CapitalAnalyst

Australia Edition - direct from Canberra

Looking at its stripes, the 2021 budget is a strong stimulus cocktail with maybe more than one black swan, will Treasurer Josh Frydenberg stay composed, corona free … or for that matter will Australia?

The Treasurer delivers the recovery budget

THE ECONOMY

Australia is on the road to recovery according to Josh Frydenberg's budget speech. There are now more jobs in the economy than existed pre-pandemic. The budget is designed to underpin the recovery. It has one key performance indicator: unemployment. Treasury predicts that this will fall to 4.75% in two years before settling at 4.5% in 2024.

However even that rate of unemployment will not be enough to lift wage growth to the long-term average of 3%. Treasury predicts that wages will not grow by more than 2.5% over the forward estimates, despite expenditure of more than $550 billion and debt reaching close to $1 trillion.

There are still uncertainties about the economic future. There is no date for the reopening of international borders and there is no new expenditure for quarantine facilities. Treasury also predicts that Australia will be fully vaccinated by the end of this year, which is something of a leap of faith. There are also fragilities in the international economy with Europe falling back into recession and the prospect of the Indian third wave of Covid spreading to other countries.

For these reasons the Treasury has taken a conservative approach to some of its estimates. It assumes that real GDP growth will rise to 4.25% next year before falling back to 2.5% in the out years. This is much lower than the growth rates projected by the Reserve Bank. Treasury has also maintained its long-term iron ore price of $55. If, as seems likely, these assumptions are wrong then the debt and deficit situation will be significantly better than forecast in the budget papers where deficits are predicted to stretch all the way out to 2031.

The projected deficit is $161 billion for 2021-22 but, rather than tackling this in the next four years, the government's focus is instead on payments and long-term serviceable debt.

While the budget is likely to meet its ambition of reducing unemployment, there is some doubt about how transformational it will prove to be. There are some structural reforms in the budget, but they are mainly in the area of social expenditure including nearly $18 billion over four years for aged care. The way these funds will be applied means the expenditure will continue after the end of the forward estimates. The same applies to the increased expenditure on childcare and early childhood education.

These spends will create many more jobs, particularly for women, but they will not facilitate structural change in the economy. This will have to be driven by private sector investment. The government has developed a mix of short and long-term policies to encourage investment in new industries.

There is slightly more than $500 million to extend 'jobtrainer' for two years to increase the supply of skilled labour and an additional $2 billion for manufacturing research and development. There is also a policy for a tax concession patent box so that innovators can make greater returns from commercialising inventions. There are also funds for the development of green energy products.

These policies indicate that the government is looking to shift the economy in the direction of a technology intensive low carbon economy that has bigger manufacturing and knowledge sectors. If it wins another term in government, the social and economic transformation could be profound.

Labor’s pitch for government

THE ECONOMY

Anthony Albanese’s budget reply speech adopted the same formula as last year. It began as trip down memory lane as he recounted his upbringing in a housing commission house in Camperdown as the child of a single mother, segued into an attack on the incompetence of a government that has run up $1 trillion of debt with nothing to show for it and culminated with a single big announcement.

Last year it was universal free childcare. This year it was a $10 billion Housing Australia Future Fund, which will build 20,000 social houses a year, 4,000 of which will go to women fleeing domestic violence.

The opposition leader linked the housing policy back to his own childhood.

"Our home gave us so much more than somewhere to sleep," he said in his speech to parliament.

"It gave my mum and I pride and dignity and security, and it gave me a future, a future that led me here tonight”.

Labor's plan also includes a promise to build 10,000 affordable homes for frontline workers such as nurses, police, and cleaners who, Mr Albanese said, were the "heroes of the pandemic".

Apart from the signature housing policy, Mr Albanese signalled Labor’s support for the green economy as a source of new jobs. Mr Albanese said a Labor government would provide cash payments to 10,000 apprentices working in "new energy" areas such as rooftop solar, energy efficiency upgrades and green hydrogen.

Apprentices would receive $2,000 when they start, followed by $2,000 a year for up to four years as they train — a total of up to $10,000.

The apprenticeships would be offered over four years from 2022-23 at a total cost of $100 million.

"The rest of the world has figured this out: cutting pollution means creating jobs," he said.

In a sop to the unions the opposition leader promised to criminalise wage theft. This was dropped from the industrial relations reforms when Labor refused to pass changes to the industrial relations framework that the employers wanted.

This was not a big vision pitch for government. Labor is obviously leaving that for the election campaign. At the moment shadow treasurer, Jim Chalmers, is having fun talking about the 21 slush funds that the government has in the 2021 budget. These can obviously be repurposed to fund Labor initiatives without doing violence to the deficit.

On the day Mr Albanese was pushed off top billing in the news by the deal done by the government with Moderna to get another vaccine for the under fifties, later this year.

Not much in the budget for energy and climate change

THE ECONOMY - ENERGY AND CLIMATE CHANGE

Green activists and the oil and gas industry were both disappointed with the budget. There was not a hint of support for a green new deal to drive growth and jobs in the economy nor was there $600 million for a new gas fired power station in the Hunter Valley.

