BUDGET 2015–16

Building confidence or castles in the air?

The Prime Minister promised, and the Treasurer has now delivered, a 'dull' budget for the year ahead.

In the context of fiscal policy, 'dull' means nothing that will overly concern the electorate or undermine consumer or business confidence. There are a few winners and some losers, but little that can be classified as 'unfair' or that is likely to get the sort of furious response we saw following the 2014 Budget night announcements.

However, 'dull' also means that there is no medium to longer term strategic thinking about how the Budget can eventually be returned to surplus. This will inevitably require political resolve and an understanding by the electorate that there is no silver bullet to solve the problem.

Budget highlights

Small business a winner; Fiscal adjustment loses out

The Treasurer has announced a Budget deficit of $35 billion, or 2.1% of GDP, for 2015–16, down from $41.1 billion (2.5% of GDP) in 2014–15.

The 2015–16 Budget is pitched as 'responsible, measured and fair', with a Budget surplus projected to return by 2019–20 and the economy shifting up to trend growth in 2016–17.

The key measures announced – tax and investment breaks for small business, and childcare assistance – are described as 'redirecting government spending' rather than unfunded new initiatives. In particular, $7.4 billion in savings is due to the abandonment of the Paid Parental Leave Scheme.

However, real growth in expenditure is forecast to increase over the four years of the forward estimates. On average the increase is a modest 1.1% per annum, but this marks a significant rise to 3.3% by 2018-19.

Spending when measured as a per cent of the economy is projected to drift a little lower over the next four years, from 25.9% to 25.3%. This is still quite high by historical levels and, given population trends, is an unsustainable trend over the longer term given the current revenue base.

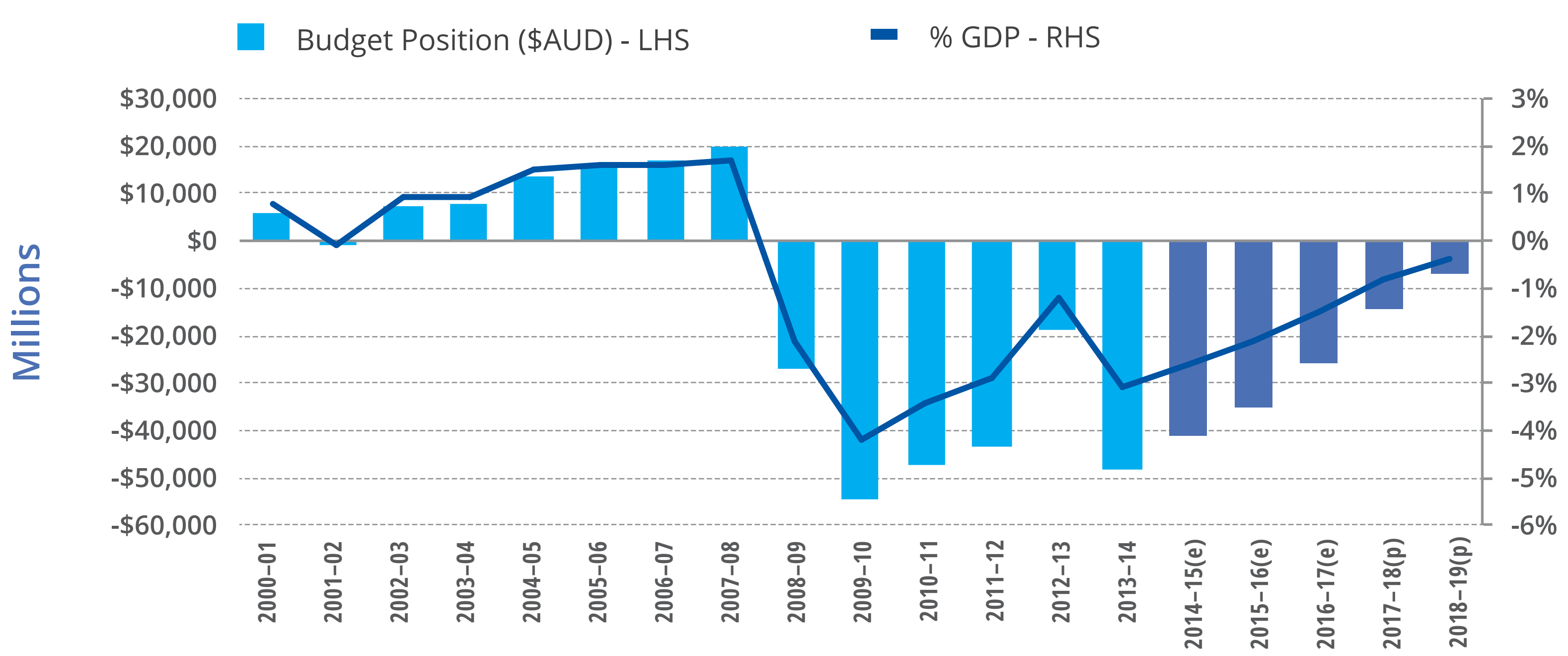
The impact of the collapse in commodity prices has significantly eroded Government revenues from the corporate tax base as well as taxes from income and superannuation. Since last year's Budget, total receipts are projected to be some $50 billion lower over the four years to 2017-18.

