

2009-10 Federal Budget Analysis

Tel: (08) 9365 7701
economics@cciwa.com



Knowledge Influence Support

CHAMBER OF COMMERCE
AND INDUSTRY
WESTERN AUSTRALIA

Comment

The 2009-10 Federal Budget undersells Western Australia's importance to the economic wellbeing and prosperity of the Nation.

The centrepiece of the 2009-10 Budget is heavy investment in nation building infrastructure such as roads, railways and ports. These projects are important to the Nation's long term economic performance, as they will generate wealth, encourage new investment, and create jobs over many years.

The Federal Government has unveiled a budget that aims to spend Australia out of the current global economic slowdown. Debt will rise to \$188 billion by 2013, and the Government is not expecting the budget to return to surplus for six years.

CCI's preliminary examination of the Budget reveals Western Australia will receive less than seven per cent of the \$22 billion national infrastructure spending package on wealth creating projects such as roads, railways and ports.

Considering Western Australia accounts for over 40 per cent of Australia's total exports, is home to more than 10 per cent of Australia's residents, and accounts for around 14 per cent of Australia's economy, this year's Federal Budget has not adequately taken into account the needs of a growing, and nationally significant state. This under-investment will put more pressure on the State Government, and the private sector, to raise the funds needed to upgrade and build the roads, railways, ports, and other critical infrastructure needed to sustain strong economic growth.

CCI is also concerned about the reduction in the permanent skilled migration intake, which will bring the program below 2007-08 levels. A sizeable Skilled Migration Program is necessary to help offset the number of people who depart

2009-10 Federal Budget Highlights

- Deficit of \$57.6 billion in 2009-10.
- Net debt to peak at \$188.2 billion in 2012-13.
- Focus on infrastructure investment, with WA allocated funding for common user infrastructure at Oakajee Port, and the Northbridge Link.
- Measures to assist small business growth including an expanded R&D tax credit and investment allowance.
- Reduction of the permanent skilled migration intake by 20 per cent.
- Introduction of a Paid Parental Leave scheme from 2011.
- Economy is expected to contract by ½ per cent in 2009-10, with unemployment peaking at 8.25 per cent in 2010-11.

Australia permanently each year, and ensure that future skills requirements are met.

CCI welcomes the Federal Government's decision to contribute to the construction of a new deep water port at Oakajee which will unlock the mineral wealth in the State's Mid West region, and help fund the sinking of the railway line dividing the city and Northbridge. These are important projects that the State has long needed.

CCI also welcomes the Government's decision to increase the investment allowance for small businesses to 50 per cent, and measures to encourage businesses to invest in research and development. These initiatives will help small business, which is the lifeblood of the economy, bring forward important investment decisions, and encourage innovation.

CCI also supports the Government funded paid parental leave scheme, given that the cost of this scheme does not fall directly on employers. Paid Parental leave is likely to be a key incentive to encourage women to remain in the workforce, and return to the workforce following childbirth.

However, CCI is concerned there appears to be a lack of fiscal discipline which will consign future generations to high levels of debt. Of most concern is that the Government intends to rid the country of the deficit purely by relying on a return to normal economic activity. As a result, it is difficult to suggest that hard decisions were made to ensure that the budget is returned to surplus.

CCI has called on the Federal Government to embark on wide ranging review of government spending to speed up efforts to put the budget back into the black.

Fiscal Outlook

An underlying cash deficit of \$32.1 billion is expected in 2008-09, up from \$22.5 billion estimated in the *Updated Economic and Fiscal Outlook* (UEFO) in February 2009 and down from a surplus of \$19.7 billion in 2007-08. The worsened fiscal outlook since the UEFO largely reflects a weaker revenue outlook (Table 1).

In 2009-10, the Government is expecting to deliver a deficit of \$57.6 billion, which is equal to

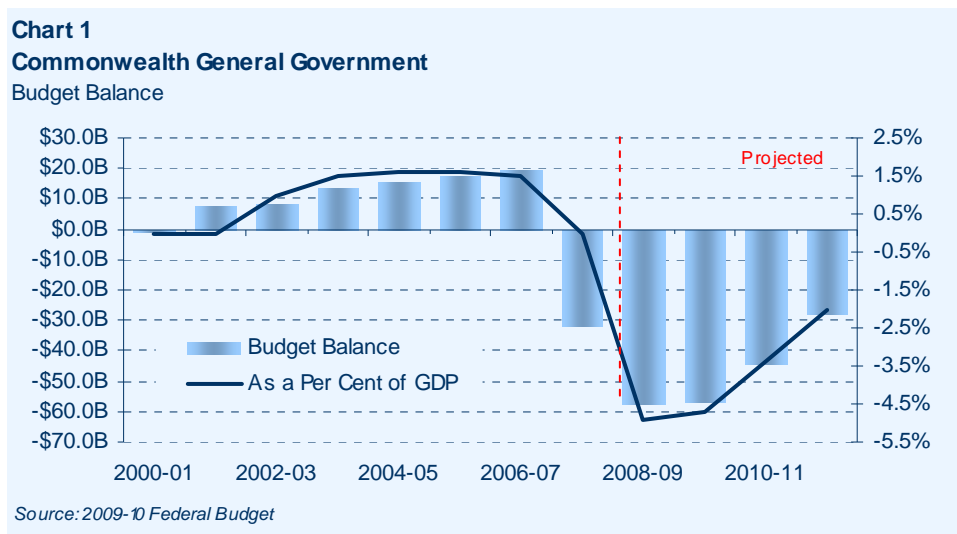
Table1
Key Budget Aggregates
Commonwealth Government

