__Briefing Paper:__

Commonwealth 2020-21 Budget Update: Dropping the Ball on Economic Reconstruction

October 2020

The Commonwealth government tabled its 2020-21 budget on 6 October, six months later than the usual timing because of the dramatic events associated with the COVID-19 pandemic and resulting recession. There is no doubt it is a budget unlike any other in Australia's postwar history: with the largest deficit (as a share of GDP) since the Second World War, enormous fiscal measures (both tax cuts and new spending[1]), and a sense of urgency to address the health, economic and social effects of this unprecedented catastrophe.

While the budget certainly unleashes unprecedented fiscal power, its underlying logic and specific policy design are unsatisfactory in many ways. We present here analysis and commentary on several aspects of the budget, drawing on input from all of the Centre's research staff: Economist and Director Dr. Jim Stanford, Senior Economist Alison Pennington, and Economist Dan Nahum.

Hoping for a (Business-Led) Miracle

The budget assumes that Australia's macroeconomy will quickly spring back to life over the coming financial year, and that this recovery will be primarily led by private businesses. As the Treasurer Mr. Frydenberg put it in his budget speech, "The private sector … is the engine of the Australian economy." The budget assumes that government just needs to provide some helpful 'juice' (in the form of tax cuts, wage subsidies, and other incentives), and the private sector will do the rest. But historical experience suggests this very ideological commitment to a market-driven recovery is highly risky.

[1] In the 2021-22 financial year, tax reductions announced in the budget are worth $33 billion, while new spending initiatives are worth $21 billion. The overall package is thus weighted in favour of tax cuts over spending by about a 60:40 margin. The biggest single measure in the budget is the provision allowing instant write-off of capital investment by businesses, which will be worth $31 billion over the first 3 years of the budget.

Given the shock to incomes and confidence that has been experienced throughout the country, and the lasting damage that has been done to several important economic sectors (including as airline transportation, tourism, higher education, entertainment and hospitality, and more), expecting a self-propelled private sector snapback is folly. Indeed, when consumers and businesses have been so damaged, the economy generally requires a more direct, hands-on form of support. During any severe recession, direct spending is the most powerful and effective form of fiscal stimulus. And municipal, state and federal governments are capable of immediate direct job creation through expanded public sector employment – not just the private sector. Historically, public sector job creation programs in direct services (like healthcare and education), and policy and administration roles, have been pivotal to generating jobs for those left behind during recessions (especially youth).

Other heroic assumptions underpin this vision of business-led recovery. The budget explicitly assumes an effective vaccine will be developed and rolled out nation-wide within the next 12 months, that internal and international borders will reopen, and that consumers and businesses will open their wallets and dramatically boost their spending.

The budget expects economic performance to worsen in the current financial year (reflecting the decline in most economic indicators which has already occurred). But it then projects real GDP growth rebounding to 4.75% in the 2021-22 financial year, led by a 6% surge in business investment (which has been falling for years, long before coronavirus), and a 10.25% surge in consumer spending. The government's expectation of enormous growth in consumer spending is inconsistent with its own somber forecasts of future employment and wage trends: it predicts unemployment will rise next year (to 7.25%), and wage growth will slow down even further (discussed below).[2] With no jobs and flat incomes, where can a surge in consumer spending come from? Of course, the government pretends tax cuts will do the trick: but as outlined below, tax cuts are no substitute for normal, steady increases in wages.

It is certainly possible for Australia's economy to rebuild strongly after a historic catastrophe like this pandemic. Reconstruction after calamity has happened before (such as after the conclusion of the Second World War[3]), and it could happen again. But sustained reconstruction won't happen by itself, through the 'automatic' actions of the private sector. It will require concerted, powerful measures by government to lead the

[2] In fact, cumulative nominal wage growth over the 4 years of the budget and its forward estimates only matches growth in consumer spending, implying zero growth in expected real wages for 4 years. And the government expects employment to grow faster than total labour compensation, which implies a *decline* in realized compensation per worker.