Yet total receipts as a per cent of GDP are anticipated to rise from 24.0% of GDP in 2015–16 to 25.2% in 2018–19.

It is unsurprising then that the Treasurer has noted that 'more work needs to be done' to lower spending, foreshadowing that – while most have avoided much pain this time around – the Budget adjustment task has a long way to go. Sooner or later, some pain is unavoidable.

In the short term, however, the focus will be on the newest initiatives announced by the Government in the 2015-16 Budget. With childcare benefits not coming into effect until July 2017, the chief thrust of new policies is directed at small businesses.

Underlying Federal Budget position



SMALL BUSINESS MEASURES

From 1 July 2015:

- The tax rate for companies with annual turnover of less than $2 million will be lowered from 30% to 28.5% at a cost of $1.45 billion.
- For the majority of small businesses that are not run as companies, an annual 5% tax discount – up to $1,000 – is introduced at a cost of $1.8 billion.

Effective immediately:

- Small businesses can claim up to $20,000 as an immediate tax deduction for **all** purchases.

Other measures include:

- Start up costs for new businesses can be immediately deducted.
- Employee share schemes will not attract tax until the benefit is realised
- FBT no longer applies to any portable electronic device used for work.

2 Key measures

+ and - represent the change to net budget position

EXPENDITURE

SMALL BUSINESS PACKAGE - $5.5 billion

Includes **accelerated depreciation** measures will lift the threshold for an immediate tax deduction for all individual assets between the value of $1000 and $20,000. This measure will lead to a cost to revenue of **$1.8 billion**.

Small business will no longer need to pay **Fringe benefits tax** on portable devices like laptops and tablets. The government believes this will lead to an unquantifiable cost to the budget.

Also includes a 1.5% corporate tax rate cut for businesses with turnover of less than $2 million and a 5% tax cut for small unincorporated businesses.

FAMILIES PACKAGE - $4.4 billion

A **$4.4 billion** Families Package was announced which will be made up of a new Child Care Subsidy measure costing **$3.5 billion** and an **$869 million** Child Care Safety Net to assist vulnerable, disadvantaged and additional needs children. Both measures are scheduled to commence on 1 July 2017.

HELPING AUSTRALIANS INTO WORK - $370 million

Includes new youth unemployment strategy worth $330 million.

Four existing wage subsidy programs will be consolidated into a single national wage subsidy pool to encourage small business in hiring job seekers.

The waiting for the dole period for under 25 year olds has been reduced from six months to four weeks.

NORTHERN AUSTRALIA INFRASTRUCTURE FACILITY - $800 million

Government will create a concessional loan facility to stimulate private investment in Northern Australia. It will have a capacity of $5 billion.