	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
	Actual	Estimated Actual	Budget Estimate	Forward Estimate	Forward Estimate	Forward Estimate
Revenue (\$b)	278.0	303.8	295.9	290.6	294.8	320.8
% GDP	26.6	26.9	25.9	26.2	26.2	26.1
Expenses (\$b)	258.5	280.6	324.4	338.2	344.5	356.4
% GDP	24.7	24.9	23.8	24.2	24.1	24.1
Fiscal Balance (\$b)	16.8	21.0	-32.9	-53.1	-56.0	-41.8
% GDP	1.6	1.8	1.9	1.7	1.7	1.6
Underlying Cash Balance (\$b)	17.2	19.7	-32.1	-57.6	-57.1	-44.5
% GDP	1.6	1.5	1.8	1.5	1.4	1.3

Source: Commonwealth Budget 2008-09

4.9 per cent of GDP - the largest budget deficit as a proportion of GDP on record (Chart 1).

While the budget papers note that taxation revenues have been hit hard as a result of the severe global recession (around \$210 billion lower over the next four years), at the same time, spending is also expected to increase by 4.3 per cent in 2009-10 and by an average 3.7 per cent over the outlook horizon to 2012-13. In this sense, new policy initiatives since the last budget have had a significant impact on the bottom line. Policy decisions have cost the budget \$97.1 billion over the four years from 2008-09 to 2011-12, while parameter variations (due to the economic slowdown) have contributed \$173.3 billion to the shortfall.



The deficit is expected to remain high at \$57.1 billion in 2010-11, \$44.5 billion in 2011-12 and \$28.2 billion by 2012-13 (or two per cent of GDP), with the budget not expected to return to surplus until 2015-16.

Public sector net debt is expected to deteriorate. The net debt position is estimated to go from a net surplus position of \$4.7 billion in 2008-09 to a net deficit of \$188.2 billion in 2012-13, equivalent to 13.6 per cent of GDP. While the Government notes this is lower than the levels of debt of other developed nations, the real concern is how quickly this level of debt will mount. Also worrying is that decisions taken today will mean that net debt will continue to feature for many years to come, with a projected net debt to GDP ratio of 3.4 per cent.

Revenue

Taxation revenues have been hit hard as a result of the severe global recession, and have significantly undermined Government revenue in the near term. Compared to the 2008-09 budget, tax revenue is down by \$23 billion (or eight per cent). This is estimated to be the largest fall in receipts compared to the budget forecast since 1930-31.

The fall in taxation revenue has primarily been driven by individuals and companies. Tax receipts from individuals are down by \$3.4 billion (or 2.6 per cent) compared to the previous year, while tax revenue from companies is down by \$3.3 billion (or 5.3 per cent). Sales taxes have also declined by \$1.2 billion (or 2.8 per cent) compared to 2007-08.

As a result, total government operating revenue has fallen by \$8.1 billion (or 2.6 per cent) between 2007-08 and 2008-09, to \$295.9 billion.

Revenue is expected to fall even further in the budget year. In 2009-10, operating revenue is also expected to decline by \$5.3 billion (or 1.8 per cent), to \$290.6 billion.

Across the forward estimates, revenues are expected to improve as the economy returns to usual growth. On average, revenue is expected to grow by three per cent over the forward estimates.

Key Revenue Measures

- From 1 July 2009 the threshold for the 30 per cent income tax rate will be lifted from \$34,000 to \$35,000 and the 40 per cent income tax rate will be reduced to 38 per cent. The Low-Income Tax Offset has also been increased from \$1,200 to \$1,350.
- From 1 July 2009, the cap on concessional superannuation contributions will be reduced from \$50,000 to \$25,000 (indexed), and the transitional cap from \$100,000 to \$50,000. From 2012-13 those aged 50 years and over will be subject to the lower \$25,000 (indexed) cap. The Government will also temporarily reduce the matching rate of the superannuation co-contribution (and maximum amount payable) that is paid on eligible personal superannuation contributions.
- Effective 1 July 2010, the Government will introduce three new 'Private Health Insurance Incentive Tiers', with singles earning more than \$120,000 and families earning more than \$240,000 no longer entitled to the private health insurance rebate.
- The bonus tax deduction under the Small Business and General Business Tax Break will be increased to 50 per cent for small businesses (from 30 per cent) which will provide an important incentive for small business to invest further in their business.
- From 1 July 2010, the Government will replace the current R&D tax concessions with an expanded tax credit to improve support for smaller firms in tax loss as well as rewarding larger firms for their R&D.