[3] For a full discussion of the relevance of Australia's postwar reconstruction to rebuilding after COVID-19, see Alison Pennington and Jim Stanford, "Rebuilding After Covid-19 Will Need a Sustained National Reconstruction Plan," *Journal of Australian Political Economy* 85 (2020), pp. 164-174.

process of national economic reconstruction – like the proposals advanced by the ACTU in its five-point *National Reconstruction Plan*.[4] The government has indicated no such vision with this budget, which is framed around an unnecessary and constraining celebration of private sector leadership.

And the fiscal stance of the budget is further muddled by the government's insistence to cut back the JobKeeper and Coronavirus Supplement benefits, and refusal to confirm any increase in the permanent rate of JobSeeker benefits. This needless austerity will draw tens of billions of dollars of spending power out of the economy, undermining the stimulative power of other elements of the budget and exposing hundreds of thousands of Australians to frightening insecurity.

The hopes of the 2020-21 budget for an imminent rebound in economic activity are summarised in Table 1 (along with a comparison to actual data from the previous financial year ending in June).

Table 1
Assumptions and Reality
Commonwealth Budget Forecasts
(% change, year over year)

	June 2020 Quarter Actual[1]	**Budget Forecast**	
		2020-21	**2021-22**
Real GDP Growth	-0.2%	-1.5%	4.75%
Business Investment	-1.8%	-9.5%	6.0%
Employment Growth	-4.3%	2.75%	1.75%
Unemployment Rate	7.0%[2]	7.25%	6.5%
Wage Price Index	1.8%	1.25%	1.5%
Consumer Price Inflation	-0.3%	1.75%	1.5%
Total Labour Compensation	0.4%	1.0%	0.75%
Consumer Spending (nominal)	-12.2%	-4.75%[3]	10.25%[3]

Source: Author's calculations from Commonwealth Budget and ABS National Accounts and Labour Force data.
1. Year over year growth unless otherwise indicated.
2. Quarterly average.
3. Consumer spending subject to GST.

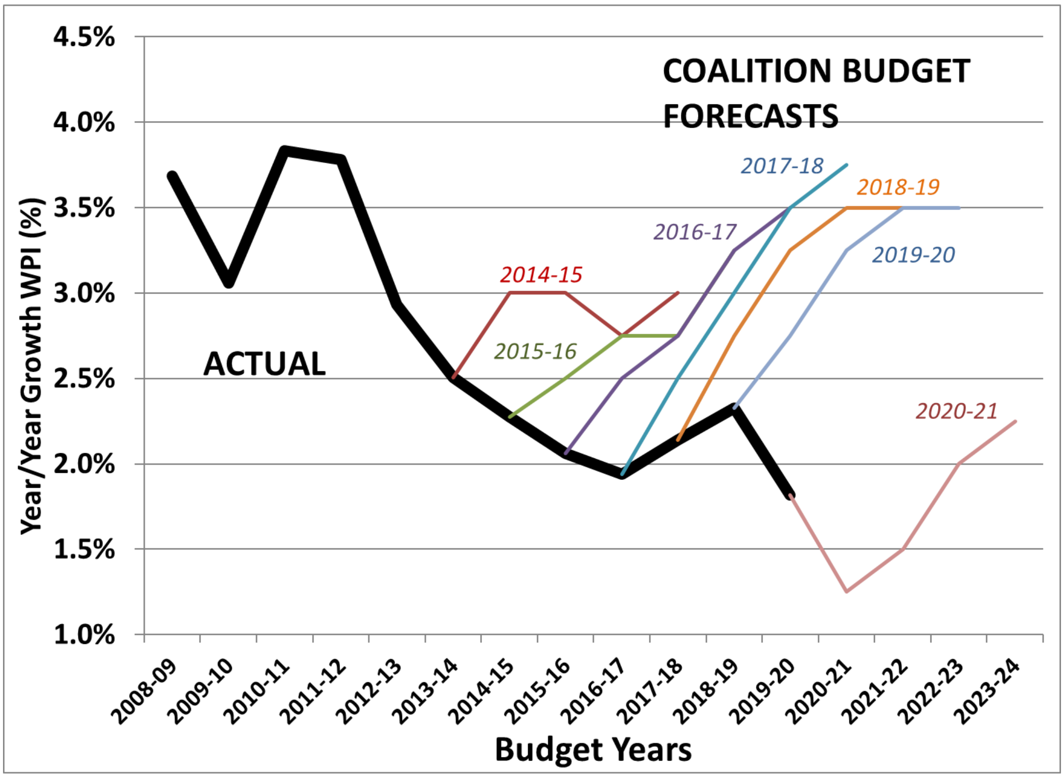
[4] See *Australia's Economic Reconstruction after COVID-19: A National Jobs Plan, And Five Ways to Get Started*, ACTU, July 2020.