For the government it is pretty much business as usual. And why not? After all Australia is growing faster than any other developed economy. On the other hand, Labor is going full on with the green new deal, based on the precept that long term sustainable growth will be based on the green economy.

Labor is in concert with Joe Biden who has committed $2 trillion to promoting a green economy. This is dwarfed by China, which has a $20 trillion stimulus package, not much of which is devoted to low carbon emission technology.

The Morrison government's 2021-22 budget revealed on Tuesday confirmed $1 billion on measures to lower emissions and $58.6 million to support an expansion of the gas industry. In addition, the fossil fuel producers have been hit with a temporary levy which will apply to offshore petroleum production to recover costs of decommissioning the Laminaria-Corallina oil fields which are situated in waters off the coast of Darwin.

Green activists and the Guardian Australia are claiming that the government is prioritising a gas-led recovery, but the budget numbers do not seem to bear this out. They are particularly exercised by a payment of $30 million to a company, owned by Twiggy Forrest, which intends to build a gas fired power station. The Guardian asked why a billionaire was receiving government hand-outs? On the other hand, the same green activists are calling for government support for renewables, a large chunk of which is owned by Mike Cannon-Brookes, another billionaire.

In his speech the Treasurer, Josh Frydenberg, pointed to the fact that the Commonwealth was funding Snowy 2.0 and the ‘Battery of the Nation’, which were buttressing the very rapid introduction of renewables into the Australian grid. This is a significant contribution to green energy.

Another point of contention is electric vehicles. It is difficult to see how subsidising these would make a contribution to the Australian economy as they would predominantly be imported from China and Japan and require virtually no maintenance other than the change of batteries.

There are murmurings that Australia could become a long-term supplier of batteries because of our supplies of lithium but there is no sign of large-scale Australian investment in battery factories.

Angus Taylor will produce his technology roadmap before the end of this year. It is likely that this will generate more funding for green technologies in next year’s budget, depending on how the economy goes.

The budget backs agriculture 2030 plan

THE ECONOMY - FOOD AND AGRICULTURE

Commentators seem to be obsessed with the idea that the budget is a Labor light budget. This reveals the paucity of knowledge of political philosophy among journalists. The difference between social democrat governments and conservative governments is that the former believe in high levels of intervention in the economy (picking winners), while the latter believe that intervention should be general with the market allocating where resources go.

In this budget the government has preferred general measures to support things like business investment. These predominantly take the form of tax concessions. The government has provided over $20 billion worth of taxation concessions to businesses with turnovers under $5 billion. All of these apply to farmers and reports are that they have been taking liberal advantage of these measures since the last budget to buy new equipment and motor vehicles. It is expected that they will do so with the measures in this budget.

However, the absence of large appropriations specifically for farmers has led to a claim that they have been dudded in this budget which includes an $850 million subvention for the Agriculture 2030 program. The focus of the funding is bio-security, soil improvement, and assistance with freight costs. There is also additional funding for skills training which will assist with labour supply. Farming has become more technology intensive in recent years. There is a need for people with skills like drone pilots, data processing and special systems.

There is also additional spending on disaster relief and water management that will provide benefits for farmers. However, the biggest challenges for farmers come on the trade front. Fiona Simson, president of the National Farmers Federation, said farmers had called on government to invest in the development of a long-term trade strategy that consolidated and diversified agriculture's export market base.

"Tonight, we've seen $213 million for trade including the enhanced representation and promotion of Australia's interests through the WTO and the establishment of a new international agriculture envoy program to protect agriculture's export interests."Ms Simson said climate change was both an enormous challenge and opportunity for farmers."Farmers are poised to continue to lead the nation in its reduced emissions future. The $237.9 million to help farmers better understand and manage their soils across a number of portfolio and priority areas acknowledges the importance of gaining a better understanding of soil carbon measurement and planning."

There is a fear within the farming community that Australian exports are likely to be hit with carbon tariffs in Europe and the UK. The idea that Australia should accept such tariffs is being advanced by EU trade negotiators but this should be resisted by Australian negotiators. Under international trade law importers can only impose a carbon tax if the same tax is imposed on their domestic producers. This will never happen because European and British farmers will never accept such a tax. Under EU law acceptance of such a tax would have to be unanimous and Poland would veto it.

Australian farmers will sell a lot of wine, barley and beef to Britain without the need for trade envoys.

Budget bonus for farmers in special measures on soils

THE ECONOMY - FOOD AND AGRICULTURE

Squirrelled away in the budget portfolio papers for the Department of Agriculture in Tuesday night's budget was an amount of $196.9 million in new funding over four years to implement the National Soil Strategy and associated measures as part of an Australian Government Action Plan.

The National Soil Strategy sets out how Australia will value, manage and improve its soil for the next 20 years. The strategy highlights three overarching goals: first, prioritising soil health, second, empowering soil innovation and stewards and third, strengthening soil knowledge and capability. Actions to address these goals will ensure that soil continues to contribute to agricultural productivity, environmental sustainability, and economic growth.

