Permanent and political

An analysis of Federal Government spending post-pandemic

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Introduction

Prime Minister Scott Morrison and Treasurer Josh Frydenberg have stated repeatedly that their government's approach to stimulus spending in the wake of the covid crisis was for 'temporary and targeted' measures to boost economic activity in the short term without creating 'structural pressure' on the budget. For example, in announcing first of three stimulus packages on March 12, 2020, Scott Morrison said:

> "The measures are all temporary, targeted and proportionate to the challenge we face. Our actions will ensure we respond to the immediate challenges we face and help Australia bounce back stronger on the other side, without undermining the structural integrity of the Budget."[1]

Similarly, when announcing the second stage of the covid crisis support Scott Morrison stated:

> "We know this will be temporary."[2]

The Prime Minister made the centrality of the short-term nature of spending programs explicit when explaining his preference for curtailing income support programs with his comments on May 11, 2020:

> "The JobKeeper and the JobSeeker program, as you note, have a legislative life which was set out over a six-month time frame…So, look, we'll take that one step at a time. But I need to stress again that that was a temporary lifeline put

[1] Prime Minister of Australia (2020) *Economic Stimulus Package,* https://www.pm.gov.au/media/economic-stimulus-package

[2] Prime Minister of Australia (2020) *Supporting Australian Workers and Businesses,* https://www.pm.gov.au/media/supporting-australian-workers-and-business

> in place to help Australians through the worst of this crisis. It comes at a very significant cost, not just to current but to future generations as well. And it will be there to get us, to meet that objective, but it's not envisaged – never was – to be a longer-term arrangement."

He expressed the same sentiment nearly a year later, on April 15, 2021:

> "A scheme that is burning cash, their cash, taxpayers' cash to the tune of some $11 billion a month cannot go on forever, Australians understand that."[3]

Treasurer Frydenberg relied on the same rationale to explain the design of the Commonwealth support package on July 29, 2021:

> "The expansion of the NSW COVID-19 business payment remains consistent with the approach we have taken throughout the pandemic in delivering temporary, targeted and proportionate economic support"[4]

And in explaining the design of the 2021 budget the Treasurer explained:

> "It (the 2021 budget) provides around $40 billion in targeted, temporary support to boost aggregate demand. 2021 budget."[5]

However, despite the frequency with which the claim that increased public spending was temporary was made, and the fact that unemployment is now well below its pre-covid level, Commonwealth spending is not just well above its pre-covid path, Treasury forecasts that Commonwealth spending will remain well above its pre-covid path for at least a decade.

While an increase in Commonwealth spending is not itself evidence of a problem, the fact that the government has failed to deliver on its commitment to rely only on temporary increases in expenditure creates several economic and democratic problems, including:

- The democratic desirability of the new sustained spending programs. While policies such as an increase in unemployment benefits and free childcare were temporarily provided during the crisis, they were withdrawn on the flawed

[3] Prime Minister of Australia (2020) *Press Conference – Australian Parliament House, ACT,* https://www.pm.gov.au/media/press-conference-australian-parliament-house-act-21jul20

[4] Coade (2021) *Government Expands Temporary Covid-19 Support for NSW Businesses*, https://www.themandarin.com.au/164404-government-expands-temporary-covid-19-support-for-nsw-businesses/

[5] Frydenberg (2021) *Post-Budget National Press Club Address*, https://joshfrydenberg.com.au/latest-news/post-budget-national-press-club-address/

claim that the Morrison Government was committed to avoiding new permanent increases in spending.