Still Waiting for a Pay Rise

In contrast to its optimism regarding macroeconomic snapback next year, this budget has a very pessimistic view on wages. It expects wage growth to slow further to just 1.25% in the 2020-21 financial year (the weakest on record, and lower than expected CPI inflation), and only a very slow recovery after that. Over the four years of the budget and forward estimates, cumulative wage growth (of just over 7% over 4 years) barely matches the cumulative rise in consumer prices in the same period. The budget thus forecasts zero change in real wages over its entire outlook. Worse yet, it expects growth in total labour compensation to lag behind growth in employment in the first two years. This implies a reduction in average nominal wage income per worker (likely due to an increase in the proportion of part-time and casual work).

Figure 1 illustrates the contrast between the past optimism of Coalition budgets and the grim reality of the slowest sustained wage growth in Australia's post-war history since 2013. This year, the government is now telling Australian workers to basically abandon hope that wages will ever get much better.

Figure 1. Wages: Budget Forecasts versus Reality



Source: Authors' calculations from Commonwealth budgets and ABS, Wage Price Index. Actual shows 12-month growth to June of each year.

Absent pro-active measures to strengthen wages (like higher minimum wages, restored collected bargaining, and an end to wage restraint in the public sector), the government's pessimism is justified. But it should be held to account for effectively admitting defeat regarding wages – and accepting that wage growth will remain at current record lows for years to come. If the government cared about the trajectory of wages (and stronger wages would certainly help boost consumer spending more reliably than tax cuts), it would take direct measures to support wage growth: such as boosting the minimum wage, restoring collective bargaining (including at the sectoral level), ending wage austerity for public sector workers, and expanding direct public sector employment.

Tax Cuts Don't Cut It

The accelerated 'Stage 2' tax cuts announced in this budget will have a largely symbolic impact, if that, on disposable incomes for most Australians. The plan brings forward previously announced changes to tax rates and thresholds by two years. The main beneficiaries of those lasting changes are higher-income earners. But to 'dress up' this very unfair aspect of their proposal, the government added one twist: the previous Low and Middle Income Tax Offset (LMITO) will be maintained for one year – instead of being cancelled, as originally planned, when the Stage 2 measures came into effect.

The effect of this measure for low- and middle-income households is a *one-time tax rebate* of up to $1080 per taxpayer (for those with pre-tax incomes between $45,000 and $90,000). That benefit will disappear in 2021-22 and after. However, the impact of the changes in thresholds (including raising the 19% marginal tax rate threshold from $37,001 to $45,000, and the 37% marginal tax rate threshold from $90,000 to $120,000) is *permanent* (unlike the LMITO savings which disappear in the second year of the budget and beyond).

The benefit of those permanent changes is heavily skewed to higher-income earners: people earning over $120,000 receive benefits of $2430 per person per year, while people earning $60,000 get $1080, and people earning below $37,000 get nothing. The Australia Institute has estimated that 88% of the combined *permanent* benefit of the Stage 2 tax cuts (for 2021-22 and beyond) go to the highest-income fifth of taxpayers. Those tax cuts will reduce federal revenues by around $15 billion per year in 2021-22 and after.[5]

Even for relatively well-paid workers (even those at $100,000 or somewhat higher), the boost to disposable income resulting from these politically-tailored tax cuts will never replace the foregone income resulting from a lack of normal wage growth in the economy. Consider a worker earning $60,000. One year of 'normal' wage increases of 3.5% would boost their disposable income by $1400: considerably more than the Stage

[5] Since the Stage 2 tax cuts were already legislated to begin in 2022-23, the actual "cost" of the measure as expressed in this budget ($23.5 billion over the first two years) represents only its acceleration, and does not reflect the full loss of revenue on an ongoing basis.

2 tax saving. But after three years of 'normal' wage increases, their disposable income is about $4300 higher: four times more than the value of the tax cut. Tax cuts (even permanent ones) only boost the level of annual disposable income once; wage increases, in contrast, have a compound effect year after year.

