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Speech to the Australian Chamber of Commerce and Industry

Fiscal Strategy Update

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CHECK AGAINST DELIVERY

Introduction

I would like to thank ACCI for the opportunity today to outline the Morrison Government's revised fiscal strategy and the reasons why we must recalibrate our approach if we are to successfully grow our economy and secure a strong recovery from this unprecedented crisis.

The 2020-21 Budget, which will be delivered in 12 days' time, will deal with a recession like no other in living memory.

It will lay out the next phase of the Government's economic recovery plan for Australia and in doing so respond to the greatest economic shock this country has experienced in more than 100 years.

COVID-19 has given rise to a global health and economic shock that dwarfs previous crises.

Our actions to date have served to cushion the blow from the immediate impacts of this shock and position the economy to begin its long road to recovery.

We have been able to respond quickly and decisively because we had the fiscal firepower to do so.

After years of hard work repairing the nation's finances, the Budget was back in balance and spending was under control.

As the RBA Governor said of the Australian economy last month:

> *"We've got strong fundamentals, a strong public debt position, a strong national balance sheet."*

Our economic response to the pandemic was guided by clear principles that we outlined in March.

We said that our response would be temporary, targeted, use existing delivery mechanisms where possible, and be proportionate to the shock and its impact on the economy. And it was.

These principles will continue to guide our actions as we move into the next phase of our economic recovery plan.

The 2020-21 Budget will lay out our detailed plans for getting Australians back to work and businesses back to business in a COVID-safe way.

Given the depth of the economic shock we face, this will require continued support to enable the economy to recover and rebuild for the future.

The Budget will set out our plans to ensure Australia emerges from this global economic and health crisis ahead of the pack by boosting our longer-term economic potential.

This will only be possible if we continue to keep the virus under control while living in a COVID-safe economy.

Our revised fiscal strategy will guide our transition from emergency support, to a jobs-led recovery which will grow the economy and strengthen the budget.

It will also outline the path to reducing debt as a share of the economy so that we can confidently respond to any future shock that may emerge.

Australia's strong economic and fiscal position allowed us to respond quickly and decisively to the COVID-19 pandemic

Australia entered the COVID-19 pandemic from a position of economic and fiscal strength.

Despite the drought, the 2019-20 MYEFO forecast that Australia's real GDP would grow by 2¼ per cent in 2019-20 and 2¾ per cent in 2020-21.

The unemployment rate was 5.1 per cent in February, down from 5.7 per cent when we took office, with participation rates at historically high levels.

The Budget had returned to balance in 2018-19 for the first time in 11 years.

We were on track to deliver budget surpluses in each year of the Forward Estimates, building to projected surpluses of over 1.5 per cent of GDP by the end of the medium term.

It is these strong fundamentals underpinning our longer term outlook that allowed us to respond quickly and decisively to the economic shock caused by the COVID-19 pandemic.

The Morrison Government could act confidently, knowing we had the fiscal firepower to do so.

And we did need to act. We had no choice.

Australia's economy shrank by an unprecedented 7 per cent in the June quarter and employment fell by 6.7 per cent in just three months.

Prior to this, the largest ever quarterly fall in GDP was 2 per cent in the June quarter 1974.

By comparison, in the 1980s, Australia's GDP declined by 3.7 per cent from peak to trough and employment fell by 3.6 per cent.

In the 1990s, GDP fell by just 1.4 per cent from peak to trough and employment fell by 4.4 per cent.

Around 1.3 million people or just over 10 per cent of the labour force lost employment or were stood down on zero hours in April.

However, through getting the virus under control and as a result of the economic support we have put in place, around 60 per cent or 760,000 people have now regained employment or hours.

While the unemployment rate in August was 6.8 per cent, it is expected to rise over coming months due to the lockdown in Victoria and as people re-enter the labour force to look for work.

This unprecedented shock has pushed Australia into a COVID-19 recession — our first in 28 years.

This outcome was unavoidable and would have been far worse in the absence of our strong fiscal response.

The Morrison Government's economic support has cushioned the blow, helping households and businesses and creating a bridge to the economic recovery.

To date, we have announced $314 billion in support or around 15.8 per cent of GDP.

That's in contrast to an estimated $55 billion or around 2.8 per cent of GDP in support from our States and Territories.

We put in place JobKeeper — an economy-wide wage subsidy and the largest fiscal and labour market program in Australia's history.

We doubled the safety net for unemployed Australians.

We provided a cash flow boost to business to provide working capital.

We helped to pause small business bank loan repayments and provide rental relief for tenants.

These are just some of the measures put in place to support the economy.

Our support has been timely, targeted and proportionate. We did what was necessary and we did it quickly by using existing channels wherever possible.

