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Budget Review 2007–08

Introduction

The purpose of the *Budget Review 2007–08* is to assist Senators and Members by identifying some of the key features of Budget measures contained in the Commonwealth Budget 2007–08. While selective in focus, it is not the intention of this document to make value judgements about the relative importance of different measures or to provide a comprehensive overall assessment of the Budget.

Nevertheless, the opening feature article provides analyses and comments on the broader economic context of the Budget and the underlying assumptions underpinning the Government's fiscal strategy. Similarly, the second article adopts a broad perspective in examining aspects of the Budget that give effect to the Government's Industry Statement as announced on 1 May 2007 and the sixth article provides an overview of social policy aspects of this year's Budget. The remaining articles are more tightly focussed and examine the impact of the Budget across a broad range of specific issues and initiatives.

The *Budget Review 2007–08* has necessarily been prepared under time pressure with a view to making it available to parliamentarians as soon as possible after the handing down of the Budget. While great care has been taken to ensure that this brief is accurate and balanced, it is written using information publicly available at the time of production. Clients of the Library are invited to raise any points requiring amplification or clarification directly with the research specialist concerned and any general comments on papers are also welcome. Any other feedback should be forwarded to me.

Roxanne Missingham

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Parliamentary Librarian
May 2007

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Budget 2007–08: Key Features

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Introduction

The Budget delivered on 8 May 2007 by the Hon. Peter Costello MP is the twelfth under the Howard Government and the twelfth brought down by the current Treasurer. All but two of these have been surplus budgets (as measured by the underlying cash balance).[1] In cash terms, the latest Budget has an underlying surplus of $10.6 billion, produced by revenues of $245.6 billion and outlays of $231.9 billion.[2] This exceeds mid-year estimates by $0.9 billion. Continued cash surpluses are forecast into the future at slightly higher levels: $12.7 billion in 2008–09, $13.8 billion in 2009–10 and $12.4 billion in 2010–11. In accrual terms, the Budget is in surplus by $10.0 billion for 2007–08, $0.1 billion above mid-year expectations, and this is produced by an accrual revenue of $246.8 billion and outlays of $235.6 billion.

The present Budget comes at a time of continued economic prosperity, with unemployment at a 32 year low[3] and an ongoing mineral resources boom which, at the time of writing, shows few signs of abating. In the lead-up to the Budget, considerable commentary had therefore been apparent on the challenges inherent in managing an economy running at or near full employment.[4] In describing the Budget prior to his presentation, the Treasurer said:

> … the Budget which will be held tonight is the culmination of months of work, of carefully assessing the investment needs of the Australian nation, making sure that we properly use our resources and pitching our sail to the future to make sure that we are ready for the future challenges which are going to come upon us in the decades which lie ahead. It will be responsible economic management. It will have measures which will help families. But most of all it will be preparing for the great challenges of the future, challenges which we are going to face in relation to the ageing of the population, challenges on the environment and making sure that we so strengthen our economy that we can meet those challenges from a position a strength.[5]

These sentiments also reflect earlier discussion in the 2007 Intergenerational Report and elsewhere of the need for fiscal policy to improve outcomes in relation to the so-called ‘three Ps’: productivity, population and participation.[6]

A good deal of the Budget detail had already been informally revealed in the media prior to the Treasurer’s presentation. This included the changes to arrangements for claiming the childcare rebate, increased defence funding, land transport and industry spending initiatives, the indigenous housing package, increased dental funding and the changes to solar panel rebates.[7] Tax cuts were also widely expected and, for the fifth Budget in a row, were delivered. The surprise for many observers on Budget night was some larger, previously unannounced spending and policy measures, particularly the additional expenditures on education and the introduction of the Higher Education Endowment Fund.

In the immediate aftermath of the Budget, the main focus of much of the media was on the tax cuts and education spending.[8] For example, on the morning of 9 May the headlines said:

- ‘Tax Cuts Target Voters’ in *The Australian Financial Review*
- ‘Costello Masterclass — Treasurer trumps Labor with billions for education’ in *The Australian*
- ‘Blown Away — $70b on education, tax cuts’ in *The Sydney Morning Herald*, and
- ‘Costello’s Clever Carrots’ in *The Age*.

This brief attempts to cover some of the main features of the Budget. First, it discusses the main revenue and spending aspects of the Budget.[9] Second, the economic growth forecasts contained in the Budget are discussed, as well as the outlook for other macroeconomic aggregates, including inflation, unemployment, the current account and interest rates. Third, a brief consideration of the main Budget measures in relation to the ‘three Ps’ is provided.

Spending and taxing priorities

Receipts

There was considerable discussion around the revenue side of the Budget this year, focussing on two main themes. First, the size and distribution of the personal tax changes garnered a good deal of attention. (These are discussed in greater detail in a separate paper[10] below). Second, the overall size of the revenue receipts also received large coverage. Many reports leading up to the Budget observed that the Government was ‘awash with cash’ due to increased corporate tax receipts connected to the mining boom. Access Economics, for example, referred to ‘a brimful war chest’ and to the Treasurer ‘pulling revenue rabbits out of his hat’.[11]

Revenue underestimates and continued ‘fiscal surprises’

Treasury continues its record of underestimating revenues, with forecast revenues continuing to be well out of line with actuals. As with other recent Budgets, these ‘fiscal surprises’ are in large part because of higher corporate receipts, up 10.8 per cent on the previous year. Superannuation receipts have also shown a marked increase over previous years.

This year’s revenues are indeed considerable. Since December’s Mid Year Economic and Fiscal Outlook (MYEFO), estimated total revenue for 2006–07 have been revised upwards by $3.7 billion to $235 billion, while for 2007–08 estimates have been revised up by $4.0 billion to $246 billion. This latter revision is the net result from the negative contribution of the tax cuts announced in the Budget (expected to reduce receipts by $5.6 billion in 2007–08 and by $31.1 billion over the forward estimates) and $9.6 billion of 'parameter and other variations'.

Parameter variations include such things as greater than expected revenues from taxes, 'slippage' in the implementation of past policy decisions, and changes in the economic assumptions underlying spending or revenue projections. [12] Over the forward estimates, the amount of these variations is expected to reach $53.6 billion. This is partly a result of the buoyant economy, and also partly the result of the increasingly prevalent Budget practice of what *Australian* journalist George Megalogenis has dubbed 'regifting' (where unspent moneys earmarked for certain policy purposes in past Budgets are recycled on new measures).[13]

Sources of revenue in the Budget

The following table shows revenue receipts for the Budget year, and for purposes of comparison also looks at how these receipts have changed in a five year period since the 2002–03 Budget (see Table 1).

Table 1: Receipts: 2007–08 estimates (cash basis)

	$m	Share of total receipts %	Change 2002–03 to 2007–08 %
Individuals	117 950	48.0	31.2
Companies	62 964	25.6	92.2
Superannuation funds	8 280	3.4	71.1
Petroleum resource rent tax	1 890	0.8	10.4
Fringe Benefits tax	4 050	1.6	17.1
Total income tax	**195 134**	**79.4**	**47.1**
Customs and Excise Duty	28 350	11.5	10.2
Other indirect taxation	3 373	1.4	11.6
Total Taxation	**226 857**	**92.4**	**40.5**
Interest	**3 992**	**1.6**	**306.5**
Dividends and other	**14 762**	**6.0**	**24.3**
Total Receipts	**245 611**	**100.0**	**39.1**

Source: Budget Strategy and Outlook 2007–08, Budget Paper No. 1.

In line with previous Budgets, taxation receipts make up over 90 per cent of total receipts. The rest are interest, dividends from bodies such as the Reserve Bank of Australia and the Future Fund, and other small amounts. These figures exclude GST receipts, which are expected to be worth some $43.1 billion, or around 3.8 per cent of GDP, in 2007–08.[14] The reasons for excluding the GST from reported revenues are discussed elsewhere,[15] but basically the Commonwealth's argument is that the GST is a tax which it collects for, and appropriates to, the states.

Over the five years between the 2002–03 Budget and the current Budget, the most significant increases in taxation receipts have come from company and superannuation tax. The latest available figures (2004–05) quoted in the Budget papers suggest that over three-quarters of company income tax is collected from two per cent of incorporated taxpayers, these being large companies with over $100 million in revenue annually.[16] Interest as a source of receipts has also grown considerably, and this includes interest earned on Australian Government cash balances and on Future Fund assets. The long term decline in indirect taxation as a revenue source also continues, in part because the base for such taxes does not grow as quickly as the income tax base, and in part because of the combined effect of previous policy changes, such as the abolition of wholesale sales tax and removal of indexation from petrol excise.[17]

Expenses

Overall new spending initiatives (including capital measures) announced in this Budget amount to $36.7 billion over the forward estimates.

The Government announced a considerable number of spending initiatives in this Budget which, in total, contribute the bulk of the change in the Budget balance. These include:

- $3.3 billion over five years towards increased Child Care Benefits and more timely provision of the Child Care Tax Rebate[18]
- $3.5 billion over four years for universities under the *Realising Our Potential* initiative
- $6.6 billion over thirteen years to acquire Super Hornet aircraft, and
- $703 million over four years for Australia's military contribution in Afghanistan.

The relative importance assigned to different expenditure functions in this Budget, as well as changes from the previous year's Budgets, can be shown by separating expenses into functional areas and ranking them by order of magnitude (see Table 2). As in previous years, social security and welfare expenditure represents over 40 per cent of total expenditure. The next highest items are health at 18.2 per cent, defence at 8.4 per cent and education at 7.5 per cent. Between 2006–07 and 2007–08, expenses are estimated to increase on average by 6.3 per cent in real terms. A number of areas are expected to increase by significantly more than this, including transport and communications, defence, fuel and energy, recreation and culture, and public order and safety.

Looking out over the forward estimates, the approximate share of total spending taken up by each function remains constant or decreases slightly for most functions. This decrease is basically to make room for an increase in 'other purposes', including significant anticipated increases in notional spending on the 'Contingency reserve'.[19] This Reserve reflects, in part, the tendency for agencies to underestimate their spending and for that bias to grow over time. It also consists of commercial-in-confidence and national security-in-confidence items which cannot be disclosed separately, as well as several other items.[20]

Table 2: Expenses: 2007–08 estimates

	$m	Share %	Change 2006–07 to 2007–08 %
Social security and welfare	96 450	40.9	3.5
Health	42 964	18.2	7.1
Defence	19 880	8.4	14.5
Education	17 752	7.5	7.3
General Public Services	15 768	6.7	8.4
Other economic affairs	5 617	2.4	5.5
Fuel and energy	5 360	2.3	13.8
Transport and communication	4 516	1.9	32.8
Public order and safety	3 670	1.5	10.7
Housing and community amenities	3 011	1.3	2
Recreation and culture	2 979	1.3	11.4
Agriculture, forestry and fishing	2 799	1.2	2.6
Mining, manufacturing and construction	2 029	.9	7.7
Other purposes	12 794	5.5	1.4
Total expenses	**235 590**	**100.0**	**6.3**

Source: Statement 6: Expenses and net capital investment 2007–08, Budget Paper No. 1, May 2007.

Total Commonwealth payments excluding the GST payments to the states are estimated to be 21.5 per cent of GDP in 2006–07 and 2007–08, with this share rising to 21.6 per cent in 2008–09 and 21.8 per cent in 2009–10 and 2010–11. A rising share of GDP taken up by expenditures, together with relatively constant shares of expenditures by function, implies that most functional areas will see rises in spending in real terms over the forward estimates. The Budget anticipates that, in terms of functions, the most significant increases are likely in several areas, including social security and welfare and health (partly as a result of the ageing of the population); education (in part due to indexed Commonwealth payments and also as a result of initiatives announced in the Budget); and defence (due largely to acquisition, military personnel and recruitment and retention initiatives).

State of the economy and economic outlook

A further important part of the Budget documentation is an assessment of the state of the economy. There is a comprehensive discussion of the state of the economy in Statement 3: Economic Outlook, Budget Paper No. 1. The Statement contains forecasts of the major economic variables that are summarised in an important table, headed ‘domestic economy forecasts’.[21] Some of the main items are presented below (Table 3).

Table 3: Major Economic Aggregates, Forecasts

	Estimates 2006–07	Forecasts 2007–08
Household consumption (per cent change)	3.5	3.5
Business investment (per cent change)	4	7.5
Exports (per cent change)	3	5
Imports (per cent change)	8.5	6.5
Net exports (per cent contribution to GDP growth)	-1.25	-0.5
Current account balance ($billion)	58.25	65.75
GDP (per cent change)	2.5	3.75
Unemployment (per cent)	4.75	5
Consumer Price Index	2.75	2.5
Wage Price Index	4.25	4.25

Source: Statement 3: Economic Outlook 2007–08, Budget Paper No. 1, May 2007.

These forecasts show household consumption growing at a moderate rate of 3.5 per cent in 2007–08, which is slightly down on the higher levels of previous years, most notably 4.2 per cent in 2004–05. Business investment is forecast to improve over 2006–07 levels, underpinned by strong growth in mining and construction, albeit at levels lower than the highs experienced in the last five years. Exports are also expected to grow at a faster rate of 5 per cent in the coming year – this more moderate forecast is a departure from the over-forecasting of exports in previous Budgets. However, while exports (particularly non-agricultural exports) are expected to grow, so are imports, up by 6.5 per cent in 2007–08 on the back of a higher exchange rate and domestic demand. The forecast is therefore for net exports to decline, and to deduct approximately 0.5 per cent from GDP growth in the coming year. This is an improvement on the expected 1.25 per cent deduction in 2006–07, but still a source for concern given that a positive forecast of export performance in the coming year is prefaced partly on a moderate recovery in rural exports from the drought.

A slight rebound in unemployment is also expected, up from 4.75 per cent in 2006-07 to five per cent in 2007–08, in part due to changes in eligibility requirements for recipients of the Disability Support Pension and Parenting Payment.[22]

Forecast Australian growth

The Budget forecasts real GDP to grow by 3.75 per cent in 2007-08, up from growth of 2.5 per cent in 2006–07. This upwards revision on earlier forecasts was expected, and reflects in part the continued strong performance of the Australian economy in early 2007. If this forecast rate transpires it would mean that, in regional terms, the Australian economy is likely to be among the better performers for the next couple of years.

These forecasts are broadly in line with those put out by the IMF in their latest *World Economic Outlook* (WEO) in April. The IMF forecast growth in the Australian economy of

2.6 per cent in 2007, rising to 3.3 per cent in 2008, and forecast a slight slowing of world growth for the same period.[23] The WEO states:

> In Australia and New Zealand, real GDP growth weakened slightly in 2006, reflecting slower domestic demand and the impact of a severe drought in Australia. Growth is expected to pick up during 2007–08.[24]

However, despite the general consensus that projected growth is likely to improve on 2006 levels in 2007 and 2008, there are some sources of uncertainty in relation to growth in the short term. These are described in the next section.

Some short term risks…

In discussing forecast growth of the Australian economy, the Budget Papers state:

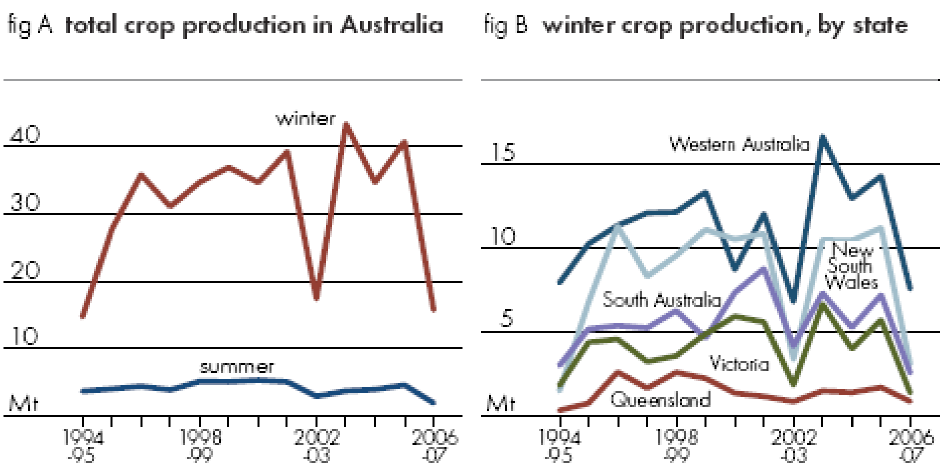
> The forecast for 2007–08 reflects an assumed return to average seasonal conditions and a partial recovery from the drought, which is expected to add ½ of a percentage point to GDP growth. Strong growth in 2007–08 also reflects solid growth in consumption and business investment, a modest increase in dwelling investment and accelerating export growth.[25]

The Budget Papers acknowledge that, despite these assumptions, the drought and its impact on agricultural performance (not to mention on exports and the wider economy) remains a considerable source of uncertainty.[26] In April, ABARE forecast a fall in farm output of around 20 per cent in 2006–07, with a decline in winter crops by 60 per cent (see Figure 1).[27] Estimates prior to the Budget suggested that, if such falls do occur, farm output will make a negative contribution to GDP growth of something in the order of 0.75 per cent in 2006–07.[28] Continued reductions in agricultural output would put a significant brake on growth in 2007–08. What remains uncertain is not just future rainfall, but the extent of such rainfall required for a significant recovery from drought conditions.

Poor recent productivity performance, and the limit it may place on growth, also remains an area of risk in relation to forecasts of improved growth in the coming year.[29] Problems with extrapolating trends from short periods of data exist, as do problems with international comparisons of productivity performance.[30] Nevertheless, aggregate figures are suggestive of a pronounced slowdown in Australian productivity, both in international and historical terms (see Figure 2). This was emphasised recently by the Reserve Bank Governor, Glenn Stevens, who stated in February:

> There are figures here that I think are probably worth recording… in the part of the economy for which you can do a good measurement—the market sector— for about 13 or 14 years up to 2004 the rate of (productivity) growth was 2.6 per cent a year on average. It was quite volatile year to year, but that was the average. Since then—and it has only been a two- or three-year period since then, and even that is a shortish period to be drawing a trend from—the trend rate of growth has been 0.9 per cent. That is quite a slowdown.[31]

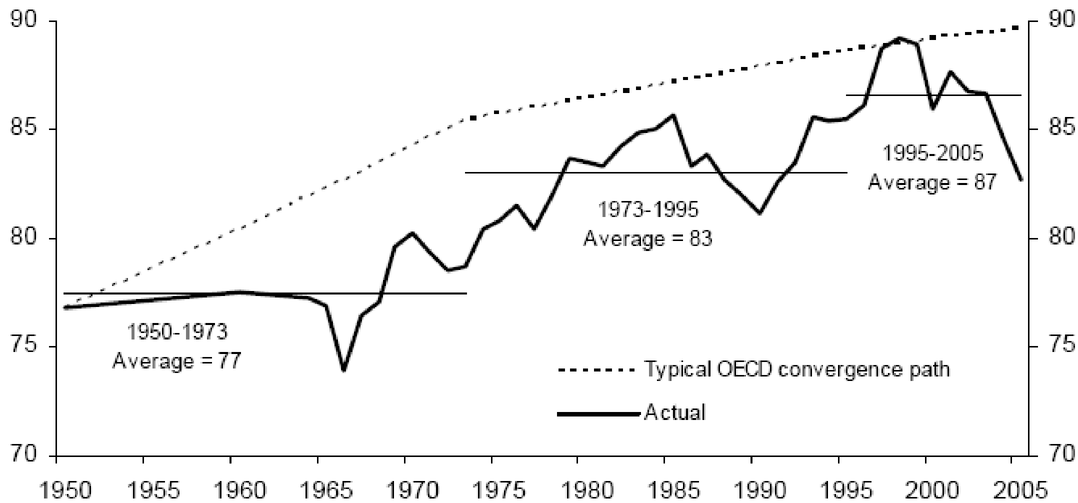
Figure 1 Projected winter and summer crop production



Source: Australian Bureau of Agricultural and Resource Economics (April 2007)[32]

While there is no explicit forecast for average labour productivity growth in the Budget Papers, some experimental estimates can be obtained by comparing GDP and employment growth forecasts. This is shown below (Table 4), together with estimates derived using a similar experimental methodology applied to figures from the 2006–07 Budget Papers and the December 2006 MYEFO.

Figure 2 Australian productivity, per cent of US level



Source: Productivity Commission (2007, p. 25)[33]

Table 4: Budget and MYEFO experimental estimates of productivity growth

	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Budget 2006-07						
GDP growth	2.5	3.25	3.5	3.25	3.25	
Employment growth	2.0	1.0	1.5	1.25	1.25	
Implied productivity growth	0.5	2.25	2.0	2.0	2.0	
MYEFO						
GDP growth		2.5	3.75	3.0	3.0	
Employment growth		2.25	1.25	1.25	1.25	
Implied productivity growth		0.25	2.5	1.75	1.75	
Budget 2007-08						
GDP growth		2.5	3.75	3	3	3
Employment growth		2.5	1.5	1.25	1.25	1.25
Implied productivity growth		0.0	2.25	1.75	1.75	1.75

Sources: Budget Paper No. 1, 2006–07, MYEFO, December 2006, Budget Paper No 1, 2007–08. Library estimates.

