



## **OVERVIEW OF THE 2005/6 FEDERAL BUDGET**

### **“A Budget of Conviction that Delivers on Key National Objectives”**

**(Heather Ridout, Chief Executive, Ai Group)**

*“This Budget I announce tonight is framed for the future – the future opportunities of our young people, the future care of our aged, the future health services that our citizens will need and demand, the security of the nation, and the future growth of the Australian economy which is necessary if we are going to realize these goals.*

*This Budget is about sharing the benefits of this strong economic management not just with more Australians, but with all Australians: -*

- *To increase their participation in the workforce;*
- *To build their skills;*
- *To reward their efforts;*
- *To enhance their security; and*
- *To fund their future.*

The Hon Peter Costello, Federal Treasurer

### **Key summary**

The Federal Treasurer, the Hon Peter Costello, delivered his tenth Federal Budget tonight (Tuesday 10 May 2005). The centerpiece of the Budget is substantial tax cuts to business and individuals “to drive growth in the economy”, along with the abolition of the superannuation surcharge.

For business, the 3 per cent tariff on business inputs where there are no domestic substitutes under the tariff concession scheme has been abolished, effective from 11 May 2005, at a cost of \$1.3 billion over five years. Removing the 3 per cent tariff under the TCS will reduce business costs and improve the international competitiveness of Australian business. Ai Group has been the prime mover in lobbying the Federal Government over a number of years to have this impost removed.

For individuals, the Government has announced tax cuts worth \$21.7 billion over four years. These cuts are in addition to the tax cuts provided in the 2004/5 Budget, worth \$14.7 billion over four years (from 2004/5). Again, these cuts will boost disposable incomes and improve incentives in the workforce. This will ensure that more than 80 per cent of taxpayers will have a top marginal tax rate of no more than 30 per cent.

As well, the Government has decided to abolish the superannuation surcharge from 1 July 2005, at a cost of \$2,515 million over three years from 2006/7. The Government had previously announced its intention to reduce the surcharge to 10 per cent in 2005/6 and 7.5 per cent in 2006/7. The announced measure is a substantial improvement on the previous announcement and will boost savings and provides an incentive for additional voluntary contribution.

Two other areas are key to this year's budget – the changes to welfare arrangements and the implementation of (election) commitments on skills and training.

From the 1 July 2006, those on Parenting Payments will be expected to look for at least part-time work when their youngest child turns six and is ready for school. This change will be supported by increases in out-of-school hours child care places, at a cost of \$266.4 million over four years. Increases will be provided for Out of School Hours Care (84,300 places), Family Day Care (2,500 places), In-Home Care (1,00 places) and Jobs, Education and Training fee assistance.

Also from 1 July 2006, any new recipient of the Disabilities Pension if they are capable of working more than 15 hours a week will no longer be entitled to the pension. To assist people to look for work, rehabilitation services will be increased by 41,700.

In the area of skills and training, the Budget announces extra 4,500 pre-vocational training places for traditional trades (at a cost of \$20 million over four years), and an additional 7,000 School Based New Apprenticeships so that more students can begin their apprenticeship while continuing their school studies (at a cost of \$25.9 million over four years). As well, \$65.4 million is being provided in 2005/6 to establish the first of 24 Australian Technical Colleges to provide high quality education for students who want to pursue a career in trades.

Further details on these and other initiatives are outlined later in the document.