To date we have seen $106 billion in direct fiscal support go out the door in just 5 months. Never before has this level of support flowed into the economy in such a short space of time.

This support has been financed through Government borrowing.

AOFM is issuing bonds at a rate of around $4 billion to $5 billion per week and has issued $267 billion since the onset of the crisis. Strong demand for our debt reflects our strong credit rating.

We also allowed the 'automatic stabilisers' in the Budget to operate freely, helping to cushion the impact of the economic shock.

We allowed tax receipts to fall in line with falling activity and we allowed spending on welfare payments and income support to rise, as more people needed a safety net.

And we went further. Our temporary and targeted measures, such as JobKeeper and the Coronavirus Supplement, were designed to move in line with economic need.

This amplified the effects of the automatic stabilisers, providing more assistance, when and where it was needed most.

In this crisis, we had to rely more heavily on fiscal policy, because conventional monetary policy had little room to move.

The Reserve Bank was only able to cut interest rates by 0.50 per cent.

By comparison, the Bank cut interest rates by 4.25 per cent during the GFC, the equivalent of a $100 billion fiscal boost over a twelve month period.

By acting quickly and decisively, we have avoided much steeper falls in activity, even higher unemployment and many more business failures.

We avoided the much sharper contractions of countries like the UK, France and NZ, which have seen quarterly falls in GDP of around 20 per cent, 14 per cent, and 12 per cent respectively.

In our July Economic and Fiscal Update, Treasury estimated that our policy support to date would increase the level of real GDP by around 4¼ per cent in 2020-21.

And that our policy support would reduce the peak in the unemployment rate by around 5 percentage points, saving around 700,000 jobs.

As the RBA Deputy Governor emphasised on Tuesday, our economic support constituted an 'entirely appropriate and timely policy response' that will leave households 'better placed to support the recovery as it unfolds'.

He also noted that our response has helped to moderate the decline in business investment, with the effect of the instant asset write-off evident in a pick-up in business spending on computer equipment and vehicles towards the end of the June quarter.

By limiting economic damage in the near-term, the Government's economic support will reduce the potential for longer-term economic scarring, giving us the best chance of recovering stronger and faster.

The medium-term effects of COVID-19 have made it necessary to recalibrate the Government's Fiscal Strategy

Despite our success in cushioning the blow from COVID-19, we know that this crisis will have long-lasting effects on Australia's economy and on our fiscal position.

Our economy will be persistently smaller as a result of the pandemic than forecast in the 2019-20 MYEFO, both in real and nominal terms.

In the near-term, real GDP is forecast to grow strongly, but this growth will come off a lower base.

By the end of 2020-21, Australia's real economy is expected to be around 6 per cent smaller than forecast in the 2019-20 MYEFO.

And the recession places pressure on all three elements of potential growth in the economy — population, participation and productivity.

Australia's future *population* will be smaller, and older, than we previously assumed because of the sharp drop we are seeing in net overseas migration.

Australia's population growth is expected to slow to its lowest rate in over a hundred years.

As published in the July update, net overseas migration is expected to fall substantially, from around 154,000 in 2019-20, to around 31,000 in 2020-21.

The Budget is expected to reveal a substantial decline in Net Overseas Migration compared with the figures in the July Update, with net migration *outflows* now likely in both 2020-21 and 2021-22.

While migration will eventually return to the levels we are accustomed to, lost migrants will not be replaced.

And given our migrant workers tend, on average, to be younger, this will lower labour force participation and average hours worked across the economy into the future.

As with past recessions, here and around the world, the unemployment rate will also take time to return to pre-crisis levels, despite our unprecedented response.

This economic scarring, together with lower levels of business investment, is likely to dampen participation and productivity — the other two key elements of potential growth.

The other key change in our economy, will be a persistently lower level of prices and wages.

With high levels of spare capacity in the economy, it will be some time before inflation returns to the mid-point of the Reserve Bank's target range.

And wages growth is also likely to remain subdued for at least the next few years, until the jobs market tightens.

These changes to the underlying economy, which stem directly from the COVID recession, will weaken our medium-term budget position, even as our targeted policy support is phased out.

We very carefully designed our policy support so that measures would not weaken our budget in a structural sense. We wanted our support to flow now, when it's needed most and not to become a structural drag on the budget.

As a result, around 98 per cent of our policy measures as of the July Update as well as the JobKeeper extension will be spent over just two years.

Nevertheless, a smaller economy, with lower price and wage growth, will generate less income for the Government over the medium-term.

Income taxes will grow more slowly, reflecting a smaller wages bill.

Corporate taxes will also grow more slowly, reflecting lower profits and economic activity.

And consistent with previous downturns, corporate tax receipts will recover more slowly than the broader economy.

