



OVERVIEW OF THE 2008/09 FEDERAL BUDGET

“The Rudd Government’s first budget is well and truly on task. It has taken a hard-nosed approach to spending to address inflation and it makes ambitious investments in nation-building,”
Heather Ridout, Chief Executive

“This Budget is designed to meet the big challenges of the future.

It is a Budget that strengthens Australia’s economic foundations, and delivers for working families under pressure....

A Budget carefully designed to flight inflation, and ensures we meet the uncertainties of the future from a position of strength ...

A Budget that begins a new era of strategic investment in Australia’s future challenges and opportunities”

The Hon Wayne Swan, Federal Treasurer

Key Summary

In his first Federal Budget, the Federal Treasurer, Wayne Swan, has delivered tonight (Tuesday 13 May 2008), a range of budget initiatives targeting the surplus, taxation, working families, education, infrastructure, defence and social security.

The **centrepiece** of the Budget is the \$55 billion Working Families Support Package to **individuals**, targeting initiatives in tax, child care, education, housing and other elements of family budgets. Key to the Package is implementation of promised personal income tax cuts of \$47 billion over four years.

The Budget delivers on three important **investment** funds. The Building Australia Fund will receive an initial allocation of \$20 billion to fund critical transport and communication infrastructure. The Health and Hospitals Fund will receive an initial allocation of \$10 billion to finance health infrastructure, such as hospitals, medical technologies and research facilities. The Education Investment Fund will receive an initial allocation of \$11 billion to finance capital investment in higher education and vocational education and training (VET), including \$6 billion from the Higher Education Endowment Fund.

In response to **climate change**, the Budget includes measures totaling \$2.3 billion over five years to help reduce greenhouse emissions and adapt to climate change. This includes the Energy Innovation Fund (\$150 million over 4 years), a Green Car Innovation Fund (\$500 million over 5 years) and the Clean Business Australia initiative (\$240 million over 4 years) which will assist businesses to reduce greenhouse

emissions. As well the Clean Energy Enterprise Connect Centre (\$20 million over 4 years) will provide business improvement services to small to medium enterprises (SMEs).

For **business**, the Budget commits \$251 million over 5 years to establish ten Enterprise Connect Innovation Centres. The centres will provide business and advisory and diagnostic services targeted to assist SMEs to improve productivity and capacity for innovation. As well, the Budget reduces the withholding tax from 30% to 7.5% for most non-resident investors, in an effort to encourage financial institutions to invest in Australia. The Budget also confirms the Government's commitment to regulatory reform. However, as a saving measure, the Budget close the Commercial Ready Program (a saving of \$70 million in 2008/09), although this is subject to the National Innovation Review) and cut back expenditure of the Global Opportunities Program.

For **education** and **skills**, the Budget honours the Government's commitment to an Education Revolution, with an additional \$5.9 billion over 5 years. As well, \$1.2 billion is provided over 5 years to provide up to \$1 million per school to deliver computers and communication technologies. A further key initiative is the provision of \$1.9 billion over 5 years to deliver 630,000 additional training places to fill skills shortages.

Finally, for **defence**, the Budget delivers on a commitment to provide 3% real growth per year on average in Defence's underlying funding base to 2015-6, and extends this commitment to 2017-18.

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

Fiscal Balance

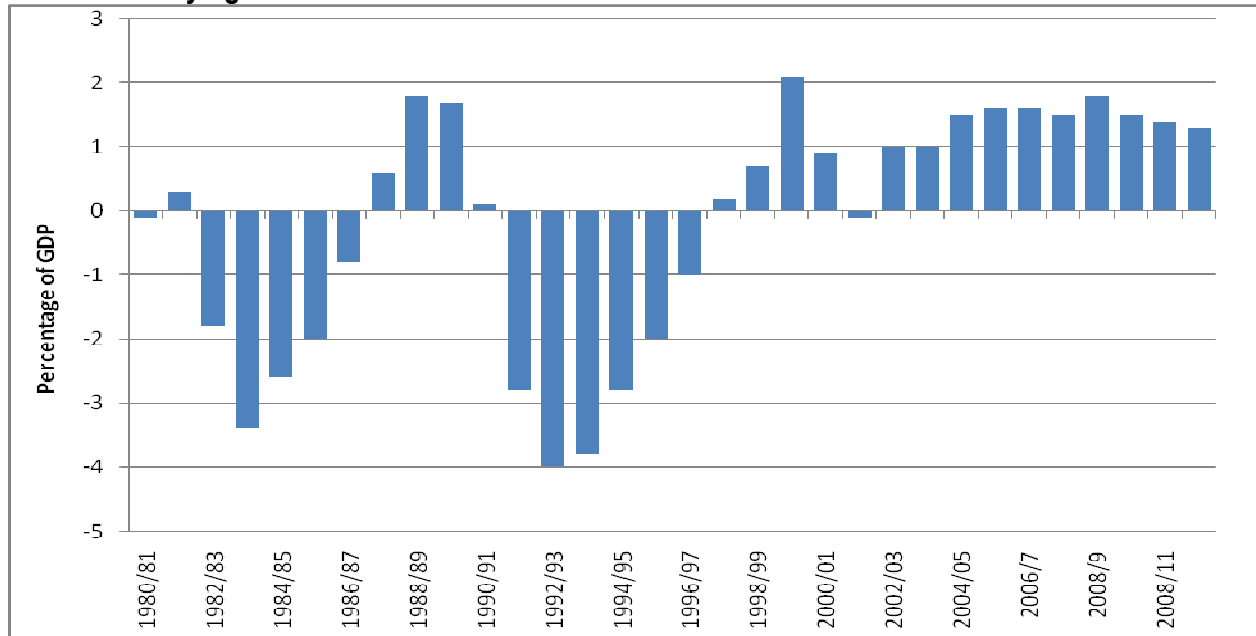
For the current financial year (2007/08), the Mid Year Economic and Fiscal Outlook (MYEFO) estimated revenue of \$251.9 billion, but just four months later, today's Budget has revised this up to \$303.8 billion, \$51.9 billion higher. Consequently, the underlying cash surplus has been revised up from 1.3% of GDP to 1.5%.