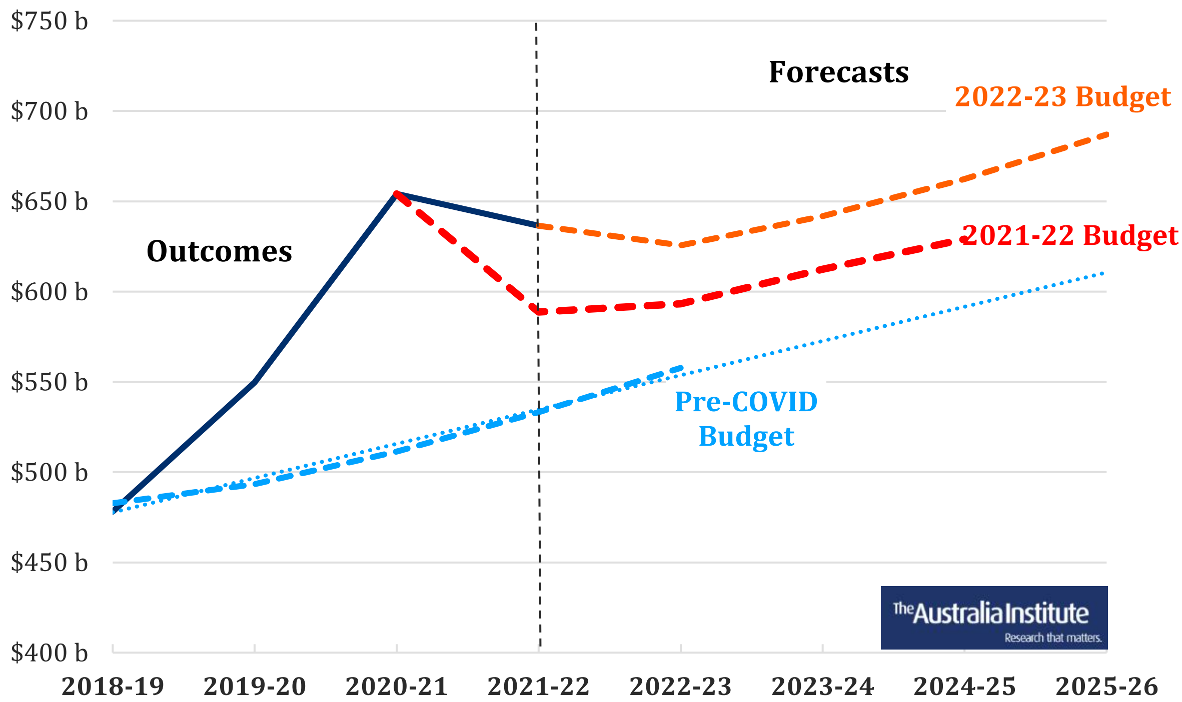
- The appropriateness of the stage 3 tax cuts which were legislated before covid and before the Morrison Government's sustained surge in spending.
- The efficiency of new spending programs such as the $7.4 billion worth of new dams which were approved without cost benefit analyses or business cases being developed.[6]

[6] The Australia Institute (2022) *Media Release: $7.4b Dam Announcement Doesn't Hold Economic Water: Research,* https://australiainstitute.org.au/post/7-4b-dam-announcement-doesnt-hold-economic-water-research/

Temporary and targeted or sustained and significant?

Figure 1 shows that Treasurer Frydenberg has failed in his goal of ensuring new spending measures introduced in response to covid 19 were temporary in nature. The 2019 Budget shows Commonwealth spending in 2018–19 was $483 billion and at the time this was expected to grow to $558 billion by 2022–23, an increase of 16 percent. However, this year's budget now forecasts that spending in 2022–23 will be $626 billion, an increase of over 30 percent on 2018–19 spending levels. Put another way, Josh Frydenberg now expects to spend $68 billion more in the next financial year than he planned to spend when he delivered the 2019 Budget.