## **Fiscal Balance**

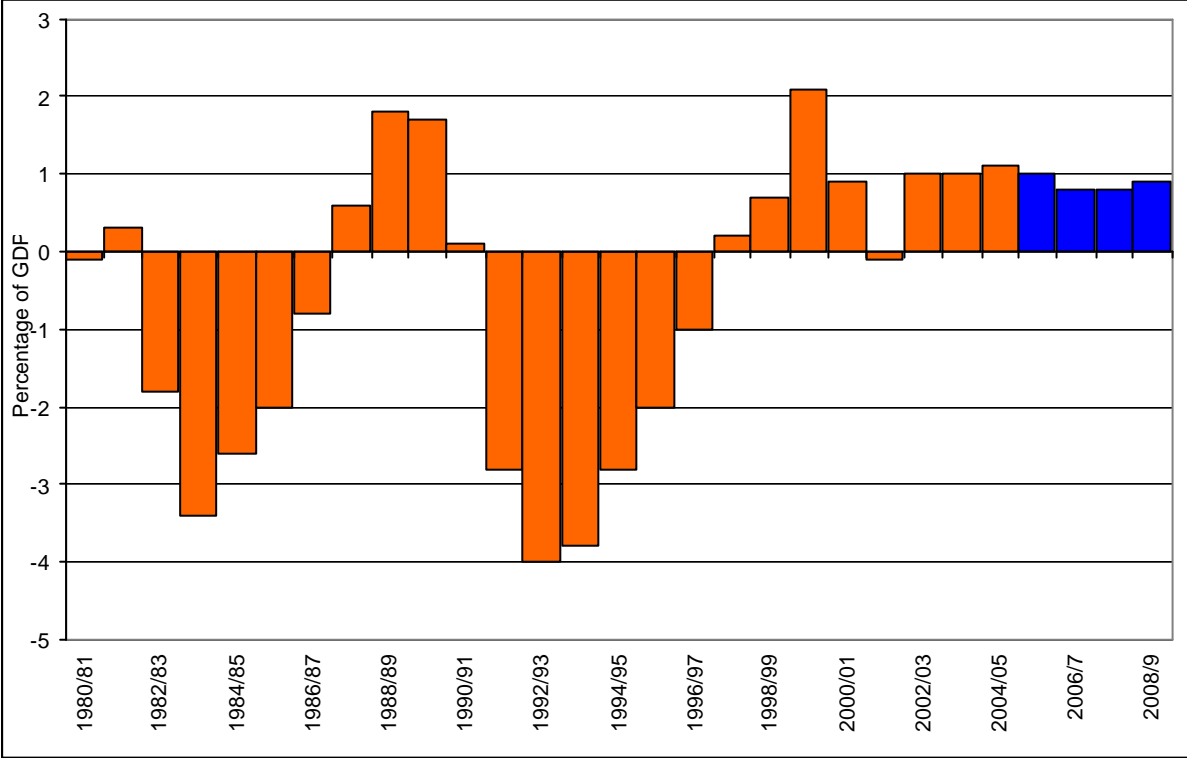
The Government has budgeted for an underlying cash surplus of \$8.9 billion, almost \$4.4 billion higher than forecasted in the Mid Year Economic and Fiscal Outlook (released in December last year). This is in contrast to last year's surplus of \$9.2 billion.

In accrual terms, the 2005/6 fiscal balance is a surplus of \$7.4 billion, higher by \$400 million than the fiscal balance in 2004/5.

The underlying cash balance is projected to be \$9.3 billion in 2008/9.

Total revenue is expected to rise by 5.8% (from \$202.7 billion to \$214.5 billion), while total expenditure is set to rise from \$195 billion to \$206.1 billion). The vast bulk of the \$12 billion increase in revenue is expected to come from income taxation (from individuals, companies and superannuation). Company tax collections are expected to contribute around \$7.5 billion in additional revenue and are expected to yield over \$48 billion in 2005/6.

**Chart 1 Underlying cash balance**



**Ai Group Assessment**

Ai Group endorsed the Government’s strategy in delivering a Budget that reduces business costs; improves incentives; encourages saving and further supports the vital area of skills formation within a framework of continuing fiscal responsibility.

This approach will underwrite current and future growth while keeping inflationary pressures at bay.

The Budget is strong on conviction and sets out an action agenda consistent with our current and emerging national objectives.

Ai Group, having long sought its removal, applauds the end of 3 percent tariff on business inputs under the Tariff Concession Scheme. This tax on manufacturing impeded competitiveness and its removal from tonight will be widely welcomed by Australian industry.

The Budget makes substantial progress in reforming personal income taxation. These reforms, also advocated by Ai Group, will add much-needed incentive to workforce participation, saving and business investment.

The abolition of the Superannuation Surcharge will add directly to Australia's savings and was part of Ai Group's submissions to Government.

