

ANZ Budget Update: business and industry summary

No big surprises, but the devil is in the timing

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Key points

- As expected, the importance of this Budget for business lies mainly in infrastructure spending projects, which will provide a short-term activity stimulus and hopefully, a long-term productivity gain.
- There are scarce few sweeteners for businesses in this Budget. Small businesses get a (temporarily) bigger tax deduction for immediate investments, but several other business taxes and charges will rise.
- Industry-specific measures will mainly affect healthcare, residential construction, superannuation funds and education and training providers.
- the Carbon Pollution Reduction Scheme (CPRS) made its debut in this Budget, even though it has not yet been passed into law by Parliament. It is described as 'broadly revenue neutral' for Budget purposes, but will cost around \$250mn in administration costs in its first 3 years.

Key spending and saving measures

Spending measures	Cost over 5 yrs to 2012-13
Pension increases for aged and carer pensions	\$4.5bn
Education infrastructure investment	\$3.7bn
Infrastructure spending on roads, rail and ports	\$5.7bn
Health care and hospitals infrastructure investment	\$3.4bn
Jobs and Training Compact for people under 25 years	\$1.6bn
Clean Energy Initiative including carbon capture & storage, solar energy projects, renewables	\$1.3bn
Universal paid parental leave from 2011	\$0.7bn
Extension of first home owners boost to end Dec 2009	\$0.5bn
Small & general business tax break (50% to Dec '09)	\$0.3bn
Savings measures	Saving over 5 yrs to 2012-13
Superannuation – reduced concessional contribution caps	\$2.7bn
Superannuation – reduced government co-contribution	\$1.4bn
Family Tax Benefits & Baby Bonus – pause to indexation	\$2.4bn
Defence expense savings – land sales worth up to \$100mn plus purchasing and operating budget savings	\$2.0bn
Private health insurance subsidy – tighter means test	\$1.9bn
Closing tax loopholes on hobby farms, employee share schemes, foreign sourced incomes	\$1.6bn
Pension income tax – increase income tests	\$1.2bn
Medicare Safety Net Caps – tighten price caps on private medical services paid by the Medicare Safety Net	\$0.5bn

Source: Federal Budget 2009-10

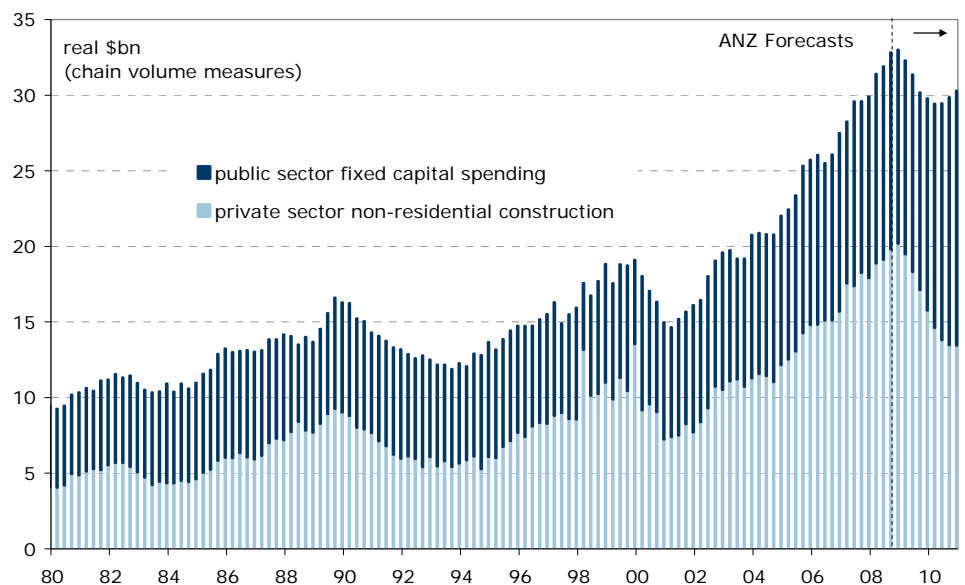
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Government spending on major infrastructure

Government spending on infrastructure is an important source of demand for heavy engineering and non-residential construction firms. In sheer size however, it has been dwarfed in recent years by private non-residential construction. Even with these spending boosts, it cannot 'fill the gap' being left by reduced private demand. We expect the value of total government fixed capital investment (by all three levels of government) to rise by 4.5% in real terms, from around \$51bn in 2008 to \$53bn in 2009, and then leap by 19% to \$63bn in 2010. But private sector non-dwelling construction (non-residential buildings and engineering structures) will drop by 9.3% from \$78bn to \$70bn in 2008, and then plummet by 21% to just \$55bn in 2010, as the business investment pipeline dries up.