For 2008/09, the Government has budgeted for an underlying cash surplus of \$21.7 billion, \$3.3 billion higher than forecasted in the MYEFO.

Total revenue is expected to rise by 5.2% (from \$303.8 billion to \$319.5 billion), while total expenditure is set to rise by 4.2% (from \$280.6 billion to \$292.5 billion). The majority of the \$16 billion increase in revenue in 2008/09 is expected to come from company tax, which accounts for \$13 billion of the increase. This is in contrast to individuals who contribute an extra \$3 billion in income tax.

The Budget papers also note that the rising terms of trade is estimated to generate \$33 billion in 2008/09 in tax revenue arising from an estimate \$100 million or 9% improvement on GDP.

Chart 1 Underlying cash balance



Ai Group Assessment

Ai Group has described the Rudd Government's first budget as well and truly on task. It has taken a hard-nosed approach to spending to address inflation and it makes ambitious investments in nation-building.

The Government has backed up its promises in education, personal taxation, in developing business capabilities and in building infrastructure including broadband with sizable allocations over the next few years. This puts money behind a fresh start and should provide the foundation for a much-needed expansion of our national capacity and a lift in productivity. The Government has the opportunity to build further on these directions with its reviews of taxation, innovation, regulation, industry policies and defence.

By more than offsetting new spending with savings and by running a large surplus, the Government has adopted a responsible approach which should be helpful in addressing inflation. As acknowledged in the Budget, the economy looks set to slow appreciably and there remains a lot of uncertainty with the domestic and global outlook. In this context it is appropriate that the Government has left open the option of further fiscal tightening down the track.

Ai Group particularly welcomes:

- The initiatives in skills, vocational education and training and higher education, including the Education Investment Fund;
- The commitments to the Building Australia Fund;
- The personal income tax cuts;

- The variety of measures to assist in reducing greenhouse emissions and adapting to climate change;
- The Enterprise Connect Innovation Centres for small and medium sized businesses;
- The expansion of the skilled immigration program; and
- The new model for employment services.

Added to these, the remodelling planned for the Federation represents an ambitious plan to improve intergovernmental cooperation and to deliver better outcomes across a variety of areas.

Ai Group welcomes the Australian Tax Review. We have sought a cross-jurisdictional review of taxation arrangements and this review provides an opportunity to make some real improvements in the pattern of taxation across the Commonwealth.

The removal of Commercial Ready, while part of the tightening of spending, leaves a gap in the overall innovation system. The current National Review of Innovation provides scope for a consideration of the total system. Industry will be looking to this review for a significant enhancement of innovation programs.

Key Economic Parameters

The Treasurer expects growth in **gross domestic product** (GDP) to slow from a year average of 3.5% in 2007/08 to 2.75% in 2008/09. The growth of **household consumption** is expected to moderate from 4.50% to 2.75% over the year.

Inflation is expected to moderate slightly from 4% in 2007/08 to 3.5% in 2008/09, above 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 2008/09 year.

Employment growth is expected to ease to 1.25% (down from 2.5% in 20067/708). The **unemployment rate** is forecast to remain steady at 4.5% in 2008/09 with the participation rate remaining steady.

Australia's **export** performance is anticipated to improve somewhat, from 3% growth in goods and services exports in the current year to 6% growth in 2008/09. 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 9% in 2008/09 compared with an 11% growth figure in 2007/08.