The Government has made further important investments in vocational education and training through the funding of new pre-vocational places, additional School-Based New Apprenticeships and the establishment of the Australian Network of Industry Career Advisers. The measures to reduce the tax burden on temporary residents will improve business access to skilled personnel.

The Budget also makes important progress on intergenerational challenges with cautious changes to welfare arrangements backed by improved childcare and training support.

The creation of the Future Fund is to be applauded. It represents a prudent and sensible policy response to the emerging budgetary pressures.

## **Key Economic Parameters**

The Treasurer expects **gross domestic product** (GDP) to recover to 3.5% in 2005/6, compared with a disappointing 2.0% for 2004/5. The growth in **household consumption**, is expected to ease further from 4.0% in the current year to 3.25% in 2005/6.

**Inflation** is expected to rise slightly from 2.5% in 2004/5 to 2.75% in 2005/6, well within the Reserve Bank of Australia's target range of 2-3%. The drift upwards in the CPI is expected to match a rise in **unit wage costs** of 4.0% in 2005/6 (compared with 3.74% in 2004/5).

**Employment** growth is expected to fall to 1.75% (down from 2.75% in 2004/5. The **unemployment rate** is forecast to continue to improve with a fall from 5.25% to 5.0% in 2005/6.

Australia's **export** performance is anticipated to improve significantly, from 2% growth in goods and services exports in the current year to 7% growth in 2005/6. **Imported goods and services**, are anticipated to grow by 8% in 2005/6 compared with a 10% growth figure in 2004/5. The **current account deficit** is expected to improve from \$56.25 billion to \$48 billion over the next financial year. This represents an improvement in the current account deficit from 6.5% to 5.25% of GDP.

**Private investment** growth is expected to be lower than in 2004/5. Investment in **dwellings** is expected to fall by 2% in 2005/6 coming on top of a similar fall in 2004/5. Investment in new **machinery and equipment** is expected to rise by 7% in the year ahead (compared with a 11% rise in 2004/5). The rate of growth in new investment in **non-dwelling construction** is expected to be stable at about 2% in the coming year.

In terms of the world environment, the **United States** growth forecasts have fallen back from the strong level of 4.4% in 2004 to 3.5% in 2005 a rate anticipated to continue for 2006. The **Japanese economy** is expected to slow from 2.6% in 2004 to 1.25% in 2005. **Chinese** growth is anticipated to abate slightly from a rate of 9.5% to 8.25% in 2005. Growth among other **East Asia** countries is expected to drop from 6.1% to 4.75% over the course of 2005. In the **Euro area** GDP growth is expected to fall somewhat from 1.8% in 2004 to 1.5% in 2005.

## **Review of Main Initiatives Affecting Business**

### **Tariff Concession Scheme**

The Government will abolish the 3 per cent tariff on business inputs with no domestic substitutes under the Tariff Concession Scheme from midnight tonight, at a cost of \$1.3 billion over five years. Goods entering the country for home consumption on or after 11 May will attract the free rate of duty.

Up to now, relief from this nuisance tariff was provided as free trade agreements where negotiated, including United States, Thailand and Singapore.

Removing the tariff will reduce business costs and help to improve competitiveness for Australian business where imported inputs are a significant cost to production.

## Tax Changes

The Government announced significant income tax changes in the 2005/6 Budget. These come on top of measures announced last year that were due to take effect from 1 July 2005. The measures that were due to take effect from 1 July this year were a rise in the threshold at which the 42% tax rate took effect from \$58,000 to \$63,000 and the increase in the top threshold from \$70,000 to \$80,000.

The additional changes to take effect from 1 July this year are a drop in the rate of tax applying between \$6,000 and \$21,600 from 17% to 15% and a further increase in the threshold at which the top rate of 47% begins to apply to \$95,000.

From 1 July 2006 the top two thresholds in the income tax scale will rise further – to \$70,000 and \$125,000 respectively.