Figure 1: Forecast Commonwealth spending since 2019



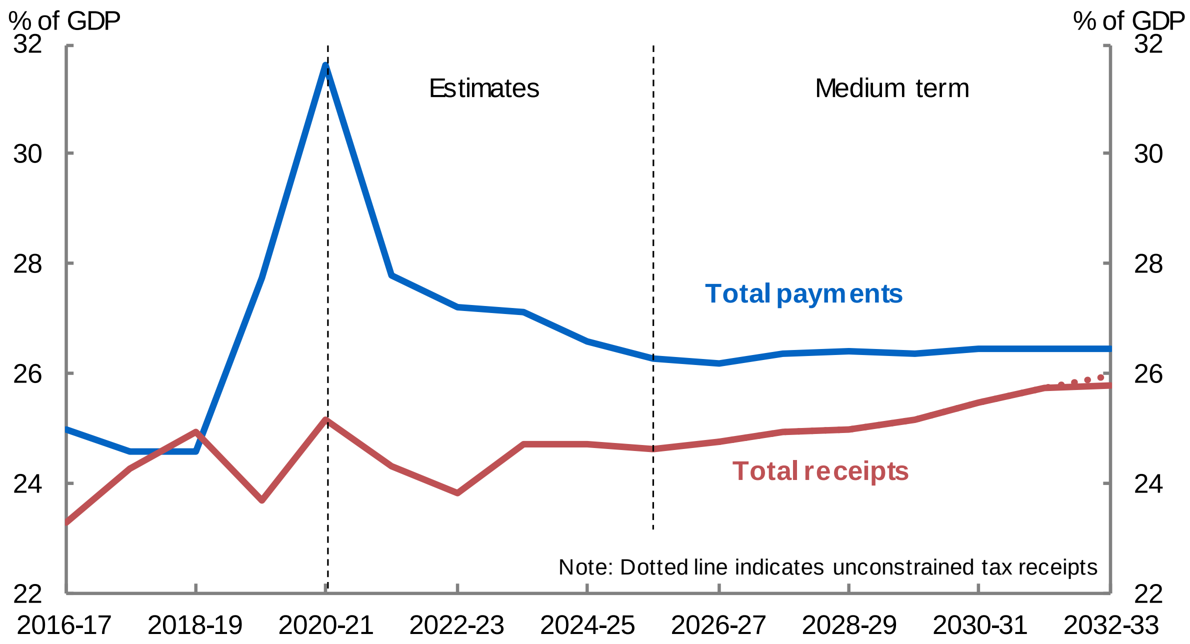
While economists overwhelmingly support the idea that an increase in government spending is desirable when unemployment is rising (so-called Keynesian stimulus), once unemployment begins to fall significantly and inflation begins to rise, increases in government spending need to be carefully selected to increase the productive capacity of the economy and/or be offset with increased tax revenue to minimise inflationary pressures.

Figure 1 shows another surprising fact. While the economy has recovered faster than the Treasurer expected, Commonwealth spending has fallen much slower than expected. Last year's budget predicted that spending would fall by $72 billion between its 2020–21 peak and 2021–22, however, this year's budget shows that even though the economy grew faster than expected spending fell by only $17 billion between 2020–21 and 2021–22.

Figure 1 also shows that while the 'temporary' boost in spending might not have fallen nearly as fast as the Treasurer promised, the future rate of Commonwealth spending increases in the 2019, 2021 and 2022 budgets are near identical. In short, despite protestations to the contrary, the budget forecasts make clear that there is nothing temporary about the Coalition's spending commitments with around one third of the new 'temporary' spending during the covid crisis remaining as a permanent increase in public spending.

While Figure 1 has been created by the authors using data contained in the Budget Papers, as Figure 2 makes clear, the Treasury are themselves aware of the long-term structural shift in spending that has occurred, with spending remaining significantly above its pre-covid levels (as a percentage of GDP) for at least another decade. That said, Figure 2 also highlights that Treasury expects some significant reductions in Commonwealth spending to occur around 2024 although little detail on the form of these future spending cuts can be found in the budget papers.

Figure 2: Total payments and receipts (Treasury)



