

SOME MACROECONOMIC IMPLICATIONS OF THE FUTURE FUND



THE UNIVERSITY OF
MELBOURNE



MELBOURNE INSTITUTE
of Applied Economic and Social Research

Simple Context: Policy Scenarios

- In previous years, P_p , a part of the labour cost of public servants, super, was borrowed against the future. Unfunded liability of \$90 billion, or 10% of GDP.
- Business as usual (BAU) scenario was to repay the loan way into the future, P_f .
- Future Fund (FF) scenario seeks to collect funds now, P_n , for meeting the unfunded liability in P_f .
- Task: Compare macro effects of the scenarios.

Scenarios

	Business as usual (BAU)	Future fund (FF)
Previous period, P_p	Super debt	Super debt
Next period, P_n	BAU	Extra saving
Future period, P_f	Extra saving and repay super debt	Repay super debt

Macroeconomic Context

- Currently, government expenditure represents about 30% of GDP
- With population ageing, and current programs, expenditure is projected to increase to 36% of GDP by 2040
- Fiscal policy has a medium term structural policy focus
- Relative to the BAU scenario, the FF scenario seeks to bring forward, from P_f to P_n , the funding of public servant super liabilities

Options for funding the Future Fund

- Compared with the BAU scenario, for the FF scenario, the government budget over the next decade or so, period P_n , is changed by a combination of one or more of:
 - A smaller budget surplus or deficit, D
 - A reduction in expenditure, G , or
 - An increase in taxation, T .
- And the opposite in the future period, P_f .

Macroeconomic Effects of FF

- Short term fiscal policy effects
- Longer term supply side effects on factor supply and productivity

Pn funding option for Future Fund: Smaller Surplus or Larger Deficit, with G and T Unchanged

- A simple swap on the liabilities side of the government balance sheet. Less unfunded superannuation matched by larger general budget debt
- Or, can there be some money illusion effects, such that “debt aint debt”?

Pn Funding Option for Future Fund: Higher Tax Rate and Same G and D

- Higher tax wedge in Pn, but lower in Pf, for FF scenario versus BAU scenario
- If less than perfect Ricardian equivalence:
 - In Pn, less labour and capital supplied and lower GDP
 - In Pf, more labour and capital supplied and higher GDP
- To the extent FF provides some tax smoothing, in aggregate a smaller deadweight loss from tax distortions

Pn Funding Option for Future Fund: Lower Expenditure G, and Same T and D

- Potential current period loss if
 - Complementary social investment deferred lowers productivity of private investment
 - Supply of public goods deferred
- If reduction of government provided private goods largely offset by increased private expenditure, and less private saving. No aggregate effects
- Reduce wasteful G, a net gain

Some Other Possible Effects of the Lower G or Higher T Funding Options

- Bringing forward funding of super liabilities reduces risks and budget vulnerability
- Tighter budget makes it more difficult to achieve necessary reforms to expenditure and tax policies
- Future Fund will change composition of national saving and investment

Some Conclusions

- Future Fund brings forward the time at which past debt for public servants is funded
- A smaller surplus funding option changes composition of government balance sheet, but not much else
- A higher tax funding option shifts economic growth, and tax smoothing reduces tax distortion costs
- The effects of a lower expenditure funding option depends on expenditure affected