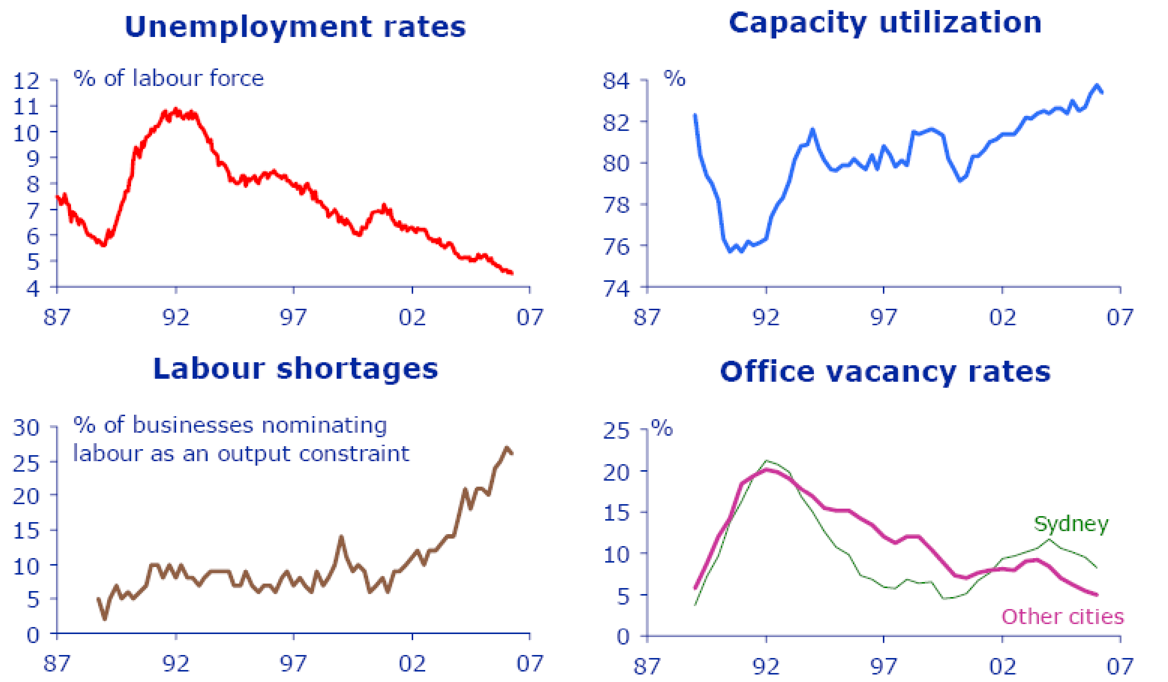
Elsewhere, Treasury have stated that their long run forecast is for labour productivity growth of around 1.8 per cent per annum over the next 40 years.

The causes of poor recent productivity growth remain the subject of considerable debate. However, what appears certain is that the extent to which productivity levels can improve in the short to medium term will be a fundamental determinant of further sustained and non-inflationary growth across time.

A further related source of risk to the Budget forecasts is emerging capacity constraints. This risk is discussed in *Budget Paper No. 1*. The potential for such constraints to put a brake on further growth continues to garner wider attention and debate in the media.[34] Certainly, given the strong economy a range of capacity indicators show that the economy is running at full throttle (see Figure 3). The Reserve Bank therefore continues to monitor such constraints with interest — on this issue it is worth again quoting RBA Governor Glenn Steven's comments on 21 February 2007:

> In the broad, after a long period of fairly solid economic growth, we have approached what for practical purposes can be called full capacity, at least for the moment. The evidence for that proposition is quite widespread... It may well be possible for these trends to go further yet, but a wide array of business enterprises the bank talks to in our regular liaison have been saying for some time that it is harder and more costly to find appropriate staff, and that the factor most constraining further expansion is not insufficient demand but insufficient capacity, either of labour or capital or both.[35]

Figure 3 Indicators of capacity constraints



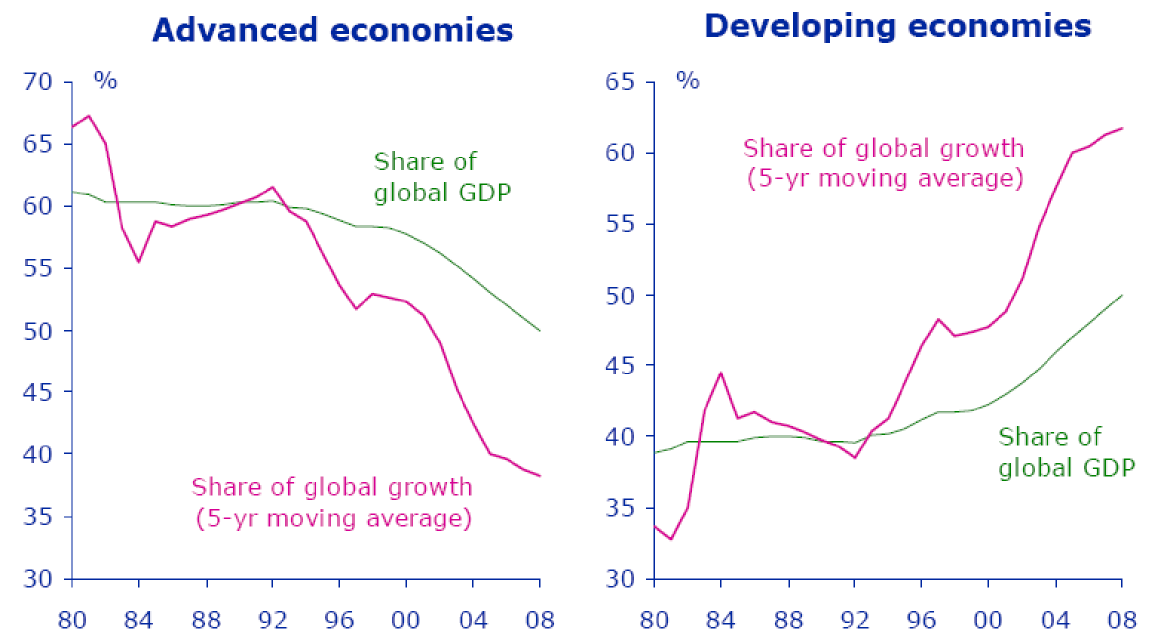
Source: ANZ Economics (based on statistics from Australian Bureau of Statistics; National Australia Bank; Property Council of Australia).

World economic outlook

The world economy has continued to post very strong growth figures in the past year, with world GDP growing at 5.4 per cent in 2006.[36] The role of developing countries in this continued strong performance is particularly noteworthy (see Figure 4). In the past three years over 70 per cent of world growth has come from developing countries, despite them comprising only 47 per cent of world production.[37] China and India remain the standout contributors in this regard, with growth rates of 10.75 per cent and 9.25 per cent in 2006 respectively.

IMF projections in April 2007 suggest a slight slowing in world GDP growth over the next two years, to (still *very* robust) annual rates of 4.9 per cent in 2007 and 2008. In part this slowing is due to a levelling off of growth in the US and some European economies going forward. For the US, the IMF has projected growth to be relatively low at 2.2 per cent and 2.8 per cent in 2007 and 2008. This relative pessimism appears well founded in part: in the March 2007 quarter, for example, GDP growth in the US was at a 1.3 per cent annual pace, the lowest rate since the first quarter of 2003. A major contributor to this poor performance has been a sluggish housing sector, with residential investment declining by 17 per cent in the March 2007 quarter. In its most recent WEO, the IMF has argued that the extent to which the world economy can continue its high growth trajectory may, in part, be determined by its ability to 'decouple' from the adverse effects of slow growth in the US economy.

Figure 4 Advanced and developing economy shares of global GDP [a]



[a] Note. 'Advanced' economies comprise the US, Western Europe, Japan, Canada, Australia, New Zealand, Korea, Taiwan, Hong Kong, Singapore and Israel.

Source: ANZ Economics (based on IMF WEO).

Treasury projections are broadly in line with this assessment. The international growth forecasts in the Budget Papers are shown below (Table 5).

Table 5: International GDP growth forecasts

	Actual	**Estimate**	**Forecasts**	
	2005	2006	2007	2008
United States	3.2	3.3	2.25	3
Euro area	1.5	2.8	2.25	2.25
Japan	1.9	2.2	2	2
China	10.4	10.7	10.5	10.25
India	8.7	9.1	8.25	7.75
Other East Asia	5.0	5.6	5	5
Major trading partners	4.4	4.8	4.5	4.5
Total OECD	2.6	3.2	2.5	2.75

World	4.9	5.4	5	5

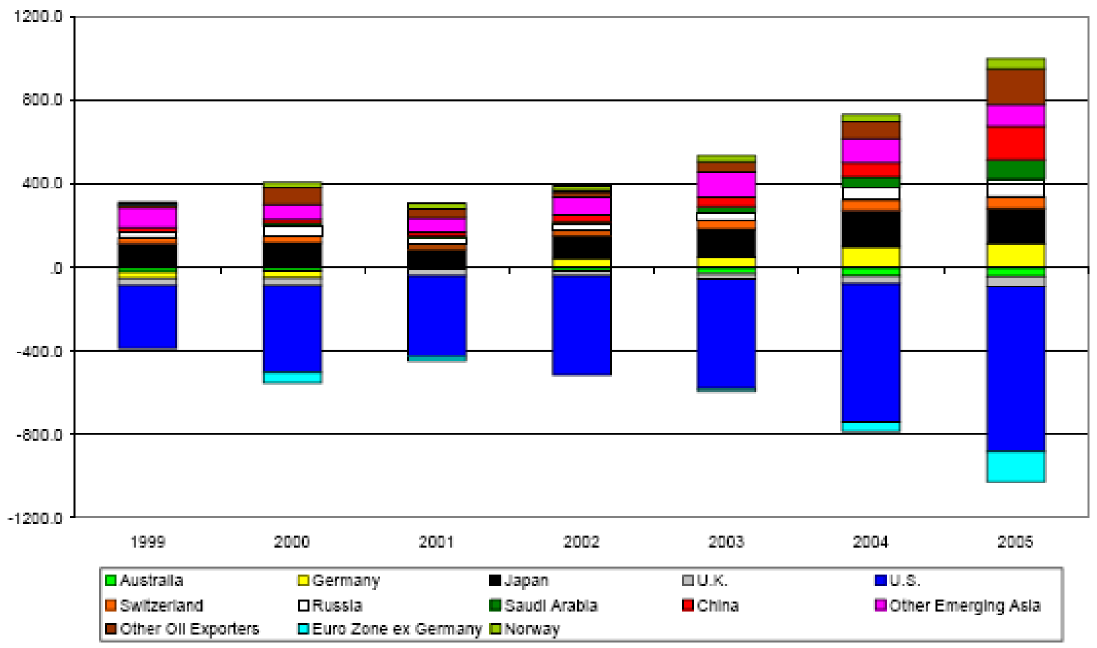
Source: Statement 3: Economic Outlook, 2007–08 Budget Paper No. 1.

As with domestic growth forecasts, some sources of risk remain in regard to world growth in the short term. These include not only the indifferent recent performance of the US economy, but also supply-side inflationary pressures (particularly in the US and UK), the oil market, and global external account imbalances (discussed in the next section).[38] A slowing in global productivity growth also remains a medium term concern for international observers such as the IMF.

Continued global external imbalances

Despite the healthy outlook for the international economy, some major imbalances persist (see Figure 5), especially the large and persistent current account deficit (CAD) in the US. It is now a number of years since the IMF warned of the US CAD.[39] Since then there have been no major economic upheavals yet but the US CAD remains very high at around 6.5 per cent

Figure 5 Major current account balances
$US billions



Source: US Treasury (2006)[40]

of GDP. Past predictions have ranged from ‘business as usual’ to something dramatic and harmful is on the horizon. In the meantime China continues to loom larger on the world economy to the extent that almost every economy has been affected. Most economies have been affected by the competition coming from China—jobs have been lost or threatened while there have been benefits such as access to cheaper consumer goods. China has been producing major surpluses on the current account of its balance of payments, surpluses that are to a large extent the counter-part of the US deficits.

The latest IMF WEO report appears more optimistic on prospects for resolving the problem of global imbalances than in previous years, suggesting that a smaller than assumed depreciation in the US dollar may go some way towards improving this problem. However, it also pointed to the need for more fundamental reform in deficit countries, stating:

> A consistent theme that emerges… is that a market-led real depreciation of the U.S. dollar and a real appreciation of the currencies of surplus countries could potentially play a helpful role in narrowing global imbalances. At the same time, the adjustment process will involve a rebalancing of domestic demand toward surplus economies, including a rising private saving rate and further fiscal consolidation in the United States. Policies that remove obstacles to the reallocation of resources and to international trade would help lower the dislocation in economic activity that might accompany this adjustment process. [41]

The continuing dichotomy in the world between CAD and current account surplus nations, with this dichotomy splitting very much the US/UK/European/Australian economies from the Established Asian/Emerging Asian economies, is likely to remain an area of concern for some time.

Inflation outlook and possible impact of the Budget

A large amount of commentary leading up to the Budget cautioned the Government against large spending and/or tax cuts, suggesting that the effect of this would be to put upwards pressure on interest rates in an already fully stretched economy.[42] In regard to spending, several commentators (and the Treasurer) placed emphasis on the crowding out argument, whereby high government spending places upwards pressure on interest rates as the public sector competes for resources with the private sector.

Despite the buoyancy of the economy described elsewhere in this paper, the inflation outlook has moderated recently. Latest CPI figures for March showed a sharp drop in headline inflation to 2.4 per cent. This was due to a combination of factors, including an easing in the prices for petrol, food (in particular bananas) and imports. After earlier comments by Reserve Bank Assistant Governor, Malcolm Edey, in March this year that were widely interpreted as signalling a tightening bias by the Bank, many analysts had been predicting a further rate rise in April or May, but this did not transpire.[43] The last cash rate rises occurred in May, August and November of 2006.

In its most recent (May 2) *Statement on Monetary Policy*, the RBA have also revised downwards their inflation forecasts (see Table 6). While the Bank mentions some possible risks, including exchange rate appreciation, recent wage growth, oil prices and drought, the Bank's view appears to be that these will exert modest pressure on prices in coming quarters.

Table 6: RBA Inflation Forecasts

Percentage change over year to quarter shown

	June 2006	Dec 2006	June 2007	Dec 2007	June 2008	Dec 2008	June 2009
CPI	4.0	3.3	1.75	2.25	2.5 - 3	2.5 - 3	2.5 - 3
Underlying inflation	2.9	3.0	2.5	2.5	2.5 - 3	2.5 -3	2.5 -3

Source: RBA Statement on Monetary Policy, May 2007, p. 58.

For its part, the Government now forecasts inflation at 2.5 per cent for 2007–08.[44] Further into the future the Government projects inflation at the same rate for each of the forward years. However, not much credence should be given to 'projections' as distinct from forecasts. Projections for inflation assume it remains at the centre of the Government's target range of 2 to 3 per cent. However, projections are used as the basis for calculating forward estimates of outlays and revenues and should not be taken as forecasts.

Some risks to this otherwise favourable outlook clearly persist. Again, the 'productivity problem' mentioned above is relevant here.[45] The value of Australian production decomposes into wages and profits with wages making up 54 per cent of Australia's total factor income.[46] For that reason the major long run influence on inflation is going to be wages. Nominal wages are expected to increase by 4.25 per cent in 2007–08 and 4 per cent in 2008–09.[47] Productivity growth ensures that labour costs per unit of output will increase by something less than the 4 to 4.25 per cent increase in wages. Productivity growth of around 1.75, equivalent to the long term average, will mean that wage increases are consistent with inflation remaining around the middle of the target range.

As discussed above, the implied forecast in the Budget is for the productivity growth rates to return to around 2 per cent in 2007–08. Given the recent poor productivity performance in Australia, these growth rates are likely to be more of a challenge than they might once have been. By implication, difficulties may therefore persist in keeping inflation within the target band over the medium term. Recent cautionary statements by the Treasurer that the inflation 'genie' is contained but never truly goes away therefore appear apt.[48] The latest post-Budget figures, showing unemployment falling to 4.4 per cent in April and strong retail and housing sectors, add further weight to such statements.

Budget impacts and 'fiscal stance'

This year's Budget continues in the tradition of surpluses of around 1 per cent of GDP in cash terms. In fact, if one were to adopt a 'fiscal target' approach to surpluses of between 0.5 percent and 1.5 per cent of GDP, the present Government has delivered underlying cash balances within that band in 7 of its 12 budgets.

However, the bottom line as expressed in the Budget Papers says very little about the actual impact of fiscal settings on the macroeconomy, and a range of alternative measures exists which attempt to net out the effects of the business cycle and other factors (such as terms of trade fluctuations)[49] to come up with a 'structural' measure of the fiscal balance.[50] The RBA, for example, measures fiscal stance by looking at the change in the Budget bottom line (cash balance) between years — $2.2 billion in 2006–07 and $3 billion in 2007–08. This would suggest a small stimulus to growth for 2007–08 from the Budget of around 0.3 per cent of GDP. Further factoring in of recently announced spending measures affecting the 2006–07 and 2007–08 balances would give a 2006–07 surplus of around $16.4 billion and a 2007–08 surplus of $8 billion, which would suggest a more significant stimulus of around 0.8 per cent of GDP.[51]

While structural measures of fiscal stance are useful, they are only one part of a broader set of parameters which the Bank factors in to its decision making.[52] The relatively moderate stimulus suggested by calculations of current fiscal stance, together with measures within the Budget aimed at improving labour supply, suggest that the Budget measures are unlikely to force the Bank's hand in the short term.

Budget measures and the 'three Ps'

Some parts of the Budget have a microeconomic, supply side focus, and this is unsurprising given the strength of the economy and the fact that we are likely to be approaching or are at full employment. The constraints this imposes on macroeconomic policy (or, at least, effective macroeconomic policy) were described by Ken Henry in his widely publicised address to Treasury officials in March:

> As a rather crude, but nevertheless instructive generalisation, there is no policy intervention available to government, in these circumstances, that can generate higher national income without first expanding the nation's supply capacity. Policy actions that expand the nation's supply capacity target at least one of the 3Ps — population, participation or productivity – that we have been talking so much about in recent years.[53]

Judged by this metric, the Budget contains a mix of measures that are likely to have a positive effect on labour force participation and productivity across time, as well as other measures that stand up less well to such scrutiny (a subset of which could be termed 'dead giveaways' in relation to the 'three Ps'). In the former category are changes such as those to child care arrangements and income tax that may affect female workforce participation, and measures in higher education, schools and vocational education and training designed to improve human capital outcomes. In the latter category, the direct benefits of measures such as one-off payments to seniors are potentially more ambiguous.[54]

The likelihood of variable lags in effect of the measures announced in the Budget should also be noted. Some measures, such as those announced in relation to skilled migration, are likely to have relatively rapid effects on labour supply. Others, such as educational reform, may take longer to yield improvements in capacity and productivity. It remains to be seen if the balance of measures provided by the Budget will be 'too little too late' in easing the capacity constraints and productivity problems described above. A further assessment issue, also yet to be fully determined, is how well the Budget measures complement a broader framework of ongoing microeconomic reform, such as that set out in COAG's recent National Reform Agenda.[55]

Endnotes

1. Essentially the 'cash balance' records the difference between the cash receipts and expenditures. If receipts exceed expenditures then the budget balance is a surplus, if receipts are less than expenditures the budget is in deficit. Instead of 'receipts' and 'expenditure' the Budget Papers now refer to 'revenue' while expenditures include both 'expenses' and 'net capital investment'. The Budget Papers now also refer to the 'underlying cash balance' which excludes asset sales and the so-called 'headline cash balance' that includes asset sales. Further detail on the budget reporting framework and processes can be found in R.Webb, 'The Commonwealth Budget: Process and Presentation", Research Brief, no. 7, Parliamentary Library, 2007.
2. The underlying cash balance as now defined in the Budget is equal to receipts less payments less expected Future Fund earnings. See *Budget Paper No. 1*, 2007-08, Statement 13, Table 1.
3. Based on the most recent ABS Labour Force statistics, 10 May 2007.
4. See, for example, the much-publicised speech given on 14 March by the Head of Treasury, Mr Ken Henry: http://www.treasury.gov.au/documents/1249/PDF/speech_14_march_2007.pdf and the Treasurer's more recent comments on the Lateline program on 12 April : http://www.treasurer.gov.au/tsr/content/transcripts/2007/035.asp
5. http://www.treasurer.gov.au/tsr/content/transcripts/2007/042.asp
6. http://www.treasury.gov.au/documents/1239/PDF/IGR_2007_final_report.pdf
7. See, for example, F Anderson and D Crowe, "Budget delivers tax break to big business", *The Australian Financial Review*, 8 May 2007. http://parlinfoweb.aph.gov.au/piweb/TranslateWIPILink.aspx?Folder=pressclp&Criteria=CITATION_ID:2CZM6%3B
8. For a detailed listing of post-Budget media coverage, see: http://libauth1/library%5Fservices/budget%5Flibrary/
9. Sections of this brief draw on discussion from previous Library Budget Briefs, in particular D. Richardson, *Budget 2006–07: Background Note* and D. Richardson, *2005–06 Budget — Main Features*.
10. L. Nielson, *Personal income tax and superannuation*.
11. Access Economics, *Commonwealth Budget Monitor*, Issue #71, May 2007.
12. Saul Eslake, *The 2007 Budget: context, construction and consequences*, presentation to the Economics Society of Australia, Canberra, 14 May 2007.
13. George Megalogenis, Budget 2007: Opinion: *'Just give or take a few billion'*, Weekend Australian, May 12 2007. http://parlinfoweb.aph.gov.au/piweb/TranslateWIPILink.aspx?Folder=pressclp&Criteria=CITATION_ID:UK1N6%3B
14. *Budget Paper No. 3*, pp. 7–9.
15. This issue is discussed in R.Webb, 'The Commonwealth Budget: Process and Presentation", Research Brief, no. 7, Parliamentary Library, 2007.

