



OVERVIEW OF THE 2007/08 FEDERAL BUDGET

“Smart budget that hits the right targets”
Heather Ridout, Chief Executive, Ai Group

“This year’s Budget has been framed to lock in ... progress.

If we lock in the achievements of the past this will help us with the challenges of the future. We want to meet and deal with future challenges from a position of strength. This is a Budget which will build our economic capacity and give us that strength.

This Budget – with its investment in education, skills, in road and rail, and sharper work incentives will add to that capacity. This investment will drive further economic growth”.

The Hon Peter Costello, Federal Treasurer

Key Summary

The Federal Treasurer, Peter Costello, delivered his twelfth Federal Budget tonight (Tuesday 8 May 2007). The **centrepiece** of the Budget is a Higher Education Endowment Fund, an initial investment of \$5 billion, supported by a \$3.5 billion education plan, *Realising Our Potential*, to improve the education system in schools, the VET sector and in universities, along with the infrastructure initiatives.

In regard to **infrastructure**, the Budget boosts investment on road and rail infrastructure by \$22.3 billion over the five years from 2009/10.

For **individuals**, the Budget provides tax cuts worth \$31.5 billion over the next four years. This is on top of the \$36.7 billion in tax cuts announced last year. As well, the Budget provides for a 10% increase (on top of indexation) in the Child Care Benefit, along with a 30% Child Care Tax Rebate to be now made as a direct payment.

For **business**, the Budget restates the recently announced \$1.4 billion support for industry over ten years, along with a range of lower compliance measures to reduce taxes on business by \$975 million over four years.

In regard to **superannuation**, on top of the significant reforms to superannuation announced last year, this Budget will double the co-contribution scheme (so that \$3 will be paid for every \$1 low to middle income earners contributed from their own

money, up to a maximum government contribution of \$3,000) in respect of the 2005/6 year only.

In response to **climate change**, to encourage households to install solar panels, the current rebate will be doubled (up to \$8,000), a rebate of over 50%. Grants of up to \$12,000 for solar panels will also be available to schools and community buildings. The cost of establishing carbon sink forests will be tax deductible for five years commencing from 1 July 2007, and \$197 million will be provided to assist developing countries to maintain their tropical forests (Global Initiative on Forest and Climate program).

Finally, for **defence**, an additional \$2.1 billion will be provided over ten years to improve recruitment and retention; to enhance the Defence home ownership scheme; and to expand cadetships and apprenticeships. As well, funding (\$6.6 billion over 13 years) is provided for the purchase of 24F/A-18F Super Hornets.

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

Fiscal Balance

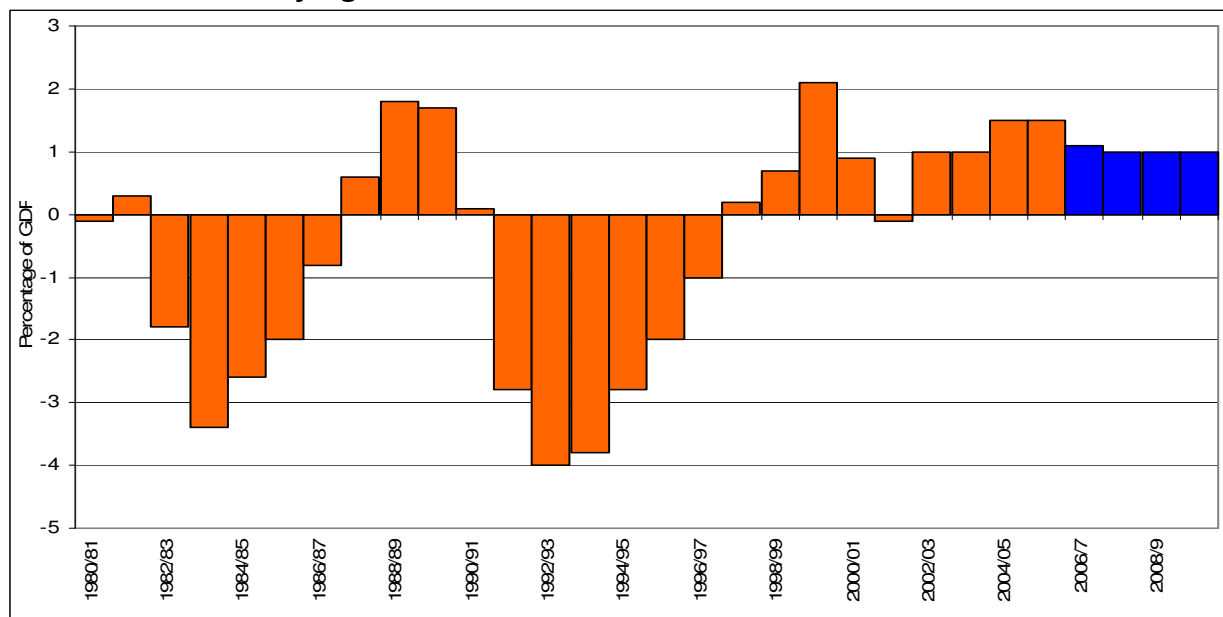
Yet again the budget estimate of revenue continues to be revised upwards.