Also includes $100 million to improve cattle supply chains.

DROUGHT ASSISTANCE - $270 million

Extension to current drought assistance programs including the drought-specific concessional loan schemes and extended access to social and mental services in affected communities.

WELFARE TRANSFORMATION PROGRAM - $60 million

An initial investment of **$60 million** to update the **welfare payment system** will help increase capabilities to detect and deter welfare fraud and ensure fairer benefits.

COUNTER-TERRORISM MEASURES - $450 million

$450 million will be spent on **new intelligence measures** including new IT and telecommunication capabilities.

FOREIGN AID + $1 billion

Foreign aid will again face significant cuts.

WELFARE INTEGRITY MEASURES + $1.5 billion

Includes removal of double-dipping from both government and employer parental-leave pay. The government will reclaim HECS debt from Australians living overseas. Saving will also come from increasing the Department of Human Services fraud prevention and debt recovery capability and improving assessment processes.

PAID PARENTAL LEAVE SCHEME + $7.4 billion

As the government abandons the scheme, funds allocated under last years' forecasts have freed up.

REVENUE

MULTINATIONAL TAX AVOIDANCE N/A

Government to introduce new laws to target tax avoidance by approximately 30 multinationals. Measures include a targeted avoidance law, new pricing documentation standards and stronger penalties for non-compliance.

The government has not released estimates of future revenue.

GST EXTENSION + $350 million

GST applied to digital products and services from July 2017.

GST COMPLIANCE PROGRAM + $445 million

Government intends to extend the program to promote GST compliance by 3 years.

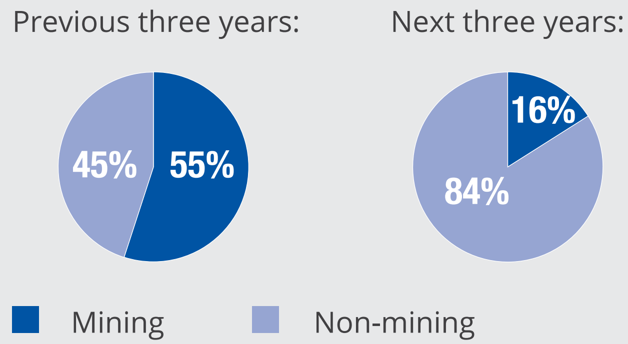
3 Macro-economic context

The return to surplus by 2019-20 is based on a number of bold assumptions:

- An iron ore price of $48/tonne - while admittedly hard to forecast, in its own words this assumption is 'risky' for the Government – for every $10/tonne fall in the spot price, revenues will fall by $2.1 billion in 2015-16 and $4.4 billion in 2016-17.
- The outlook for real wages and employment growth remains very modest, but household consumption is forecast to pick up, implying a further decline in household savings.
- Residential investment will continue to grow strongly over the next two years.
- Non-mining sector investment will pick up to 4% in the year ahead and 7.5% the following year.
- The terms of trade will start to increase from 2015-16.

If these forecasts are not met, then revenue and expenditure projections will also fall short of expectations and the surplus will recede further into the distance.

Over the next three years, the mining sector will contribute just 16% to overall GDP growth, compared with 55% over the previous three year period.



FOCUS ON RETAIL

Small retail businesses will benefit from changes to tax rates and accelerated depreciation allowances. The Budget is unlikely to have a significant impact on the retail sector more broadly, however.

The Budget's own forecasts are for a modest pickup in household consumption (a broader measure than retail sales, including for example services such as health and education) over the next two years. This modest growth comes from a gentle rise in employment but with little increase in real wages, requiring some draw down of savings.

The Budget's ability to restore consumer confidence will be the most critical factor driving spending in the short to medium term.

The Government forecasts GDP growth of 2.75% in 2015-16. Key components are:

↑ 2.75%

Household consumption
The economy is expected to get a moderate boost in household consumption in 2015-16, picking up further in 2016-17.