16. *Budget Paper No. 1,* 2007-08, Statement 5, p. 5-55.
17. *Budget Paper No. 1*, 2007-08, Statement 5, p. 5-57.
18. Includes $452 million in 2006–07.
19. *Budget Paper No. 1*, 2007–08, pp. 6-25 to 6-26.
20. A fuller description of the main elements of the contingency reserve can be found in R.Webb, 'The Commonwealth Budget: Process and Presentation", Research Brief, no. 7, Parliamentary Library, 2007.
21. *Budget Paper No. 1*, 2007-08, pp. 3-1 to 3-13.
22. These eligibility changes are likely to increase the size of the labour force, with a corresponding increasing effect on the measured unemployment rate.
23. IMF forecasts are based on calendar years.
24. IMF *World Economic Outlook 2007*, p. 60.
25. *Budget Paper No. 1* 2007-08, Statement 3, p. 3-3.
26. See Budget Paper No. 1, p. 3-5.
27. RBA Statement (p. 32).
28. RBA Statement (p. 2).
29. See, for example, AFR, Thursday 12 April 2007, p. 5, 'Costello puts productivity on COAG's critical list' (http://parlinfoweb.parl.net/parlinfo/Repository1/Media/npaper_5/WYQM60.pdf), and AFR, Friday 13 April, pp. 72-73, 'The problem is all talk and no output' (http://parlinfoweb.parl.net/parlinfo/Repository1/Media/npaper_3/NGRM60.pdf).
30. See, for example, Dolman, B., Parham, D. and Zheng, S. 2007, Can Australia Match US Productivity Performance?, *Productivity Commission Staff Working Paper*, Canberra http://www.pc.gov.au/research/swp/productivityperformance/productivityperformance.pdf
31. http://www.aph.gov.au/hansard/reps/commttee/R9961.pdf , p. EFPA 16
32. ABARE (2007, p. 4): http://www.daff.gov.au/corporate_docs/publications/pdf/industry_dev/abare-feedgrains-report.pdf
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34. At: http://parlinfoweb.aph.gov.au/piweb/TranslateWIPILink.aspx?Folder=pressclp&Criteria=CITATION_ID:ZNWM6%3B
35. http://www.aph.gov.au/hansard/reps/commttee/R9961.pdf , p. EFPA2
36. IMF *World Economic Outlook 2007,* p. 2.

37. Kennedy and Garton (2007, p. 1): http://www.treasury.gov.au/documents/1238/PDF/Steven_Kennedy_AIG_Speech.pdf
38. IMF World Economic Outlook, 2007, p.6. http://www.imf.org/external/pubs/ft/weo/2007/01/index.htm
39. This discussion is based partly on that provided in D. Richardson, *Budget 2006-07: Background Note*, pp. 13-14.
40. See: http://www.ustreas.gov/offices/international-affairs/economic-exchange-rates/pdf/2006_FXReport.pdf
41. IMF World Economic Outlook 2007, (chapter 3).
42. See, for example: http://parlinfoweb.aph.gov.au/piweb/TranslateWIPILink.aspx?Folder=pressclp&Criteria=CITATION_ID:JIWM6%3B
43. At: http://www.rba.gov.au/Speeches/2007/sp_ag_160307.html
44. Figures taken from *Budget Paper No 1*, p. 3-7.
45. This discussion draws on earlier material provided in D. Richardson, *Budget 2006-07: Background Note*, pp. 18-19.
46. Latest figure for 2005–06 from ABS, *Australian System of National Accounts*, 2005–06, Cat. No. 5204.0, 1 November 2006.
47. *Budget Paper no. 1*, pp. 1-5.
48. http://parlinfoweb.aph.gov.au/piweb/TranslateWIPILink.aspx?Folder=pressclp&Criteria=CITATION_ID:XRXM6%3B
49. For a discussion of the possible implications of including terms of trade adjustments in measures of fiscal stance in Australia, see OECD (2006).
50. Treasury do not publish such measures 'because significant assumptions about the economy's potential output level and the cyclical sensitivity of revenues are required.' See http://www.treasury.gov.au/documents/987/PDF/06_structural_fiscal.pdf
51. http://parlinfoweb.aph.gov.au/piweb/TranslateWIPILink.aspx?Folder=pressclp&Criteria=CITATION_ID:XN1N6%3B
52. See, for example, the statements by current RBA Governor Glenn Stevens on 21 Febraury 2007: http://www.aph.gov.au/hansard/reps/commttee/R9961.pdf , pp. 10-11.
53. 14 March, 2007: http://www.treasury.gov.au/documents/1249/PDF/speech_14_march_2007.pdf
54. In relation to increases in the 40 and 45 per cent tax thresholds, Treasury do suggest that recent post-Budget modelling points to positive benefits for labour supply, but that these benefits are smaller than those resulting from adjustment of the 30 per cent threshold. The latter threshold increase accounts for 'most of the positive impact on labour supply'. http://www.treasury.gov.au/documents/1260/PDF/speech_15_may_2007.pdf

55. For an assessment of the possible benefits from the National Reform Agenda, see: http://www.pc.gov.au/research/crp/nationalreformagenda/nationalreformagenda.pdf

Industry Statement – Re-commitment to current policy settings

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Background

On 1 May 2007, the Prime Minister and the Minister for Industry, Tourism and Resources released the Government's Industry Statement – *Global Integration: Changing Markets, New Opportunities*. The 2007-08 Budget gives effect to the new initiatives and enhancements to existing industry support and export promotion programs announced in the Statement.

The Industry Statement follows the Minister's call for public submissions and roundtable discussions with industry representatives to help set the future policy direction of Australian industry. In July 2006, the Minister invited public submissions to the Industry Statement, stating:

> The Government's new Industry Statement, to be finalised by early next year, will set the policy directions to maintain the country's present economic momentum over the next 20 to 30 years.
>
> Australia's recent economic performance is the envy of the world – low interest rates, low unemployment and strong growth – and current industry policy settings have served the country well.
>
> However we are now entering an era of true globalisation, of communications advances that mean business without borders and the need for industry sectors to become regular contributors to global supply chains.
>
> There are many new challenges facing our industries, including the rise of low-cost competitors like China and India. The Statement will be a considered plan to tackle the challenges while also highlighting opportunity.

The Minister received over forty submissions to the Industry Statement and, in the lead-up to the release of the Industry Statement, a Background Paper was produced to focus discussion on the Statement at a series of business roundtables across Australia.

Innovation and global integration

The Industry Statement marks a re-commitment to the current policy settings which were fashioned by the policy statements, *Backing Australia's Ability* Mark I and II. But in recognition of the potential for export growth and gains from greater integration into the global economy, the Statement provides increased support to Australian industry to compete internationally. The funding measures are predominantly geared to assist small and medium enterprises (SMEs) in developing new market opportunities and in undertaking innovation and R&D.

The Industry Statement also recognises that economic performance and innovation are influenced by a spectrum of industry policies. In some cases, policies have been specifically designed to increase innovation and to achieve better export outcomes. In other cases, existing policies have been enhanced to improve individual business capacities.

The Industry Statement includes new initiatives and enhancements to current programs worth $1.4 billion over 10 years. The key industry initiatives are:

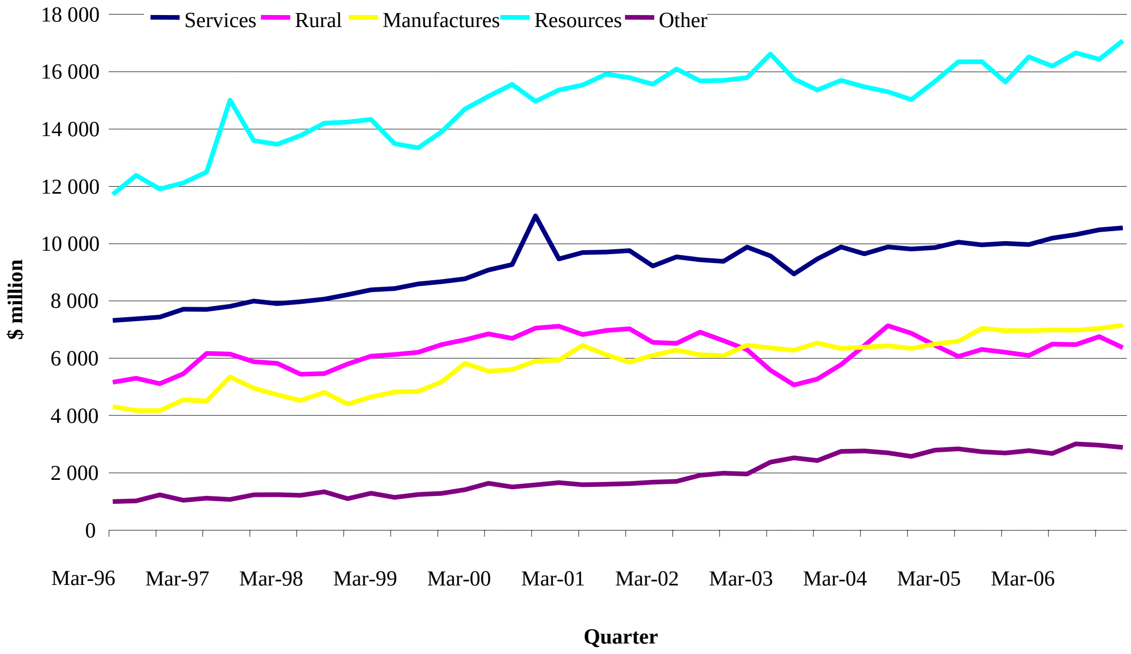
- $254.1 million for the Global Opportunities program to help SMEs identify opportunities to bid for work on international projects and integrate into global supply chains.
- $351.8 million to establish Australian Industry Productivity Centres to assist SMEs improve their performance and international competitiveness.
- More than $500 million to extend eligibility of the 175 per cent premium R&D tax concession to foreign-owned SMEs undertaking additional R&D in Australia.
- $90.3 million to support the Commercial Ready Plus progam for emerging companies and spin offs from public research organisations.
- $21.5 million for the development of a National Nanotechnology Strategy for expanding Australia's manufacturing base and $36.2 million to develop manufacturing industries based on nanotechnology.
- $54.2 million to support R&D in the food processing industry and $20.1 million to encourage technology transfer through the Intermediary Access Program.

Manufacturing exports

Australia's exports

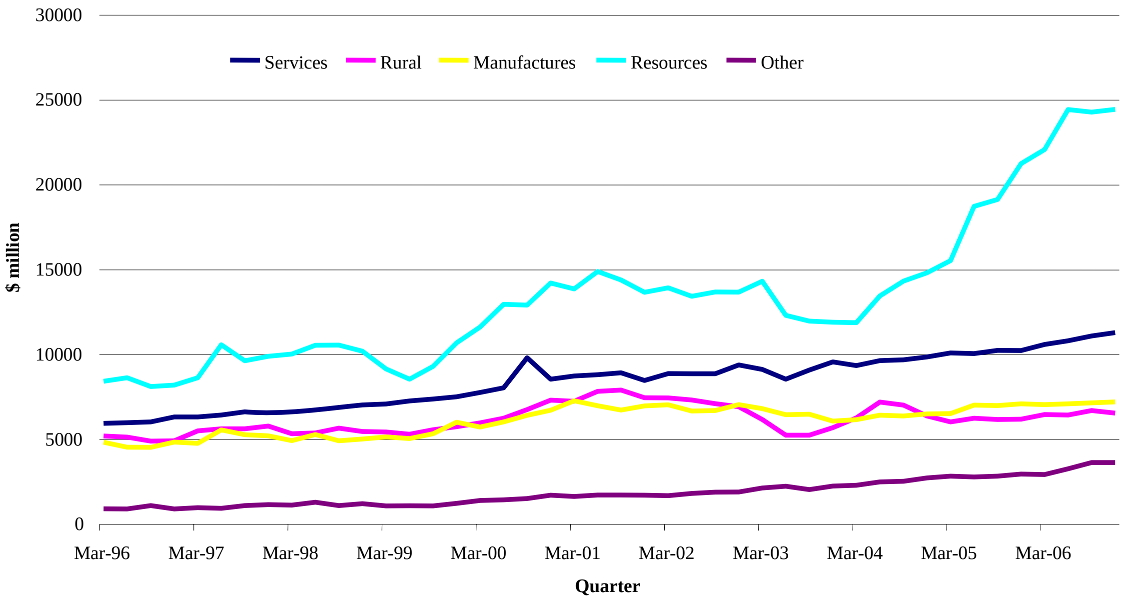
Resources (energy and minerals, principally coal and iron ore) have long been the mainstay of Australia's exports. In 2005-06, mining exports were worth $73.3 billion - around 38 per cent of the total value of Australia's goods and services exports and 8 per cent of GDP. This included $24.3 billion worth of coal, $12.8 billion of iron ore and $7.3 billion of gold exports. Energy and minerals make up nine of the top 12 individual export commodities. Bovine meat (beef and veal) was the seventh largest export commodity ($4.5 billion), wheat was the tenth largest ($3.2 billion), followed by passenger motor vehicles ($3.2 billion).[1] But as the following two charts show the current resources boom is more price (demand) driven and has less to do with export volumes (supply).

Chart 1: Export volumes



Source: Australian Bureau of Statistics.

Chart 2: Export values



Source: Australian Bureau of Statistics.

Higher world prices for energy and mineral products have sustained an historically high Australian dollar. World trade volumes have grown faster than world GDP at the same time. As a consequence, the strong Australian dollar has adversely affected all other export categories and contributed to the marked slowdown in exports of Australian manufactures. As Treasury has noted, "The significant appreciation of the Australian dollar between August 2002 and March 2004 eroded the competitiveness of Australian manufactures; those producing goods with close substitutes made overseas were forced either to cut prices or accept lower sales. More recently, the currency has stabilised and manufacturers have been able to adjust to the higher level. This is likely to have contributed to the recovery in growth in exports of manufactures in 2005."[2]

Manufacturing exports since 2001

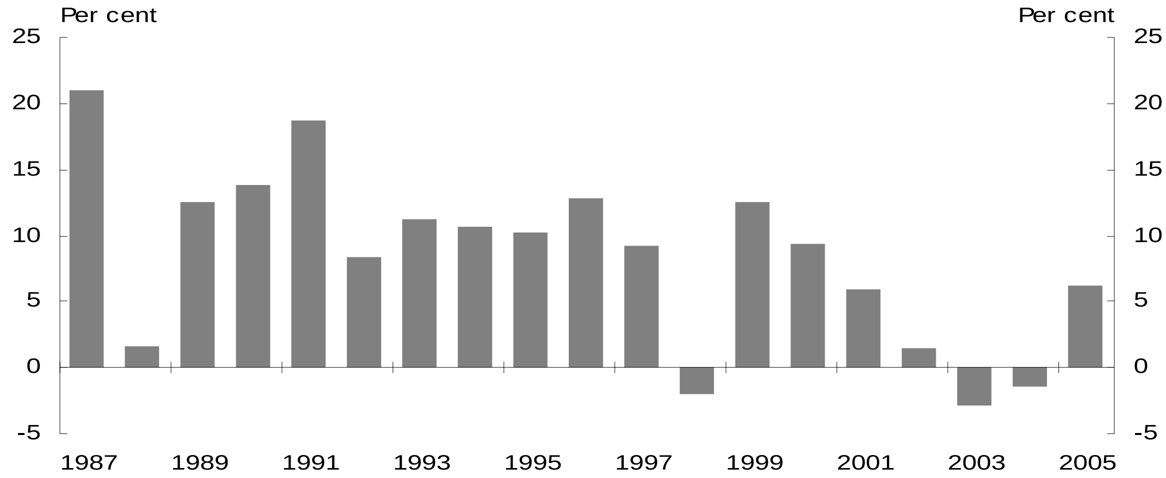
Manufacturing exports totalled $39.5 billion in 2005-06, or 4.3 per cent of Australia's GDP. They accounted for 20 per cent of the total value of Australia's exports of goods and services. Treasury estimates that more than 9,000 manufacturing companies are exporters, with the largest 1,300 of these companies producing 90 per cent of manufacturing exports.[3] The main manufacturing states, New South Wales and Victoria, are the major source of manufacturing exports.

Manufacturing exports grew steadily for most of the 1990s but slowed after 2001 despite the increase in world exports and global economic activity. As Treasury noted, the slowdown reflects international competition in key manufacturing sectors and, since August 2002, a sharp appreciation of the Australian dollar. The chart below shows the overall slowdown in manufacturing exports since 2001. For the first six years of the new millennium, growth in the volume of manufacturing exports averaged less than 3 per cent per annum (2.7 per cent). The most recent five-year trend growth in the value of Australian manufacturing exports was 0.1 per cent.[4]

Although there was a recovery in manufacturing exports in 2005-06, the growth in exports varied across manufacturing categories and this uneven growth is forecast to continue.

'Road motor vehicles', which includes new passenger motor vehicles and motor vehicle parts, is one of the larger categories of manufacturing exports. The fluctuating performance of Australian automotive and component manufacturing in recent times and a strong Australian dollar has meant that the value of road motor vehicle exports has increased by an average of less than one half of one per cent per annum since 2001. Exports of motor vehicle parts fell the most, by an average of 10.0 per cent per annum.[5]

Chart 3: Australia's manufacturing exports
(annual percentage change; chain volume measure)



Source: Australian Bureau of Statistics.

'Other machinery and transport equipment' is the largest and most diverse category of manufactured products. It includes electrical and power-generating machinery, hand tools, aircraft equipment and parts. This category has managed an annual average growth rate in the value of exports of 2.4 per cent since 2001-02. However, export growth rates vary within the category. While exports of storage containers, aircraft and transport equipment have steadily declined, high annual average growth rates for power-generating machinery (15.2 per cent), car engines (24.7 per cent) and scientific instruments (5.1 per cent) contributed to net export growth for the group.

The second largest category of manufactured products is 'Chemical and other semi-manufactures'. This includes diverse manufactured products ranging from paints, plastics, rubber tyres, papers, cosmetics, medicines and pharmaceuticals. The value of these exports has grown by an annual average of 4.6 per cent since 2001-02. Average annual growth rates have ranged from -13.3 per cent and -5.1 per cent for wood and paper products respectively to 6.7 per cent for plastics and 9.3 per cent for medicines. As in the case of manufactured products in the 'Other machinery and transport equipment' category which had high annual average growth rates at a time when the Australian dollar has risen sharply, manufacturing sectors which increased their exports relied on innovation and product specialisation.

Global Opportunities program and Australian industry productivity centres

Around half of the projected funding of the Industry Statement will be directed to the Global Opportunities program and to the establishment of Australian industry productivity centres. These initiatives seek to build, as the Minister stated, "the capacity of Australian firms to become truly global businesses" and translate proposals advocated by the Australian Industry Group (AIG). The AIG response to the Industry Statement noted that:

> Many of the measures adopted by the Government have been advocated by Ai Group over the past year in the wake of our ground-breaking report Manufacturing Futures: Achieving Global Fitness. Ai Group's report pointed to the considerable efforts by businesses in response to the twin pressures of intensifying competition from emerging economies such as China and India and the sharply higher Australian currency.
>
> Ai Group particularly welcomes the proposal to create Productivity Centres around the country to evaluate business needs and opportunities and to assist them to make productivity-enhancing investments. The initiative draws on Ai Group's Industry Statement submission which contained proposals to improve Australia's business capabilities - especially for small and medium sized businesses. The Global Opportunities program to foster greater export activity and other forms of international engagement also picks up on proposals put forward by Ai Group in the context of the expanding opportunities for Australian participation in global supply chains and networks.[6]

The policy measures are also a response to a shift in manufacturing export volumes which appears to be broad-based, with many parts of Australian manufacturing experiencing growth in their exports despite the fall in exports from 2000 to late 2004 and a rising dollar. Although still small relative to the large manufacturing exporters, these exporters contributed to the recovery in manufacturing exports and have strong prospects for further export growth.

R&D performed by subsidiaries of multinational enterprises

Currently, the R&D tax concession is available to Australian companies only. The beneficial ownership requirement prevents subsidiaries of foreign-owned companies from access to the 125 per cent R&D tax concession and the 175 per cent premium concession. In its submission to the Productivity Commission's inquiry into Public Support for Science and Innovation, GlaxoSmithKline Australia Pty Ltd outlined the nature of the restriction as follows:

> … the tax environment within Australia may not be the most favourable for stimulating science and innovation. Indeed, this is particularly the case in the context of health and medical research due to the "beneficial owner" requirements in place for accessing the tax concession. Under the *Income Tax Assessment Act* and the *IR&D Act* the concession is limited to those entities that hold the intellectual property associated with R&D domestically. This effectively prevents subsidiaries of multi-national entities, for which head office requires intellectual property to be held centrally, from accessing the benefit and means that a significant proportion of the R&D carried out by members of the pharmaceutical industry is without any significant public support by way of tax incentives. For this reason, overall the tax concession appears to facilitate the mining industry and provide significant support to the information technology sector, but has "strikingly low impact upon the fields of research associated with the medical and bio-science areas".

The rationale for restricting access to the concession was "a desire by Government to avoid transferring revenue to foreigners without delivering a corresponding benefit to Australia". However, the Commission concluded that the net social benefits to the Australian community of additional R&D conducted by foreign firms in Australia outweighed the associated revenue loss. But the Commission also noted that there was not a strong case for relaxing the beneficial ownership requirements applying to the 125 per cent concession and on balance recommended that "The beneficial ownership requirement for subsidiaries of foreign-owned firms should be relaxed for the incremental scheme alone."[7]

175 per cent premium R&D tax concession

The largest funding component of the Industry Statement is the Government's decision to extend eligibility of the 175 per cent premium R&D tax concession to foreign-owned SMEs undertaking additional R&D in Australia ($200 million over 4 years).

Relaxing the beneficial ownership provisions is expected to lead to an additional $1 billion in R&D expenditure over next five years, with more than 300 eligible companies registering for the 175 per cent concession.[8]

Eligibility for 175 per cent concession

The 175 per cent premium R&D tax concession was announced in January 2001 and has been in operation since 30 June 2001.

The 175 per cent concession is available to Australian companies for additional expenditure on R&D. To be eligible for the 175 per cent concession, companies must increase their R&D expenditure on labour during the year above a base level determined by their average R&D expenditure over the previous three years. Companies require a three year history of registering for and claiming the 125 per cent R&D tax concession.[9]

As more companies put in place R&D plans and make additional investment in R&D, the number of companies claiming the 175 per cent concession has increased. The Table below shows that the number of companies intending to claim the 175 per cent concession has increased by 24 per cent in 2004-05. This is also reflected in a 43 per cent increase in R&D expenditure by companies claiming the 175 per cent concession in 2004-05. R&D expenditure by these companies was $3.7 billion in 2004-5 (or 48 per cent of the total business expenditure on R&D in 2004-05).

