HON. J.B. HOCKEY
Treasurer

SPEECH
MID-YEAR ECONOMIC AND FISCAL OUTLOOK 2013-14
NATIONAL PRESS CLUB
17 DECEMBER 2013

******CHECK AGAINST DELIVERY******

In the depths of Opposition I chose to climb my first mountain, Mt Kilimanjaro.

At nearly six kilometres high it is the tallest free standing mountain in the world and the tallest mountain in Africa.

Sure, it's not Mt Everest, but it is much bigger than Mt Kosciuszko.

You learn lots of good lessons climbing a mountain.

Lesson number one is to be honest about the scale of the challenge.

And today the Government is being honest about the fiscal and economic challenges facing Australia.

This Mid-Year Economic and Fiscal Outlook I have released today, with the Minister for Finance, shows that Australia is now preparing to climb a challenging fiscal and economic mountain.

I want to emphasise that no challenge is insurmountable.

The Coalition went to the Australian people with a plan to get the economy and budget back on track. That is what we will do and today is the first step.

We will fix the Budget and we will deliver a stronger economy.

But it will need a response that has the support and active involvement of the entire Australian community.

Today we reveal the full impact on the Budget and the economy of six years of Labor Government.

Notwithstanding what the numbers reveal, the Government is determined to fix the problems that we have inherited.

The statement we are presenting is a realistic and comprehensive stocktake of the economy and of the Commonwealth's books.

It has been prepared on the advice of Treasury and Finance with rigorous oversight by the Government to ensure it is an accurate assessment of the state of play.

Since being sworn in, every Minister has worked with their department to identify all the issues and all the risks in the Budget and across the economy.

We make no apology for asking the hard questions and challenging the usual assumptions.

As a result, this document shows the significant task that lies ahead of the Government and the community.

We have inherited from the Labor Party Budget deficits totalling $123 billion over the next four years and unless we take action the Budget will be in deficit for at least a decade.

And we have inherited from Labor gross debt that will reach $460 billion within the next four years. Unless we take very substantial budget reform, it will rise to $667 billion over the next decade.

This document also forecasts economic growth to remain below trend of 3% for the next two years as the unemployment rate continues to rise to 6¼%.

That is the truth about the starting point from which we begin our mountain climb.

MYEFO fiscal outlook

The forward estimates

Back in the August Pre-election economic statement the then Government again forecast a return to surplus in 2016-17 — the last year of the forward estimates.

Based on new more realistic assumptions and, our determination to bring hidden budget problems out in to the open, the cumulative underlying cash balance has deteriorated by $68 billion in just four months.

Since the May Budget, the largest deterioration is for the current financial year.

Instead of an original Budget forecast by Wayne Swan of an $18 billion deficit this year and then Chris Bowen's forecast of a $30 billion deficit this year, the new more accurate forecast is a $47 billion deficit this year.

The medium term

The deterioration in the Budget is not just a short-term problem. In fact I am more concerned about the medium and long term challenges.

The previous government projected a sustained return to surplus from 2016-17 onwards. But this was underpinned by a false assumption that they would limit real spending growth to no more than 2% per year. [1]

In reality, real spending over the life of the previous government grew almost twice as fast at around 3.5 % per year.

---

[1] Build growing surpluses by holding real growth in spending to 2 per cent a year, on average, until the budget surplus is at least 1 per cent of GDP, and while the economy is growing at or above trend.

Without any substantial action by our government this massive growth in spending will actually increase to an average of 3.7 % per year beyond the forward estimates.

As a result, even if we have no personal income tax cuts for the next ten years to compensate for bracket creep, we still won't reach surplus by 2024.

The implications of this are clear — the current budget outlook is not sustainable.

Doing nothing is not an option for Australia.

If we want a dynamic, modern economy that delivers ongoing rises in living standards, the heavy lifting of deficit reduction will have to come from spending restraint rather than from a raft of new taxes.

One thing is for sure, no country has ever taxed its way to prosperity.

Much of the projected growth in spending is from social programs — including welfare, education and health.

Spending reform will inevitably require difficult choices about the policies that Australians need now and in the years to come.

I want to emphasise that budget prudence is as much about resisting new spending as it is about the quality of existing Government spending.