The same is true even for higher-income workers. Someone earning $120,000 per year gets a $2430 benefit from the Stage 2 tax cuts, as noted. But one year of normal wage growth boosts their disposable income by close to $2600. And three years of consecutive normal wage growth lifts their disposable income by more than $8000 per year. If the goal is steady, sustained improvements in living standards, tax cuts cannot replace the role of regular normal wage growth.

At the macroeconomic level, too, personal tax cuts are no substitute for normal wage growth as a force for boosting household incomes and consumer spending power. A normal 3.5% wage increase would boost aggregate labour compensation by $25 billion in just the first year – far more than these tax cuts. Then, in subsequent years, the compounding effect of wage increases drives income and consumer spending power far higher: up by $75 billion in the third year (five times as much as the aggregate tax cut).

The crucial measure to strengthen disposable incomes and consumer spending in Australia is to restore normal wage trajectories. Australia entered the COVID-19 recession suffering from several years of record-low wage growth. The recession is making matters worse. We need strong pro-active measures by government boost wages and restore spending power to Australian households.

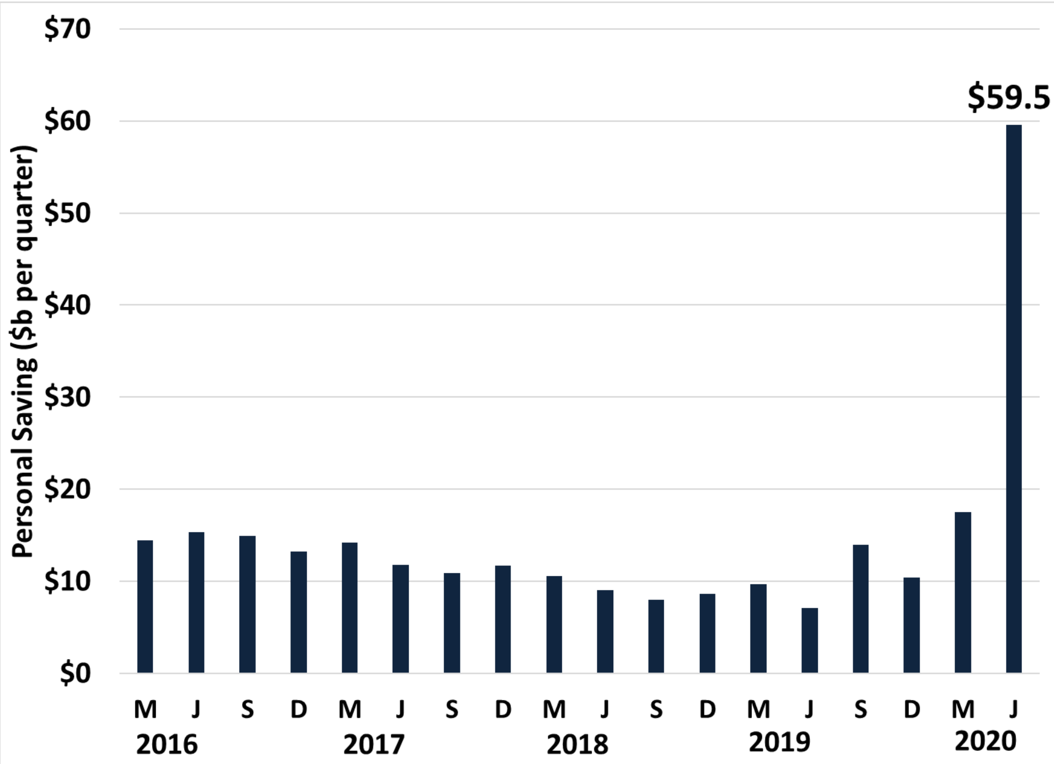
Consumer Saving and Economic Recovery

Another reason personal income tax cuts will not stimulate an adequate rebound in employment and economic activity is because of the unprecedented rise in personal saving during the pandemic and resulting recession. Household incomes from employment, small business, and other market sources fell during the first months of the pandemic. That was offset, in aggregate, by major increases in government income supports: including JobKeeper, JobSeeker, and the Coronavirus Supplement. Total personal disposable income, therefore, did not fall in Australia from the December through June quarters – a remarkable outcome considering the intense disruption in normal economic activity. This attests to the importance of the powerful government income supports in stabilizing household and business finances even as the pandemic took hold.