Table 1: Registrants as at 30 June 2006

	2003–04		2004–05	
Registrants, as at 30 June 2006	**Company numbers**	**Reported R&D expenditure ($m)**	**Company numbers**	**Reported R&D expenditure ($m**
Total registrants	5 634	6 921.5	5 830	7 785.7
R&D Tax Offset (A)	2 161	565.5	2 165	570.3
175% Premium (B)**	717	2 490.1	852	3 578.4
Tax Offset and 175% Premium (C)**	211	98.0	300	130.8
Total Tax Offset (A+C)	2 372	663.5	2 465	713.8
Total 175% Premium (B+C)**	928	2 588.1	1 152	3 709.2

Source: Industry Research & Development Board, *Annual Report 2005-06.*

Cost of 175 per cent premium R&D tax concession

The following table gives actual and projected tax expenditures related to the 175 per cent concession.

Table 2: 175 per cent tax concession for additional R&D expenditure ($m)

2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
50	85	100	115	125	140	155	170

Tax expenditure type: Deduction — *2005 TES code*: B54
Commencement date: 2001
Expiry date:
Legislative reference: Section 73Q to 73Y ITAA36

Source: Treasury, *2006 Tax Expenditures Statement*.

According to estimates in *Budget Paper No. 2, Budget Measures 2007-08*, the change to the beneficial ownership test for the 175 per cent concession will cost an additional $200 million over four years.

Table 3: Extension of the 175 per cent concession to subsidiaries of multinational enterprises

Revenue ($m)

	2007-08	2008-09	2009-10	2010-11
Australian Taxation Office	-50.0	-50.0	-50.0	-50.0

Source: *Budget Paper No. 2, Budget Measures 2007-08.*

Innovation

Innovation activity as measured by business expenditure on research and development (BERD) as a share of GDP has increased in Australia over the last six years. BERD as a proportion of GDP now stands at 0.95 per cent and is the highest recorded BERD to GDP ratio since the R&D tax concession was introduced in 1985. The continued growth in BERD dates back to 1999-2000 when the ratio fell to 0.64 per cent. Nonetheless, business investment in R&D remains below the OECD average of 1.53 per cent.[10]

In a 2006 report *Economic Policy Reforms – Going for Growth*, the OECD identified areas for reform to improve Australia's innovation performance. The report recognised that R&D spending is not an end in itself and that innovation performance encompassed framework conditions which can influence the uptake of innovation and the diffusion of technologies within a country's economy. The OECD report recommended the following indictor-based and broad policy measures to improve innovation in Australia:

Indicator-based recommendations

Improve opportunities for venture capital investments

In order to stimulate entrepreneurial ventures in knowledge-intensive activities, enhance the rate of commercialisation of university research.

Improve overall workforce skills

In order to improve the absorptive capacity of the workforce, reduce the proportion of early school leavers by pursing efforts to strengthen the vocational education and training system.

Other recommendations

Promote innovation in services

To enhance innovation in the growing services industries, broaden the opportunities for those sectors to participate in programmes facilitating the transfer of knowledge from public research institutes.

Strengthen industry-science linkages

Strengthen industry-science linkages and increase the leverage effect of public R&D expenditure on private R&D investment through sustained emphasis on public/private partnerships for research and innovation. Ensure greater foreign participation in such partnerships.

The Industry Statement includes new policies to improve business innovation, recognising its importance as one of the main drivers of long-term economic growth. The initiatives address the framework conditions required to increase innovation through collaborative research and the commercialisation of R&D, and go some way in addressing the recommendations in the OECD report. The Commercial Ready Plus program announced in the Statement will provide start-up assistance to public research spin-off companies, while the National Nanotechnology Strategy and National Research Flagship for Niche Manufacturing establish a framework for expanding Australia's manufacturing base. The development of manufacturing platforms such as nanotechnology, microelectronics and bioengineering illustrates the potential in adding value to established manufacturing activities and for creating new niche industries.

Venture capital

Venture capital is a subset of private equity and refers to equity investments in businesses at various stages of development. It includes pre-seed and start-up capital, expansion-stage capital, later-stage development capital, and finance for management buy-outs and buy-ins (MBO/MBIs). In Australia, the majority of venture capital investments are MBO/MBI type of investments, around 40 per cent of the total value of venture capital invested.[11]

Australian venture capital market

Australia's venture capital market totalled $10.9 billion as at the end of June 2006, an increase of 9 per cent on the $10.0 billion the previous year.[12] Since 2001 the venture capital market in Australia has more than doubled. The largest source of venture capital is Australian superannuation funds, representing 50 per cent of venture capital investment.

According to the Australian Bureau of Statistics *Venture Capital and Later Stage Private Equity* survey, $4.1 billion or 38 per cent of total venture capital is uncommitted (or unused). Of this, $3.4 billion was in direct investment vehicles and $700 million in funds of funds.[13]

When analysed by activity, manufacturing and transport related activities attracted the largest share of venture capital investment, $1.5 billion (or 37 per cent). Retail, services and real estate attracted $1.2 billion (or 29 per cent) and information technology, communications and electronics, $681 million (or 16 per cent).[14]

Changes to the venture capital regime

The Tax Laws Amendment (2007 Measures No. 2) Bill 2007 before Parliament makes changes to the venture capital regime following the Review of the Venture Capital Industry by an expert group headed by Mr Brian Watson.

Currently, subsection 118-425(2) of the *Income Tax Assessment Act 1997* requires that the company must at the time the investment is made be an Australian resident for the purposes of the capital gains tax (CGT) exemption. The *Taxation Laws Amendment (Venture Capital) Act 2002* extends the CGT exemption to foreign residents investing in eligible Australian venture capital investments.

The current Bill extends the CGT exemption to foreign resident investors by allowing up to 20 per cent of committed capital in venture capital limited partnerships and Australian venture capital funds of funds to be invested in companies and units trusts that are not located in Australia. As stated in the Explanatory Memorandum:

> 8.9 The venture capital regime was introduced in 2002 to provide an incentive for foreign investors from certain countries to invest in the Australian venture capital industry, to develop the Australian industry and to provide a source of equity capital for relatively high risk and expanding businesses which found it difficult to attract investment through normal commercial mechanisms.

> 8.10 This measure relaxes the eligibility requirements for the venture capital regime, without changing its intrinsic nature, by allowing eligible venture capital investments to be acquisitions of units in unit trusts and convertible notes, that are equity interests, in companies and unit trusts; allowing some investments (up to 20 per cent of committed capital) to be in companies and unit trusts that are not located in Australia; allowing limited partners to be residents of any foreign country and general partners and VCLPs to be resident of, or established in, any country with which Australia has a double tax agreement in force;

According to estimates in *Budget Paper No. 2, Budget Measures 2007-08*, extending the CGT exemption for foreign residents investing in companies and unit trusts not located in Australia will cost $25 million over three years.

Table 4: Venture capital

Revenue ($m)

	2007-08	2008-09	2009-10	2010-11
Australian Taxation Office	-	-2.0	-7.0	-16.0

Source: *Budget Paper No. 2, Budget Measures 2007-08.*

The report of the Review of the Venture Capital Industry was not published despite calls from the venture capital industry for its release.[15] Relaxing the requirement that investee companies must be located in Australia would appear to be a response to the report, although this is not clear from the Explanatory Memorandum. While the improved taxation treatment of venture capital investments will offer a better mix of investment options and higher capital returns for foreign resident investors, it is difficult to see how the intrinsic nature of the venture capital regime, which is to attract venture capital for new and innovative Australian companies, will not change.

Endnotes

1. Department of Foreign Affairs and Trade, *Composition of Trade Australia 2005-06*, November 2006.
2. Treasury, *Australia's manufactures exports*, Treasury submission to the House of Representatives Economics, Finance and Public Administration Committee public inquiry, August 2006, pp. 7-8.
3. Ibid, p. 2.
4. Department of Foreign Affairs and Trade, *Composition of Trade Australia 2005-06*, November 2006.
5. Department of Foreign Affairs and Trade, *Exports of Primary and Manufactured Products Australia 2005-06*, February 2007.
6. "Government's proactive industry statement good for business", Press Statement by Australian Industry Group Chief Executive, 4 May 2007.

7. Productivity Commission, *Public Support for Science and Innovation*, Canberra, 9 March 2007, p. 395.
8. Minister for Industry, Tourism and Resources, Press Release, "Tax changes to boost R&D by $1 billion", 8 May 2007.
9. Industry Research and Development Board, *Annual Report 2005-06*, Canberra, 2006, p. 27.
10. See Australian Bureau of Statistics, *Research and Experimental Development, Businesses, Australia 2004-05*, Catalogue No. 8104.0, 28 August 2006.
11. Australian Bureau of Statistics, *Venture Capital and Later Stage Private Equity 2005-06*, Catalogue No. 5678.0, 16 February 2007.
12. Ibid.
13. These are funds which offer multiple managers and multiple strategies to achieve above market investment returns.
14. See Australian Venture Capital Journal, No. 162, March 2007, p. 10.
15. Ibid, pp. 3-5.

Personal income tax and superannuation

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Personal Income Tax

Another Budget, another set of personal income tax cuts. The following table shows the changes to the personal income tax rates since 1 July 2002.

Table 1: Marginal Personal Income Tax Rates 2002–03 to 2008–09

Marginal Tax Rate % p.a.	2002 –03 $ p.a.	2003 – 04 $ p.a.	2004 –05 $ p.a.	2005 –06 $ p.a.	2006 –07 $ p.a.	2007 –08 $ p.a.	2008 –09 $ p.a.
0	0 – 6 000	0 – 6 000	0 – 6 000	0 – 6 000	0 – 6 000	0 - 6 000	0 - 6 000
15				6 001 – 21 600	6 001 – 25000	6001 - 30 000	6 001 - 30 000
17	6 000 – 20 000	6 001 – 21 600	6 001 – 21 600				
30	20 001 – 50 000	21 601 – 52 000	21 601 – 58 000	21 601 – 63 000	25 001 – 75 000	30 001 – 75 000	30 000 – 80 000
40					75 001 – 150 000	75 001 – 150 000	80 001 – 180 000
42	50 001 – 60 000	52 001 – 62 500	58 001- 70 000	63 001 – 95 000			
45					150 000+	150 000+	180 000 +
47	60 001+	62 501+	70 001+	95 001+			

Sources: Budget Paper No. 1, 2006–07, p. 5–29 & Budget Paper No. 2 2007– 08 p.18

The major change in the personal income tax scales for 2007–08 was the raising of the threshold at which the 30 per cent tax rate applies from $25 001 to $30 001 p.a. This change will benefit most tax-payers (not those in the $6001 to $25 000 p.a. bracket), but produce a larger proportionate benefit to those on a lower income.

In the 2008–09 financial year the personal income tax thresholds again change, with the emphases on cutting the tax of those on a higher income.

Low income tax offset

From 1 July 2007 the low income tax offset will increase from a maximum of $600 to $750 per year. Further, the threshold at which this offset begins to reduce increases from $25 000 to $30 000 p.a. The gross yearly income at which this offset no longer applies will be $48 750 p.a. from 1 July 2007, up from $40 000 p.a.

If a person is eligible for the full low income tax offset they will not pay tax until their annual income exceeds $11 000 p.a.[1]

Dependent Spouse Rebate

From 1 July 2007 the maximum Dependent Spouse rebate will increase from $1 655 to $2 100 per year.

This rebate is available to a taxpayer where the dependent spouses' separate net income is less than $282 per year. The rebate is reduced by $1 for every $4 that the dependent spouse's income increases. Thus, the threshold at which the dependent spouse's net income leads to this rebate no longer being available to a married taxpayer rises from $6 901 to $8 681 from 1 July 2007.[2]

Increasing Medicare levy low income thresholds

Each year the Medicare levy low income thresholds increase in response to increases in inflation, as measured by the Consumer Price Index (CPI). If either an individual's or family's income is below these thresholds they are not required to pay the Medicare levy for that financial year.

From 1 July 2007 these thresholds will be $16 740 for an individual and $28 247 for a family. They will apply to the 2006–07 financial year.[3]

Other changes

This budget contained some minor additional concessions for some Australian Defence Force (ADF) personnel deployed overseas during the evacuation of Australian citizens from Lebanon and will make the Defence Force Income Support Allowance tax free in limited circumstances.

Impact of these changes

The following table shows the amount of tax paid, at various income levels, including the estimated impact of the altered shade-in rates for the Medicare Levy and Medicare Surcharge at various income levels, compared to the net tax paid in earlier years. The Medicare levy shade in rates for low income earners have been estimated for the years 2006–07 to 2008–09 and thus the total amount paid at the $20 000 p.a. category may be slightly different than will actually be the case. These uncertainties, however, do not cause a significant difference in the following figures.

Table 2: Individual Tax Paid 2003-04 to 2008-09, by Annual Income

Taxable Income p.a.	2002–03	2003–04	2004–05	2005–06	2006–07	2007–08	2008–09	% decrease 06–07 to 07–08	% decrease 06–07 to 08–09
$10 000	$530	$445	$445	$365	$0	$0	$0	0%	0%
$20 000	$2530	$2445	$2445	$2165	$1800	$1634	$1591	9%	12%
$30 000	$5830	$5622	$5622	$5310	$4400	$3300	$3300	25%	25%
$40 000	$8980	$8772	$8772	$8460	$7950	$6850	$6850	14%	14%
$50 000	$12 130	$11 922	$11 922	$11 610	$11 100	$10 350	$10 350	7%	7%
$60 000	$17 080	$16 632	$15 912	$15 360	$14 850	$14 100	$14 100	5%	5%
$70 000	$22 030	$21 457	$20 362	$19 450	$18 100	$17 350	$17 350	4%	4%
$80 000	$26 980	$26 407	$25 312	$23 900	$21 850	$21 100	$20 600	3%	6%
$90 000	$31 930	$31 357	$30 262	$28 350	$26 100	$25 350	$24 850	3%	5%
$100 000	$36 880	$36 307	$35 212	$33 050	$30 350	$29 600	$29 100	2%	4%
$110 000	$41 830	$41 257	$40 162	$38 000	$34 600	$33 850	$33 350	2%	4%
$120 000	$46 780	$46 207	$45 112	$42 950	$38 850	$38 100	$37 600	2%	3%
$130 000	$51 730	$51 157	$50 062	$47 900	$43 100	$42 350	$41 850	2%	3%
$140 000	$56 680	$56 107	$55 012	$52 850	$47 350	$46 600	$46 100	2%	3%
$150 000	$61 630	$61 057	$59 962	$57 800	$51 600	$50 850	$50 350	1%	2%
$160 000	$66 580	$66 007	$64 912	$62 750	$56 350	$55 600	$54 600	1%	3%
$170 000	$71 530	$70 957	$69 862	$67 700	$61 100	$60 350	$58 850	1%	4%
$180 000	$76 480	$75 907	$74 812	$72 650	$65 850	$65 100	$63 100	1%	4%
$190 000	$81 430	$80 857	$79 762	$77 600	$70 600	$69 850	$67 850	1%	4%

Source: Parliamentary Library

As can be seen, the lower income earners gain the greatest advantage in the coming financial year, however, higher income earners gain the greatest proportional advantage in the 2008–09 financial year.

The major impact of these changes, particularly the increase in the low income tax offset from $600 to $750 p.a. for the coming tax year is that those with ordinary income below $11 000 p.a. will receive this amount tax free.[4] Further, these changes mean that those taxpayers eligible for the Senior Australians' Tax Offset (SATO) pay no tax if their income is below $25 867 (single) or $43 360 (couple) in the 2007–08 financial year. Under current tax rates these income levels are $24 867 (single) and $41 360 (couple).[5]

Comments

Media reaction to these changes has been mixed. On one hand some commentators suggest that the $6 000 tax free threshold that each taxpayer receives is now meaningless. Further, any additional reductions in the personal income tax rates simply provide additional cuts to high income earners. However, other commentators suggest that the comparatively small scale of the changes continues the government policy of incremental change in the tax system and is a responsible approach to the reform of the personal income tax system given the current economic circumstances of full employment (for practical intents and purposes) and continued strong economic growth.[6] Finally, some commentators suggest that the raising of the 30 per cent marginal tax rate threshold and the increase in the low income tax offset will increase the supply of labour into the economy and therefore, in the current economic circumstances, is a very commendable measure.[7]

Superannuation

Compared to the changes announced in the 2006–07 Budget speech the following changes are comparatively minor. Nevertheless, they are still significant changes. The following commentary notes the most prominent of the announced changes.

Co-contributions

The centrepiece of this years superannuation changes is the one-off doubling of the government superannuation co-contribution amount for 2005–06.[8] If a person was eligible for a $1000 superannuation co-contribution in respect of a personal contribution(s) to their superannuation fund (or funds) they would be eligible for an additional $1000 under this announced measure. The bulk of these payments are to be made by 30 June 2007.[9] The relevant legislation has already passed through Parliament.[10]

The superannuation industry had called for the income thresholds applying to the Government co-contributions scheme to be lifted.[11]

Currently, if a person’s total income for co-contribution purposes is $28 000 p.a. or below, for every dollar they contribute in after tax money the government will contribute $1.50. This rate of contribution decreases if the person’s income is above the level. No co-contribution payments are made if the person’s total income is above $58 000 p.a., no matter what amount of personal superannuation contributions the person makes.

The lower threshold will rise by increases in the Adult Weekly Ordinary Time Earnings (AWOTE) from 1 July 2007.[12] In the 12 months to the end of December 2006 AWOTE increased by 3.2 per cent. The upper threshold is the lower threshold plus $30 000.[13] If these increases are applied to the above thresholds from 1 July 2007 the Government Co-contribution thresholds will be about:

- lower threshold - $28 896

- upper threshold - $58 896.

These are indicative figures only as the basis for the calculation is the March Quarter's AWOTE.

New Participating Employers Rules

The Budget papers included a measure that will prevent a public offer fund requiring that new employers sign a 'participating employer' agreement before accepting their contributions made on behalf of the fund member.[14]

A public offer fund is one that can accept contributions from the public. All retail superannuation funds and most, if not all, industry superannuation funds are public offer funds.

A 'participating employer' is one who enters into an agreement with the superannuation fund. Often, this agreement entails making superannuation contributions more regularly than is required by superannuation law. For example, a participating employer may be required to make their superannuation guarantee contributions on a monthly basis, rather that every quarter as required by law.[15] Apparently, an estimated 10 per cent of large superannuation funds use trust deeds that require employers to pay their superannuation guarantee contributions monthly instead of quarterly.[16]

Under the choice of superannuation funds regime an employer must choose a 'default' superannuation fund that will accept the employer's contributions. This is the fund where an employer's superannuation guarantee contributions are sent on behalf of an employee, if that employee does not choose a fund. A fund that requires an employer to be a 'participating employer' before the employer's contributions are accepted cannot be a default fund for choice of superannuation fund purposes, because it will not accept the employer's contributions without an agreement first being signed.[17]

Comment

This measure potentially widens the number of funds an employer may select as their 'default fund' under the choice of superannuation fund regime. Potentially, all public offer superannuation funds will be open to the employer when deciding on their default fund. Further, the Budget Papers note that this measures will allow employees to remain in their chosen fund following a change of employer, rather than having their contributions paid to another fund.[18] This would occur where the new employer was prevented from contributing to the chosen fund due to that fund requiring the new employer to become a participating employer.

Industry funds have generally required employers to be 'participating' employers. This particular measure may also be interpreted as a measure to restrict the capacity of an industry superannuation fund to required employers to become participating employers. This may lead to less frequent superannuation contributions from employers which in turn may see some employers in the more volatile sections of the economy going out of business leaving the required superannuation contributions un-paid.

Taxation of lump sum superannuation death payments to non-dependents of defence personnel and police

Normally, lump sum superannuation payment made on the death of a fund member to their dependents (including those in an interdependent relationship) are made tax free. Payments made to non-dependents are taxed, the actual rate depending on the source of the funds and the age of the person receiving the payment.

Under the proposed measure payment made to non-dependents of ADF personnel and police killed in the line of duty will also be paid tax free. This treatment will apply from 1 January 1999.[19]

Comment

The proposed measure is unusual for two reasons. Firstly it is retrospective. Non-dependents who have already received a superannuation death benefit resulting from the death of either an ADF or police force member killed while on active duty since 1 January 1999 will receive an ex-gratia payment.

Secondly, this proposed measure further distinguishes military and police service superannuation from the arrangements covering the bulk of the population. This may be necessary to encourage recruitment and retention of service personal.

Commonwealth Government Employees Superannuation Schemes

The Budget announced a number of measures relating to the Commonwealth Superannuation Scheme (CSS) and the Public Sector Superannuation Scheme (PSS):

- a review of the PSS Maximum Benefit Limits, to ensure that long serving PSS members do not have an incentive to retire once they have reached the point where their superannuation benefits no longer increase in real terms
- removal of the current mandatory requirement for CSS and PSS members to contribute a set percentage of their after tax salary to these schemes
- CSS and PSS members to be able to withdraw amounts from the scheme on either financial hardship or compassionate grounds
- Spouse pensions cancelled upon remarriage before 1976 in some civilian schemes and 1997 in certain military schemes) will be reinstated, and

- PSS members to be able to choose their own superannuation arrangements. Previously, PSS members were not able to choose to have contributions made to a scheme other than the PSS.[20]

Comments

Generally, the above changes allow CSS, and particularly PSS, members enhanced flexibility and choice in their superannuation arrangements. Consequently, these measures will give these members many of the same rights and advantages enjoyed by those public servants in the other government superannuation funds and the private sector.[21]

The benefits provided by the CSS and PSS are very generous by community standards. It is doubtful whether many PSS members will take advantage of the right to participate in the Choice of Superannuation fund regime.

Though the details are not yet released the reform of the Maximum Benefit Multiples for the PSS is likely to entail an increase in these multiples. Briefly, under the PSS a member's benefits do not increase once their benefit multiple reaches '8'. The benefit is then 8 times the person's final average salary over the three years prior to retirement. Under the proposed changes it is likely that this number will be increased and a longer period of time required to reach the maximum benefit multiple. Generally, a PSS member has to work for 40 years (if their personal contributions are at the standard 5 per cent of after tax salary) to reach the current maximum benefit multiple, so the proposed changes will, most likely, cater for those PSS members whose working lives exceed 40 years. While rare, such PSS members do exist. Further, in line with increased workforce participation of older workers, such members are becoming more common.