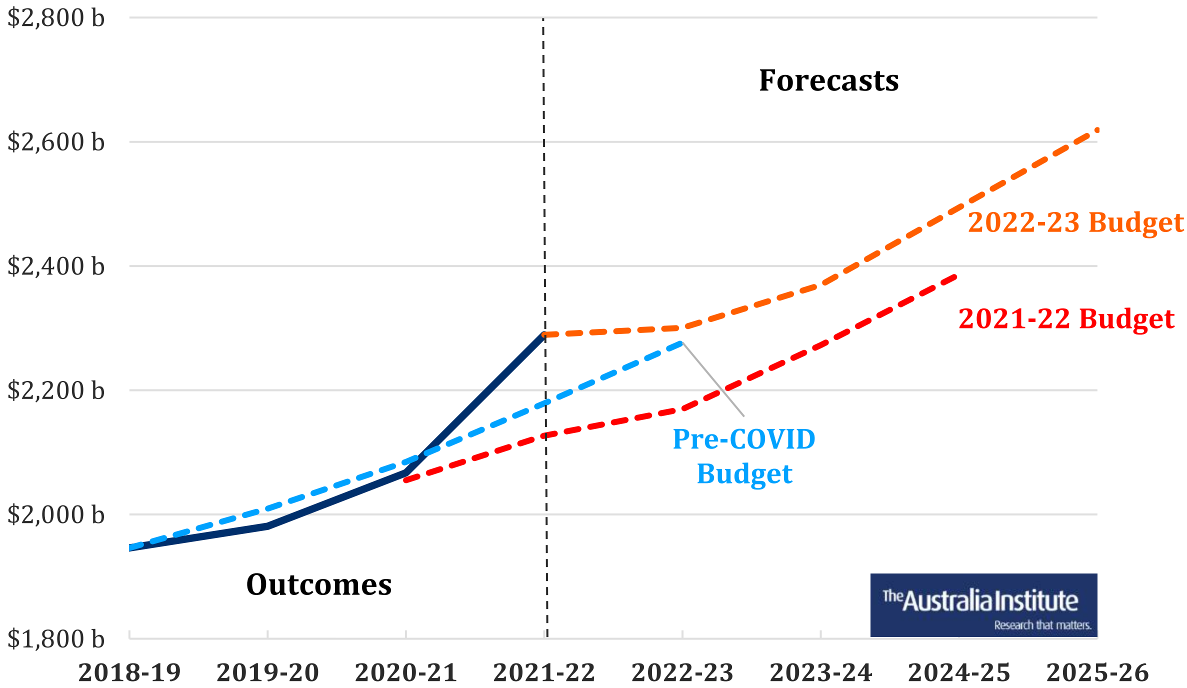
Note: Total receipts includes taxation and non-taxation receipts. The 2022–23 Budget projections have tax receipts reaching the 23.9 per cent tax to GDP cap in 2031–32.

Source: Commonwealth Government (2022) *Budget Paper No. 1, Budget Strategy and Outlook 2022-23,* p 84, https://budget.gov.au/2022-23/content/bp1/download/bp1_2022-23.pdf

What is happening to GDP?

While Commonwealth spending has surged well above the levels forecast pre-covid, real GDP (that is, GDP adjusted for changes in consumer and commodity prices) remains well below the levels forecast in 2019. That said, as shown in Figure 3 nominal GDP (that is GDP calculated using actual market prices) has surged well above the levels forecast in the 2019 budget.

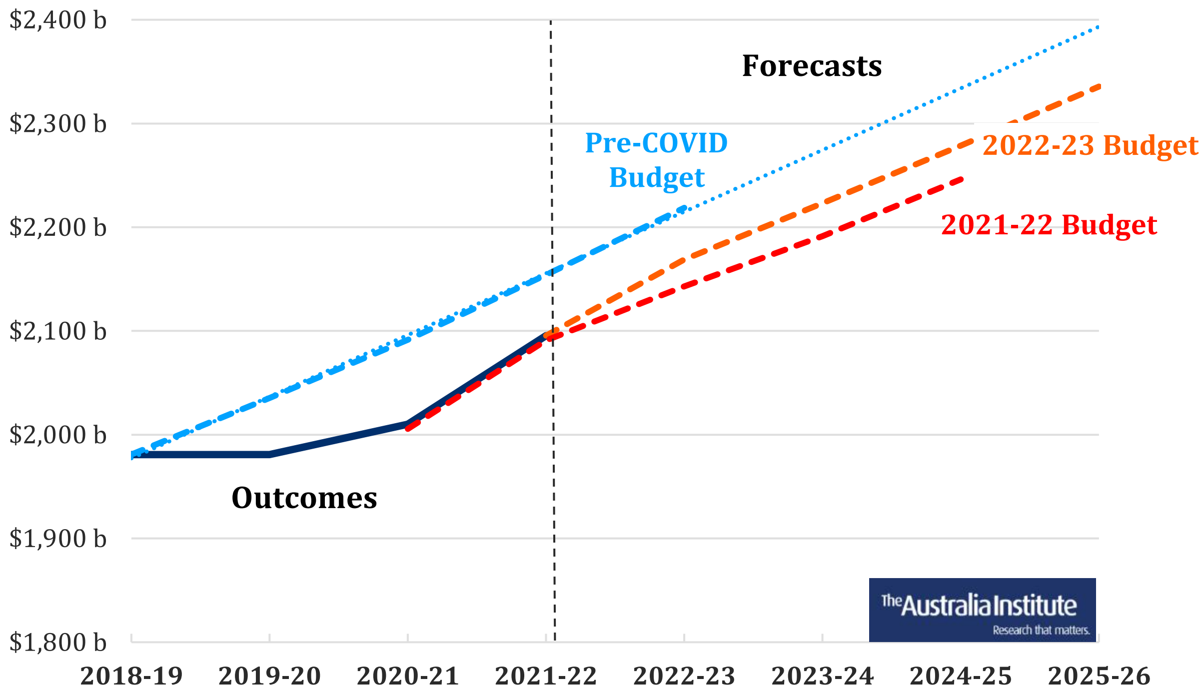
Figure 3: Nominal GDP forecasts and actual



