study of party leadership selection, Professor Jean-Benoit Pilet and Professor William Cross showed that 80 per cent of parties selected their leader through either a vote of elected party delegates (51 per cent), a vote of all party members (27 per cent) or an open primary (three per cent).²⁸

By contrast, the leaders of Australian political parties have historically been removed and selected by the parliamentary party group. This is still the case in the Liberal, National and Green parties, and was – until 2012 – the only method of selection in the Australian Labor Party. (Under reforms introduced by former Prime Minister the Hon. Kevin Rudd that were designed to “shore up” his leadership, the Labor parliamentary party group can now elect to give members a 50 per cent share in the vote for party leader).

Given that leadership instability has now become a characteristic of Australian politics, it may be time for other Australian parties to think about changing the way leaders are selected and removed, with a view to ensuring a greater degree of political stability that is necessary for the implementation of longer term political and economic visions.

Ways to engage communities in policymaking and economic reform

This chapter started with discussion on the rise of populist parties and leaders across the democratic world. Australian policymakers are in a fortunate position here, because there are several lessons to be learned from the experience of Europe and the US. While many regard populism as a threat to democracy, it teaches us a few things about the nature of economic reform in the current political climate:

- Populism highlights some of the most pressing concerns facing individuals and societies. However, it does not provide meaningful policy solutions. There is still space, and indeed a pressing need, for policy-making based on evidence and sound consultation.
- Populism is not inevitable – it depends on how much air time our leaders are prepared to give it.
- Populist leaders and parties highlight the need to identify and articulate economic reform in terms of the immediate challenges and life experiences of individuals and communities.

Changes in the domestic political context also highlight a number of opportunities for successful economic reform:

- Citizens are no longer as attached to the established political parties and broad ideological cues. Those looking to build support for economic reform therefore have an opportunity to engage and mobilise citizens directly, online and offline, and involving diverse coalitions of interests.



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- Communication techniques that take a vision and personalise it to relate directly to issues affecting individuals, business and communities are most effective in creating interest and support.
- Reform needs to involve and incorporate younger generations of Australians, who engage in politics differently. Social media and working through and/or involving online advocacy organisations and businesses is particularly effective in reaching these individuals.

Elections and election campaigns are not particularly useful arenas for creating mandates for economic reform, though Australian voters' attitudes to economic issues indicate that:

- Parties and government need to be strong and disciplined in communicating their policy visions.
- Reform will be only be successful where leaders and policymakers can demonstrate that they actually have the capacity to act.
- The decline of partisan attachments and the role of the major parties in influencing vote choice are declining, but this presents a significant opportunity to construct economic reforms as a series of salient policy issues that transcend partisan politics.

Finally, strong leadership is crucial, but implementing a long-term vision is particularly difficult in Australia due to persistent leadership instability. Compared to comparable political systems, Australia is now an outlier in how it selects and removes its party leaders. Political parties may want to consider:

- Reforming the process of how party leaders are removed and appointed, with the aim of increasing stability to facilitate longer-term decision-making, considered policy-making and producing sound economic reforms.

This list of recommendations is by no means exhaustive. However, it does illustrate that while the nature of politics in Australia is changing and bringing new challenges, this change also presents significant opportunities for driving economic reform and engaging individuals and communities well into the future.

The views in this article are those of the author and should not be attributed otherwise.

Endnotes

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Balancing the budget



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Introduction

Eighteen months ago the national board of CEDA made a very unusual decision. It agreed the persistent Australian Government Budget deficit was a grave problem, and one requiring action by CEDA. It agreed to invite a group of experts to form a Balanced Budget Commission to propose solutions. When presented with the unanimous report of the Commission in late 2015, the CEDA Board endorsed it in its entirety – also unanimously.

Launched by CEDA's National Chairman, Paul McClintock AO at the National Press Club in March 2016, CEDA's *Deficit to balance: budget repair options* contributed to a growing national sense that the Federal Government Budget deficit needed to

be closed, and sooner and more plausibly than the leisurely timetable promised.