What the above measures do not do is introduce a general 'transition to retirement' pension for CSS and PSS members. Once a general superannuation fund member passes their preservation age (generally 55 but rising to 60 for those born after 1 January 1960) they may convert some or all of their superannuation benefits to a pension, without having to retire. Though this has been considered by the government, to date CSS and PSS members are not able to access these pensions once they pass their preservation age, without first retiring.[22] Should a PSS or CSS member return to work for the government their pension continues to be paid.

Finally, the restoration of spouse pensions cancelled upon remarriage is an over due equity measure.

Endnotes

1. The Hon Peter Costello MP, Treasurer, *Budget Paper No. 2*, 2007–08, p. 18.
2. ibid, p. 19.

3. ibid, p. 19.
4. ibid, p. 18.
5. ibid, p. 19.
6. Elizabeth Kazi, 'Tinkering cuts chance of reform', *Australian Financial Review*, 10 May 2007, p. 13.
7. John Edwards, 'Shape of tax cuts a credit to Costello', *Australian Financial Review*, 10 May 2007, p. 71.
8. The Hon Peter Costello MP, Treasurer, *Budget Paper No. 2*, 2007–08, p. 308.
9. ibid., p. 309.
10. That is, Superannuation Laws Amendment (2007 Budget Co-contribution Measures) Bill 2007.
11. Association of Superannuation Funds of Australia, *Pre Budget Submission for the 2007–08 Budget*, January 2007, p. 3.
12. Subparagraph 10A(2)(c) Superannuation (Government Co-contribution for Low Income Earners) Act 2003.
13. Subparagraph 10A(3)(c) Superannuation (Government Co-contribution for Low Income Earners) Act 2003.
14. The Hon Peter Costello MP, Treasurer, *Budget Paper No. 2*, 2007–08, p. 22.
15. The relevant Act is the Superannuation Guarantee (Administration) Act 1993.
16. Jonathan Barrett, 'One-off gift seen as vote grabbing', *Australian Financial Review*, 10 May 2007, p. 13.
17. The Hon. Mal Brough MP, then Minister for Revenue and Assistant Treasurer, 'Superannuation Choice – A smooth transition for business and employees', *Media Release*, 19 January 2005.
18. The Hon Peter Costello MP, Treasurer, *Budget Paper No. 2*, 2007–08, p. 23.
19. ibid, p. 23.
20. ibid, p. 200 and Senator the Hon. Nick Minchin, 'Increased choice for public service superannuation contributors', *Media Release*, 28/2007, 8 May 2007.
21. Other government superannuation funds include the Public Sector Scheme Accumulation Plan and the Australian Government Employees Superannuation Trust. Both are accumulation style plans and operate in largely the same manner as private sector accumulation style plans.
22. Department of Finance and Administration, 'Transition to Retirement web page at http://www.finance.gov.au/super/transition.html (accessed 10 May 2006).

GST concessions for business in the 2007-08 Budget

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Introduction

The most significant change to the GST base since its introduction from 1 July 2000 was the 2007-08 Budget announcement to increase, with effect from 1 July 2007, the GST registration threshold for businesses from $50,000 to $75,000 and the GST registration threshold for non-profit bodies from $100,000 to $150,000.

This section of the Budget Brief 2007–08 will outline the GST concessions made to business generally and to small business in particular as indicated in Budget Measures 2007–08, *Budget Paper No. 2*.[1] As all the GST revenue collected by the Commonwealth is distributed to the States and Territories, the budget measures affecting the GST revenue are indicated in Federal Financial Relations, *Budget Paper No. 3* in accordance with Commonwealth Budget practice followed since the introduction of the GST from 1 July 2000.[2]

The Treasurer in Press Release No. 038 of 8 May 2007 titled *Simpler Tax for Small Business* indicated that the 2007 budget measures in relation to small business were directed at assisting some two million small businesses, that is around 95 percent of all Australian businesses, by reducing red tape and compliance costs.[3]

Background to proposed changes

On 12 October 2005, the Prime Minister and the Treasurer in a Joint Press Release announced the appointment of a Taskforce headed by Mr Gary Banks to identify practical options for alleviating the compliance burden on business from Commonwealth Government regulation.[4] The report of the Taskforce titled *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business* (the report of the Banks Taskforce) was released on 7 April 2006.[5]

The background to most of the 2007 Budget measures relating to the concessions for small business may be traced to the Banks Taskforce report and the Australian Government's final response to its recommendations.[6]

Increasing the GST registration threshold

The Treasurer in Press Release No. 038 indicated that the turnover threshold for registration of businesses for the GST will increase from $50,000 to $75,000 from 1 July 2007. The threshold for non-profit bodies will increase from $100,000 to $150,000. Entities that register for the GST, even though they are below the proposed thresholds will have the option of remitting GST only once a year.

The Treasurer added that both thresholds will be higher in real terms than when the GST was introduced in July 2000. This measure is in accordance with Recommendation 5.38 of the report of the Banks Taskforce (page 119).

This measure involves a change to the GST base and requires the unanimous agreement of the States under section 11 of the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999*. This measure is expected to reduce GST revenue payable to the States and Territories by $318 million over four years as follows:[7]

Table 1: Reduction in GST Payable due to increasing the GST registration threshold

	2007–08	2008–09	2009–10	2010–11
Australian Taxation Office ($m)	-56.7	-82.9	-87.1	-91.4

Source: Budget Paper No.3

In consequence, a larger number of small businesses and non-profit bodies will be able to opt out of the GST system. *Budget Paper No. 2* (page 16) sets out the impact of this measure as follows:

> Those that voluntarily register for GST will have the option of remitting GST annually, rather than quarterly or monthly.
>
> Taxpayers choosing not to register for GST will be able to claim, against their business income, the GST-inclusive cost of deductible business expenses, rather than the GST-exclusive amount. They will not be able to claim fuel tax credits.[8]

Thus, there will be reduced compliance costs to entities, with annual turnover of between the present and proposed GST registration thresholds, which might choose not to register for the GST.

There will also be a reduction in income tax revenues to the Commonwealth as the additional taxable entities choosing not to register for the GST, will be able to claim the GST inclusive costs of deductible business expenses for income tax purposes. The impact on revenue is reflected in *Budget Paper No. 2* (page 16) as follows:

Table 2: Reduction in income tax revenue due to non-registration of taxable entities

	2007–08	2008–09	2009–10	2010–11
Australian Taxation Office ($m)	-0.7	-4.7	-4.4	-4.0

Source: Budget Paper No.2

There will be a consequential reduction in administration costs to the Australian Taxation Office (ATO) which may be expected to deal with a smaller number of GST registrants and Business Activity Statement (BAS) returns. The impact on ATO administration costs is reflected in *Budget Paper No. 2* (page 16) as follows.

Table 3: Reduction in administration costs for ATO

	2007–08	2008–09	2009–10	2010–11
Australian Taxation Office ($m)	-0.9	-0.9	-0.9	-1.0

Source: Budget Paper No.2

Increasing the threshold for requiring an approved tax invoice for GST

At present businesses are allowed to claim input tax credits for purchases with a GST-exclusive value of $50 or less without the need for an approved tax invoice. The threshold of $50 will be increased to $75 with effect from 1 July 2007. This measure will reduce compliance costs to businesses but may have adverse consequences for GST revenue as well as income tax collections.

Appendix C of *Budget Paper No. 3* (page 46) shows the following impact on GST collections which will be borne by the States and Territories:

Table 4: Additional costs of collecting GST borne by States and Territories

	2007–08	2008–09	2009–10	2010–11
Australian Taxation Office ($m)	-0.9	-1.1	-1.2	-1.3

Source: Budget Paper No.3

There will be a negative impact on income tax collections because the ‘no-ABN withholding’ arrangements threshold will also increase from $50 to $75. *Budget Paper No. 2* (page 17) estimates the cost to revenue as follows:

Table 5: Reduction in income tax collections due to increase in ‘no-ABN withholding arrangement threshold

	2007–08	2008–09	2009–10	2010–11
Australian Taxation Office ($m)	-2.8	-3.6	-3.8	-4.0

Source: Budget Paper No.2

This measure which affects the GST base will also be subject to the approval of all the States. This measure implements the broad suggestion at page 114 in the Banks Taskforce report that tax thresholds should be reviewed periodically.

PAYG instalments paid annually when voluntarily registered for GST

Entities that are not required to be registered for GST (turnover less than $75,000 for businesses and $150,000 for non-profit bodies as proposed) but voluntarily register, will have the option of remitting GST annually as indicated in section 3 above.

At present, taxpayers may remit PAYG annually if they are not registered for the GST and meet other eligibility criteria. To align the PAYG and GST payment and reporting it is proposed that from 1 July 2008 those entities who voluntarily register for the GST will be permitted to remit PAYG and GST at the same time annually, lodging only one BAS. This measure will result in reducing compliance costs for these entities.

The costs to the Commonwealth of accepting PAYG instalments annually instead of monthly or quarterly is set out on page 17 of *Budget Paper No. 2* as follows:

Table 6: Cost to Commonwealth of change to annual PAYG instalments

	2007–08	2008–09	2009–10	2010–11
Australian Taxation Office ($m)	-	-100.0	-20.0	-20.0

Source: Budget Paper No.2

The impact of this measure, which has already received the approval of the States, on GST collections is set out on page 47 of Appendix C to *Budget Paper No. 3* as follows:

Table 7: Reduction in GST collected due to change to annual PAYG instalments

	2007–08	2008–09	2009–10	2010–11
Australian Taxation Office ($m)	—	-35.0	-5.0	-5.0

Source: Budget Paper No.3

One of the four principles set out in the Banks Taskforce report at pages 111 and 112 for developing future tax changes is that measures to protect the revenue base must balance the revenue risk against the cost of compliance. This concessionary measure appears to have been guided by this principle.

Simplified accounting methods for GST—extending availability

The Banks Taskforce Report on page 118 highlighted the compliance problems faced by small businesses such as restaurants and grocers with mixed GST inputs. The report records that research commissioned by the National Association of Retail Grocers of Australia found that GST compliance costs as a percentage of GST collected were 28.25%, 13.53% and 1.25% for small, medium and large retail grocers respectively. To ease the compliance burden for small restaurants, cafes and caterers the Banks Taskforce in Recommendation 5.37 on page 118 recommended that they should have access to a simplified accounting method.

The measure in *Budget Paper No. 2* on page 22 titled *Simplified accounting methods — extending availability* will give the Commissioner of Taxation power to develop simplified accounting methods (SAMs) for all entities with an annual turnover of less than $2 million that have mixed supplies – taxable and GST free or mixed purchases. This measure will take effect from 1 July 2007. The cost to the ATO of administering this measure is as follows as stated at page 22 of Budget Paper No. 2.

Table 8: Cost to ATO of administering simplified accounting methods

	2007–08	2008–09	2009–10	2010–11
Australian Taxation Office ($m)	-	1.0	1.0	1.0

Source: Budget Paper No.3

Concluding comments

The GST tax concessions (such as increasing the registration threshold from $50,000 to $75,000, increasing the threshold for tax invoices from $50 to $75, and extending the simplified accounting system) proposed in the 2007–08 Budget will assist business generally and micro businesses in particular in reducing compliance costs.

The Treasurer in the Press Release titled *Simpler Tax for Small Business* whilst referring to the above budget measures in relation to the GST also indicated that it was proposed to implement a small business framework. This will include measures to standardize the eligibility criteria for accessing small business concessions for GST, the simplified tax system (STS), capital gains tax (CGT), fringe benefits tax (FBT) and PAYG instalments. Any business with turnover of less than $2 million will, subject to other terms applicable to each concession, be able to access any of these concessions. The details of the small business framework were set out in a Joint Press Release titled *Making Tax Compliance Easier for Small Business — The New Small Business Framework* issued by the Treasurer and the Minister for Small Business and Tourism on 13 November 2006.[9] The Tax Laws Amendment (Small Business) Bill 2007 was introduced into the House of Representatives on 10 May 2007 to implement the new small business framework.[10]

The Australian Government has on page 306 of *Budget Paper No. 2* indicated that it will spend $40 million over four years on a New Business Intensive Assistance Programme. This measure is to enable the ATO to conduct face-to-face and telephone visits to assist new businesses that prepare their own BAS. It is intended to address the problem that access to tax professionals may be too costly for some new micro businesses and the shortage of tax practitioners.

While all these measures appear to offer relief to small businesses, some tax practitioners have reservations whether they will go far enough to reduce the compliance burden of the very small businesses. These businesses carry an undue cost of the GST collection burden as indicated in section 6 above.

Mr Peter Moltoni, the President of the Taxation Institute of Australia (TIA) in a commentary titled - *Budget 2007- 08: Is everyone a winner?* - posted on 8 May 2007 on the TIA website, summed up the twin concerns of small business and tax professionals on the adequacy of the measures to give real relief to small business as follows:

> "Despite these wins the Taxation Institute is concerned that the Government has only been selective about reducing the complexity of our tax laws" said Mr Moltoni.
>
> "It is clear small business is likely to suffer in the future, as the 2007–08 Budget will deliver increased compliance costs coupled with a lack of qualified tax accountants.
>
> This situation is exacerbated by the reduction of Government funding of accounting and business courses which will result in increased HECS for students in this area and will discourage them from pursuing an accounting career, therefore, impacting upon the entire tax profession in the future.
>
> Additionally, the use of offsets for delivering the tax cuts further entrenches complexity in the system, thereby making future tax rate simplification more problematic.
>
> Despite our compliance cost concerns, we acknowledge that individuals and some small business will benefit from proposals to simplify GST compliance and the PAYG for small business."

An example of the TIA's concerns on the increasing complexity and uncertainty of tax law is provided by the history of the tax legislation relating to the consolidation regime. The consolidated regime has been operational from 1 July 2002 and was intended to simplify and ease compliance costs for wholly owned groups by taxing them as single entities. The ATO website lists 16 Acts that have either introduced or amended aspects of the consolidated regime since 1 July 2002.[11]

On budget night, the Minister for Revenue and Assistant Treasurer issued a press release titled *Improving the income tax law for consolidated groups* indicating further amendments in 15 areas of the consolidation regime, some of which will be retrospective from 1 July 2002.[12] The TIA's concern of increasing tax law complexity is illustrated by the example of the consolidated regime and its complexities and this is only a segment of tax law.[13]

Endnotes

1. Budget Measures 2007–08, *Budget Paper No. 2*.
2. Federal Financial Relations 2007–08, *Budget Paper No. 3*, summary of GST measures in Table 3, p.7 and details in Appendix C, pp. 43-48.
3. The Hon. Peter Costello MP, *Simpler Tax for Small Business*, Press Release No. 038, Parliament House, Canberra, 8 May 2002.
4. The Hon. John Howard, MP, the Prime Minister and the Hon. Peter Costello, MP, the Treasurer, *Taskforce on reducing the regulatory burden on business*, Joint Press Release, Parliament House, Canberra, 12 October 2005.

5. Regulation Taskforce 2006, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra, January 2006.

6. Australian Government, Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business, Australian Government's Response, (final response), 15 August 2006.

7. Federal Financial Relations 2007–08, *Budget Paper No. 3*, p. 8 and Table 3 in Appendix C at p. 45 In this connection, please refer to page 309 of *Budget Paper No. 2* on the arrangements between the Australian Government and the States to compensate the States for the cost of the decision to allow certain small businesses and non-profit organisations to pay their GST liability on an annual rather than monthly or quarterly basis.

8. Budget Measures 2007–08, *Budget Paper No. 2*, p. 16, and section 11 of the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999*, p. 16.

9. The Hon. Peter Costello MP and the Hon. Fran Bailey MP, *Making Tax Compliance Easier for Small Business — The New Small Business Framework*, Joint Press Release, 13 November 2006.

10. Please refer to pages 6 to 8 of the Explanatory Memorandum to the Tax Laws Amendment (Small Business) Bill 2007 for a summary of the new law.

11. The Australian Taxation Office, *Consolidation: legislation and supporting material*, 14 May 2007.

12. The Hon. Peter Dutton, MP, the Minister for Revenue and Assistant Treasurer, Press Release No. 050, Parliament House, Canberra, 8 May 2007.

Infrastructure

Richard Webb
Economics Section

Interstate distribution of local road grants

Introduction

In conjunction with the Budget, the Government released a report by the Commonwealth Grants Commission (CGC) on the distribution among the states of Commonwealth identified road grants to local government. The recommendations of the report titled Review of the Interstate Distribution of Local Road Grants would, if adopted, change the amount each of the states receive. The following examines the Report and some of its implications.

Historical perspective

Commonwealth financial assistance grants to local governments take two forms, general purpose grants and grants for roads known as 'identified local road grants'. Until 1990–91, the Commonwealth provided specific purpose grants to local governments for local roads under the *Australian Land Transport Development Act 1988*. The grants were distributed on the basis of criteria in this Act. The October 1990 Special Premiers' Conference agreed that road funds would be 'untied' with effect from 1 July 1991, that is, the conditions applying to road grants would be abolished and local governments could spend the funds for any purpose.

In June 1991, the *Local Government (Financial Assistance) Act 1986* was amended to allow road funding to be added to general purpose grants from 1995–96 and hence distributed on a per capita basis. But this would have been to the detriment of Western Australia, Tasmania, the ACT, the Northern Territory and Queensland. The 1995 Premiers' Conference therefore decided that local road funds would continue to be distributed on the basis of the criteria in the *Australian Land Transport Development Act 1988*. The effect of this decision has been to freeze the interstate distribution of identified local road grants at the historical shares that applied in 1991–92 when grants were untied.

New Methodology

It has long been recognised that the historical shares may not reflect the relative financial needs of local government for local roads. In 2005, the Government asked the CGC to recommend a new methodology. The CGC recommended that:

> … as an interim measure, until reliable and comparable data on road characteristics are available for all States, the local roads grants be distributed among the States on the basis of average expenditure per person in urban, rural and remote areas and the population of each State resident in those areas.

The assessed s6tate shares of local road maintenance expenditure, based on the CGC's approach using data for 2002–03 to 2004–05 are shown in Table 1.

Table 1: Assessed state shares of local road maintenance expenditure based on data for 2002–03 to 2004–05 and recommended distribution for 2006–07 (per cent)

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Current shares (including supplementary funds for South Australia)	28.3	20.1	18.3	14.9	7.8	5.2	3.1	2.3	100.0
Recommended shares from CGC report (based on data 2002–03 to 2004–05)	31.3	22.0	20.2	11.3	8.9	3.3	1.2	1.8	100.0
Adjusted shares from CGC report for 2006–07#	31.1	22.0	20.5	11.3	8.8	3.3	1.2	1.8	100.0

Source: CGC, *Report on the review of the interstate distribution of local road grants*, p. ix.
#: the CGC shares have been adjusted for movements in population shares to December 2005.

For 2006–07, the estimated identified local road grant is $1168 million.[1] Applying the current shares and the CGC's recommended shares for 2006–07 to this amount results in the following distribution among the states.

Table2: Estimated state amounts of local road funding for 2006–07: current shares and CGC recommended shares ($ million)

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Current shares	477	338	309	251	132	88	52	39	1686
CGC recommended shares for 2006–07	524	371	346	191	148	56	20	30	1686
Gain(+)/loss(-)	+47	+33	+37	-60	+16	-32	-32	-9	0

Source: Based on CGC, *Report on the review of the interstate distribution of local road grants*, p. ix and Budget Paper No. 3 2007–08, p. 23.

Table 2 shows that if the CGC's recommendations for 2006–07 were adopted, NSW, Victoria, Queensland and South Australia would gain while Western Australia, Tasmania, the ACT and the Northern Territory would lose.

Conclusions

The CGC's recommendations will be controversial because they would entail substantial redistributions of grants among the states. Western Australia, in particular, can be expected to oppose adoption of the recommendations.

Key reference

Commonwealth Grants Commission, Report on the review of the interstate distribution of local road grants, 2006.

North-south railway

Introduction

Factored into the AusLink 2 transport program is a provision for further study of a possible inland north-south railway line between Brisbane and Melbourne. Details are yet to be announced. The following contains background to this concept.

Domestic freight projections

Australia faces a formidable freight transport task. The Bureau of Transport and Regional Economics (BTRE) has projected the total domestic freight task—measured in billions of tonne-kilometres—to grow at an annual rate of 2.8 per cent between 2003 and 2020, that is, by almost 60 per cent. Interstate freight is expected to grow even faster at 3.8 per cent annually. Based on past trends, the BTRE projects rail's share of non-bulk freight to fall from 21 to 17 per cent but to remain the largest mode in the transport of bulk freight (coal, minerals and grains).

These projections do not, however, take account of the 'potential for rejuvenation' in north-south routes similar to that which has taken place on east-west rail routes. While rail's share of the land transport market on the east-west corridor between Perth and the eastern states is around 80 per cent, rail's share of the Melbourne-Brisbane market is about 30 per cent, 9 per cent on the Melbourne-Sydney leg, and 11 per cent between Sydney and Brisbane where the track follows the coast. Reasons for rail's low share on the existing Melbourne-Sydney-Brisbane corridor are the poor state of the track, and congestion in the Sydney metropolitan area; the latter is the single most important barrier to better service reliability. These factors increase rail's costs reducing its ability to compete with road freight.

The Government has allocated $1.8 billion over the five years to 30 June 2009 for investment in the existing corridor. This investment is projected to double rail's market share between Melbourne and Brisbane. The Australian Rail Track Corporation (ARTC) will undertake $1.3 billion of the investment; the balance will be funded through Auslink. The ARTC is a wholly-owned Commonwealth company established to provide a 'one-stop shop' for train operators seeking access to the interstate track between Brisbane and Perth. The ARTC is also responsible for capital investment in train corridors, and manages the interstate network and infrastructure maintenance. Projects in the ARTC's investment program can be found here.