These changes are summarised below (with changes highlighted in bold):

### *Personal Income Tax Scales*

Current thresholds (\$)	Tax rate (%)	Thresholds from 1 July 2005	Tax rate (%)	Thresholds from 1 July 2006	Tax rate (%)
0 to 6,000	0	0 to 6,000	0	0 to 6,000	0
6001 to 21,600	17	6001 to 21,600	<b>15</b>	6001 to 21,600	<b>15</b>
26,001 to 58,000	30	26,001 to <b>63,000</b>	30	26,001 to <b>70,000</b>	30
58,001 to 70,000	42	<b>63,001 to 95,000</b>	42	<b>70,001 to 125,000</b>	42
70,001+	47	<b>95,001+</b>	47	<b>125,001+</b>	47

## Superannuation Surcharge

In a surprise move the Government has decided to remove the Superannuation Surcharge entirely from superannuation contributions accruing after 1 July 2005. The surcharge rate of contributions tax is collected in arrears after superannuation funds receive notice of taxpayers' taxable incomes. The measure is therefore not expected to impact on revenue collections in 2005/6.

## Vocational Education & Training

A broad range of initiatives will be introduced to bolster the development of the pool of Australia's skills. Initiatives focus upon the development of important trade skills, as well as additional places for vitally important pre-vocational training places and establishment of a vibrant, industry focused network of careers advisors. Initiatives for included:

- \$65.4m to establish the first round of Australian Technical Colleges
- \$120m extend eligibility to entitlement of Youth Allowance for New Apprentices
- \$27.5m for the Australian Network of Industry Careers Advisors
- \$15.3m for Scholarship for New Apprentices
- \$12.6m for 5,000 places in New Apprenticeship Access Program
- \$28.7m for a toolkit for each New Apprenticeship (in a specific trade)
- \$4.3m for establishment of Institute of Trade Skills Excellence.

These measures provide a welcome boost to the vocational and education & training sector in times of challenging skill shortages.

### **Skilled Migration**

The Government has increased intake of 20,000 skilled migrants per annum to help alleviate the current skill shortages. Additional support for skilled migrants is provided by Department of Family & Community Services (\$12.6m); Department of Health & Aging (\$2.8m); Department of Education, Science & Training (\$15.3m).

### **Assisting the Reform of State and Territory Taxes**

The Government has made provision for further assistance to the States and territories to assist them in removing the business transaction taxes whose removal was to be financed by the GST. The Commonwealth Government 's offer of assistance is conditional on the States and territories accepting the Commonwealth's timetable for the removal of these taxes.

### **Temporary Residents**

The Government has improved the taxation of temporary residents by easing the impost of capital gains taxation and by providing a four-year exemption for temporary residents from tax on most foreign source income. Some changes were also made to the treatment of shares received under employee share ownership schemes

### **Deduction for "Blackhole" Expenditure**

The Government has moved to provide deductions for certain expenditures – such as pre-business expenditure - that were not previously allowed as a deduction. This is a welcome measure and accepts on of the recommendations of the Ralph Review of Business Taxation.

## **Export Market Assistance**

The major area of disappointment for business is the failure to address the shortcomings in the Export Market Development Scheme. Ai Group has lobbied extensively to have the effectiveness of this scheme restored and although some modifications were announced last year no further changes were announced in this Budget.

The Government did announce the appointment of 30 export facilitators to pursue export opportunities arising from the Australia-US Free Trade Agreement to assist small and medium sized exporters take advantage of export opportunities in the US.

## **Infrastructure Spending**

In addition to the funding previously announced under AusLink on major rail and road expenditures, the Government has committed an additional \$90 million over two years (from 2006/7) for the Road Safety Black Spot Program. This was an election commitment made by the Government.

## **Venture Capital Review**

Funding has been provided in the Budget for a review of the venture capital industry. This review was foreshadowed in the 2004 election and is designed to assess the impact of recent reforms, including to Australia's venture capital tax laws, and the contribution of the industry to the national economy.

David Miles, Brian Watson and Gary Potts have been appointed to undertake the review.

## **Small Business**

The Government has provided a 25% entrepreneurs' tax discount worth \$3750. As well, \$330 million in tax breaks for small business switching to accrual accounting.