The construction industry will therefore, unfortunately, be one of the sources of rising unemployment as non-residential demand falls away through 2009-10, although not by as much as if no new spending had been announced. The total construction industry (residential, non-residential and engineering construction) is massive, employing 990,000 people as of February 2009, or 9.1% of total employment, plus additional employment in upstream and downstream industries such as materials manufacturers and suppliers and hardware retailers. The Government estimates that its new infrastructure spending and other 'Nation Building' measures will help to support 210,000 Australian jobs.

Even with this boost, total non-residential construction will dip in 2009-10



* All public sector capital spending including commonwealth, state and local governments. Sources: ABS and ANZ Economics and Markets Research.

Transport infrastructure

Last year the Government announced it would identify priority projects for immediate funding from the \$10bn Building Australia Fund, which was created in last year's Budget for national infrastructure. This Budget allocates \$5.6bn of this Fund to specific transport projects over the next 5 years (see table below). Much of this spending however, will be slow to trickle through, with the majority allocated to the latter years of the outlook period. New transport projects show a heavy emphasis on metro rail and public transport projects, presumably in order to address urban commuter congestion, which is a serious issue in most cities.

New road funding is concentrated on 'Network 1', the freight route along the eastern seaboard from Melbourne to Cairns. Ports, which have been major bottlenecks during the recent (but now past) mining boom get short shrift, with only Darwin and the regional port of Oakajee in WA earmarked for development in the outlook period. These major freight transport projects all have the benefit of adding to both short-term stimulus and long-term transport (and hence all industry) efficiency and productivity.

Budget 2009-10: Major new infrastructure spending allocations

\$mn	2008-09	2009-10	2010-11	2011-12	2012-13	Total
(Road) Network 1	742.0	75.0	424.0	624.0	526.0	2,391.0
Metro rail	263.0	196.0	469.7	834.6	1,143.4	2,906.7
Public transport	32.0	30.0	79.0	65.0	74.0	280.0
Clean Energy	0	400.0	300.0	300.0	300.0	1,300.0
Education fund	68.0	595.4	935.4	650.6	317.1	2,566.5
Hospitals fund	186.0	465.7	847.5	813.2	643.0	2,955.4
Total new infrastructure spend	1,291	1,762.1	3,055.6	3,287.4	3,003.5	12,400

Source: Budget 2009-10.

Schools and hospitals infrastructure

The other major infrastructure spending beneficiaries are all public schools and hospitals, which will see a much needed \$2.5bn and \$2.9bn worth of capital improvements respectively over the 5 years. These will be paid out of their respective Education Investment and Hospitals Funds, which were established in last year's Budget for this purpose. These are the first major Fund allocations.

Energy infrastructure

The 'Clean Energy Initiative' components of the Budget are less clearly targeted at infrastructure spending and are more about R&D. About half is allocated to 'carbon capture and storage' research and demonstration plants (for coal-fired power sites) with the remainder going to solar power demonstration plants and a smaller portion to other renewable energy research projects.

Telecommunications and broadcasting infrastructure

For the National Broadband Network (NBN), the Government expects the total investment will eventually cost \$43bn, with significant contribution from the private sector. The initial government investment however, will be just \$53mn in 2009-10 to kick start the establishment of the investment vehicle, with no further spending allocated in the outlook period to 2013. Another \$250mn is allocated to immediately address regional broadband 'blackspots'.

In related measures, the switch to digital television will cost \$26mn in 2009-10, doubling to \$51mn in 2010-11 and \$41mn in 2011-12. The ABC is receiving a boost to both its capital funding and annual operating revenue in order to provide new digital services, including a third ABC television channel for children's programs and new 'regional broadband hubs'.

Other capital spending

As well as these big-ticket headline items, there is the usual list of small one-off capital works projects. In 2009-10 the list is very small indeed. It will include: \$15mn to expand the national crisis coordination facility (at attorney-general's); \$14mn to the ABC for capital improvements; \$250mn for regional blackspots in the national broadband network; \$12mn to fit out offices for the new Dept of Climate Change; \$16.7mn for a new office for FaHCSIA in Tuggeranong; \$6mn to redevelop the Villawood Detention Centre (but costing a total of \$141.7mn to 2012-13); and \$12.6mn for security upgrades to Australian embassies.

A major area of omission in these infrastructure plans seems to be water and drought reform (a major focus of last year's Budget), which were apparently overlooked in this year's list of projects. The only additional allocation appears to be accelerated funding for water rights buy-backs for the Murray-Darling Basin.

Support for residential construction industries

Residential construction will benefit from a much-anticipated extension to the popular First Home Owners Grant for 3 months (to 31 Sept 2009), phasing down to \$14,000 for new homes and \$10,500 for established homes until 31 Dec. This

will cost an additional \$486.2 mn in 2009-10. The old FHOG of \$7,000 will continue thereafter. No means testing or other limits have been applied.