Future Directions?

Even with this investment, it is projected that the existing corridor will reach capacity around 2019. This raises the question of where future investment in capacity should be made. The concept of an inland route between Melbourne and Brisbane which bypasses but is linked to Sydney, has a long history. Most recently, the concept has been associated with Mr Everald Compton and Australian Transport and Energy Corridor Limited (ATEC).

The Commonwealth's involvement in the proposal has taken several forms including the financing of pre-feasibility studies. The most recent such study—the North-South Rail Corridor Study—was released in September 2006. The study examined four route options but was instructed not to determine the preferred route. Key conclusions of this study include that government would have to contribute funds for the project to proceed because the cost of investment would not allow commercial rates of return. The construction costs and transit times of the options are shown in the table.

Table: Construction costs and transit times of the optional routes

Route	Far west via Shepparton	Far west via Albury	Central inland via Shepparton	Central inland via Albury	Coastal via Shepparton	Coastal via Albury	Hybrid via Shepparton	Hybrid via Albury
Cost ($ bn)	3.6	3.1	8.5	8.0	10.7	10.2	6.8	6.3
Transit time Melbourne -Brisbane (hours)	21.3	20.6	24.5	23.7	22.4	21.6	26.4	25.7

Source: Department of Transport and Regional Services, *North-South Rail Corridor Study, Background Briefing*, p.10.

Key references

Bureau of Transport and Regional Economics, Freight Measurement and Modelling in Australia, Report 112, Bureau of Transport and Regional Economics, Canberra, 2006.

Department of Transport and Regional Services, North-South Rail Corridor Study, report prepared by Ernst & Young, Hyder Consulting Pty Limited, and ACIL Tasman Pty Limited, Department of Transport and Regional Services, Canberra, 2006.

Endnotes

1. Budget Paper No. 3 2007–08, p. 23.

Social policy aspects of the Budget—introduction

As discussed elsewhere in this Budget review, the Budget's expenditure and tax cuts amount to approximately $70 billion over four years. A large amount of this expenditure has been directed towards what can be broadly described as social policy areas (for example, education, health, community services, income support and Indigenous affairs). It includes approximately $3.5 billion on education, $3.6 billion on payments to families and older Australians and $2.3 billion on health, over four years. The tax cut of $31.5 billion over four years which will favour low income earners is anticipated to 'improve incentives to work among low-income earners and second-income earners considering returning to work after a period of caring for children.'[1]

Much of the initial media commentary on social policy aspects of the budget was positive—for example, welcoming increased expenditure on education and health and medical research as investments in the future, and increased funding for Indigenous health and housing as directed towards an area of obvious need. However, some reviews were less positive in their assessments. For example, in his review of the Budget, Peter Saunders, Social Research Director at the Centre for Independent Studies, opened with the following questions:

> What was the overall rationale driving Peter Costello's 12th budget? What fundamental objectives was he trying to achieve? What key principles informed his decisions?[2]

His answer was that:

> … it (the Budget) has no rationale; there is no clear objective; there are no guiding principles. Good governments establish a predictable environment so people can plan their lives and make rational economic decisions. But in this and previous budgets, money gets withheld or handed out capriciously, arbitrarily, unpredictably.[3]

One does not necessarily have to agree with this conclusion to appreciate the point that questions about the policy context and rationale for particular budget measures provide a useful starting point for any budget analysis. Much of the media analysis of the Budget appeared to eschew this kind of approach in favour of analyses of the political or economic context of the budget as a whole. Very few analyses of particular portfolio areas went beyond the question of whether interest groups believed the amounts pledged to be enough.

This section of the Budget review examines the policy context for a range of measures in social policy related portfolios in the Budget. It seeks to provide a clearer understanding of the background, rationale and policy direction for these measures and therefore a better understanding of the Budget from a social policy point of view. In addition to the question of whether funding commitments are adequate, the types of issues examined include *how* funding will be spent, whether particular measures are consistent with previous approaches, the apparent rationale for particular measures and the likely success of particular measures.

Key points from the analysis include:

- the Budget includes expenditure in a wide variety of social policy areas that has been well-received by relevant interest groups and commentators

- several measures make improvements to existing programs such as the expanded assistance for jobseekers with special needs and changes to enable more timely delivery of the Child Care Tax Rebate

- nevertheless, in some cases, improvements to programs may not be sufficient to address key problems (for example, funding for expanded assistance for jobseekers may not be enough to meet the need for such assistance)

- some measures appear likely to stimulate demand for particular programs or services, raising questions about how this demand will be met (for example, there is no evidence that payments to individuals to encourage apprenticeships will be complemented by increased payments to the states and territories to provide apprenticeship training)

- on closer examination, some measures can be regarded as less substantial or significant than portrayed by some commentators (for example, the Higher Education Endowment Fund, and the Medicare dental health measure)

- there has been a continuation of policy directions familiar from recent years, including the use of one-off cash payments to provide financial assistance to certain groups of people; a preference for Commonwealth programs over state and territory programs in the fields of school education and vocational education and training; and the continued move towards ‘mainstreaming’ of Indigenous policy and service delivery and

- there are several areas in which, given the size of the budget surplus, opportunities for fundamental reform have not been pursued or commitments have fallen far short of what some regard as required (for example, Indigenous employment, health and housing, prevention of chronic disease, and dental health).

This last point is particularly important when one considers the large amount of ‘unexpected’ revenue available to the Government in this and previous budgets. The 2007–08 *ANZ Federal Budget Report* (ANZ Report) estimates that the total of such ‘windfall gains’ for this and the next four years is around $70 billion, a figure matching the 2007–08 budget commitment. For the nine years covered by this and the past four budgets it is $398 billion.[4]

The authors of the ANZ Report, while describing the Budget as a ‘good election year budget’, noted that ‘nonetheless, we find it impossible not to wonder whether future generations of Australians might not look back upon the nearly $400bn of windfall gains that have been redistributed through this and the preceding four Budgets and wonder whether we could not have had rather more far-reaching reform, for that enormous sum.’[5] While the personal tax system is identified as one area requiring far-reaching reform, from the point of view of social policy program expenditure, one might also reasonably suggest similarly fundamental reforms/commitments, such as closing the gap in life expectancy between Indigenous and non-Indigenous Australians, a comprehensive strategy for reorienting the health system towards preventive healthcare, and a comprehensive dental health strategy.

Endnotes

1. S. Eslake, 'Lots of redistribution spiced with some reform', *ANZ Federal Budget Report*, 9 May 2007, p. 3, http://www.anz.com/Business/info_centre/economic_commentary/Federal_Budget/2007-08Budget_Report.pdf, accessed on 17 May 2007.
2. P. Saunders, 'Peter Costello is just like Santa on steroids', *Australian*, 10 May 2007, http://parlinfoweb.aph.gov.au/piweb/TranslateWIPILink.aspx?Folder=pressclp&Criteria=CITATION_ID:JW0N6%3B, accessed on 17 May 2007.
3. ibid.
4. S. Eslake, op. cit., p. 2.
5. ibid., p. 3.

Education

Introduction

The Government has made a feature of its increases to education expenditure in the 2007–08 Budget although expenditure increases on measures in other areas such as national security and defence, transport and infrastructure, and the environment are greater. The increase in education expenditure is associated with a range of new measures in all three education sectors, presented in the budget papers under the uniform banner *Realising our potential*.

The additional expenditure provided by these measures totals $3.5 billion over the next four years, increasing from $534 million in 2007–08, to approximately $970 million in each of the out-years. The relative share of this additional funding is 57 per cent for the higher education sector, 24 per cent for schools and 19 per cent for vocational education and training.

The measures have widely been viewed as a government election year strategy to counter the ALP's blueprint for education, *The Australian economy needs an education revolution*, released in January 2007. Much of the Government's budget presentation and the media's commentary have focused on the $5 billion investment in the new concept of a Higher Education Endowment Fund. Consequently the education measures more generally have been represented as the Government's own 'revolution' in education policy.

The following notes consider some of the main measures in this context.

Higher education

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Higher education is the centrepiece of the Government's education initiatives. However in an election year and with an anticipated spending budget the Treasurer opened his budget speech with an investment rather than a spending measure: the announcement of a $5 billion perpetual Higher Education Endowment Fund (HEEF).

Higher Education Endowment Fund (HEEF)

The HEEF measure invests $5 billion of the budget surplus in an endowment fund, the earnings of which will provide funds for university capital works and research facilities from 2008–2009. Budget papers estimate the HEEF will earn $304 million annually but the Australian Vice-Chancellors' Committee (AVCC) suggests this is conservative and that the HEEF could secure earnings of $500 million or more a year.[1] Earnings would have to be much higher than the estimates if the HEEF is to fund a reported $1.2 billion maintenance and infrastructure backlog.[2] However universities will not be guaranteed an annual share of the earnings which will be distributed to eligible higher education providers in a competitive tender process by the Minister for Education, Science and Training after advice from the HEEF Board. Eligible providers are the public universities and any private universities eligible for grants to support research and capital development projects as Table B providers under the *Higher Education Support Act 2003*. Currently there are three Table B providers: Bond University, the University of Notre Dame and the Melbourne College of Divinity.

Budget papers make it clear that the HEEF may also receive additional capital from future budget surpluses, from philanthropic investment which will be tax deductible and, if asked, will also manage individual institutions' endowments. Less clear is how applications for funds will be assessed. The Minister's media release suggests the best proposals will 'support Australian Government policy with respect to diversity, specialisation and responsiveness to labour market needs' and that 'the Board would take into consideration whether universities had been able to raise matching funds, for example from state or territory governments, industry, alumni or members of the public.'[3] This has been interpreted as a mandatory requirement but the President of the AVCC, Professor Sutton, is reported as having been assured by 'Department of Education, Science and Training officials that it was not a requirement that universities must raise matching funds to get earnings from the endowment.'[4] However it seems likely that the HEEF will benefit those universities, such as the Group of Eight, that already win 70 per cent of national competitive research grants and have substantial revenue from private sources.[5] In 2004 the Group of Eight raised $98 million of the $171 million university income from donations and bequests.[6]

Funding for capital works and research facilities has been provided from the Capital Development Pool (CDP), the Research Infrastructure Block Grants (RIBG) programme and the annual Appropriations Act. The Portfolio Budget Statements for 2007-2008 provide estimates for the CDP and RIBG programmes of $80.09 million and $207.98 million respectively. The annual appropriations have been in the order of $186 million over 3 years. [7]

There is no indication in the budget papers that dividends from the HEEF would replace this existing funding. In fact the supporting information in the HEEF measure media release describes the HEEF as 'additional and ongoing funding' and the Treasurer in a post budget interview guaranteed that the fund would not 'take over existing education funding'.[8] However the Minister has since been reported as stating that HEEF funds would 'eventually supersede other capital funding sources such as the Capital Development Pool'.[9] HEEF dividends would have to be substantially higher than the $300 million forecast if they were to replace all existing capital funding sources, let alone provide the additional funding promised, and funding sufficient to meet existing shortfalls in capital and research facilities. The Group of Eight claim a notable weakness of the budget initiatives is the failure to address the shortfall in research infrastructure funding.[10]

The Government claims the HEEF as an 'unprecedented investment for the future of universities.'[11] The measure has been interpreted as doubling the $5.8 billion funding to higher education but the more modest $304 million annual dividend, not the capital investment, provides the additional funds as part of the $1.7 billion additional higher education funding. The HEEF measure has been welcomed by the universities but other budget measures have attracted more comment, in particular additional funding and changes to the Commonwealth Grants Scheme.

The funding of student places

University student places are funded through the Commonwealth Grants Scheme (CGS). Under the CGS the Australian Government funds each higher education provider for an agreed number of Commonwealth supported places (previously called HECS places) in particular disciplines. The disciplines are grouped in twelve funding clusters with both the Commonwealth and the student contribution amounts varying across the clusters. Universities can offer full-fee places to domestic students once the Commonwealth supported places are filled. The Budget makes a number of changes to the operation and funding of the CGS and has removed the cap on the number of domestic full-fee places universities can offer, which until now has been capped at 35 per cent of course enrolments.

Under the budget measure, *Realising our potential – increasing university funding*, $559.6 million over four years will fund changes to the CGS. From January 2008 the number of funding clusters will be reduced from 12 to 7.[12] CGS funding will be increased for Commonwealth supported places in mathematics and statistics ($2729), allied health ($1889), engineering, science and surveying ($684), clinical psychology ($2729), education ($109), nursing ($109), behavioural science and social studies ($840), and medicine, dentistry, and veterinary science ($1081). The significant increase in funding for mathematics and statistics meets the findings of the final report of the National Strategic Review of Mathematical Sciences Research. In the final report, *Mathematics and Statistics: Critical Skills for Australia's Future*, the authors claimed that the 'relative funding of mathematical sciences departments in universities is inadequate and does not reflect either their crucial importance or the cost of delivering quality training of students.' The report emphasised increasing the Commonwealth grant for supported places in mathematics rather than reducing the student contribution. By increasing the Commonwealth grant for mathematics and statistics the budget measure contrasts with ALP policy to reduce the student contribution fees for those students and further reduce them for those mathematics and science graduates entering teaching.

Conversely the accounting, administration, economics and commerce disciplines have been aligned with law thus reducing their Commonwealth funding and increasing the maximum student contribution rate. Student contribution rates are based on graduates' potential earnings, and the Government's decision is based on the higher salaries and competitive nature of the labour market for these disciplines.[13] The Minister has stated that universities do not have to increase the student contribution for these disciplines, but considering that most universities took the opportunity of increasing HECS by the maximum 25 per cent in 2005 it could be expected that graduates in accounting, administration, economics and commerce will have an increased HELP debt.

In *Realising our potential – allowing more responsive universities* the Budget provides $223.2 million over four years to relax the caps on Commonwealth supported places and domestic full-fee paying undergraduate places. Universities will be fully funded rather than penalised for over-enrolments of up to 5 per cent in Commonwealth supported places. While they will be required to deliver specified Commonwealth supported places in nursing, teaching, medicine and engineering they will now be allowed ‘to adjust student numbers and course mixes to meet student demands and employer needs.’[14] Included in this mix will be the ability to offer an uncapped proportion of domestic full-fee places. There is some confusion in interpretation of this initiative. Currently the number of full-fee paying places is capped at 35 per cent and the *Higher Education Support Act 2003* (HESA) ensures that providers fill Commonwealth supported places before accepting other enrolments. The Minister’s budget press release states universities ‘will still be required to offer their Commonwealth funded places before offering full fee places.’[15] The difference between filling or rather offering places is not explained.

The effect of both removing the cap on full-fee places and creating greater flexibility in the course mix has the potential for universities with high demand courses to ask for fewer Commonwealth-supported places and replace them with full-fee places, particularly in courses where revenue from full-fee places is higher than that from Commonwealth grants.[16] However the University of Technology Sydney’s Vice-Chancellor, Ross Milbourne, predicts the number of domestic full-fee places might actually fall due to the ‘expansion in commonwealth-supported offers and the fact universities can move commonwealth-supported places to high-demand areas.’[17] Regardless of the different possibilities this initiative is another means for universities to create niche markets and, like the HEEF budget measure, to differentiate the providers in the sector.

The policy to remove the cap on domestic full-fee places also differentiates government and opposition policies. Since 1998, when full-fee places were introduced, the ALP has promised to abolish or phase them out.[18] A Labor government would need to compensate universities with further funding for Commonwealth supported places. Estimates of this have varied widely with the focus on full-fee places in medicine costing over $100 000. However it should not be assumed that fee-paying courses in demand are all expensive, like medicine. Law, for example, is one of the cheapest courses to run.[19]

In the 2007–2008 Budget the Government is providing $208.6 million over four years to assist the universities to specialise and diversify through the *Realising our potential – Diversity and Structural Adjustment Fund*.[20] This and other budget measures further implement the Government’s policy to remove the ‘one-size-fits-all’ model in the sector. In a wide-ranging speech on the need for diversity the Minister claimed the ‘sector must stop trying to be all things to all students … that means I want to see the development of a diversified higher education sector, made up of universities which differ from each other in terms of mission, discipline mix, course offerings, modes of delivery, management and in academic structure.’[21]

Increased funding of $1.7 billion to higher education is strategically directed to enable greater specialisation and diversity in the sector. Vice Chancellors responded positively to the measures with AVCC President Gerard Sutton reported as saying it was ‘a fantastic outcome

... spectacular for the university sector.'[22] Criticism focuses on perceived outcomes of a more privatised, stratified and less equitable sector.[23] However all stakeholders have welcomed the increased funding to the higher education sector which may overcome criticism of previous funding cuts and perceptions that since Commonwealth spending on non-government schools has overtaken Commonwealth spending on universities the Government has neglected the higher education sector.[24]

School education

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Social Policy Section

The justification for the school education measures in the 2007–08 Budget is widely accepted because it is well documented by research that improving student outcomes, including literacy levels, will improve life outcomes. A number of the measures have also been foreshadowed by the recommendations of recent inquiries and reports commissioned by the Government, covering such issues as the teaching of literacy, a national Year 12 certificate, Year 12 curriculum content, the teaching of Australian history, and performance pay for teachers.[25]

The Budget introduces new measures, and continues and/or expands existing measures that directly fund schools, school communities and parents. These measures include literacy and numeracy vouchers, Australian Technical Colleges (ATCs), and rewarding schools for improvements in literacy and numeracy. The Investing in Our Schools Programme, which also falls into this program category, was extended by legislation passed in March 2007.[26]

Another feature of the budget measures for school education is that they reinforce the trend towards greater Australian Government involvement in school education—a trend which is also evident in the ALP's policies announced to date.[27] The Budget also signals the introduction of a number of new conditions for funding for the next quadrennium of schools funding (2009 to 2012), thereby expanding the conditions for funding that were legislated by the passage of the *Schools Assistance (Learning Together—Achievement Through Choice and Opportunity) Act 2004*.[28]

Continuing and expanded programs

There have been some concerns about the effectiveness of some of the programs which are continued or expanded by the budget measures. For instance there is concern about the measure to provide literacy and numeracy vouchers for students, thereby expanding the Reading Assistance Scheme which had its origins in the Tutorial Voucher Initiative (TVI), a pilot scheme that ran in 2005. While an evaluation of the TVI reported that most parents were satisfied with the TVI, fewer tutors assessed the TVI as effective.[29] Of more concern was the uptake rate which was 40 per cent of eligible students, although the government regarded this as a 'successful result' for a national pilot.[30] There were some refinements to the Reading Assistance Scheme as a result of the TVI evaluation and more are proposed for the new program. To date the uptake for the 2007 program, at about 60 per cent, is a significant improvement on the TVI.[31]

The TVI attracted criticism from those who considered that the funds would be better directed towards schools.[32] These criticisms have continued. Typical of these criticisms is that of the Victorian Branch of the Australian Education Union:

> The voucher program has been running in Victoria for three years and take-up is less than 30 per cent. That money should be made available to support programs in schools. Teachers and principals know these kids and know what their needs are in a way that private tutors simply cannot.[33]

Other concerns may be aroused by the Government rewarding schools for improving literacy and numeracy attainment while giving parents rather than schools the means to achieve this. As the Victorian Association of State Secondary Principals, which considers the tutorial vouchers 'a complete waste of money', asks: 'Why not put the money directly into schools so we could lower class sizes, have more targeted literacy and numeracy programs?'[34]

The 2007–08 Budget provides for another three Australian Technical Colleges (ATCs). The establishment of the ATCs has not proceeded as anticipated. The funding for the original ATCs program has been increased and shifted between program years, with various reasons given. The previous Minister for Vocational and Technical Education attributed the additional costs to the flexibility of the program which had resulted in higher operational costs, and more new sites and multiple campuses than were anticipated.[35] The proposed ATC for the proposed Lismore Ballina region has not yet eventuated.

Critics of the ATCs view them as duplicating, at greater cost, existing state systems of vocational training and education.[36] Some have argued that the colleges should take on a broader range of subjects to ensure their viability in the long term. Given that the ATCs, with the addition of three more, are intended to cater for a maximum of 8400 students, some critics see them as having little impact on the skills crisis. There are also concerns about retention rates given the workload demands that will be placed on these students.[37]

The announcement of three new ATCs also comes ahead of the Government's expectation that there will be an evaluation of the ATCs in 2008.[38]

New programs

Two budget measures—the Summer Schools for Teachers and the rewarding of schools for improvements in literacy and numeracy outcomes—and the announcement that performance pay will be a condition of funding for the next quadrennium of schools funding, signal the arrival of performance pay for teachers.

Performance pay for teachers is contentious. The April meeting of the Ministerial Council on Education, Employment, Training and Youth Affairs (MCEETYA) rejected the federal

Minister's proposal for performance pay, instead opting to investigate different approaches to recognising and rewarding teachers through enhanced career structures.[39] The Government's own commissioned report from the Australian Council of Educational Research (ACER) noted that: 'The historical record is clear that few merit based pay schemes have survived when applied to teaching.'[40] ACER was cautious in its response and considered that its review of performance pay schemes indicated 'the need to move gradually', recommending further research focussed on developing 'valid and reliable systems and measures for gathering evidence for individual performance pay decision … [and] … learning how to operate team- or school-based performance award programs.'[41] It is not clear from either the budget measures, or the announced performance pay condition for the next quadrennium of funding, whether the implementation of either will take into account these recommendations.