For the current financial year (2006/7), the Mid Year Economic and Fiscal Outlook (MYEFO) estimated revenue of \$231.9 billion, but just four months later, today's Budget has revised this up to \$235.5 billion, \$3.6 billion higher. Consequently, the underlying cash surplus has been revised up from 1.1% of GDP to 1.2%.

For 2007/8, the Government has budgeted for an underlying cash surplus of \$10.6 billion, \$0.9 billion higher than forecasted in the MYEFO.

Total revenue is expected to rise by 4.8% (from \$235.5 billion to \$246.8 billion), while total expenditure is set to rise by 6.3% (from \$221.6 billion to \$235.6 billion). The majority of the \$11.3 billion increase in revenue in 2007/8 is expected to come from company tax, which accounts for \$6.3 billion of the increase. This is in contrast to individuals who contribute an extra \$2.2 billion in income tax. The third largest contribution to the increased revenue take in 2007/8 is from superannuation taxation, which adds \$0.8 billion.

Chart 1 Underlying cash balance



Ai Group Assessment

The Federal Government has set out to prove the adage that good policy can be good politics by delivering a smart budget that hits the right targets.

It includes a range of targeted measures that address current priorities and introduces important initiatives with the future firmly in mind. The innovative and comprehensive *Realising our Potential* package will contribute to social and nation-building objectives. Together with the infrastructure initiatives, these measures will contribute over time to lifting the speed limit of the economy by enhancing Australia's productive capacity.

The carefully-targeted nature of the measures and the overall exercise of fiscal discipline will ensure that concerns of inflationary and interest rate pressures can be put to one side.

The budget aligns the politically resonant with key economic objectives powered by the enormous fiscal surplus that has enabled broad-based spending together with tax relief.

The alignment of policy and politics is evident in:

- Tax cuts that will stimulate workforce participation and saving by lowering effective marginal tax rates.
- Investments in improving education and training including the more attractive incentives for apprentices, new Australian Technical Colleges, greater emphasis on competency-based progressions in the training of apprentices and the innovative changes to higher education, the well-targeted school-based initiatives will improve the education and training systems add to productivity over time.

- An improved Child Care Rebate and increased Child Care Benefits which will also stimulate workforce participation.
- Additional, capacity-expanding investment in transport infrastructure through far-reaching spending on road and rail networks
- Increased rebates for household expenditure on solar panels to assist in addressing climate change
- Defence initiatives including the emphasis on recruitment and retention.

A number of the budget measures, notably the investments in education and training, the income tax cuts, the greater investment in infrastructure, the industry policy measures and the benefit paid through the superannuation co-contribution scheme pick up on proposals put forward in Ai Group submissions.

The industry policy measures detailed in the budget, and which were contained in last week's Industry Statement, will be well received by industry. The relaxation of eligibility for the 175% component of the Research and Development Tax Concession; the new Productivity Centres around the country to evaluate business needs and opportunities; and the Global Opportunities program are all sensible and valuable initiatives.

The increase in the skilled migration intake will help alleviate skill shortages which remain a chronic drag on business competitiveness. The initiatives in higher education, VET and schools will assist in improving the performance of our education system over the medium to longer terms.