The residential construction industry will also benefit from increases in funding for public and defence housing. The Defence department will also provide an indirect boost through an estimated \$100mn in defence land sales, which will provide a boost to local land available for redevelopment in some locations.

Some residential energy efficiency programs are being enhanced, but others - such as the phase-out of inefficient light bulbs, the 'Green Loans Program' and efficient appliances - are being cut or phased out. In the longer term, less favourable tax treatment for holiday homes and hobby farms (see below) could be detrimental to residential homes demand in some regional locations.

Measures affecting health services providers

There is little or no new direct funding for health services in this Budget. Instead, the \$3.2 bn Health and Hospitals Fund established last year will be used to invest in hospital infrastructure projects 'of national significance', cancer care and research. \$465 mn of this Fund will be spent in 2009-10, rising to \$847mn in 2010-11 and \$813 mn in 2011-12.

Health spending cuts have been made across a wide range of health and ageing portfolio programs, most notably by imposing new pricing caps on items paid by the Medicare Safety Net. This will save \$198.5mn on Safety Net payments for obstetrics services over the 5 year Budget period and \$261 mn on other Safety Net funded items. Depreciation allowance changes for diagnostic imaging and pathology equipment will also net savings of around \$65 mn p.a. from 2011-12, although these services will at the same time benefit from new bulk billing incentives worth up to \$57mn p.a.

In other health portfolio cuts, the 'assistive technology in community care' program has been abolished, saving \$6mn p.a., as has the '45 year old health check' promotion (saving \$1mn p.a.). The Better Health Initiative, which promotes health checks and healthy lifestyles is being cut by around \$38mn p.a. E-Health programs and small GP training items have also been scaled back. In total, the health and ageing portfolio has increased its expenses in 2009-10 (+715mn) but faces a funding cut in 2012-13 (-\$223mn).

Other Budget measures affecting the health sector — and especially private health services — are the changes to the government subsidy for health insurance, which will now be means tested (reducing from \$75,000 in income for individuals and \$150,000 for families, and cutting out altogether at \$120,000 for individuals and \$240,000 for families) and increases in the Medicare surcharge levy for high income earners who do not have health insurance. The means testing on the insurance subsidy will save the government (and, by implication, cost insured individuals) \$1.8bn over the next 4 years, while the increased Medicare levy will net an additional \$145mn over the same period.

These changes will only affect high income individuals and families — around 10% of individual taxpayers (1 million people) earned over \$75,000 in 2006-07 and an estimated 6% of households (470,000 households) earned over \$150,000 in 2005-06. But they are likely to have a big effect on health insurers and private health service providers, depending on how these families respond (e.g. by reducing their health insurance or forgoing elective procedures). It will result in higher health insurance and health service costs for these individuals, and possibly reduced demand for private health services from them as a result.

Superannuation and investment measures

Several changes to superannuation and taxation arrangements announced in this Budget will affect mainly high-income and/or high-wealth individuals, but could have big ramifications for superannuation and investment services that include these people as clients. Other measures will affect everyone. They are:

- the annual cap on concessional superannuation contributions will reduce from the current \$50,000 p.a. to \$25,000, and for over 50 year olds (y=until

2012), it will reduce from \$100,000 to \$50,000. This will mainly affect higher income earners making additional super contributions.

- For lower income earners, the superannuation co-payment will reduce from 150% to 100% over the next 4 years, saving around \$400mn p.a.
- Tighter targeting of tax benefits for employee share schemes, whereby the option to defer tax payments will cease and the tax discounts for upfront tax payments on employee share purchases will only apply to employees earning under \$60,000 p.a. This measure will apply immediately, from 12 Mar 2009. It will net the Government \$10mn in 2009-10, \$90mn in 2010-11 but then falling back to \$60mn in 2011-12. This will make such share schemes less attractive to higher income employees, who have typically made more use of this option. But it is unclear how this change will make employee share schemes more attractive for lower income employees, as is the stated intention.
- Tax file number withholding arrangements will be extended to closely held trusts, such as family trusts, to better ensure that assessable distributions to beneficiaries match their tax returns. This tightening is expected to net \$50mn p.a. in additional tax revenue.
- Tighter rules on non-commercial tax losses by high income individuals, whereby ongoing losses on hobby farms, holiday homes and the like can no longer be claimed as tax deductions against salary income by taxpayers earning \$250,000 p.a. or more. This will apply immediately and is expected to raise up to \$700mn over the outlook period to 2012-13. This measure may have the effect of reducing the value of such 'lifestyle' properties.
- For self-funded retirees, the compulsory annual drawdown withdrawal from their pension accounts has been halved, so that fewer retirees will need to sell investment assets to meet the drawdown requirement (due to the drop in value for many retirees' investment funds). This will cost the government \$10mn in 2008-09 and \$15mn in 2009-10 through higher pension outlays.