This is because businesses are able to deduct losses that occur during downturns against profits in future years, lowering the tax they would otherwise pay.

In the July Economic and Fiscal Update, we estimated that total receipts as a share of GDP would decline from 25.1 per cent to 24 per cent in 2020-21.

The Budget will show this ratio remaining below pre-COVID levels across the medium-term.

While tax receipts tend to move in line with nominal GDP, this is not generally the case for government payments.

A large share of government spending operates more like a 'fixed cost' for a business, making it less responsive to changes in the economy.

In the near-term, payments will spike as a result of our large-scale and temporary economic support.

But over the medium-term, the *level* of payments, in dollars, is likely to remain broadly comparable to our estimates at MYEFO, once our temporary fiscal support has finished.

However, this level of payments will represent a larger share of a smaller economy.

In the July Update, we estimated that payments as a share of GDP would rise from 24.8 per cent to almost 34 per cent in 2020-21 reflecting the extraordinary levels of support being provided.

But by the end of the medium-term period, payments are still expected to be materially higher than pre-COVID levels as a share of GDP.

So, as you can see, the changes to our economy that flow from this COVID recession will have a lasting impact on our budget position, even as our targeted policy support is unwound.

Lower tax receipts and higher spending as a share of the economy will impact our fiscal position for many years to come. Even as the economy recovers.

This is the nature of this unprecedented COVID-19 recession.

The Government will adopt a new two stage fiscal strategy that emphasises jobs and growth. This is key to stabilising and then reducing our debt-to-GDP ratio

Of course, as our economic circumstances have changed, our fiscal strategy must also change.

Our previous fiscal strategy has served us well.

It helped us to contain spending growth and return the Budget to balance — without increasing taxes or cutting essential services.

It was designed to guide a steady and sustained fiscal consolidation with increasing surpluses, against the backdrop of a steadily growing economy and low unemployment.

Our previous fiscal strategy that brought our Budget back to balance was based on three key components.

The first is our commitment to investing in a stronger economy to boost productivity and workplace participation.

The second is our commitment to strong fiscal discipline and containing the size of government — which comes from controlling growth in spending and maintaining the tax-to-GDP ratio below 23.9 per cent.

The third is our commitment to achieving budget surpluses on average over the course of the economic cycle; building to surpluses of at least 1 per cent of GDP when economic circumstances permit; and reducing debt to build resilience and fiscal flexibility.

Under the previous strategy our plan was to deliver budget surpluses of sufficient size to significantly reduce gross debt and eliminate net debt by the end of the medium term.

Unfortunately, in the face of this shock, this is no longer the prudent or appropriate course of action.

It would now be damaging to the economy and unrealistic to target surpluses over the forward estimates — given what this would require us to do in terms of significant increases in taxes and large cuts to essential services.

This would risk undermining the economic recovery we need to bring hundreds of thousands more Australians back to work and to underpin a stronger medium-term fiscal position.

It is getting Australians back to work and having profitable businesses hiring and investing that offers the greatest leverage in repairing the budget.

So in the Budget in less than two weeks' time, we will be recalibrating our fiscal strategy to match the circumstances we now find ourselves in.

The revised fiscal strategy blends important elements of our former strategy with new features that reflect the current economic reality. It is designed to operate in two distinct phases.

The first phase of our revised fiscal strategy is focused sharply on boosting business and consumer confidence and promoting jobs and growth throughout the economy.

Our first priority must be to secure a strong and sustained economic recovery and drive the unemployment rate down as fast as possible.

The first phase of our new fiscal strategy does this in three key ways.

First, we will continue to allow the automatic stabilisers to work freely to support the economy.

Second, we will continue to provide temporary, proportionate and targeted fiscal support, including through tax measures, to leverage private sector jobs and investment.

Third, we will continue to push ahead with structural reforms that position the economy for the jobs of the future and which improve the ease of doing business.

The first phase of our Strategy will remain in place until unemployment is on a clear path back to pre-crisis levels.

We will review progress on the economic recovery in each Budget update, but I expect Phase 1 to remain in place until the unemployment rate is comfortably back under 6 per cent.

Once we are confident that the recovery has taken hold, we will move to Phase 2 of our revised fiscal strategy which is focused on restoring our fiscal position.

This will also consist of three elements.

First, we will maintain our central focus on jobs and growth, combined with structural reforms that increase our economy's potential.

Second, there will be a deliberate shift from providing temporary and targeted support for the economy to stabilising gross and net debt as a share of the economy.

Our 23.9 per cent cap on the tax to GDP ratio will be retained.

Third, we will start the hard work of rebuilding our fiscal buffers, so that we can be prepared for the next economic shock.

We have a big mountain to climb. But this is an achievable goal. And it does not require us to increase taxes or reduce spending on essential services.