The Government will clearly be planning further announcements in the lead up to the election and business will be looking for more action in a number of areas such as export support; corporate tax reform; innovation and incentives for businesses to adopt energy and water efficiency measures.

Key Economic Parameters

The Treasurer expects **gross domestic product** (GDP) to lift from a year average of 2.5% in 2006/7 to 3.75% in 2007/8. The growth of **household consumption** is expected to remain at a healthy 3.5% in 2007/8.

Inflation is expected to moderate slightly from 2.75% in 2006/7 to 2.5% in 2007/8 around the midpoint of the Reserve Bank of Australia's target range of 2-3%. **Unit wage costs** are expected to continue to grow at around 4.25% in the 2007/8 year.

Employment growth is expected to ease to 1.5% (down from 2.5% in 2006/7). The **unemployment rate** is forecast to rise slightly to 5% in 2007/8 with the participation rate continuing its recent improvement.

Australia's **export** performance is anticipated to improve somewhat, from 3% growth in goods and services exports in the current year to 5% growth in 2007/8. It should however be noted that the Budget has overestimated the growth in exports for

several years now. **Imported goods and services** are anticipated to grow by 6.5% in 2007/8 compared with an 8.5% growth figure in 2006/7.

The **current account deficit** is expected to deteriorate from \$58.25 billion to \$65.75 billion over the next financial year. This represents a rise in the current account deficit from 5.75% to 6% of GDP.

Private investment growth is expected to be higher than in 2006/7. Investment in **dwellings** is expected to grow at 2.5% in 2007/8 maintaining the modest pace evident in 2006/7. Investment in new **machinery and equipment** is expected to rise by 6.5% in the year ahead (compared with a fall of 1.5% in 2006/7). The rate of growth in new investment in **non-dwelling construction** is expected to ease from 12% to 7% over the coming financial year.

In terms of the world environment, the **United States** growth forecast is expected to be 2.25% in 2007 down from 3.3 in 2006. Growth in the **Japanese economy** is expected to ease to 2% from a rate of 2.2 in 2006. **Chinese** growth is anticipated to abate fractionally from a rate of 10.7% to 10.5% in 2007. Growth among other **East Asia** countries is expected to ease from 5.6% to 5% over the course of 2007. In the **Euro area**, GDP growth is expected to slip to 2.5% in 2007 from a rate of 2.8 in 2006.

Review of Main Initiatives Affecting Business

Tax Changes

Personal Income Tax Cuts

From 1 July 2007 the rate of tax on incomes between \$25,000 and \$30,000 will drop from 30% to 15%. This policy was proposed by Ai Group in its Pre-Budget Submission.

Also from 1 July 2007, the Low Income Tax Offset (LITO) will rise from \$600 to \$750. The phase out of the offset will begin from \$30,000 instead of \$25,000. As a consequence of the change in LITO the effective tax free threshold will rise from \$10,000 to \$11,000.

From 1 July 2008 the rate of tax on incomes between \$75,000 and \$80,000 will drop from 40% to 30%. The threshold for the top rate will rise to \$180,000. Both of these measures are consistent with Ai Group's proposals to phase down the rates of tax on higher incomes.

In addition the benefits of additional cash in hand, the tax changes will improve the incentives for low income earners to participate in the workforce, in particular by lowering effective marginal tax rates. Many low and medium income families will experience a decrease in effective marginal tax rates by 15 cents in the dollar from 1 July from this year.

In total the personal income tax changes are scheduled to cut income tax collections over the next four years by \$31.5 billion. Over the same period income tax collections could be expected to be around \$500 billion.

Present Scale			Scale from 1 July 2007			Scale from 1 July 2008		
Income range \$		%	Income range \$		%	Income range \$		%
0 -6,000	0		0 -6,000	0		0 -6,000	0	
6,001 -25,000	15		6,001 -30,000	15		6,001 -30,000	15	
25,001 -75,000	30		30,001 -75,000	30		30,001 -80,000	30	
75,000 -150,000	40		75,000 -150,000	40		80,000 -180,000	40	
150,001 +	45		150,001 +	45		180,001 +	45	

Business Tax Changes

The Budget introduced some changes to business income taxation.