Expenses

Australian Government general government sector expenses have been boosted in the near term as a result of policy decisions aimed at supporting economic growth.

Real spending is estimated to grow by 2.4 per cent in 2009-10 to \$338.2 billion, and rise to 28.7 per cent of GDP (up from 24.8 per cent in 2007-08 and 27.1 per cent in 2008-09). Expenses are expected to peak at 28.7 per cent in 2010-11, before falling back to 27 per cent of GDP by 2012-13.

The increase in Government spending as a percentage of GDP during 2009-10 and 2010-11 largely reflects the fiscal stimulus packages which were announced in late 2008 and early 2009 in response to the global financial crisis. Policy decisions have cost the budget \$97.1 billion over the forward estimates.

Over the forward estimates, spending is expected to slow in line with the Government's intention to keep real growth in expenditure to two per cent per year until the budget returns to surplus. In real terms, expenses growth is expected to average 1.7 per cent over the forward estimates.

The largest share of government expenditure is directed towards social security and welfare, which accounts around one third of the Budget outlay. This is followed by general government services and health, which account for 24 per cent and 15 per cent of expenditure respectively. Spending in these areas has fallen when compared to the corresponding percentages in the 2008-09 Budget of 35 per cent, 27 per cent and 16 per cent.

By purpose, the strongest real growth across the Budget and forward estimates is expected to occur in relation to the other purposes (39.4 per cent), transport and communication (17.3 per cent), general public services (7.6 per cent), mining, manufacturing and construction (6.8 per cent) and health (six per cent) functions.

Key Expenditure Measures

- The First Home Owners Boost has been extended for an additional six months until 31 December 2009 at a cost of \$539 million. However, the First Home Owners boost will be reduced by half for contracts entered into between 1 October 2009 to 31 December 2009.
- A Paid Parental Leave (PPL) scheme for new parents will be introduced from January 2011, at a cost of \$731 million over five years. An eligible person will receive taxable PPL payments at the level of the Federal Minimum Wage for a maximum period of 18 weeks. Businesses will not be faced with any up front costs for the scheme, and will not be liable for superannuation payments on the leave.

Infrastructure Investment

The 2009-10 Budget includes a \$22 billion allocation towards infrastructure investment, and includes:

- \$8.5 billion for upgrading road, rail and port infrastructure;
- Up to \$43 billion for the National Broadband Network, including an initial investment of \$4.7 billion. This investment will deliver super fast broadband to Australian homes and businesses, with the roll out commencing in Tasmania from mid-2009;

- \$3.6 billion for the Clean Energy Initiative to support the development of low-emission technologies, including the establishment of a new innovation investment body which will invest in new Solar Flagship projects, and carbon capture and storage projects;
- An allocation of \$2.6 billion from the Education Investment fund for infrastructure in universities and research facilities, including uncapping the number of public university places, increasing the rate of indexation for higher education funding; and
- \$3.1 billion for health and hospital infrastructure, cancer care and medical research.

In WA, the two key capital projects have been funded as part of the 2009-10 budget. However, the state's allocation represents less than seven per cent of the total allocation for road, rail and port infrastructure.

Some \$339 million has been committed for the development of Oakajee Port common user facilities, subject to further work and consideration of the project by Infrastructure Australia. This funding has been allocated for the development of common use water, power and road infrastructure to support the Oakajee Port.

A further \$236 million has been allocated for the Northbridge Link Project.

WA has also received moderate funding for health and education infrastructure. Some \$256 million has been allocated for a replacement rehabilitation unit at the Fiona Stanley Hospital, with a further \$180 million for infrastructure works at the Midland Health Campus. Regional WA has also received \$8.6 million for renal services in the Kimberley, and \$7.9 million for a replacement paediatrics unit in the Broome area.

A further \$20.5 million has also been allocated from the Education Infrastructure Fund for an Engineering Pavillion in Perth.

Broader Policy Measures

- The permanent skilled migration intake will be reduced by a further 6,900 places in addition to the 18,500 reduction made in March this year. This represents a fall of almost 20 per cent on previous planning levels, and brings the program below 2007-08 levels.
- From 2012, Australian public universities will be funded on the basis of student demand at a cost of \$490.6 million over the next four years.
- Establishment of a national regulatory and quality agency at a cost of \$57 million over four years.
- Indexation of funding for universities.