Such actions will slow the speed of our recovery.

With historically low interest rates, it is not necessary to run budget surpluses to stabilise and reduce debt as a share of GDP — provided the economy is growing steadily.

And even though debt will be at much higher levels than we are accustomed to, it remains sustainable and will be put back on a steady path of reduction.

Our peak debt to GDP ratio will still be significantly lower than most comparable countries. And low interest rates make our debt servicing task easier.

Our revised fiscal strategy is consistent with our core values. These have not changed.

It will maintain our emphasis on fiscal discipline, lower taxes, containing the size of government and investing in a strong economy.

But as we should, we will place greater weight on supporting the economic recovery in the near term and on economic reforms that lift potential growth in the medium term.

Only through repairing the economy can we repair the Budget.

That is why the Government's plan for a stronger Australian economy sits at the heart of the revised fiscal strategy.

By supporting economic growth now and over the medium-term our Economic Recovery Plan will underpin stronger public finances over time.

The Plan will support aggregate demand and more jobs in the near term, while also starting to deliver the flexible and dynamic economy that we need to unlock Australia's longer term growth potential.

This is how we will rebuild our economy and secure our future.

Let me be clear. The road to a stronger economy and building back our fiscal buffers is not through endless Government subsidies.

That is not a plan that will set up Australia for sustainable economic growth in the future. That is a plan for economic subsistence.

Similarly, higher taxes are a road to less investment, fewer jobs and a weaker economy. Higher taxes will slow the recovery and make our economy less competitive.

As was demonstrated at the last election, Australians understand that higher taxes mean they keep less of what they earn, so that the Government can spend more.

We want to drive down the cost burden on businesses that employ Australians, so we are locking in affordable, reliable and secure energy and cutting red and green tape.

We are investing in the next generation of energy technologies that will deliver lower emissions, lower costs and more jobs.

More and cheaper gas will also underpin a stronger economy, making energy affordable for families and businesses and supporting jobs as part of Australia's recovery.

We have already brought forward $10 billion in transport infrastructure spending to create more jobs and boost aggregate demand.

We will continue to invest in our workforce, particularly our young jobseekers, by improving our skills, training and education systems.

We also want to reform our industrial relations system to make it more flexible.

This will ensure that new and growing businesses can access the skills they need to thrive, creating more opportunities for Australian workers.

This is also why we will embark on the most significant reforms to insolvency law in almost thirty years.

By adopting key aspects of the US Chapter 11 bankruptcy process, we will introduce a single, simpler, faster, more cost-effective insolvency process for small business.

It will see our system move from a rigid, one-size-fits-all "creditor in possession" model to a more flexible "debtor in possession" model.

This will enable small business owners to remain in control, provide them with an opportunity to restructure and ultimately increase their chances of surviving this COVID crisis.

That is why our Economic Recovery Plan is focused on measures that boost the supply side potential of our economy, making it more flexible, more dynamic and more competitive.

We are breaking down barriers that will allow businesses to take advantage of the digital economy and encouraging research and development across the economy, including in our advanced manufacturing sector.

A stronger economy and budget translates into a stronger ability to guarantee essential services and deliver on our commitment to lower taxes as a share of the economy.

Growing our economy faster will enable us to repair the budget and pay down debt over time. And that is what our Plan is designed to do.

COVID-19 will change the way our economy operates.

We can see that COVID-19 is already changing global trade patterns and supply chains.

It is increasing the uptake of digital technology and online distribution.

More Australians are adopting flexible work arrangements.

While many firms will re-open and jobs return, tragically, the effect of a recession is that some will not. At the same time, our Economic Recovery Plan will support new jobs and industries to emerge.

We must set ourselves up for success by creating a more flexible and dynamic economy. This is how we secure future growth and prosperity.

Conclusion

The Government's track record on the economy and fiscal discipline is clear.

A strong fiscal position is what enabled us to respond decisively and effectively to this crisis.

Despite the success of our response, the long-term effects of the pandemic mean that our previous Fiscal Strategy needed to be updated to respond to the current environment.

Our revised fiscal strategy is built around supporting the economy in the near term, to make sure Australians are back in work and businesses are back to business as soon as possible.

It maintains our core values as a government, with an enduring focus on fiscal discipline, lower taxes and containing the size of government.

And it lays the foundations for a stronger, more dynamic and more competitive economy.

Because that is how we will repair the Budget — not through higher taxes and not through austerity.

A stronger economy and a stronger budget position, with gross debt and net debt stabilising before heading on a steadily declining trajectory.

This will allow us to rebuild the fiscal buffers that allowed us to respond so decisively during the COVID-19 pandemic.

And that is what we owe to future generations.

Ends.