The bonuses for teachers to attend summer schools could be perceived as a de facto performance pay system—they have been announced as 'Rewarding Australia's high quality teachers.'[42] The school based rewards for schools that improve their literacy and numeracy attainment also have the potential to operate as a performance pay system with the Minister for Education, Science and Training confirming that the funding could be used to pay 'greater rewards to outstanding teachers.'[43]

Save our Schools has voiced other concerns about the school reward measure, considering that such schemes have the potential for schools to manipulate outcomes and disadvantage certain categories of students:

> … overseas experience with school performance rankings shows that schools generally respond by cheating on tests, 'gaming the system' and poaching or creaming-off high achieving students from other schools rather than taking on more low achieving students … Many schools in England and the US increase their test outcomes by excluding low achieving students from tests in a variety of ways such as exempting them from tests … suspending them at test time and …encouraging them to be absent … or to leave the school.[44]

General recurrent grants for schools

Both the Government and the ALP are intent on improving the quality of schooling and educational outcomes through the funding of targeted programs. Only one budget measure—the additional funding for regional and remote non-government schools—impacts on general recurrent grants (GRGs) for schools which form the bulk of Australian Government specific purpose payments for schools (an estimated 82 per cent in 2007–08).[45] This is in spite of the findings of two reports. The first, a MCEETYA report, called for additional funding of $2.4 billion for government schools to enable them to achieve a minimum National School Resourcing Standard.[46] The second, a government-commissioned report on government primary school resourcing, concluded that without additional financial and other resources, the National Goals for Schooling were outside the reach of many government primary schools.[47] Last year the Australian Primary Principals Association (APPA) drew attention to the lower rates of general recurrent grants for government primary schools and called for them to be funded at the same rate as government secondary schools, thereby providing an additional estimated $101 million for government primary schools.[48]

The measure to increase funding for non-government regional and remote schools is recognition that the socio-economic (SES) system of Australian Government funding for non-government schools does not currently factor distance into its funding formula. The measure also requires state and territory government education systems to provide an equivalent increase for regional and remote government schools, in spite of weighting mechanisms for distance that already exist in their funding formulae.

The Government is currently reviewing the SES system of general recurrent grants for non-government schools.

Other issues

One area of school policy not mentioned in the Budget is languages education. The ALP has announced that it will re-establish an Asian languages and studies strategy for Australian schools. The Department of Education, Science and Training has commissioned two inquiries on languages education which are due to report by July this year. It may be the case that the Govenment will announce changes to its school languages program as a consequence.[49]

There is no information in the Budget that the school education budget measures, and the proposed new funding conditions for the 2009–2012 funding quadrennium, take account of any administrative costs that may result. However the Minister for Education, Science and Training has stated, in announcing funding for the APPA to hold a national forum to create a draft charter to define the role of primary schools, that:

> Schools have been asked to provide a huge range of services that go far beyond what was traditionally the role of schools, and this has the potential to have a negative impact on their ability to teach students and allow them to develop the fundamental skills in areas such as reading, writing and mathematics … The charter will help to define the role of primary school education and to allow schools to focus on the vital task of educating young people.[50]

There are claims that the some of the new conditions of funding foreshadowed in the Budget and by the Prime Minister do not appear to take account of policies and programs already in place in schools. For instance, the NSW education minister has pointed out that NSW government schools have bullying programs and annual reports, and that principals have capacity to choose their staff.[51]

The Australian Government is intent on improving school performance and education outcomes. Many like Kevin Donnelly, education consultant and former government advisor, consider the federal government's approach to education is on 'the right track'. However, as Donnelly has expressed, the government's reforms have the potential to undermine their policy gains to date by formulating a policy program that is 'overly bureaucratic, intrusive and centralised.'[52]

Vocational education and training (VET)

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The $638 million increase in expenditure over four years on new *Realising our potential – VET* measures builds on the $837 million over five years *Skills For the Future* initiatives announced by the Prime Minister in October 2006. In effect the new budget measures are broadly consistent with already established government policy priorities. These priorities are for the funding of the Commonwealth's own VET related programs (e.g. Australian Apprenticeships and Australian Technical Colleges), with an increasing focus on payments to individuals in preference to increasing grants to the states and territories for the running of their VET institutions.

The *Realising our potential* and previous measures have extended the regime of financial incentives available to individuals to encourage them to engage in VET. Traditionally the Commonwealth's VET financial incentive payments have largely been in the form of wage subsidies to employers of apprentices. These subsidies have been enhanced and in recent years have become more targeted to areas of skill shortage, e.g. employer support for mature age apprentices in occupations in high demand. In addition, a range of financial supports that target individual VET students have been introduced. Some of these apply to VET students generally, e.g. income support measures, while others target particular groups, e.g. skills vouchers for mature workers to enhance basic skills, and toolkits and scholarships for apprentices in areas of skill shortage. The *Realising our potential - VET* measures continue the targeting of apprentices in areas of skills shortage with the introduction of a tax-free wage top-up and training vouchers to help them meet the cost of their course fees.

An interesting addition to the range of financial support measures for VET students across the board is the introduction in this budget of student loans in the form of FEE-HELP for Diploma and Advanced Diploma students. The VET sector's role in meeting the growing demand for higher level skills has been evolving. This has focused attention on the inter-relationship between the VET and higher education sectors, and issues associated with the differences in their fees and funding arrangements. The measure is one that could potentially have longer term implications for the future direction of VET funding.

A comparison of the size of the increase in expenditure on these measures with the other main area of Commonwealth VET expenditure—its grants to the states and territories to support them in the funding of their TAFE institutes and other providers—brings the Government's priorities into relief. Its contribution under the *2005–08 Commonwealth-State Agreement for Skilling Australia's Workforce* provided additional funding of only $215 million for the quadrennium. If matched by the states and territories, it was expected to deliver 128 000 additional training places.[53] With the new expenditure in this budget the Commonwealth's expenditure on grants to the states and territories will decline as a proportion of the Commonwealth's administered expenses on VET, from 52 per cent in 2006–07 to 47 per cent in 2007–08.

Another point of comparison is the Government's expenditure on the establishment of Australian Technical Colleges (ATCs). The aim of these secondary colleges is to promote apprenticeships in traditional trades by giving students a head start in school-based apprenticeships in these areas. Although a school education expense, the 2007–08 budget proposal to establish three more ATCs, in addition to the original 25, has been presented as a *Realising our potential – VET* measure. With the added funding for the three new ATCs the establishment costs for these colleges is expected to amount to a total of $552 million (this excludes ongoing schools funding to which ATCs will be entitled). In 2007 there will be approximately 2000 students in the ATCs and this number will rise to 8400 by 2009.[54] While this initiative is adding to the supply of apprenticeship training it is small in comparison with that provided by the broader state and territory VET system. As at September 2006 there were 404 200 apprentices in-training, 159 100 of whom were 'traditional apprentices'. It is also interesting to compare the cost to the Commonwealth of creating these 8400 places in the ATCs, with the 128 000 training places provided for in the state and territory VET systems under the *2005–08 Commonwealth-State Agreement for Skilling Australia's Workforce* (see above).

There is some evidence that the Government's funding of individual incentives is having some impact on the demand for, and participation in, VET. For example, between 2005 and 2006 there has been an 8 per cent increase in 'traditional apprentices' in-training. These policies, together with other factors, such as the demand for workers to develop higher level skills, are expected to contribute to an increase in the demand for VET.[55] A consequence is likely to be a focus on the adequacy of supply side funding, i.e. funding for the state and territory VET sector which annually trains approximately 1.6 million students. Some have estimated that funding would need to grow by 5 per cent per annum to meet this demand.[56] How the VET sector is to be funded to meet this demand is therefore likely to be an ongoing issue and one that will arise in the context of the negotiations for a new *Commonwealth-State Agreement for Skilling Australia's Workforce* when the current one expires in 2008.

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Employment Assistance

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The changing number and characteristics of jobseekers

Australia's overall unemployment rate fell to 4.4 per cent in April 2007—its lowest level since November 1974.[1] This factor, together with the Government's Welfare to Work changes that commenced on 1 July 2006, is influencing the number and characteristics of unemployed jobseekers requiring employment assistance.

The numbers of unemployed jobseekers receiving government provided income support are the lowest now for many years. In March 2007, the number of unemployed jobseekers receiving Newstart Allowance (NSA) was 473 278 and the number receiving Youth Allowance (other) (YA) was 71 619.[2] This compares with the total number of NSA recipients (there was no YA at that time) of 790 542 in June 1996.[3] However the numbers of long-term unemployed (those on payment for 12 months or more) have remained relatively static.[4] The number of long-term unemployed on NSA in March 2007 was 281 937 representing 59.6 per cent of the NSA total, compared with 282 652 in June 1996 representing 35 per cent of the total.

Therefore, while the number of unemployed jobseekers on government income support is now lower than in the past, the proportion on income support for more than 12 months, the long-term unemployed, is larger now than in the past. This is a likely effect of the current economic boom. While those unemployed jobseekers with readily marketable skills quickly find work, the harder to place jobseekers with significant and/or multiple employment barriers remain reliant on income support. In short, although there are record low levels of overall unemployment and lower numbers of unemployed jobseekers on government income support for many years, those remaining jobseekers on NSA or YA are in many cases those with significant employment barriers.

Furthermore, as a result of the Government's Welfare to Work changes, the numbers of jobseekers required to look for, and accept work, with different characteristics from those of the past and who have differing needs is likely to increase.[5] For example, these include:

- Jobseekers with a partial capacity for work, being those who would have previously qualified for the Disability Support Pension (DSP). These are the persons assessed as being able to work for more than 15 hours a week and therefore do not now qualify for DSP, but may not be capable of full-time work. These jobseekers would have only part-time employment participation requirements.

- Jobseekers who are partnered parents who do not have a qualifying child under age six. These persons would have previously qualified for Parenting Payment – Partnered (PPP), but are now provided with NSA or YA and required to look for and accept part-time work (up to 15 hours a week).

- Jobseekers who are single parents who do not have a qualifying child under age eight. They can no longer claim Parenting Payment – Single (PPS) from 1 July 2006. They are now provided with NSA or YA and required to look for and accept part-time work (up to 15 hours a week).

There are also more jobseekers soon to enter the pool. From 1 July 2007 a further 233 000 jobseekers on PPP or PPS will be required to look for at least 15 hours a week work.[6] These are the PPP or PPS recipients who claimed before 1 July 2006 and are allowed to stay on PPP or PPS until their youngest child turns age 16. They had a year before being required to seek part-time work (up to 15 hours a week). The year ends when their youngest child turns seven or 1 July 2007, whichever is the later.

Budget measures

In response to these trends the 2007–08 Budget has expanded assistance for jobseekers with special needs. There are several enhancements to assistance provided to the unemployed in their endeavours to obtain work. The measures in part recognise that there are increasing numbers of jobseekers on NSA and YA who have particular barriers to employment. These measures are:

- Mobility allowance – expanding eligibility criteria. Mobility Allowance (MA) is paid to a person with a disability who is undertaking work, or vocational training, voluntary work, or independent living/life skills training, and is unable to use public transport without substantial assistance. MA is paid at the higher rate ($104 per fortnight) to PPP/PPS recipients and Supported Wage System workers who have a reduced productivity capacity related to a disability.[7]

- Parenting payment – expanded access to supplementary concessions. PPP recipients with a partial capacity for work will also be provided with access to the Pensioner Concession Card (PCC) as are currently PPS recipients with a partial capacity for work. Additionally, PPP and PPS recipients with a partial capacity for work will be able to retain their PCC for 52 weeks after they have lost payment of PPP/PPS due to employment income.[8]

- Additional places in vocational rehabilitation services and the disability employment network provided by an extra $39.8 million over four years.[9]

- Changes to access and the use of training credits on the Work for the Dole Program (WftD). $13.1 million over four years to provide a $500 incentive payment for WftD participants and to provide equity of access to part-time training credits for part-time WftD participants.[10]

The 2007–08 Budget has also expanded access to the Personal Support Program (PSP) in further recognition that, although the numbers have declined, many of those jobseekers remaining on income support have very significant employment barriers.

An extra $15.8 million has been provided to fund an extra 2000 places in the PSP over the next four years.[11] The PSP aims to enable people with multiple non-vocational barriers to employment to achieve economic and/or social outcomes that are relevant and appropriate to them. Barriers may include homelessness, drug and alcohol issues, psychological disorders, and domestic violence.

The PSP seeks to bridge the gap between crisis assistance and employment related assistance. The PSP is delivered by a network of community based and private organisations that provide individualised support and assistance to participants for up to two years. The participant and their provider jointly develop an action plan to address the participant's non-vocational barriers. Providers monitor participants' progress regularly and formally complete a report after 8 and 16 months of assistance.

Comment

These initiatives primarily appear to target jobseekers who may not be capable of full-time employment, thus addressing issues for the new types of jobseekers on NSA arising out of the Welfare to Work changes that commenced from 1 July 2006.

However, most of the initiatives do not involve significant amounts of expenditure, with the exception of the PSP expansion of $15.8 million and the additional places in vocational rehabilitation services and the disability employment network costing $39.8 million. The changes essentially expand access to, or fund extra assistance in, existing programs. The bulk of the assistance to these jobseekers will be provided by the contracted job placement providers under Job Network (JN). However there are no changes in this budget to the overall fee structures paid to JN providers, nor are there any extra funds for the contracted job placement providers that will provide this assistance to these jobseekers with special needs.

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Health

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Introduction

The 2007–08 health budget includes new expenditure in a range of areas across the health portfolio. A number of these new measures have been welcomed by the Opposition and interest groups. For example, the Shadow Minister for Health, Nicola Roxon, welcomed additional funding for health and medical research ($485 million in grants to leading research facilities), the Royal Flying Doctor Service and the establishment of a new dental school at Charles Sturt University.[1] The Australian Medical Association (AMA) welcomed new funding for Indigenous health, aged care, combating obesity, rural health dental care, chronic disease and after-hours GP services (although with the reservation that actual funding amounts were 'well short of what is needed to make a *real* difference').[2]

Perhaps the two most strongly contested areas of political debate in the health portfolio over the past year have been dental health and preventive health (particularly in the area of chronic disease). The Government made two announcements in the Budget directly related to these areas. These announcements, as well as measures regarded by some commentators and interest groups as significant omissions from the Budget, will be examined below.

Prevention of chronic disease

Background

For much of this year, the question of whether the Australian Government places sufficient emphasis on policies aimed at preventing chronic disease in the community has been the subject of much political debate. Chronic diseases are generally defined as those characterised by such features as complex and multiple causes, (usually) gradual onset, and long duration involving gradual deterioration of health. Cardiovascular disease, cancers, diabetes, asthma, arthritis and other musculoskeletal conditions are examples of chronic diseases.

Chronic diseases are widely regarded as a significant health concern both in Australia and internationally. In addition to the threat posed to individual quality of life through physical limitations and disability, chronic diseases pose particular problems for health systems. People with chronic diseases are frequent and extended users of the health services. This means that they are associated with high health expenditure. The major chronic diseases account for around 70 per cent of total health expenditure in Australia.[3]

The National Chronic Disease Strategy has argued that preventive strategies should be a major part of efforts to address the problem of chronic disease because 'a number of the major chronic diseases can be prevented or their onset delayed.'[4] However, it also notes that, on the whole, the health system remains oriented towards acute and short term responses.[5] Further, national expenditure on public health activities such as health promotion and prevention remains at a relatively low level (only 1.7 per cent of total recurrent health expenditure in 2004–05 was directed to public health).[6]

This situation has led many commentators to call for the Australian health system to be reoriented towards preventive strategies for healthcare delivery and funding. That is, on the promotion of health, rather than treatment of disease. The then Health Minister, Senator Kay Patterson, made this point in 2002 when she argued that prevention should become the 'fourth pillar' of Medicare, alongside the Pharmaceutical Benefits Scheme, the Medicare Benefit Scheme and public hospital services.'[7]

In recent years, Commonwealth health budgets have included a variety of measures which the Government has described as being part of an increasing focus on preventive health. These have included measures directed at specific diseases, as well as initiatives aimed at greater involvement of general practitioners (GPs) in prevention (e.g., through the introduction of new Medicare items). The Commonwealth has also increasingly collaborated with the states and territories on strategies aimed at preventing chronic disease through, for example, the National Chronic Disease Strategy and the Australian Better Health Initiative.

The political debate around prevention in recent months has focused on the question of whether Australian Government efforts in this area are sufficient. For example, Shadow Health Minister, Nicola Roxon, has sought to highlight the threat posed by chronic disease to national productivity (also raised in recent reports such as the 2006 Access Economics report, *The Economic Costs of Obesity*, and the 2007 Productivity Commission report, *Potential Benefits of the National Reform Agenda*), and argued for a greater focus on prevention from the Government.[8] The Minister for Health and Ageing, Tony Abbott, has rejected the proposition that the Government is not sufficiently oriented towards the prevention of chronic disease, arguing that, for example, in 2006, 'through Medicare the government spent some $200 million on preventive health and treating chronic disease with 650,000 GP team care plans; 250,000 team care plans; 500,000 allied health consultations; and some 250,000 senior health checks.'[9]

Prevention and chronic disease budget measures

In the 2007–08 Budget, the Government has announced additional funding of $236 million for 'measures to help Australians to avoid preventable chronic illness.'[10] The measures include:

- $103.4 million over four years for a new program to identify those at risk of type 2 diabetes and help for them to modify risky behaviours. This implements a COAG announcement from 13 April 2007. The program is to be delivered through GPs and risk will be evaluated on the basis of a standardised survey (or 'tick test'). People at risk of developing type 2 diabetes may be referred to accredited 'lifestyle modification programs'

- $10.6 million over four years for a series of national nutrition and physical activity surveys aimed at enhancing understanding of lifestyle related health problems and developing education campaigns to help people avoid such problems

- new public information and education campaigns on the health benefits of breastfeeding ($8.7 million) and the prevention of Hepatitis C ($17 million) and sexually transmitted infections ($9.8 million)—all over four years. The current national education campaign on skin cancer will also be extended at a cost of $11.5 million over two years

- one-off grants totalling $11.7 million over four years for physical activity projects in the community and

- extended eligibility for two cholesterol lowering drugs through the Pharmaceutical Benefits Scheme to help people at risk of developing heart disease ($77.6 million over four years).

The Budget also includes other measures which, while not included in the prevention announcement, address the problem of chronic disease. These include:

- $291.3 million over four years for new Medicare items to enable patients with chronic and complex illnesses to receive longer, more comprehensive care sessions from consultant physicians

- $337.6 million over four years through Medicare to help people whose chronic conditions are made (or are likely to be made) worse by poor oral health (see below for an analysis of the dental health budget measure) and

- $57 million over four years on other measures, including the continuation of the Sharing Health Care Initiative to help people better manage chronic conditions through informed self-management.

These measures, like those in previous budgets aimed at preventing and managing chronic disease, represent a range of approaches and target a range of health problems. The largest financial commitments are to be provided through Medicare via the primary care system. The use of the primary care system to help prevent chronic disease is widely regarded as an important part of the prevention agenda. It is consistent with the Government's approach in previous years and will most likely assist many people. One concern, though, is that (as discussed in the section on dental health) evidence suggesting that only a very small percentage of those with chronic diseases in Australia have actually been placed on a care management plan does not inspire great confidence in this as the primary mechanism for preventing or managing such diseases.

As such, while the package of chronic disease measures will most likely lead to improvements for many people, it is probably best characterised as moving the health system only incrementally in the direction of a greater orientation towards prevention. For example, it appears unlikely to provide much of a boost to the current level of national expenditure on prevention-related activities (which, as noted above, is around only 1.7 per cent of total recurrent health expenditure). The package is also, on the whole, relatively limited in scope in that it targets a number of important chronic health problems (or aspects of chronic health problems) such as diabetes or obesity. However, it fails to bring them together as part of a more integrated or comprehensive strategy.[11]

Dental health

Although the provision of public dental services is largely funded by the states and territories, the Commonwealth has funded dental benefits in the past (the School Dental Scheme in the 1970s and the Commonwealth Dental Health Program in the mid 1990s are examples), and continues to fund certain dental services today (such as the Cleft Lip and Cleft Palate Scheme and dental services for service personnel and veterans). Since July 2004 limited dental treatments through Medicare have been available for eligible patients with chronic conditions on referral from their GP.

As access to dental health care has become an important public issue, fuelled by media reports of up to 650 000 Australians on public dental waiting lists, calls for a greater Commonwealth role in funding dental services have increased. A number of recent parliamentary inquiries have recommended increased Commonwealth funding (although none advocated funding dental care through Medicare).[12] Additional pressure has come from within government with some government backbenchers calling for increased dental funding in this year’s budget.

The 2007–08 Budget provides funding of $377.6 million to expand Medicare benefits for dental services for patients with chronic conditions and complex care needs (and some residents of aged care facilities). Eligible patients will be able to claim Medicare benefits (up to a maximum of $2000 per year including extended Medicare Safety Net benefits) for a range of dental services, on referral from their GP, provided they have a GP Management Plan and Team Care Arrangement in place.[13] Full details of the services are yet to be finalised, but will include a diagnostic consultation and a range of dental services.

This measure expands Medicare benefits for dental treatment that were first introduced in 2004 as part of a broader allied health care initiative for people with chronic conditions.[14] At the time the Government emphasised this initiative was as a health measure ‘not a dental care scheme.’[15] The allied health component has proven popular with over half a million allied health services provided in 2005–06, but uptake of the dental component has been considerably lower with only 5532 services provided.[16]

The Government estimates that around 200 000 patients will benefit under the enhanced dental care items to be made available by this expanded measure, but it is unclear how this target will be achieved. Although there are currently around 392 000 GP Management Plans in place to manage patients with chronic conditions, few patients on these plans have taken up the option of dental treatment using the currently available Medicare items.[17] High out-of-pocket costs have been recorded, with departmental figures showing some patients paying up to $692 extra for certain services.[18] Strict eligibility requirements may also be inhibiting uptake.[19]

This expanded measure in this year's budget addresses some of the financial barriers faced by patients by increasing the maximum amount that can be claimed from Medicare in a calendar year from $220 to $2000, and expanding the range of dental services available. However, where in the past high out-of-pocket costs incurred by the patient counted towards the extended Medicare Safety Net (thus easing the financial burden of further medical costs), this may no longer apply to patients accessing dental treatment. Although full details are yet to emerge, concern has been raised that that the total cost of dental services incurred by Medicare will be capped at $2000—including the cost to Medicare of the extended Medicare Safety Net[20]. If this is the case, dental patients may have to meet the 'gap' between the Medicare rebate and the fee charged by the dentist once the cap is reached, potentially eroding the benefit of the increased amount that can be claimed.