Carbon Pollution Reduction Scheme (CPRS)

Even though the CPRS has not yet been passed by parliament, the Government has included it as a line item for several portfolios in this year's Budget. These provide further indications of the Government's own cost and revenue assumptions for the scheme, and thus the burden it might impose on industry.

The Budget says the CPRS has been designed to 'be broadly budget neutral', with an implementation cost of (only) \$260mn over its first three years, from 2010-11. Revenue raised from permit sales (fixed at \$10 per tonne in 2011-12) will be repaid in assistance to households and industry and an adjustment to fuel taxes once trading commences.

The CPRS' costs and revenue appear to be very unevenly spread over the outlook period. Implementation of the CPRS is budgeted to cost a whopping \$7.4bn in 2010-11 and \$3bn in 2011-12, but to contribute \$988mn in revenue in its third year of operation in 2012-13. The Australian Carbon Trust, which will enable interested individuals to purchase CPRS credits, is allocated \$29mn in establishment funding in 2009-10, and a further \$37mn in 2010-11, but very little afterwards. Provision for the CPRS and related measures has also been made in the Government's contingency reserves.

Business-wide tax and revenue measures

Business taxes and charges going down:

- Small business tax deductions on eligible investment assets are temporarily increased to 50% upfront for goods (such as vehicles and machinery) ordered between 13 Dec 2008 and 31 Dec 2009 and installed by 31 Dec 2010. This will be worth an estimated \$141mn to small businesses over the 4 year outlook period to 2012-13.
- For general businesses (i.e. not classed as 'small'), the 30% tax deduction on eligible investment goods will be continued indefinitely.

- Temporary tax relief for small businesses will be provided by reducing PAYG instalments for the 2009-10 tax year. The GDP adjustment factor for calculating PAYG instalments will be adjusted from 9% to 2% for the year, to reflect expected changes in the CPI for this year. This will benefit an estimated 1.5mn eligible small businesses this year, by reducing the chance of their PAYG instalments over-estimating their actual taxable income. This is expected to cost \$720mn in 2009-10 but be revenue neutral onwards.

Business taxes and charges going up:

- Fees and charges for business collected by ASIC will now be indexed annually with the CPI from 2010-11 (as opposed to *ad hoc* fee increases in the past). ASIC fees will grow by a collective \$14mn in 2010-11 and a total of \$84.3 mn over the 3 years to 2013-14.
- Beer and wine based pre-mixed drink products that 'mimic' spirit-based drinks will now be taxed as if they are spirit-based drinks (based on their sweetness, taste and ingredients). This will net an additional \$20mn p.a. in tax revenue and \$10mn p.a. in customs revenue from 1 July 2009.

All other business taxes and charges will remain unchanged (despite much media speculation about various components), including general business investment tax rebates, FBT and company car allowances.

Business-wide miscellaneous measures

General industry assistance and budget measures:

- a one-off \$50mn boost to the Export Market Development Grants (up from \$150mn) in 2008-09, to cover an estimated extra 1,800 businesses with eligible costs, due to over-subscription to this popular scheme.
- \$10mn p.a. for a new small business 'Support Line' phone service and related online support program.
- a new 'Commercialisation Institute' to support small business R&D and help prepare new innovations for the market.
- Paid parental leave for all Australian employees will commence in 2011, at an initial cost to the Government of \$237mn, rising to \$478mn by 2012-13. It will pay eligible parents the minimum wage (currently \$543 p.w.) for 18 weeks. Parents receiving this leave will not get the baby bonus as well. Those not eligible for paid leave will receive the baby bonus instead. The Government has said it aims to make this scheme cost-neutral for employers, but the status of superannuation, insurance and other labour on-costs for employees on parental leave is still under review.
- While not ostensibly an industry assistance measure, many Australian businesses supply materials, goods and services to the defence department (e.g. uniforms, tanks, munitions, spare parts and food). They are likely to be affected by Budget plans to rationalise Defence supplies, warehousing and inventories. The Defence portfolio has an increased Budget allocation of \$1.4bn in 2009-10 (mainly to cover operations in Afghanistan), but this is to be more than unwound over the next 4 years (-\$1.7bn). The nature of these future savings are not specified, but will presumably mean fewer purchases.
- The Australian Bureau of Statistics has received a small funding increase (+\$15mn p.a.) to restore its statistical capacity. The ABS has announced it will restore the monthly labour market survey series. These restored data will help government and businesses to plan better through the downturn.

Assistance for farms and rural industries:

- Confirmed additional exceptional circumstances assistance for 2009-10 (\$194mn extra), but no additional spending beyond that date. Extra funding for small business drought relief (\$10mn) and associated advisory services (\$45mn) is also confirmed for 2009-10 but no further.
- Axing the 'Land Water Australia' program, saving \$46mn over 5 years.

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