Less than three months later, Prime Minister the Hon. Malcolm Turnbull called an election. When re-elected, he chose a CEDA platform for the first major economic address of his new government. His topic was the need to repair the deficit, and his main argument was the one used six months earlier by McClintock: large and long running deficits on recurrent spending steal from future generations to support spending on current generations.

Nearly a year after the publication of the CEDA report, how much progress has Australia made?

As McClintock told the audience at the October 2016 CEDA State of the Nation conference in Parliament House, there has been some progress – but not nearly enough.

It was encouraging to see the two major parties reaching agreement on deficit reduction measures, including legislation changes to superannuation. It was discouraging that the agreement had been on a relatively small amount in the context of the deficit problem.

The subsequent Mid-Year Economic and Fiscal Outlook (MYEFO) released 19 December 2016 confirmed the deficit outlook was getting worse instead of better.

We return to the new numbers later in this chapter, but it is useful first to recall why the deficit matters, and how CEDA approached the problem.



“Launched by CEDA’s National Chairman, Paul McClintock AO at the National Press Club in March 2016, CEDA’s *Deficit to balance: budget repair options* contributed to a growing national sense that the Federal Government Budget deficit needed to be closed...”

The problem posed

Australia is now in its 26th year of uninterrupted economic expansion. This expansion has seen output more than double, living standards increase by more than half, and household wealth increase to more than five times the level it had reached when the long expansion began at the end of 1991.

Yet despite this long period of prosperity, the Australian Government is now in its ninth year of continuous and substantial fiscal deficits. It now expects deficits to continue for at least another four years.

Excluding the deficit caused by the exceptional spending of World War II, every previous Australian Government deficit has arisen from economic contractions; not so these. As a cumulative share of gross domestic product (GDP), the actual and prospective deficits in the 10 years to 2018–19 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. Even this bleak projection assumes relatively favourable economic and fiscal circumstances.

The National Board of CEDA was troubled by a number of factors: the persistence of large fiscal deficits during a prolonged period of prosperity; the Treasury’s projections that deficits would continue accumulating indefinitely on current policies unless taxes increase in lockstep with increased spending; and the likelihood that continuous deficit would erode Australia’s economic strength and political choices. The Board concluded there was no economic problem in Australia graver than the persistence of large deficits now and for decades to come.

Yet it was also apparent to the Board that while the problem was very serious indeed, and would become much more so if not addressed, there were solutions well within the usual boundaries of the Australian political context of the last two decades.

The 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.



“Prime Minister the Hon. Malcolm Turnbull chose a CEDA platform for the first major economic address of his new government. His topic was the need to repair the deficit...”

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 of Australian Government spending as a share of GDP, if the budget was to be in balance on average.

The Board also recognised that as a bipartisan organisation with wide membership in both business and government, and a long history of public policy engagement, CEDA was well positioned to identify illustrative fiscal solutions that would meet community-wide acceptance.

After discussion the Board resolved to ask a range of experts to join a CEDA Budget Balance Commission under the chairmanship of CEDA 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.

At its first meeting in November 2015 the Commission agreed the deterioration in the Australian Government’s fiscal position posed 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. Nor did the fiscal deterioration 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 very much worse.

The Commission agreed that bringing the Budget back into balance could not be delayed for long, otherwise rising debt interest would constrict the spending choices open to Australian governments.

The Commission adopted several principles for its work.

The first principle was that the budget should be balanced as fast as it was possible to do so, bearing in mind the requirement to also sustain economic growth. Balance by 2018–19 was selected as the target.

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 close to 23.9 per cent as the maximum average that would be sustainable. This was 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. If the Australian Government Budget is to be on average balanced, if 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.

The Commission's principles evoked 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 thus a limit to Australian Government spending as a share of GDP. For more than three decades there has been a clear consensus among the major parties that the Federal Budget, on average, needs to be balanced, and that the tax share of GDP needed to be constrained. In recent years both Labor and Liberal governments, including the current Turnbull Government, have adopted 23.9 per cent of GDP (or close to it) as the tax ceiling in projection of the future Budget balance.