However, despite the maintenance of overall personal incomes, consumer spending still declined sharply after the pandemic hit. Initially this was largely due to restrictions on retail trade imposed for health reasons. Later, however, the weakness in consumer spending reflected pessimism and fear among consumers, who decided to hang onto much of their income as precaution against future hard times. Nominal consumer spending fell by $35 billion (or 13%) in the June quarter.

The combination of plunging consumer spending, alongside surprisingly stable personal incomes, implies a dramatic increase in the rate of personal saving. According to ABS data, households saved an astounding 18% of their disposable income in the June quarter, or almost $60 billion (see Figure 2). This represents nearly a $50 billion increase in personal saving compared to the December quarter – equivalent to a drain of about 10% of total quarterly GDP. Indeed, if consumers had spent their income at the normal proportional rate, rather than hoarding it as a precaution, Australia would not have slipped into recession in the March and June quarters.

Figure 2. Household Saving.



Source: Authors' calculations from ABS National Accounts.

The current propensity of Australian consumers to set aside disposable income constitutes a significant leakage from normal macroeconomic processes. We can't blame Australian households for being cautious with spending decisions, given the economic and epidemiological uncertainty they confront. But it is a reality of the current macroeconomic situation that reluctance to spend by households will undermine the stimulative effects of any personal tax cut. During times of recession (or depression), the most important priority for macroeconomic policy must be directly boosting spending through direct government expenditure on programs, services, and public investment. Spending is far more powerful than tax cuts in motivating new work, additional incomes, and eventually stronger tax revenues for government itself.

The distributional differences between spending and tax cuts are another reason why tax cuts are ineffective – all the more so given the record-high savings of Australian households. The National Accounts data illustrated in Figure 2 do not disaggregate household saving according to income level, but it is certain that the bulk of the savings were set aside by higher-income households which enjoyed the possibility of being able to increase savings despite the sharp falls in employment and wage incomes. Yet as noted above, the Stage 2 income tax cuts are weighted very strongly in favour of those same higher-income households.

Making matters worse, at the same time as delivering tens of billions of dollars of tax savings into the hands of higher-income individuals (who will save much or most of that benefit), the government is cutting income supports for lower- and middle-income Australians on JobKeeper and JobSeeker. The combined stimulative effect of tax cuts for higher-income households who do not spend much of those revenues, while cutting income supports for households who spend virtually every dollar, could very well be negative: this combination of policies could undermine consumer spending, rather than strengthening it.

Women's Economic Security

Women have experienced disproportionate shocks to their jobs and incomes during the pandemic. And while some women's jobs have returned, there is a mismatch between jobs lost in the initial downturn and those recreated in the subsequent partial recovery. Women lost mostly full-time jobs (56% of all jobs lost since March), but 88% of jobs regained since May have been part-time.

The budget announced $240.4 million in funding purportedly to lift female workforce participation back to pre-crisis levels. But this *Women's Economic Security Statement* provides no job creation plan to meet the challenges of women without jobs or who have left the workforce since March. It will not address the structural barriers holding women back from accessing paid work. Failure to dedicate funding in sectors that clearly support women's employment (including education, healthcare, and social services) will ensure there will be insufficient jobs for women to move into.

The government plans to expand an existing mentoring and start-ups program that will support less than 300 new female-led businesses. Token funding will also be provided for leadership programs to increase women's representation in male-dominated occupations, and for workplace sexual harassment. And funding will be provided for 500 women to undertake cadetships or advanced apprenticeships in STEM fields. None of these measures will make an appreciable difference to women's economic inequality.

Failure to repair and generate women's jobs will exacerbate the unequal gendered impacts of the pandemic crisis. Investment in the social infrastructure of the economy – healthcare, education and caring services- should be prioritised as an effective and legitimate industry policy. These sectors are jobs intensive, have double-employment benefits for women (employing women directly as well as freeing them up from unpaid caring work to participate in the workforce), and can drive higher productivity and GDP growth that benefits all of society.