↑ 6.5%

Dwelling investment
Dwelling investment will remain healthy in 2015-16, before tapering off slightly in 2016-17.

↓ 7%

Business investment
Led by a fall in mining investment of 25% and 30% over the next two years. Non-mining investment is expected to increase in 2015-16, and further strengthen in 2016-17.

↓ 8.5%

Terms of trade
The terms of trade is expected to deteriorate in 2015-16 on the back of falling commodities prices, before stabilising in 2016-17.

↑ 5%

Exports of goods and services
Exports will be a key contributor to growth in both 2015-16 and 2016-17.

↑ 1.5%

Employment
Employment is expected to improve moderately in 2015-16, picking up slightly in 2016-17.

6.5%

Unemployment rate
Unemployment is expected to deteriorate further in 2015-16, before improving slightly in 2016-17.

↑ 2.5%

CPI
Consumer prices are anticipated to increase moderately in 2015-16. This is in line with Urbis forecasts for the same period.

↑ 2.5%

Wages
Wage growth is expected to remain modest for both 2015-16 and 2016-17, reflecting the moderate pace of economic growth and mild labour market conditions.

The verdict

Impact

The Budget's official aim, the Treasurer has told us, is to encourage 'all Australians to get out there and have a go'.

Coupled with historically low interest rates, there are real incentives for small businesses to bring forward investment. However it is questionable whether much of the spending will generate significantly higher growth and employment, especially as much will likely end up on imported items: computers, cars, or tradie's tools.

More importantly, the Budget needed to re-instil confidence in business and consumers.

There will undoubtedly be a collective sigh of relief across the electorate that this Budget was indeed relatively 'dull' in that there were no nasty surprises, and there is certainly enough to make at least a few small businesses smile.

However, over the coming weeks increasing attention will likely be paid to the lack of progress in addressing long term Budget repair. That Damoclean Sword still hangs above us.

And doubtless the significant delay in delivering the promised improvement in child care assistance, together with the abandonment of the PPL scheme, will leave a sour taste in some parents' mouths.

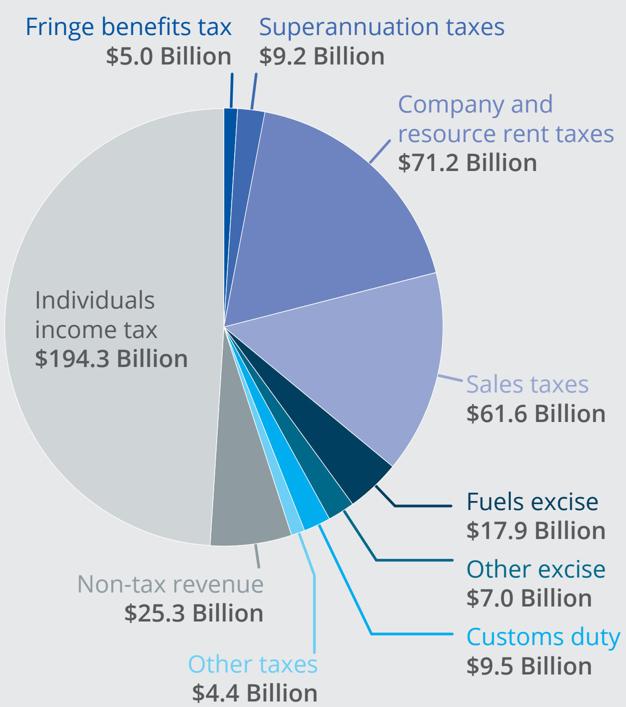
Critically, there is nothing in this Budget that is likely to change the outlook for new investment by larger businesses – the type of major investment initiatives that will really assist in lifting growth and employment, but which are currently on hold in the face of spare capacity and sluggish demand.

Nor is there significant new infrastructure investment to help build national productivity.