- The maximum contribution for education units of study will be increased from 2010 to better support universities to provide high quality teaching courses. Higher Education Loan Program (HELP) repayments will also be reduced for education graduates.
- \$3.8 billion over four years to support apprenticeships and traineeships with greater job opportunities and to help with the costs of the tools of their trade.
- \$1.9 billion for Skilling Australia for the Future Program, including \$884.6 million to provide an additional 238,200 VET places to people currently outside the workforce; \$704.6 million to provide an additional 391,800 places within the workforce; \$242.2 million for an additional 85,000 Australian Apprenticeship places; \$83.2 million for strengthened industry skills councils; and \$4.1 million for skills and training information centres.
- Streamlining programs that support young people with the transition to employment, education and training opportunities from 2010, and includes the consolidation of Local Community Partnerships, Regional Industry Career Advisers and National Industry Career Specialists into a new Community and Education Engagement Partnership Program.

Economic Outlook

Commonwealth Treasury forecasts have once again been revised down, with considerable risks still said to surround these latest forecasts given the fragility of the global economy and possibility it could deteriorate further. On the upside, however, international policy action, and prospects for an earlier recovery in China, could support a sharper turnaround than currently expected. The Australian economy is expected to experience no growth in the current 2008-09 financial year, before contracting the year after (Table 2).

Table 2
Australian Economic Aggregates

	Year Average Growth (%)			
	2007-08	2008-09	2009-10	2010-11
Expenditure		Budget	Budget	Budget
Household Consumption	3.7	1.0	-0.25	1.75
Dw elling Investment	1.4	-2.5	0.0	11.5
Business Investment	6.7	2.5	-18.5	3.5
<i>Domestic Final Demand</i>	4.2	1.5	-1.25	2.0
Exports	3.8	-0.5	-4.0	4.5
Imports	9.2	-1.5	-6.5	6.5
Net Exports (cont.)	-1.2	0.3	0.8	-0.5
<i>Gross Domestic Product</i>	3.3	0.0	-0.5	2.25
Labour Market				
Employment	2.7	-0.25	-1.5	0.5
Unemployment Rate	4.5	6.0	8.25	8.5

Source: 2009-10 Federal Budget.

The Commonwealth Government has forecast the economy to contract by 0.5 per cent in 2009-10, which compares to its previous forecast of a 0.75 per cent increase outlined in the UEFO. The main contributors to the slowdown are sharp falls in business investment and exports, as well as a smaller contraction in household consumption. The Commonwealth Treasury have forecast a relatively strong recovery, with growth expected to reach 2¼ per cent in 2010-11. This growth outlook is significant insofar that it also influences the fiscal outlook. If growth is weaker than forecast, this will in turn also affect the recovery of the nation's fiscal position.

Domestic final demand is expected to contract by 1.25 per cent in 2009-10, on the back of a strong fall in business investment (of 18.5 per cent) and to a lesser extent household consumption (of 0.25 per cent).

Total national exports are expected to fall by four per cent in 2009-10 (after falling moderately by 0.5 per cent in 2008-09), however this will likely be more than offset by a 6.5 per cent fall in imports (after a fall of 1.5 per cent in 2008-09), so that net exports will actually contribute 0.8 percentage points to GDP growth in 2009-10.

The terms of trade are expected to decline from recent record highs, taking around \$35 billion out of the economy in 2009-10. The terms of trade are forecast to fall by 13¼ per cent in 2009-10, due to significant falls in commodity prices.

Nominal GDP is forecast to fall by 1½ per cent in 2009-10, reflecting the contraction in real GDP of ½ per cent and the substantial decline in the terms of trade, which reflects the general decline in broader economy prices (of one per cent in that year), as measured by the GDP deflator.

The labour market is anticipated to deteriorate significantly over the outlook period, with a sharp rise in the unemployment rate as a result of the recession. Employment is expected to fall by ¼ per cent in 2008-09 and by 1½ per cent in 2009-10 for the nation. As a result, the unemployment rate is now expected to peak at 8½ per cent in 2010-11. This is up from an unemployment rate of seven per cent, which was forecast in February 2009 and published in the UEFO. Such an unemployment rate is consistent with almost one million people being unemployed by early 2011.

Wages growth around Australia is expected to slow to 3.25 per cent in 2009-10 and 2010-11, reflecting the easing in labour market conditions.

Inflation is forecast to continue to moderate over the forecast period as the global recession eases previous demand pressures, and increasing spare capacity. Inflation is forecast to slow to 1¾ per cent through the year to the June quarter 2010 and 1½ per cent through the year to June quarter 2011. With the inflation rate expected to fall to under the Reserve Bank of Australia's two to three per cent target band for inflation, this leaves open the door for further interest rate cuts if economic conditions continue to deteriorate.

CCI Economics

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