The **current account deficit** is expected to improve from a deficit from 6.25% to 5% of GDP.

Private investment growth is expected to moderate in 2007/08. Investment in **dwellings** is expected to grow at 2% in 2008/09, down 0.5% from the previous year. Investment in new **machinery and equipment** is expected to grow by 11% in the year ahead (compared with a rise of 8.5% in 2007/08). The rate of growth in new investment in **non-dwelling construction** is expected to ease from 9.5% to 8.5% over the coming financial year.

In terms of the world environment, the **United States** growth forecast is expected to be 0.75% in 20078 down from 2.2 in 2007. Growth in the **Japanese economy** is expected to ease to 1.25% from a rate of 2.1

in 2007. **Chinese** growth is also anticipated to abate from a rate of 11.9% to 10% in 2008. Growth among other **East Asia** countries is expected to ease from 5.8% to 4.25% over the course of 2008. In the **Euro area**, GDP growth is expected to slip to 1.5% in 2008 from a rate of 2.6 in 2007.

Review of Main Initiatives Affecting Business

Tax Changes

Personal Income Tax Cuts

The tax cuts will increase disposable incomes and provide additional incentives to participate in the workforce.

From 1 July 2008:

- The 30 per cent threshold will be raised from \$30,001 to \$34,001
- The low income tax offset (LITO) will be increased from \$750 to \$1,200
- The 40 per cent threshold will increase from \$75,001 to \$80,001
- The 45 per cent threshold will increase from \$150,001 to \$180,001.

Someone earning \$50,000 a year will have a tax cut of \$1,000 in 2008-09 compared to the previous year.

From 1 July 2009:

- The 30 per cent threshold will be raised to \$35,001
- The LITO will be increased to \$1,350
- The 40 per cent tax rate will be reduced to 38 per cent.

From 1 July 2010:

- The 30 per cent threshold will be raised to \$37,001
- The LITO will be increased to \$1,500
- The 38 per cent rate will be reduced to 37 per cent.

The increase in the LITO creates an effective tax-free threshold for low-income earners of \$14,000 in 2008-09, \$15,000 in 2009-10 and \$16,000 in 2010-11.

From 1 July 2008, senior Australians eligible for the senior Australians tax offset will pay no tax on their annual income up to \$28,867 for singles and \$24,680 for each member of a couple. By 1 July 2010, these thresholds will rise to \$30,685 for singles and \$26,680 for each member of a couple.

The Government's goal is that by 2013-14 the number of personal income tax rates will be reduced to three (15 per cent, 30 per cent and 40 per cent) and the LITO will be further increased.

Other Changes

Income testing

Income testing arrangements for accessing government financial assistance will be broadened to include certain salary sacrificed contributions to superannuation, net financial investment and rental property losses and reportable fringe benefits. This will limit high income earners access Government benefits.

Fringe Benefits Tax (FBT)

Access to FBT for certain tax planning arrangements will be addressed by:

- subjecting 'meal card' type arrangements to FBT — where an employer pays for meals provided to an employee for consumption at the employer's premises, as part of a salary package arrangement;
- removing the FBT exemption for work-related items used mainly for private purposes such as laptops;
- removing the double benefit t from employee depreciation deductions on FBT exempt items used mainly for work purposes;
- ensuring that FBT applies to employee arrangements involving jointly held assets.

Employee share schemes

A loophole in the rules for choosing when shares and rights are assessed will be closed to restore the intended outcome and prevent inappropriate tax minimisation.

Luxury Car Tax

The rate of tax on luxury cars will be increased from 25 per cent to 33 per cent.

Investment Funds

The Government is taking a strategic approach to the investment of budget surpluses by creating three new funds. These funds will meet capital shortages in infrastructure, education and health. Initially, the Government will invest \$40 billion in these priorities, largely from the 2007-08 and 2008-09 surpluses.

Building Australia Fund (BAF)

Based on current estimates, the BAF will receive \$20 billion over the next two years to fund shortfalls in national transport (roads, rails and ports) and broadband. The Communications Fund will be closed and its assets of \$2.4 billion transferred to the BAF.

Education Investment Fund (EIF)

The Government will invest \$5 billion to establish the EIF. The EIF will absorb and extend the Higher Education Endowment Fund, bringing total funding to around \$11 billion. The EIF will fund capital expenditure in Australia's higher and vocational education institutions.

Health and Hospitals Fund (HHF)

The Government will allocate \$10 billion to the HHF to finance the renewal and refurbishment of the nation's hospitals and to fund major medical research facilities and projects.

Innovation and Industry

The Government is introducing new measures to boost innovation in Australian business. The findings of the National Review of the Innovation System may well add to these initiatives over time.