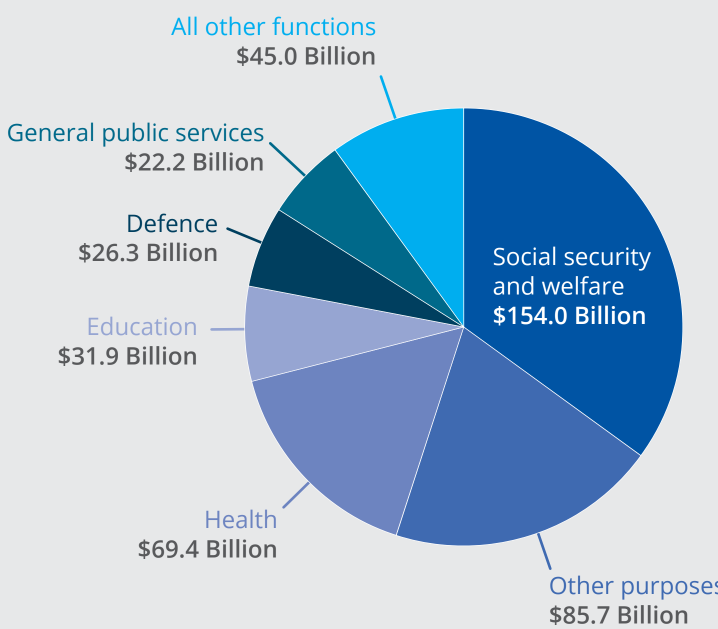
The task of Budget repair for the long term still lies ahead of us and difficult choices have to be made. Where can we make cuts to expenditure that are fair and do not leave the most vulnerable in our society exposed? How can we continue to invest in education and infrastructure, which are critical to Australia's future growth. And how do we build the revenue base back to a sustainable level that reflects the end of the mining boom?

This was a Budget carefully crafted to avoid criticism and restore confidence. Judging by the initial reactions, it has fallen short on both counts.

Where revenue comes from...



Where taxpayers' money is spent...



The Economic Advisory Team

Urbis' Economic Advisory team has highly developed skills in macro and micro economic modelling, forecasting and analysis, applied across a wide range of sectors, industries and policy portfolios.

For government

Economic research, analysis and modelling plays a crucial role in policy development across all portfolios and at all levels of Government. Urbis' Economic Advisory team supports governments to deliver optimal policy outcomes that will withstand stakeholder scrutiny, by providing a rigorous understanding of economic, social and environmental drivers and their associated costs and benefits.

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For organisations

Organisations are challenged on a daily basis as the domestic and global economic landscape changes along with the policy environment in which they operate. Urbis' Economic Advisory has deep and broad experience in assisting peak bodies, not-for-profits and businesses to better understand and negotiate the economic, financial and policy terrain and so deliver outstanding results to stakeholders.

Key areas of expertise:

- Urbis' Economic Advisory group is able to provide comprehensive economic analysis to support the robust evaluation of existing policies, programs and projects, as well as the development of new ones.
- We have helped governments at all levels to understand the economic consequences of a wide range of initiatives encompassing education, family support, employment, justice, technology, the environment, housing and infrastructure.

Services offered:

- Economic impact assessments
- Cost Benefit and Return on Investment analysis, including triple bottom line assessments, to meet standards required by relevant government guidelines across state and federal jurisdictions.
- Economic impact assessments (policy, program, projects, industry and attractions/ events) including through CGE and Input–Output Modelling.
- Government policy reviews and Regulation Impact Statements (preparation, peer review and industry responses and submissions).
- Social Return on Investment analysis (Urbis is a member of the Social Return on Investment Network, UK).
- Regional and industry economic analysis.
- Economic and econometric modelling, forecasting and foresighting.
- Strategic infrastructure needs assessment and analysis.
- Survey design, delivery and analysis.
- Stakeholder consultations and workshops.
- Development of thought leadership papers.
- Macroeconomic outlook presentations (board, strategic planning, seminars and conferences).