June Insights

with Cameron Bagrie

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SMARTER BETTER BUSINESS

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ARTICLE OVERVIEW

The government is trying to sort out its house with the Budget setting the tone on frugal spending and fiscal restraint but with a dose of populism (tax relief). Many businesses, farmers, and households are grappling with similar challenges, whether it's addressing failings or trying for more optimisation. However, the Budget lacked a miraculous solution to address the woeful productivity performance. Better policy settings will help, but frugality is the norm for the coming years. Do more with less and we'll get out of this mess.

The 2024 Budget was the appetiser in a sequence of main courses that could prove difficult for society to stomach.

Turning deficits into surpluses and containing debt requires tough choices. Households, farmers, and businesses can face the same challenges. Cutting costs, or getting more from less, can be difficult.

The Budget projected it will take until 2027/2028 to return to surplus. If a business projected that run of deficits, the CEO and board would be gone. Governments have the luxury of time, and spending restraint is difficult.

The government deficit in the Budget is projected to be $13.4 billion in 2024/25, more than double the deficit ($6.1 billion) projected in the Half Year Economic and Fiscal Update (HYEFU). The main culprit behind the larger deficit is the economy, with $4.6 billion less tax revenue. Finance costs (higher interest rates) add $1.4 billion. The contribution from state-owned enterprises and Crown entities is down by $0.9 million.

Getting the books back into the black is going to require frugal Budgets. The 2024 Budget included some frugality but a dose of populism (tax relief).

The real test will be the 2025, 2026 and 2027 Budgets, where the operating allowance for new spending has been set at $2.4 billion. The 2024 Budget was a $3.2 billion package on average each year. The previous Finance Minister was running $4-6 billion packages.

According to the Treasury:

- "it is estimated that departments' baseline expenses could need to increase by around $2.5 billion in the 2025/26 year to maintain the existing level of services. This analysis does not take into consideration additional demand pressures on services e.g., demographic changes, spending on new policies, or the crystallisation of specific fiscal risks or contingent liabilities."
- "The high-level analysis indicates that the future budget allowances are unlikely to be sufficient to cover future cost pressures on existing services."
- "This means any shortfall and spending on new initiatives will need to be offset by expenditure savings, reprioritisation or revenue raising policy changes for each of the next three Budgets for the Government to manage within the signalled budget allowances. This will involve difficult choices and trade-offs for the Government which are likely to become harder over time."

The words of Bachman Turner Overdrive are ringing in my mind with regard to spending restraint: “You ain’t seen nothin’ yet.”

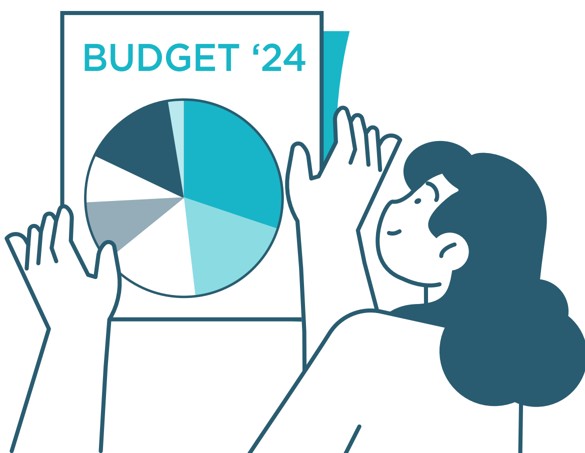
The first round of spending containment or looking for savings is always the easiest. However, with government spending rising from $87 billion in 2018 to a projected $138 billion (or from 28.0% of gross domestic product (GDP) to 33.5% of GDP), there will be room for more. The danger is that savings or spending reprioritisation could impact service levels. Spending is still projected to rise from $138 billion to $156 billion (13%) over the next four years.

The government claims they are helping the Reserve Bank and paving the path to lower interest rates by exhibiting spending restraint. The fiscal stance (a measure of whether the government is adding to or subtracting from growth) is negative in aggregate over the next four years. However, it is less negative than projected in the HYEFU, and tax relief turns the fiscal stance stimulatory in the upcoming fiscal year. The Reserve Bank was relying on the HYEFU forecasts; the Budget delivered less of a contraction, which will add more to growth and inflation. If tax relief lifts spending and inflation, higher interest rates could be needed.

Any business knows the importance of the sales line. The equivalent for the Minister of Finance is the economy and tax revenue. Getting on top of inflation and allowing interest rates to come down is one problem. The bigger one is productivity. It defines how fast the economy can grow consistently year after year. According to The Treasury:

- “Productivity for the whole economy averaged 1.4% per annum between 1993 and 2013 but averaged only 0.2% per annum over the past 10 years.”
- “The Budget Update 2024 forecasts still assume an improvement in productivity growth over the next few years towards our long-run productivity growth assumption of 1% per annum.”

There was no game changer in the Budget directed at productivity. Improving education will take time. Infrastructure spending is projected to decline in the coming four years, which is at odds with the government’s infrastructure rhetoric.



Ultimately, any improvement in productivity is going to have to be business driven with a backdrop of better government policy. Tough times require tough people to make tough decisions. Cost cutting, drives for efficiency, and finding new ways of doing things including embracing digitisation will be key themes over 2024 and 2025. The 2024 Budget was just a representation of what we are seeing across many parts of the economy. Get your house in order. Embrace change. The business sector will do it faster and better.