In a softening economy there are many businesses under pressure.

There are also many individual taxpayers under financial pressure.

Our challenge is to lift the tide so that all boats will rise.

Taxpayers can no longer afford old government spending priorities.

Australians will now have to adjust their expectations of what government can sustainably provide otherwise our nation's prosperity and our people's quality of life will be at risk.

Reasons for fiscal deterioration since PEFO

There are a number of factors which have driven the recent fiscal deterioration.

Softer economic outlook

The first factor is a softer outlook for the Australian economy after taking into account the latest national accounts data.

The automatic impact of the weaker forecast has been a lowering of government tax receipts and an increase in government outlays.

While global economic conditions remain more subdued than expected, it is the case that the Australian economy's growth transition from resources investment to the non-resource sector is also proving slower than expected.

There is cause for optimism.

The Australian economy is well-placed to emerge from its growth transition with a stronger non-resources economy. And, barring unforeseen circumstances, global growth is expected to pick up while domestic interest rates remain low.

The recent strengthening in consumer and business confidence, and a recent pick up in the housing market, give me confidence that, with the right policies, the economy has plenty of scope to strengthen.

Nonetheless, it is clear that the growth transition will not be easy.

Our economy's adjustment to the large movements in the terms of trade has been, and will continue to be, challenging.

The softer outlook for the Australian economy is reflected in the growth forecasts — real GDP growth for next year is down a half of a percentage point to 2½ %.

In the resources sector, activity is shifting from investment to exports — which are continuing to rise — but the decline in mining investment looks to be sharper than expected. Ongoing cost-cutting in some parts of the resources sector is feeding into lower investment intentions.

From 2014 until 2016 the fall in mining investment could detract up to 2% from economic growth. It is therefore crucial that we do everything we can to facilitate new mining investments such as the Roy Hill iron ore project in the Pilbara and gas projects across the country.

Moreover, it is essential that we get rid of the carbon and mining taxes which are impediments to new mining investment.

It is also the case that we need to speed up mining approvals so that we don't have delays that may cause investors to have second thoughts about projects, as in BHP's change of heart on Olympic Dam.

In our first 100 days my colleague the Minister for the Environment, Greg Hunt has approved over $180 billion of investment projects. This is a good start.

Even more importantly, the Prime Minister just last Friday made significant headway in establishing a national one stop shop for project approvals to expedite the tortuous regulatory processes associated with major project investment in Australia.

Whilst investment in the non-resources sector is declining this year, the recent fall in the Australian dollar and generational low interest rates should ease some of the pressures being faced by firms outside of the resources sector.

It is frustrating, but hopefully temporary, that the slower transition to the non-resources sector is flowing through to softer job creation and wages growth. Both are weaker this year than previously expected, and both are well below-trend.

The silver lining is that slow wages growth is one of the mechanisms through which job creation will be supported as the economy transitions.

The combination of softer growth for real GDP and wages has dragged down the forecast for the nominal economy, which is now expected to grow by 3½% this year and next.

This is weaker than previously forecast- down by ¼% this year and by a full 1% next year.

This has translated into a significant write-down in tax receipts and higher outlays for government programs.

As a result, the softening economy has contributed to more than half of the deterioration in the Budget.

Revisions to forecast methodologies

The deterioration in the fiscal position since the election also reflects revisions to projections for key economic variables in the latter years of the forward estimates.

The terms of trade are now expected to fall more sharply over the next few years as the global supply of the commodities that Australia exports — particularly iron ore and coal — ramps up.

This change reduces nominal GDP growth in the projection period and contributes $2 billion to the deterioration in the budget bottom line.

We have also adopted more realistic assumptions for the unemployment rate.

As was revealed in the August Economic Statement, the unemployment rate is forecast to rise to 6¼% by June 2015.

To better align the projected unemployment rate with the assumption for economic growth, the unemployment rate is now assumed to remain at 6 ¼% in the last two years of the Budget period.

In recent economic updates a reversion to the trend rate of 5% has been assumed. This fed through to a misleading improvement in the budget bottom line through lower unemployment benefit payments.

It was a key factor upon which the previous Government was able to claim they would deliver a surplus at the end of the Budget forward estimates.