- Plans to change the taxation of finance leasing have been shelved. These changes had been foreshadowed following the Review of Business Taxation. The Government's decision not to proceed with these measures will involve a sacrifice of revenue of around \$260 million over four years.
- The turnover cap of \$100 million above which companies were not eligible to recoup tax losses under the Same Business Test has been removed. This will remove an anomaly introduced in 2005 and reduce companies' tax bills by approximately \$175 million over four years.
- Technical changes to the consolidation regime and the Petroleum Resource Rent Tax at no cost to the revenue.

Company tax collections are anticipated to generate \$64,580 million in 2007-08 (up from \$58,270 million in 2006-07). Company tax collections are expected to be at an historic high of around 5.7% of GDP in 2007-08.

Changes to Superannuation

The Budget will double the co-contribution scheme (so that \$3 will be paid for every \$1 low to middle income earners contributed from their own money, up to a maximum government contribution of \$3,000) in respect of the 2005/6 year only.

Higher Education Endowment

The government has announced the establishment of a new, perpetual Higher Education Endowment Fund (HEEF). This fund will have an additional investment of \$5 billion funded from 2006-07 surplus. This fund will significantly increase financial investment and endowments accumulated in the university sector. This fund will be governed by the Future Fund Board of Guardians and is structured to encourage philanthropic support. \$912 million will be disbursed over the next three years.

Realising Our Potential

A broad range of initiatives have been announced in the 2007-2008 budget. This includes an additional investment of \$1.7 billion in higher education, \$668.1 million in vocational education and training and \$843 million in schools funding over the next four years. These measures include:

Higher Education

- *Increasing University Funding* designed to simplify funding structures and provide additional funding for key disciplines (\$559.6 million over four years)
- *Allowing More Responsive Universities* allowing universities to adjust to and meet labour market needs & skill demands (\$223.2 million over four years)
- *Diversity & Structural Adjustment Funding* to promote structural reform by universities to support greater specialisation, diversity and responsiveness (\$208.6 million over four years)
- Additional assistance to help teacher education students to gain more practical experience before entering the profession (\$77 million over four years)
- Increasing the number of Commonwealth Scholarships, increasing rent assistance and extending eligibility for Youth Allowance & Austudy to students study masters by Coursework.

Vocational Education & Training

- *Apprenticeship Wage top-up* payment of \$1,000 per year for first and second year apprentices under thirty years of age in trades facing skill shortages (\$342.5 million over four years)
- *Apprenticeship Training Vouchers* of up to \$500 per year for all first and second year apprentices in trades facing skill shortages to help them or their employers meet the cost of their course fees (\$206.4 million over four years)

- Three additional *Australian Technical Colleges* in Perth, Brisbane & Western Sydney (\$83.6 million over five years)
- *Fast Tracking of Apprenticeships* that supports genuine competency progression (\$58.5 million over four years)
- FEE-HELP for Diploma and Advance Diploma course to encourage those already with trade qualifications to further build on their skills & knowledge

Schools

Over the next four years an additional \$1.2 billion funding will be provided for the school sector, including

- *National Literacy & Numeracy Vouchers* to the value of \$700 for parents who children do not achieve current literacy & numeracy benchmarks in Yrs 3, 5 & 7. (\$457.4 million over four years)
- *Summer School for Teachers Programme* to provide additional professional development and improve the quality of teaching in core disciplines (\$101.7 million over four years)
- *Rewarding Schools for Improving Literacy & Numeracy Outcomes* – schools to receive up to \$50,000 for demonstrated improvement in literacy and numeracy outcomes (\$53.2 million over four years)

Other initiatives include assistance for intensive English as a Second Language (ESL) tuition for migrants, national aptitude testing for tertiary admission, funding to support work for the development of core curricula standards and national teacher registration standards.

Industry Statement

The Federal Budget restates the announcement made last week in regard to industry policy. The Industry Statement, “Global Integration: Changing Markets, New Opportunities”, contains \$1.4 billion of initiatives over the next 10 years.