The government proposes to relax the work test requirements for eligibility for Paid Parental Leave (from 13 months prior to birth or adoption, to 20 months). This is estimated to benefit only 9,000 individuals, and 3,500 for Dad and Partner Pay (2 weeks at minimum wage). These supports do not begin to meet the scale of caring demands facing working families.

The Plight of Young Workers

The budget also announced a new JobMaker wage subsidy to encourage employers to hire young workers. The subsidy is payable for up to 12 months to employers who hire young workers currently on JobSeeker. The subsidy is worth $200 per week for those under 30, and $100 for those aged 30-35. Recipients must work at least 20 hours per week. The government claims this will support up to 450,000 youth jobs, but this claim is very optimistic.

Indeed, this largest single job-creation measure in the Budget resembles a mass youth work-for-the-dole scheme. Without sufficient labour protections or requirements on employers to retain workers, the JobMaker Hiring Credit will lead to batches of young vulnerable people being churned through low-skilled, low-paid work for short periods of time. The program incentivises employers to sack existing more expensive employees, replace them with young casual workers, and will undermine any possibility of the jobs leading to long-term established careers with secure working conditions.

Remember, too, that wage subsidy schemes are already offered to employers who hire long-term unemployed within administration of the welfare system. Without strong protections to ensure jobs are retained at the conclusion of programs, paid properly, provided opportunities for skills and training, and covered by work, health and safety protections, this program presents major concerns.

JobTrainer and the Skills Crisis

The government has committed an additional $1.2 billion to support Australian businesses to employ 100,000 new apprentices or trainees. Businesses hiring a new trainee will be eligible for a 50% wage subsidy of up to $28,000 per year. This is in addition to the 50% wage subsidy for 180,000 apprentices introduced in March for businesses with apprentices already on their books.

Before the pandemic struck, the number of apprentices and traineeships in our skills pipeline had already declined by over 200,000 compared to 2012.

Moreover, apprentices need somewhere to undertake their formal studies, and the government did not commit any new funding to TAFEs (in fact the budget did not even mention TAFE).

What work will the apprentices do? Besides some moderate infrastructure spending announced, the government has not committed to the long-term sustained projects needed to increase demand and confidence among employers to invest in new recruitment and training.

Manufacturing

The government announced a $1.5 billion dollar manufacturing package, with most funds targeted at six priority areas: Resources technology and critical minerals, Food and beverages, Medical products, Recycling and clean energy, Defence, and Space

The package also includes a Manufacturing Modernisation Fund, which will offer $52.8 million in grants (worth $100,000 to $1 million) to local companies (conditional on industry committing $3 for every $1 from government).

The $1.5 billion in support is a small figure in the scheme of things: less than half of one percent of annual manufacturing industry gross value added.

The government's claim that Australian manufacturing is held back by high wages and energy prices is not credible. The absence of a clear energy policy, especially one that integrates low-cost renewable sources, is the key reason Australian energy prices are high. And now the government argues that an expansion of domestic gas production (rather than cheaper renewables) is a precondition for the expansion of manufacturing.

It is especially contradictory to discuss strengthening manufacturing without addressing the crisis in Australia's VET system. Without properly-resourced pathways for skills and technical knowhow, advanced and niche areas of manufacturing will struggle to find trained staff (even though at present there is significant slack in the labour force).