As a result the number of unemployment benefit recipients is expected to be higher and to contribute to the deterioration in the budget bottom line by $3.7 billion over the forward estimates.

These changes underscore the Government's commitment to more realistic long term assumptions on the economic and fiscal outlook.

Essential government action

In addition to the parameter changes, the deterioration in the budget position reflects prudent decisions the Coalition has taken to address unresolved issues inherited from the former government.

While these entail additional spending or forgone tax receipts, they will provide greater certainty for investors, businesses and households.

All our decisions are driven by a desire to strengthen the Australian economy.

The single largest measure is the grant of $8.8 billion to the Reserve Bank of Australia to strengthen its financial position. This has already been well explained and the immediate benefits of having a fully resourced Reserve Bank are obvious.

The former government also left us with a raft of 92 announced but unlegislated changes to taxation and superannuation dating back to 2001.

Many of these measures were included in the budget bottom line every year even though they had not been formally legislated.

We have reviewed the measures and have decided we will not proceed with 55 measures costing $2.2 billion including many that were just poor policy such as the $1.8 billion hit to the car industry with FBT changes.

We will proceed with 37 measures as announced or amended, raising $10.2 billion over the forward estimates.

The great irony is that the Labor Party announced most of these tax increases and took them to the election as policy; now the Labor Party is blocking their own tax policies in the Senate.

This prevents the government from improving the Budget bottom line that we have inherited from our predecessors!

In addition to the tax measures, we have also reversed the cuts to school education announced by Labor just before the election

This $1.2 billion in additional education funds for Western Australia, Queensland and the Northern Territory is fully funded by new off-setting savings including the abolition of the Building Stronger Communities Fund ($528m) and the later rounds of the Trade Training Centres Program ($987m).

In addition to these measures the former Government also failed to properly fund its offshore detention network.

The Coalition has had to allocate an additional $1.2 billion to build and run the centres to house illegal maritime arrivals in Papua New Guinea and Nauru.

Further expenditure includes provision for the unfunded redundancies associated with the reduction of the Australian Public Service by 14,473 staff.

This was a decision taken but never announced by the previous government and of course it was never properly funded.

All of these measures, and others, are realistic and necessary to clean up the mess.

They provide a starting point for our plans to build a stronger budget and a stronger Australia.

Election commitments and initial savings

This mid-year report incorporates the full impact of our election commitments with one exception. We have not included the cost savings arising from our election policy to reduce the public service headcount by 12,000 over two years through natural attrition.

Given that the previous Government cut over 14,000 public service jobs without any announcement, our proposal will be reviewed in light of the findings of the National Commission of Audit.

The results will be incorporated into the next Budget.

All of our policies taken together, with potential savings from streamlining the Australian Public Service, will have a positive impact on the budget position.

There are some election commitments which are not separately identified while the detailed policy work is still being completed. They have nevertheless, been provided for in the Contingency Reserve and relevant heads of revenue.

These will be detailed in the May Budget.

We are, of course, angry that our attempts to repair the Budget and reduce the debt are already being opposed by the Labor Party.

For example, we have introduced legislation to repeal the former Government’s mining tax and to repeal or revise the spending measures that were to be paid for from the proceeds of that tax.

Overall, this will generate net savings of $13.4 billion over the forward estimates.

The failure of the Labor Party to support our election policy will cost an additional $728 million to the Budget this year as a new round of School Kids Bonuses goes out the door in January.

Together with other measures, the Labor Party is now blocking $15 billion of our savings that we took to the last election and for which we have a clear mandate.

Perhaps more bizarrely, they are blocking a further $5 billion of their own savings that they promised the Australian people at the last election.

These include $1.1 billion of Research and Development Tax Changes, $2.7 billion of Higher Education Savings, $1.5 billion from the cancellation of the 2015 Tax Cuts linked to the carbon tax, and $106 million from savings on the Child Care Rebate.

So far Labor is blocking in the Senate $20 billion of savings that will reduce the deficit and reduce the debt.

Equally importantly, policies that are designed to improve economic growth — such as repealing the carbon tax and re-establishing the Australian Building and Construction Commission — are facing strident opposition from the Labor Party.

The national interest requires a sustainable long-term budget position. The Coalition has a clear mandate to reduce the deficit and debt and the Parliament must respect that mandate.