The Commission identified packages of measures that would over time balance the budget, both by the last year of the then current forward estimates (2018–19), and in the long term. The packages would be presented as alternative options, each of which would meet the fiscal balance requirement.

The packages included both the spending and revenue sides of the Budget. The measures selected either fell within an emerging consensus of the major parties, or were 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.

The Commission adopted the December 2015 MYEFO as the base case in its projection of the

short-term fiscal challenge. That document projected the deficit would contract from 2.3 per cent of GDP in 2015–16 to 0.7 per cent of GDP in 2018–19 (see Figure 1).

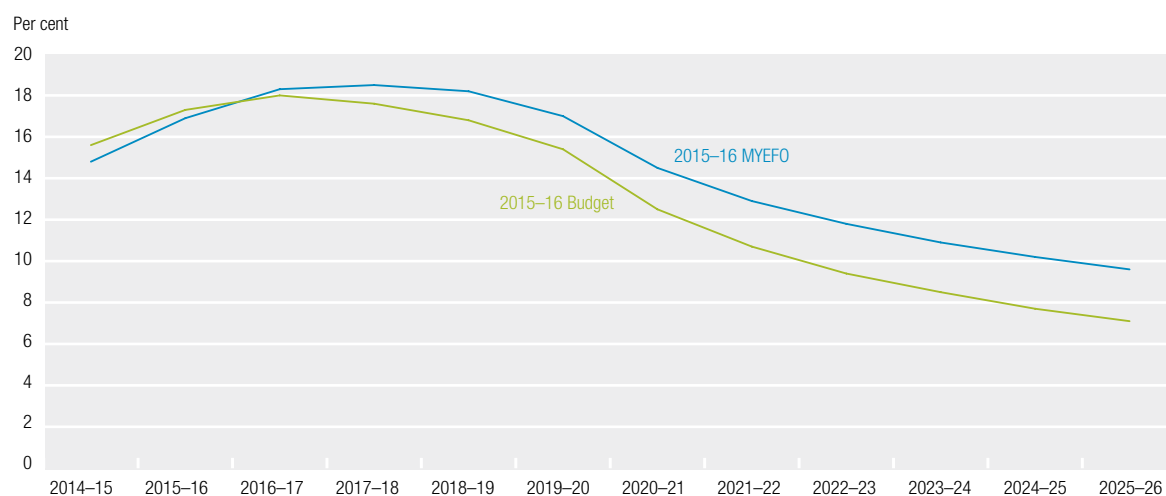
As was true of the Rudd and Gillard governments and the Abbott government, it was evident that the Turnbull Government expected much of the projected deficit reduction to be brought about by increasing revenue. Of the deficit contraction of 1.6 percentage points projected over the period, just short of one percentage point was 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 arose from an increase in personal income tax revenue as output and employment increased over the projection period.

The MYEFO projections, however, included the impact of measures not yet legislated, some of which have already been rejected by the Senate and some have not been implemented for other reasons. They appeared to total in the order of A\$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.

The Commission's task for the forward estimates period was thus to identify broadly acceptable packages that amount to a little less than one per cent of GDP in 2018–19.

FIGURE 1
Net debt as share of GDP



Source: MYEFO 2015–16

“If tax is held to 23.9 per cent of GDP and spending is projected based on current legislation, Treasury’s March 2015 Intergenerational Report (IGR) depicted the deficit reappearing from early next decade.”



In the MYEFO projections used by the Commission, tax revenue in 2018–19 was to be 23.1 per cent of GDP and spending as a share of GDP 25.3 per cent. The spending totals include savings measures that may not be implemented. Assuming they remain in place, 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 were designed to cut spending by 0.1 per cent of GDP and increase tax revenue by 0.8 per cent of GDP.

These MYEFO projections estimated that non-tax revenue would 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 was to find A\$2 billion in spending cuts from the MYEFO outcome in that year, and A\$15 billion in revenue enhancements.

The Commission identified several packages that it judged fell broadly within the perimeter of the Australian political debate. The list of packages put forward by the Commission can be viewed at the end of this chapter.