Key elements include:

- \$351.8 million for Australian Productivity Centres to assist small to medium-sized enterprises to identify opportunities to introduce world best practice, thereby improving competitiveness and productivity (a key initiative proposed by Ai Group in its Manufacturing Futures report).
- \$254.1 million for a new Global Opportunities Programme to target 30 large international projects each year to develop international engagement and exports.
- An expansion of the role of the Export Finance and Insurance Corporation (EFIC) to enable it to support export-related activities, such as offshore distribution facilities.
- \$500 million to give multinational corporations access to the 175% Research and Development Tax Concession for R & D undertaken in Australia, but where the intellectual property may reside in another country.
- \$90.3 million for a Commercial Ready Plus program to support public sector researchers and start-up companies to commercialise their research.

- \$21.5 million for a National Nanotechnology Strategy, \$54.2 million for Food Innovation Grants and \$36.2 million for a National Research Flagship for Niche Manufacturing to be undertaken in conjunction with CSIRO.
- \$14.3 million to extend the Building Entrepreneurship in Small Business Program which funds 60 small business field officers across Australia.
- \$89.2 million to establish a single online registration system for the ABN and state/territory registration of business names.

Road and Rail Infrastructure

The Budget provides \$22.3 billion over the five years from 2009-10 for the second AusLink land transport plan (AusLink 2), and funding for the continuation of untied local roads grants. In addition, an extra \$695 million will be provided under AusLink 1.

The Budget provides \$19.1 billion under the AusLink 2 programme for the five years from 2009-10 including:

- \$16.8 billion to develop and maintain a defined National Network that links major population and economic centres and facilitates the movement of people and freight internationally, nationally and between regions;
- \$1.8 billion for the construction and maintenance of local roads under the Roads to Recovery Programme;
- \$300 million for measures to reduce the risk of accidents at dangerous sites under the Black Spot Programme; and
- \$300 million for projects that support the growth of regional industry or strengthen social and economic opportunities under the Strategic Regional Programme.

As well, \$3.2 billion will be provided over five years from 2009-10 in untied local roads grants to local councils.

The Government's new investment on the National Network includes \$2.3 billion to construct the Goodna Bypass to address congestion along one of South-East Queensland's busiest freight and passenger corridors. To ensure that the project can commence as soon as possible and be operational by 2012, \$100 million will be provided in 2007-08 and \$300 million in 2008-09 under AusLink 1 with the remainder to be provided under AusLink 2.

A one-off payment of \$250 million is provided in 2006-07 for supplementary funding for the AusLink 1 Strategic Regional Programme.

Skilled Migration and Visa

The migration program is to be increased by 8,800 places to 152,800. Skilled migration represents 5,000 of the 8,800 extra places.

Defence

This year, the Federal Government's commitment to Defence will total \$22 billion - an increase of 47% in real terms since 1995-96. This represents 9.3% of Australian Government outlays and 2% of GDP.

The Government has reaffirmed its commitment to a real increase in defence spending of 3% each year until 2016.

The current Defence Capability Plan outlining \$51 billion of new acquisitions over the next 10 years will be fully supplemented by an additional \$6 billion for 24 new Super Hornet aircraft.

More specifically, the Government has given a commitment to spend an additional \$14 billion over the next 10 years to be applied to:

- A package of recruitment and retention measures that are designed to increase recruitment intakes to the Australian Defence Force (ADF) and reduce military separation rates (\$2.1 billion).
- Acquisition of 24 F/A-18F Block II Super Hornet multi-role aircraft to maintain Australia's air combat capability edge during the transition to the new F-35 Joint Strike Fighter (\$6.6 billion)
- Additional logistics sustainment funding (\$1.8 billion)
- Personnel and operating costs for the new C-17 Globemaster heavy lift aircraft (\$1.3 billion)
- A strengthening of Australia's Defence intelligence and security capabilities (\$382.2 million)
- An additional \$1.3 billion for ADF operations, including an extra \$703 million for Afghanistan, \$389 million for Iraq, \$135 million for East Timor and \$52 million for northern approaches surveillance
- Investment in security measures to protect Defence personnel and key assets (\$135 million)
- Additional funding for Defence Housing Australia (\$954 million).