Policy decisions since the election

Since the election the Coalition has methodically gone through every commitment of the previous Government.

In line with our determination to deliver the infrastructure of the future, so that Australia's productive capacity can be at its best, the MYEFO includes almost $1 billion in funding over six years for a range of infrastructure projects previously funded from the former Government's Regional Infrastructure Fund.

These productivity-enhancing projects will be funded without the failed minerals resources rent tax and will be co-funded by the States and Territories.

The Government has identified new savings measures that help pay for these commitments.

For example, a net saving of $1.1 billion over the forward estimates will be achieved from not proceeding with various uncommitted discretionary grants or spending commitments announced by the former Government. These are grants that a government in deficit cannot afford.

These savings are a down-payment on more substantial savings the Government will make in the May Budget.

The Answer

At this point I want to draw a line in the sand on the numbers that we have inherited.

As I said earlier, $123 billion of accumulated deficits and the $460 billion of gross debt are significant challenges.

But of even more concern is the trend towards a decade of deficits and gross debt of $667 billion.

Returning the Budget to sustainable surpluses will not be achieved by piecemeal savings here and there.

It will require a sustained and fundamental structural overhaul of expenditure.

Of course, our fiscal and economic objectives must be complementary.

Below trend growth and rising unemployment simply make it harder, not easier, to repair the Budget.

Our economic and fiscal plan is the answer.

Over the next six months we will continue to roll out our agenda, focused on building a stronger economy.

All options are on the table.

Some tools will be outside of our direct control. For example, as the Governor of the Reserve Bank has noted, a lower Australian dollar would help.

Other tools are more responsive to government and community control.

Productivity growth will become increasingly important in determining Australia's national income and living standards.

Without a significant improvement in our productivity growth, the declining terms of trade and the ageing of our population mean that we are facing the slowest decade of national income growth since the National Accounts were first introduced in the 1950s.

That is not acceptable to the Coalition.

The Government took a comprehensive plan for raising Australia's productivity growth to the election.

That plan is built around better infrastructure, deregulation, better competition policy, reforming the tax system, a fairer balance in the Fair Work laws, and improving the efficiency of government.

It is designed to grow the economy and help all Australians to get ahead.

Since coming to office, we've wasted no time in starting this comprehensive reform agenda.

From trade deals to tax repeals we are getting on with the job of governing for tomorrow.

But we need all Australians to be part of the journey.

The Budget

Over the next few months Australians will be asked to accept the decisions that help to make our quality of life sustainable.

The MYEFO document we are releasing today will now feed into our Budget preparation.

I want to assure Australia that the Government has begun work on preparing the next Budget.

We are doing the meticulous planning and preparation, and we understand the need for first class execution and perseverance.

Ministers are scrupulously reviewing their portfolios and getting on with the task of implementing the plans we took to the election.

The Expenditure Review Committee is already meeting and forensically examining every proposal to ensure it will achieve its aims.

We have put in place a Commission of Audit tasked with designing a program that helps government live within its means.

We have already started this process of change by abolishing over 20 government agencies, where activities are no longer needed or can be managed within existing departmental resources.

But there is scope for much more.

When it comes to both the Budget and the economy, doing nothing is not an option.

The purpose of the May Budget will be to put in place the program to grow the economy, deal with the deficit and debt, and put in place a sustainable fiscal strategy for the long haul.

Conclusion

The Coalition has known, throughout its last few years in Opposition, that the task ahead upon assuming office would be substantial.

It gives me no pleasure to know we were right.

And it certainly gives me no pleasure to know that the magnitude of the task has grown in the last few months as we have come to realise the true state of the books.

From a $29 billion blowout in the cost of the original NBN to an underfunded ACCC that has run at a loss for 3 years.

From 92 announced but unlegislated tax changes to an inadequately funded off shore detention network, every area of government has had its surprises.

Whether it is the Reserve Bank Reserve Fund or unfunded University superannuation, we will not leave budget issues for another day.

This document gives us an accurate picture of where we are now and what lies ahead.

Knowing the truth means we can get on with shaping our destiny. I want to say directly to the Australian people that, while the challenge is great and the mountain is tall, the new Coalition Government has the plan and the determination to get Australia moving again.

[ENDS]