New ideas and new technology

The Government will provide \$251 million over five years to establish Enterprise Connect Innovation Centres to connect businesses with new ideas and new technology. The centres will provide business and advisory and diagnostics services targeted at assisting small and medium businesses improve their productivity and capacity for innovation. Funding will also provide for the establishment of Industry Innovation Councils.

The Government will also provide \$42 million over four years to 36 Business Enterprise Centres to help them provide advisory services to small businesses. The business centres will provide advice on how to set up a business, public liability insurance, GST bookkeeping and marketing and sales promotion.

Support for research

To strengthen the link between research and innovation, the Government will boost Australia's research capacity by providing:

- \$326 million over four years to fund four year Future Fellowships valued at up to \$140,000 a year for 1,000 of Australia's top mid-career researchers
- \$209 million over four years to double the number of Australian Postgraduate Awards for PhD or Masters by Research students.

Commercial Ready and Global Opportunity Programs

The Government has decided to close the Commercial Ready program, a saving of \$700 million over the next four years. The Commercial Ready Program was announced in May 2004 and replaced three pre-existing programs, the R & D Start Program, the Biotechnology Innovation Fund and the Innovation Access Program. The program provided funding to support projects which encourage successful innovation through increasing the levels of R & D, proof-of-concept and the early stage of commercialisation.

As well, the funding for the Global Opportunities Program has been cut by \$62.6 million over four year. The balance of the Program funding is to be transferred to Austrade.

Skills, Education & Training

The centrepiece of the Education Revolution is the establishment of the new **Education Investment Fund (EIF)**, which will include \$5 billion 2007/08 and 2008/09 budgets and \$6 billion from the Higher Education Endowment Fund (HEEF). The key priorities of this fund will be capital expenditure and renewal and refurbishment in universities and will be extended to include vocational institutions as well as research facilities and major research institutions. There will be no cap on yearly allocations from the EIF.

Budget initiatives include:

Schools

- \$2.5 billion over 10 years for Trade Training Centres in Secondary Schools
- More than \$1 billion a year for Education Tax Refund,
- \$1.2 billion over five years to roll out the Digital Education Revolution, an additional \$200m, including \$32.6m over two years to supply students and teachers with tools and resources to support online education.
- \$577.4m over four years to provide additional literacy and numeracy support to those schools and students most in need.

Skills Training and Development

- \$1.9 billion *Skilling Australia for the Future* over five years, including 630,000 training places over five years, including 85,000 apprenticeship places. This is an increase of 80,000 places from the election commitment.

Higher Education

- \$500 million for capital projects to support improved teaching and learning, research.
- \$238.6 million over four years for 29,000 National Priority Scholarship
- \$249 million for up to 11,000 new Commonwealth supported places to replace full-fee paying undergraduate students
- \$562.2 million over four years to encourage students to study maths and science and compensate universities.

Employment Services

The Government also announced the new model for Employment Services (\$3.7billion over three years). This model will integrate services provision, move activity closer to employers and focus more significantly on the long-term unemployed. This model will commence 1 July 2009.

Climate Change

Investing in technology

Innovative technologies will be an important part of the transition to a low-emissions future. The Government is investing \$500 million over six years in the Renewable Energy Fund, \$500 million over eight years for the National Clean Coal Fund, and \$150 million over four years for the Energy Innovation Fund.

The Government is encouraging the development of low-emissions vehicles through the \$500 million Green Car Innovation Fund, and will support change in business practices through the Clean Business Australia program, at a cost of \$240 million over four years.

Skilled Migration and Visa

Migration Program

In 2008-09, the Government will increase skilled migration by 31,000 places, taking the skilled stream of the Migration Program to 133,500 places. The overall Migration Program will rise to 190,300 places. This significant increase will help to address skill shortages.

Improving the 457 visa subclass

The Government will spend \$20 million over four years to improve the integrity and responsiveness of temporary working visas. This includes developing a framework for longer-term reform to help meet Australia's future labour market needs.

Humanitarian Program

In 2008-09, the Government will provide a one-off additional 500 places for Iraqi refugees affected by the conflict in Iraq, taking the total Humanitarian Program to 13,500 places.

The Government will provide permanent resettlement in Australia to up to 600 Iraqis, including their families, who are at risk partially because of their work with Australian troops in Iraq.

These places are in addition to the Humanitarian Program places. From 2009-10, the Government will increase the Humanitarian Program by 750 places to 13,750 places.

Defence

This Budget meets the Government's commitment to provide 3% real growth per year on average in Defence's underlying funding base to 2015-16. To provide even greater funding certainty, the Government has extended this funding guarantee to 2017-18. However, over the next four years, real growth in total Defence spending is expected to average 4% a year.

This Budget also provides \$5 million for annual independent checks of the management of major acquisition projects.