A reappearing deficit

Longer term projections show that on currently legislated programs, Australian Government spending is likely to increase somewhat 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, it follows that once the deficit is eliminated, rapid expenditure growth will ensure it soon reappears.

If tax is held to 23.9 per cent of GDP and spending is projected based on current legislation, Treasury’s March 2015 Intergenerational Report (IGR) depicted the deficit reappearing from early next decade. The IGR 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 GDP, well above the limit identified by the Commission.

Of the deficit of six percentage points of GDP, however, nearly two thirds are public 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 each year decline.



“The 19 December 2016 MYEFO confirmed the seriousness of the deficit outlook.”

If, as projected by the 2015 IGR, 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 Treasury in the IGR, net public debt interest would still be very small indeed in 2054–55 if the budget is balanced from 2018–19.

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

The Commission identified some spending measures what would by 2035 amount to at least half a per cent of GDP, accumulating to 2.4 of GDP by 2049–50. Again, this is challenging but not an insuperable task.

Debt used for investment

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.

The National Broadband Network and HECS-HELP loans are examples where capital obligations for the Commonwealth are for one reason or another taken off budget. The Commission agreed that if governments do invest in well selected economic infrastructure, there is good case to handle it off budget. The spending would not therefore be counted within the 25.5 per cent of GDP constraint – though it should be subjected to rigorous cost-benefit tests and a high expected rate of return, either directly or indirectly.

The December 2016 MYEFO

The 19 December 2016 MYEFO confirmed the seriousness of the deficit outlook. Once again, the expected cumulative deficit over the four-year forward estimates period (2016–17 to 2019–20) was expected to increase over earlier estimates, this time by A\$10.3 billion. Expected tax revenue was once again the main change, with projected revenue over the four-year period falling A\$30.7 billion compared to the 2016–17 Budget estimate. The Budget was still forecast to return to balance in 2020–21, the same timeframe outlined in the May 2016 budget, but a year later than the projection on which the CEDA Budget Balance Commission based its work.

In these latest projections for 2016–17, receipts are expected to be 23.3 per cent of GDP, payments 25.2 per cent of GDP and the deficit 2.1 per cent of GDP. As before, the path to the return to surplus depends completely on increasing tax revenue. Spending as a share of GDP is now, according to these MYEFO projections, locked in at 25.2 per cent of GDP right through to the end of the forward estimates period in 2019–20. The projected decline of the deficit arises only because tax receipts are expected to increase over that period by 1.6 per cent of GDP.

Over half of that increase will be contributed by rising personal income tax. Over the four-year period beginning 2016–17, personal income tax is projected to increase by over A\$40 billion, or a little more than one fifth. This is roughly four times faster than the projected rate of growth of employment over the period and more than twice as fast as the projected rate of growth of wages, implying that most individuals in 2019–20 will be paying a higher share of their incomes as tax than they do today. CEDA's emphasis on removing some concessionality in capital gains and superannuation and extending the indirect tax base was designed to mitigate this projected rise in personal income tax on work incomes.

The logic of the CEDA paper remains. For example, if taxation receipts in 2019–20 were

increased to 23.9 per cent of GDP instead of the MYEFO projection of 23.2 per cent of GDP, the Australian Government would be in surplus in 2019–20. Indeed, if it took taxes to 23.9 per cent of GDP in 2018–19 instead of the 22.7 per cent projected, it would be in comfortable surplus that year.

As the CEDA Budget Commission showed, further changes to superannuation or capital gain tax concessionality plus some increases in indirect taxes can take Australia to surplus earlier, more reliably and with less reliance on personal income tax increases than the government now projects.

Eighteen months after the CEDA board's unusual decision, and a year after the CEDA Balanced Budget Commission report, the Australian Government's cumulative deficits and debt are higher than the alarming totals then expected, the reliance on projected increases in personal income tax on work incomes remains, and the projected resolution of the Australian Government deficit is even further off.