Source: Australia Institute analysis of Budget Papers, various years (https://budget.gov.au/)

However, because nominal GDP takes no account of inflation, more attention is usually paid to real GDP, which measures only the changes in the level of production and ignores changes in the prices of that production. Figure 4 shows that while nominal GDP is now well above the levels forecast in the 2019 budget, real GDP remains well below those levels.

Figure 4: Real GDP forecast and actuals



Source: Australia Institute analysis of Budget Papers, various years (https://budget.gov.au/)

Just as it is real wage growth (nominal wage growth less inflation) that matters most when analysing the changes in purchasing power and material standard of living for an individual, it is real GDP growth that (nominal GDP growth less inflation) that sheds the most light on the performance of the economy as a whole. That said, while it is changes in real GDP that have the capacity to drive *material* changes in the living standards of a country, changes in nominal GDP have the capacity to drive significant *distributional* changes. For example, while an inflation driven surge in nominal GDP will automatically lead to an increase in revenue from, for example, the GST (which is a fixed 10 percent of the retail price of taxable items) decisions about how much to increase the wages of public sectors workers, and the timing of such decisions, are largely at the discretion of the government of the day.

In short, surging inflation and the resultant surge in nominal GDP has a significant, immediate and an automatic impact on government revenue (including through bracket creep) while the government has significant degree of control over the size and timing of the impact, if any, of spending increases on its expenditures.

Conclusion

While unemployment is now lower than it was pre-covid the increase in Commonwealth spending has not been temporary. On the contrary, Treasury forecasts show that Commonwealth spending is expected to remain well above its pre-covid levels for at least a decade. In short, the Australian economy has not returned to the path that it was on before the covid crisis hit, but because of the recent surge in inflation, there has been a significant surge in nominal GDP and, in turn, tax revenue.

It is important to note that the Treasury forecasts on which the nominal and real GDP figures presented above are based were made before the Australian Bureau of Statistics released their unexpectedly high inflation result in May. A result which suggests that the divergence between nominal and real GDP will be even greater than the Treasury expected when the budget was delivered.

While it is clear from the Budget Papers, and from Figure 2 above, that temporary measures such as JobKeeper and the Jobseeker supplement that were introduced during the crisis caused a significant increase in government spending, it is also clear that despite the forecast made in the 2021 budget that expenditures would fall rapidly, this decline did not occur.

In short, in recent years there has been a significant and sustained increase in Commonwealth spending which has not been explained by the Treasurer and, in turn, no evidence has been presented to support the conclusion that the permanent increases in Commonwealth spending are targeted at policies that are likely to maximise economic growth or meet public expectations. The fact that it has been reported that the Morrison Government committed to spending an additional $20 billion to secure the National party's support for a net zero target supports such a conclusion.[7]

Compared to other developed countries Australia is a low tax/low spending country. This was the case leading into the crisis and, despite the recent increases in revenue and spending, remains the case today. That said, given that Treasurer Frydenberg has been adamant that the increases in expenditure that have occurred in the last two years have been 'temporary and targeted', and given that calls to retain the increase in unemployment benefits introduced during the covid crisis were dismissed on the basis that such a change would not have been 'temporary', it should be of significant concern

[7] Foley (2022) *Payback for Net Zero: Gas, Coal, Dam and Green Funds Flow for Nationals,* https://www.smh.com.au/politics/federal/payback-for-net-zero-gas-coal-dam-and-green-funds-flow-for-nationals-20220330-p5a99m.html

that Australia is still yet to have a democratic debate about how their significantly bigger government should be spending their money.

Put simply, the covid crisis has made the Australian government bigger. After decades of bipartisan promises to shrink its size there is now bipartisan consensus that public spending should remain above 26 percent of GDP for the longest period since World War II. Only once the idea that this surge in spending is ‘temporary’ is abandoned can the important debate about how best to spend such an increase begin.