At the moment the first step for farmers wanting to be paid for improving their soil is to get an audit of the soil quality. This can be an expensive process and the prospect of the Commonwealth picking up the bill must be attractive to farmers who want to participate in carbon bio-sequestration programs.

In order to introduce farmers to the soils strategy the government has decided to introduce a two-year National Soil Monitoring and Incentives Pilot Program that will be trialled to improve our understanding of Australia's soil condition and how to better manage it, assess the impact of land management practices on soil, assist farmers to improve their productivity and profitability, and better support farmers to participate in the Emissions Reduction Fund.

This pilot program includes five key elements:

• A review of existing soil data to establish the quality, quantity and distribution of information across Australia, identify gaps in soil knowledge, and inform the roll-out of the pilot.

• Payments to farmers and land managers to capture existing soil data to inform the program.

• Incentives to encourage more farmers and land managers to undertake comprehensive soil testing in exchange for sharing their data with the program.

• Re-developing the Australian Soil Resource Information System (ASRIS) to improve its ability to store soil data, track and report trends and changes in soil health, and monitor the impact of land management practices and environmental shocks over time.

• Directing existing funding from the National Landcare Program's Smart Farms Small Grants initiative to soil extension activities that encourage farmers to test their soil and help them interpret and act on results.

Apart from this the government intends to establish education modules so farmers can be accredited in soil science, to establish a national soil science challenge, and to augment the food waste to soil fund.

Overall, the government intends to spend $212 million on soil improvement over four years, with an allocation of $65 million this financial year and $91 million next year. While this may seem like small beer in light of the budget parameters, it is only a pilot program and farmers should be able to press for more if it proves successful.

At the moment there is a lot of superficial discussion by so-called climate experts on how to achieve zero emissions by 2050. Most of them seem to think it can be achieved through renewables and electric vehicles. However, serious analysis by bodies such as the International Panel on Climate Change believe it will be impossible to reach the target without the adoption of measures such as bio-sequestration. This means that soil carbonisation will become very valuable as we approach mid-century.

National 'no surprises' security

DEFENCE AND FOREIGN POLICY - THE ECONOMY

You couldn't be blamed for thinking that national security would make big headlines in the 2021 budget. It had a new minister with a strong political agenda. Although new minister Peter Dutton and the hawks in Canberra are making noises about the dogs of war barking in the Taiwan straits, apart from an extra $1 billion for ASIO, it was pretty much business as usual for the war portfolio.

The plan for defence had been established in 2016 with the Turnbull government's white paper and had been reaffirmed in the 2020 defence strategic update. This sets out the plan for the defence program out to 2030. The critical issue is, given the current sabre rattling, what defence capability will Australia actually have between now and 2030. The budget papers have very little to say on this.

There was a cursory reference to defence in the Treasurer's speech which talked about the upgrading of the Darwin defence base to accommodate more diggers and an increase in the contingent of US marines, but this was not put in a strategic context.

Peter Dutton has adopted the policy of saying nothing about defence strategy or the quantum of expenditure in the press release that accompanies the budget, but the line expenditure item is contained in the defence portfolio statement that accompanies the budget papers. In the 2021 budget $44.6 billion will be spent on defence. Since we no longer have troops serving overseas, we can assume that a larger proportion of this will be spent on procuring assets. Of the amount appropriated, $43.6 billion will be spent on the defence portfolio with the rest being spent on the Australian Signals Directorate which appears to be under funded given its role in cyber warfare.

Nevertheless, the funding is identical to the estimates in the defence strategic update, which is surprising because we have been led to believe by knowledgeable commentators that the attack class submarines and the future frigate programs were the subject of substantial cost overruns.

Marcus Hellyer writing in 'The Strategist' on Wednesday, provides an explanation:

“Despite the lack of surprises, there are a few significant things to see here. One is that Defence’s acquisition program is continuing to move a lot of money. I’ve noted several times that much of the growth in the budget is focused on that program. If we take a step back to the 2020–21 budget, the government was planning a huge $3 billion (27%) increase in Defence’s acquisition budget, from $11.2 billion to $14.3 billion. Considering Defence had only achieved roughly 5% increases in preceding years, that was very ambitious, particularly in the middle of Covid-19 pandemic that was interfering with global supply chains. Was it overly ambitious?

“In the mid-year budget update, it looked like Defence was going to get very close. Alas, it was not to be. On paper, Defence has come up $1.6 billion short. But a big part of that can be accounted for by significant foreign exchange adjustments that reduced the acquisition budget (as the Aussie dollar strengthens, Defence doesn’t need as much cash to acquire equipment from overseas). Regardless, Defence still exceeded its 2019–20 achievement by more than $1.4 billion. That’s 12.9% growth, not a bad achievement for a pandemic year.”

So, contrary to the prognostications of various commentators, things are going as well as could be expected in the defence portfolio. Moreover, it shows that Australian industry has the capacity to respond rapidly in situations of increasing strategic tension. This will give the government and our allies considerable comfort.