Options proposed

The below options were proposed in the March 2016 publication *Deficit to balance: budget repair options*, based on the 2015–16 MYEFO.

OPTION 1

IMPACT ON UNDERLYING CASH BALANCE

Revenue			Expenditure		
Code	Description	(A\$billion)	Code	Description	(A\$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 58–60 for descriptions and sourcing of proposed measures.

OPTION 2
IMPACT ON UNDERLYING CASH BALANCE

Revenue			Expenditure		
Code	Description	(A\$billion)	Code	Description	(A\$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 58–60 for descriptions and sourcing of proposed measures.

OPTION 3
IMPACT ON UNDERLYING CASH BALANCE

Revenue			Expenditure		
Code	Description	(A\$billion)	Code	Description	(A\$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 58–60 for descriptions and sourcing of proposed measures.

OPTION 4 IMPACT ON UNDERLYING CASH BALANCE

Revenue			Expenditure		
Code	Description	(A\$billion)	Code	Description	(A\$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 58–60 for descriptions and sourcing of proposed measures.

OPTION 5 IMPACT ON UNDERLYING CASH BALANCE

Revenue			Expenditure		
Code	Description	(A\$billion)	Code	Description	(A\$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 58–60 for descriptions and sourcing of proposed measures.

Revenue raising measures				
Code	Description	Expected revenue raised (A\$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)
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)

Revenue raising measures... continued				
Code	Description	Expected revenue raised (A\$billion)	Description	Source*
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)

Expenditure reducing measures				
Code	Description	Expected expenditure reductions (A\$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)

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ACT

Aged and Community Services Australia
 Australian Bureau of Statistics
 Australian National University
 Defence Housing Australia
 Federal Department of Industry,
 Innovation and Science
 University of Canberra

NSW

AGL
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 ARITA - Australian Restructuring Insolvency
 & Turnaround Association
 Arts NSW
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 Australian Energy Market Commission
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 Australian Nuclear Science and Technology
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 The Future Fund
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 The University of Sydney
 Thorn Group
 TransGrid
 Transport for NSW
 UGL
 United Overseas Bank

University of Newcastle
 University of Technology Sydney
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 UNSW Australia
 UrbanGrowth NSW
 Visa
 Water NSW
 Western Sydney University
 Wollongong City Council

NT

Darwin Convention Centre

QLD

Accenture Australia
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 Baker McKenzie
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 Bond University
 Brisbane Airport Corporation
 Brisbane Convention and Exhibition Centre
 Brisbane Marketing
 Burrell Stockbroking and Superannuation
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 Honeycombes Property Group
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Logan City Council	Townsville City Council	Aurora Energy
Lutheran Community Care	Trade and Investment Queensland	MyState
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Morgans	UniQuest	Tasmanian Department of State Growth
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NOJA Power	University of the Sunshine Coast	
North Queensland Bulk Ports Corporation	Wiggins Island Coal Export Terminal	
Open Minds		VIC
Port of Brisbane		.au Domain
QIC	SA	AusNet Services
QSuper	Adelaide Airport	Australian Energy Council
Queensland Competition Authority	Adelaide Casino	Australian Health Policy Collaboration
Queensland Department of Agriculture and Fisheries	Adelaide Convention Centre	Australian Unity
Queensland Department of Energy and Water Supply	Babcock International	Barwon Water
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Queensland Department of Infrastructure, Local Government and Planning	Bedford Group	Bombardier Transportation Australia
Queensland Department of State Development	Coopers Brewery	Box Hill Institute
Queensland Department of the Premier and Cabinet	Executive Leadership Connection	Cabrini Health
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Queensland Treasury	Funds SA	City of Ballarat
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Seqwater	Morton Philips	CSL
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Super Retail Group	RiAus	ExxonMobil
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The Star Entertainment Group	SACE Board of SA	Fed Square
	SMS Management & Technology	GTA Consultants
	South Australian Water Corporation	Homesafe Solutions
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WA Department of Agriculture and Food
 WA Department of Commerce
 WA Department of Mines and Petroleum
 WA Department of Planning
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