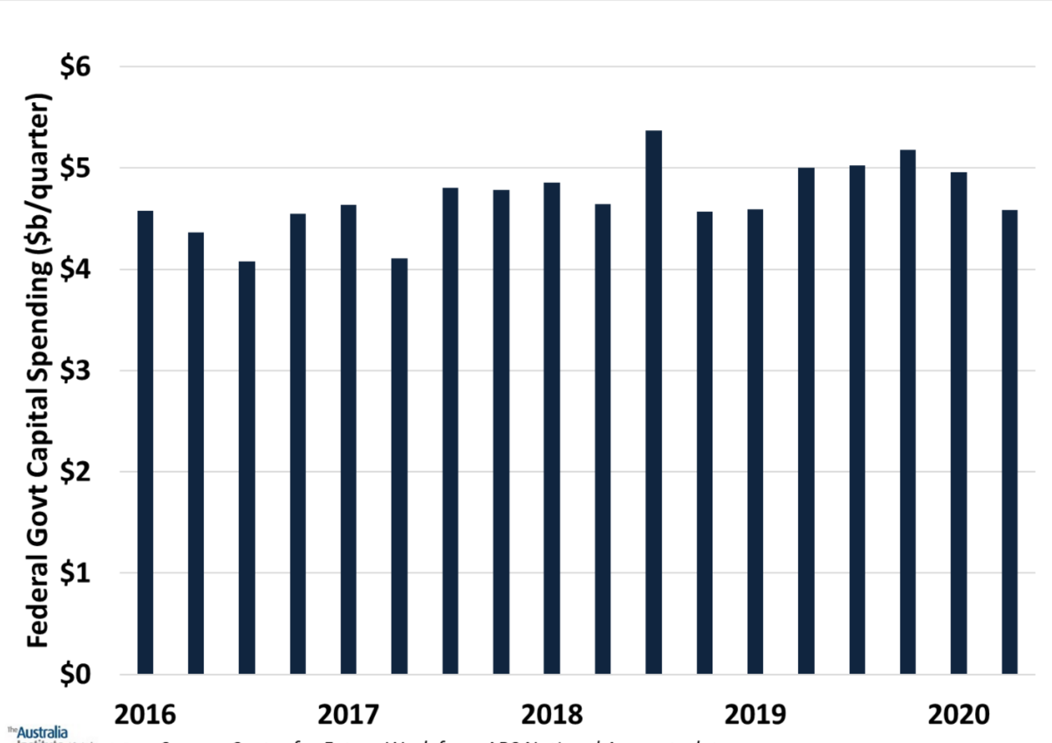
Infrastructure: Lots of Announcements, but Where's the Work?

The pre-existing ten-year $100 billion federal infrastructure investment pipeline has been supplemented with an extra $10 billion over ten years in this budget. That is a small increment given the desperate needs of the economy for new investment.

More worrisome, there is a long-standing pattern of the government making high-profile announcements of new projects, but with little evidence that these announcements translate into actual capital spending and new work.

To the contrary, actual capital spending by the federal government has been stagnant over the past 4 years – and actually fell during the first half of 2020 (even as the pandemic heightened the need for more public sector activity). The government's credibility in once again pledging more infrastructure spending is weak.

Figure 3. Infrastructure: No Sign of a Big Build



Source: Centre for Future Work from ABS National Accounts data.

One Important Victory

Lest we conclude our overview of the 2020-21 budget on too pessimistic a note, it does include several announcements of incremental funding for various initiatives – including modest funding for NDIS quality initiatives, additional home care packages, and a special payment to seniors and other benefit recipients.

One announcement in the budget did not receive a lot of media attention, but is close to our hearts: the government has agreed lift base funding in Department of Social Services Grants to cover the costs of the Equal Remuneration Award issued by the Fair Work Commission in 2012. A nine-year fund to support the gradual implementation of pay equity in the social and community services sector is expiring this year, and there was a risk that without expanded base funding those pay equity improvements would be in jeopardy.[6] Determined advocacy by unions and community groups finally pushed the government to confirm this funding. This move will benefit both workers (overwhelmingly women) and service users in this vital field.

Conclusion

This budget says explicitly that Australia's economic reconstruction after COVID-19 is to be trusted almost entirely to private business – helped along with generous tax cuts and business subsidies.

The need to strengthen public services (like health care, child care, and higher and vocational education) is largely ignored, as is the need to preserve and strengthen income security programs (with the phase-out of JobKeeper and cuts to JobSeeker going ahead).

Tax cuts, whether targeted at businesses or high-income households, will have little impact on actual spending and job-creation.

The government needs a more forceful, hands-on, and sustained reconstruction plan to ensure that the economy does not get 'stuck' in its current state of partial recovery. That needs much more public sector leadership, vision, and funding.

The government admits that wage growth is going to get weaker before it gets stronger – but is doing nothing about that critical problem (which will undermine consumer spending far more than tax cuts will stimulate it).

[6] See our recent report on this matter, *Pay Equity in Community Services: The Consequences of Federal Budgetary Decisions*, by Jim Stanford, September 2020, https://www.futurework.org.au/federal_funding_critical_to_preserve_pay_equity.