In addition many Australians with chronic conditions and dental problems will not be eligible for the dental benefits, even under the expanded dental services that will be introduced. There is some evidence to suggest that only a small percentage of those eligible are actually placed on a GP Management Plan (a prerequisite for accessing dental benefits).[21]

While this budget introduces some measures to improve the management of chronic disease, for example, additional funding for extended consultations with specialist doctors (see discussion above), improvements to the uptake of GP Management Plans and further reducing financial barriers are required before the benefits of this dental initiative will be seen.

Omissions

According to some health groups a number of health areas have been neglected in this budget. The criticisms include that this budget does not provide enough spending for Indigenous health, obesity, rural health, chronic disease and dental care, even though the Budget provided some funding for each of these areas.[22]

Budget initiatives for Indigenous health have come in for particular criticism from the AMA. The Budget provides for just over $121 million in new spending for Indigenous health, well short of the extra $460 million the AMA has called for.[23] Specific initiatives in the Budget include funding to family centred primary care, a nurse-led home visiting program for mothers and babies, improved accreditation for Indigenous health services, Indigenous workforce improvements and expansion of the Indigenous scholarship scheme. Although the Government has provided funding for some of the initiatives recommended by the AMA in its 2007–08 budget submission, such as the mothers and babies' initiative, other recommendations were not funded.[24] These include funding a national rheumatic heart disease program and implementation of the Australian Indigenous Doctor's *Healthy Futures Best Practice Framework.* The surplus from this year's budget may well have been regarded as an opportunity for the Government to address more comprehensively the poor state of Indigenous health. However, government priorities appear to have favoured other areas of the Budget in general, and other areas of health spending.

The Rural Doctors Association of Australia (RDAA) has also been strongly critical of the Budget as having failed to provide sufficient measures to increase the numbers of rural practitioners or improve access to healthcare services in rural and remote Australia.[25] One measure that the RDAA had been hoping for was a rural-specific Medicare item 'to compensate rural doctors for the professional and family isolation, and the increased skills and responsibility, of rural and remote practice.'[26]

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Income Support and Family Assistance

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Seniors Bonus and Carer Bonus payments

The Government announced in the 2007–08 Budget a one-off payment of $500 to recipients of Age Pension or Service Pension age also receiving the Utilities Allowance[1], and to recipients of the Seniors Concession Allowance[2] as at 8 May 2007. Individuals receiving Mature Age Allowance, Widows Allowance or Partner Allowance at 8 May 2007 will also receive the payment.[3] Seniors Concession Allowance is provided to self-funded retirees not on Age Pension or Service Pension and have a Commonwealth Seniors Health Card.[4]

The Government also announced a one-off lump sum payment to carers, in recognition of their contribution to caring for people with disabilities, the frail and aged. Carer Payment recipients will receive $1000 and recipients of Carer Allowance will receive $600 for each eligible person in their care. Those in receipt of both payments on 8 May 2007 will receive both lump sum payments.[5]

In addition, those in receipt of both the Carer Allowance and either the Wife Pension or Department of Veterans' Affairs Partner Service Pension on 8 May 2007 will receive both bonus payments.

Previous one-off cash payments

The one-off cash payments presented in this 2007–08 Budget are like other one-off cash payments the Government has made in the past. These payments have been:

- July 2000: an aged persons savings bonus of up to $1000, and a self-funded retirees supplementary bonus of up to $2000. These bonuses were paid as a part of the compensation measures for the introduction of the Goods and Services Tax (GST)[6]

- 2001–02 Budget: a one-off aged persons bonus of $300 to all persons over the 'age pension' age and on an income support payment[7]

- 2004–05 Budget: a one-off lump sum payment of $600 to families for each qualifying child for the Family Tax Benefit Part A (FTB-A) and for each child aged up to 18 years to whom Youth Allowance was paid[8]

- 2004–05 Budget: a one-off carer bonus payment of $1000 to each person in receipt of Carer Payment and $600 to each recipient of Carer Allowance[9]

- 2005-06 Budget: a one-off carer bonus payment of $1000 to each person in receipt of Carer Payment and $600 to each recipient of Carer Allowance for each person in their care[10] and
- 2006–07 Budget a one-off carer bonus payment of $1000 to each person in receipt of Carer Payment and $600 to each recipient of Carer Allowance for each person in their care.[11]

Alternative forms of assistance

One-off tax free payments that are also not included as income under the income test applied under the *Social Security Act 1991* (SSA) have been used as a means of providing financial assistance in recent budgets. In particular, payments to carers on Carer Payment and also those on Carer Allowance have been a feature of the last three budgets. Unlike the other payments made to carers which are ongoing, the benefit of a one-off payment, while welcome, merely serves as a temporary top-up. It can not be relied upon from year to year and once expended there is no guarantee of a further benefit. Now that the Government has considered this level of financial assistance to recipients of Carer Payment and Carer Allowance to be desirable three years in a row, it is legitimate to ask whether an increase in the ongoing rate of assistance might not be a more useful way of providing this assistance. The Government's apparent preference for delivering this assistance in the form of one-off payments would suggest that at its discretion it might well dispense with this payment when the economic cycle turns and budgetary constraints are tighter.

Child care

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Introduction

Child care affordability and the structure of Commonwealth child care fee assistance have been the subjects of much political debate since the introduction of Child Care Benefit (CCB) in 2000. The debate has continued with the introduction of the Child Care Tax Rebate (CCTR) in 2005.

Budget measures

The Government has announced changes to both the CCTR and the CCB:

- from 1 July 2007, CCTR will be paid as a direct payment (it is unclear at this stage whether the payment will be renamed) soon after the financial year in which child care costs were incurred. As part of the transition to this arrangement families will receive the rebate for 2005–06 and 2006–07 at the same time in the latter half of 2007. The change from a tax offset to a direct payment means that families with insufficient tax liability to access their full CCTR entitlement will now receive their full rebate, and

- in July 2007 the rate of CCB will be increased by ten per cent on top of the normal indexation rise (expected to be three per cent).[12]

Addressing timeliness issues

The Government's response to concerns about child care affordability was the introduction of the CCTR in 2005. It was structured as a tax rebate in part to address a long-running debate about tax deductibility for child care costs.

The CCTR allows families with children in approved care to claim 30 per cent of out-of-pocket child care expenses (up to a maximum of $4000 per child, indexed) as a tax offset against their income tax liability. The 'out-of-pocket' refers to the amount that families have to pay themselves after their CCB entitlement is taken into account. Families began to receive the 30 per cent rebate for their 2004–05 child care expenses when they finalised their 2005–06 taxation returns, that is, from July 2006 onwards.[13] This delayed payment is caused by the need to reconcile CCB entitlement for the financial year before an accurate assessment of out-of-pocket expenses can be made. That happens too late for a claim to be possible in the tax return at the end of the year in which the child care was used. So CCTR can only be claimed at the end of the following financial year. That means that the payment might be made up to two years after the out-of-pocket expense was incurred.

The original decision to deliver assistance through the tax system therefore imposed rigidities that have prevented timely delivery of the benefit of the CCTR. For this reason the CCTR has been criticised for delivering assistance much too long after child care costs are incurred, therefore providing little immediate assistance to working families coping with high child care costs. Delivering it now as a payment and bringing it forward by twelve months is therefore a logical improvement to the program as it goes some way to address the problem of timeliness.

However, delivery of the CCTR on a fortnightly basis would have been even better. It would have been more useful especially for those families in tight financial circumstances. It might also have been more effective as a mechanism for reducing workforce participation disincentives. However, it is likely that this was not considered an option as the Government is wary of the potential for a repeat of the overpayment debt problems encountered with CCB and Family Tax Benefit in the first years of this decade.

Targeting those most in need

Another criticism that has been made about CCTR is that it is not income tested and that it provides greater benefits to higher income families. This is on account of their higher 'out-of-pocket' expenses because they have lower entitlements to CCB which is income tested. As has been pointed out, however, it is misleading to look at CCTR in isolation. Viewed with

CCB, the whole package of assistance has directed most assistance to lower income families.[14]

This situation will continue with the Budget's changes. The change to providing CCTR as a direct payment will allow low-income families to access their full rebate. That change together with the increase in the rate of CCB is in fact likely to improve the progressivity of child care assistance by tipping the balance somewhat more in favour of lower and middle income families.

Eligibility restrictions

The other persistent issue around the CCTR concerns the exclusion from eligibility of non-approved care such as in-home care provided by nannies and relatives. This feature of the CCTR was given considerable attention in the report on balancing family and work by the House of Representatives Standing Committee on Family and Human Services.[15] The Committee recommended that these types of care become approved care and the users therefore become eligible for CCB and CCTR. The Government has not acted on this concern in this budget.

Carer Adjustment Payment (CAP)

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The Government has introduced a Carer Adjustment Payment (CAP). The CAP will be available where a family has a child aged up to 6 years who is diagnosed with a major disability due to accidental injury or severe illness. CAP may be made available where:

- the child has significant care requirements, e.g. requires full-time care from the carer for a minimum of 2–3 months following the incident
- the child's carer qualifies for Carer Allowance in respect of the child
- the carer is not eligible for Carer Payment
- the family is not already receiving an income support payment and
- the carer is able to demonstrate a very strong need for financial support during the adjustment period immediately after the catastrophic event.

The Government will review the eligibility criteria for Carer Payment (child). CAP is an interim payment available while the review is being conducted and it will terminate on 30 June 2008.[16]

This trial payment represents a significant departure from present policy on assistance to carers. It appears to have been prompted by the case of a young eye cancer sufferer from

Melbourne. In March the Prime Minister announced on Melbourne radio that the child's family would receive an ex-gratia payment of $10 000 to help with the costs of adjusting to their son's disability.[17]

The expansion of assistance to families coping with children with severe disabilities or illnesses will be most welcome to many families. However, establishing a form of assistance that provides improved assistance to all families having to adjust to the needs of a child with a severe disability will require some very careful policy development. The potential for arbitrarily choosing some for assistance and excluding others with equally pressing care needs is very real.

The interim CAP for example is restricted to those diagnosed with a major disability due to accidental injury or severe illness. The policy has already excluded families coping with a disability (often genetically based) that was not apparent at birth, such as autism. This is commonly diagnosed at an age of three years or more. The question arises—are these families in any less need of extra assistance?

The availability of Carer Payment for carers of children with disabilities was expanded in July last year when eligibility was made available to carers of children with severe intellectual, psychiatric or behavioural disabilities who required constant care or supervision. If the eventual payment that succeeds the interim payment requires eligibility under the Carer Payment income test, then only very low income families dealing with a newly injured or diagnosed child will benefit.

Endnote

1. For further information about the Utilities Allowance see http://www.centrelink.gov.au/internet/internet.nsf/payments/utilities_allowance.htm, accessed on 17 May 2007.

2. For further information about the Seniors Concession Allowance see http://www.centrelink.gov.au/internet/internet.nsf/payments/seniors_concession.htm, accessed on 17 May 2007.

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13 For a fuller description see Greg McIntosh, 'The New Child Care Tax Rebate' *Research Note*, no. 3, Parliamentary Library, 2005–06, http://www.aph.gov.au/Library/pubs/rn/2005-06/06rn03.pdf, accessed on 17 May 2007.

14. See Greg McIntosh, 'Commonwealth Child Care Support – What Do Families Get', *Research Note*, no. 11, Parliamentary Library, Canberra, 2006–07, http://www.aph.gov.au/Library/pubs/rn/2006-07/07rn11.htm, accessed on 17 May 2007.

15 House of Representatives Standing Committee on Family and Human Services, *Balancing Work and Family: Report on the Inquiry into Balancing Work and Family*, The Committee, Canberra, 2006, recommendations 11 to 13, http://www.aph.gov.au/house/committee/fhs/workandfamily/report/reportfinal.pdf, accessed on 17 May 2007.

16 M. Brough (Minister for Families, Community Services and Indigenous Affairs), *Financial support for carers of young children in exceptional circumstances*, media release, 8 May 2007, http://www.facs.gov.au/Internet/Minister3.nsf/content/budget07_financial_support_carers.htm, accessed on 17 May 2007.

17 J. Metlikovec, 'Mum wins $10,000 for battling carers', *Herald Sun*, 24 March 2007, http://parlinfoweb.aph.gov.au/piweb/TranslateWIPILink.aspx?Folder=pressclp&Criteria=CITATION_ID:Z6LM6%3B, accessed on 17 May 2007; and J. Howard (Prime Minister), *Interview with Neil Mitchell, Radio 3AW, Melbourne*, interview transcript, 23 March 2007, http://www.pm.gov.au/media/Interview/2007/Interview24214.cfm, accessed on 17 May 2007.

Indigenous Affairs

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The size of the budget commitment

The Minister for Families, Community Services and Indigenous Affairs, Mal Brough, in his media release, '*Budget backs a better future for Indigenous Australians*', stated that the Budget:

> … will take total spending on Indigenous specific programmes to a record $3.5 billion in 2007-08 – 42 per cent more in real terms than Labor spent in its last year in office.[1]

The totalling of all the Australian Government Indigenous Expenditure (AGIE) figures in all the 2007–08 portfolio budget statements gives a figure of $3.64 billion as the budget estimate for 2007–08. Identifiable Commonwealth expenditure on Aboriginal and Torres Strait Islander affairs in 1995–96 was $1.72 billion.[2] This 1995–06 expenditure figure in 2007–08 dollars is $2.43 million.[3] Using these figures the 2007–08 Budget represents a 49 per cent increase in real terms over 1995–96 expenditure.

The adequacy of the budget commitment

To develop a view on the adequacy of the funding, it is useful to consider changes to the size of the Indigenous population and the extent of unmet need.

On the subject of population, it might be observed that over the last 11 years there has been growth in the Indigenous-identifying population which is much higher than that for the general population. According to the *1996 Census of Population and Housing, Aboriginal and Torres Strait Islander People, Australia* (ABS Cat. No. 2034.0), the estimated resident Aboriginal and Torres Strait Islander population as at 30 June 1996 was 386 049. According to *Experimental Estimates and Projections, Aboriginal and Torres Strait Islander Australians* (ABS Cat. No. 3228.0), the estimated resident Indigenous population in 2007 (projecting forward from 2001 Census data using two different series of assumptions), might be either 510 405 (low series) or 561 387 (high series). These two 2007 projections would represent an increase of 23.2 per cent and 35.5 per cent respectively over the population estimated for 1996 giving rise to even stronger government financial implications. When adjusted for the increased Indigenous population, in real terms Indigenous specific expenditure has grown from between 10.6 and 21.6 per cent between 1995–96 and the 2007–08 Budget.

On the subject of unmet need, the following might be observed:

- Housing: the Government has made a commitment of $293.6 million over four years to start up the new Australian Remote Indigenous Accommodation (ARIA) Program. This measure may be considered against the ATSIC's estimates of funding shortfalls in Indigenous housing ($2.3 billion in 1999 and $3.5 billion in 2002) and a housing backlog that would take more than 20 years to clear.[4] The need in the Northern Territory alone has been estimated by the *National Issues in Indigenous Housing 2004/05 and Beyond: Position Paper Developed by the Northern Territory Government* to be $806 million.

- Health: the Budget makes a commitment of $37.4 million for health visits for children aged 0–8, $38.2 million for family centred primary health care; $36.9 million for upgrading services to meet national standards; and $14.6 million to continue Indigenous community drug initiatives. These measures may be considered against the March 2007 Oxfam Australia report *Close the Gap: Solutions to the Indigenous Health Crisis Facing Australia* which found that increased funding for Indigenous health services in the range of $350 to $500 million per annum was required.

- Employment: the Budget makes a commitment of $97.2 million to transform 825 Community Development Employment Projects (CDEP) positions into paid jobs. This measure and other funds to broker employment for urban CDEP participants may be considered against the 2004 study by Boyd Hunter and John Taylor which estimated that by 2011, out of a total Indigenous population of over 15 yrs of 363 577, and a labour force of 189 424, only 93 884 Indigenous people will be in mainstream employment and 36 974 in CDEP employment.[5]

The Budget provides $815.7 million in new and extended funding over five years for 26 initiatives focusing on remote housing, education, employment and health. It also changes some policy settings with the aim of achieving further improvements in these areas. However, so low is the base from which programs are trying to advance the socio-economic situation of Indigenous Australians, that there will be debate about the adequacy of the commitment.

Overall thrust

Two observations may be made on general policy direction.

Firstly, the budget initiatives continue the Government's drive to 'give Indigenous Australians greater opportunity to share in the nation's prosperity'—a drive others call mainstreaming.[6] Resources are redirected away from the areas where mainstream services and markets are strong. Where they are not, Indigenous people are offered or encouraged to seek opportunities elsewhere. The following initiatives exemplify this:

- the replacing of CDEP in strong labour markets (i.e. urban Australia) with employment brokerage services

- the ending of exemptions from having to look for work or undertake other approved activities for income support recipients in remote areas

- the funding for hostels and private boarding schools which offer young Indigenous people an opportunity to seek employment and educational opportunities away from their home community
- the expansion of places in the Indigenous Youth Mobility Programme which assists young people to access quality training in major centres
- the creation of 1000 more scholarships for higher education and ABSTUDY entitlements enhanced to better support study away from home and
- the funding for projects designed to attract Indigenous people in regional and remote communities into training through the Work Skills Voucher program.

Secondly, the Budget continues the Government's thrust towards trying to get more out of public expenditure by clarifying lines of responsibility. The Government has been trying to achieve this at an agency level with Council of Australian Governments' sponsored whole-of-government trials. It has also been trying to achieve this at a community level with Shared Responsibility Agreements (SRAs) and Regional Partnership Agreements (RPAs). Although evaluations of the success of these agency and community initiatives are yet to be completed, the Government is clearly keen to press on with the approach at the individual level—the aim here being to give Indigenous individuals a greater sense of ownership over core aspects of their lives. The following initiatives exemplify this:

- the replacing of the Community Housing and Infrastructure Programme with the ARIA program, which will only fund houses or upgrades where the houses can be transferred to state and territory housing authority ownership or made available for purchase by individuals—the strategy here intersecting with the Government's strategy to free up land tenure possibilities on communal land and
- the conversion of some of the CDEP positions into 'real' jobs in government service delivery.

Endnotes

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Film, Arts and Culture

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Social Policy Section

The 2007–08 Budget contains significant initiatives in the area of film, extra funding for performing arts companies and international cultural diplomacy, and a continuation of the course it has set with respect to general arts funding. The thrust, as has been the case for many years, is on arts as an industry and for export, and although likely to be welcomed by most high profile film and arts producers, will disappoint those who have been arguing for more to be done to facilitate broader arts education and participation.

The screen industry package

The most financially and structurally significant initiative is the provision of $282.9 million over four years to introduce a package of measures aimed at strengthening the Australian screen media industry.

Ever since David Gonski's 1997 report *Review of Commonwealth Assistance to the Film Industry* found significant functional duplication between the Commonwealth funded film agencies, some form of structural simplification of the sector has seemed a possible policy option. In 2003 an amalgamation of the Australian Film Commission and the National Film and Sound Archive/Screen Sound Australia was announced but met with such opposition that it had to be abandoned. This budget announces the amalgamation of the Australian Film Commission (AFC), Film Finance Corporation Australia and Film Australia Limited into a new single agency, the Australian Screen Authority (ASA).

Although the exact functions and budgets of the components of the new ASA are not yet available, the amalgamation is likely to be well received for three reasons. Firstly, the research and statistics functions of the AFC are going to find a home in the Australian Film, Television and Radio School, also in Sydney, and the latter will receive funds to support the transfer. Secondly, the newly established ASA is going to be given a budget far in excess of the sum of the budgets of the three agencies it will replace. Thirdly, the package introduces a new producer tax rebate, administered by the ASA, for which both Australian and overseas producers may be eligible.

An Australian producer will be eligible for a 40 per cent refundable rebate on feature films and 20 per cent refundable rebate on other media productions as long as the production meets Australian creative control criteria and minimum expenditure thresholds. An overseas producer will be eligible for a 15 per cent rebate on eligible expenditure (as opposed to 12.5 per cent under the Refundable Film Tax Offset Scheme—RFTO—which will be discontinued), where that expenditure exceeds $5 million. The definition of such expenditure will be broadened from that in the RFTO to include expenditure on post, digital and visual effects production in Australia even if the film is not made in Australia. This new mechanism will replace not only the RFTO but also the current investor tax incentives available through:

- Divisions 10B and 10BA of the *Income Tax Assessment Act 1936* (for which no new applications will be accepted after 30 June 2007) and
- the Film Licensed Investment Company (FLIC) which will not be renewed beyond its current expiry date of 30 June 2007.

Responsibility for raising money and creating successful films will henceforth rest mostly with the producer and not the investment consortium as in the FLIC's model, and, unlike under the 10BA scheme, it is the producer (or production house), rather than an individual film, that private investors will be backing.

Funding for performing arts

The Budget offers funding as a follow-up to earlier responses to two different reports. It provides $24.1 million over four years to major performing arts companies in line with the funding formula established in 2000 in the wake of the report of the Nugent Inquiry into the Major Performing Arts, *Securing the Future* (1999). This will represent an average 35 per cent increase annually for the 20 companies involved. It provides $19.5 million additional funding for small to medium performing companies as a follow up on a now elapsed earlier four year commitment which followed the 2002 *Report of the Contemporary Visual Arts and Craft Inquiry*.

Cultural diplomacy

The Budget in the Foreign Affairs and Trade portfolio includes $20.4 million over four years 'to enhance Australia's cultural diplomacy and improve market access for our cultural exports.' This allocation, for a program called 'Australians on the World Stage', pre-empts to some degree the report of the Senate Inquiry into Cultural Diplomacy due in July 2007. It will boost the amount of funds that the Australia International Cultural Council has to disperse 'to help create a better understanding of Australia in our region and further abroad' from $1 million to $5 million each year.

Arts education and regional arts

There are two areas of arts policy awaiting a full Australian Government response.

The 2005 National Review of School Music Education, (see also concerns of the Music Council of Australia and their submission to the Review), found that Australian students miss out on effective music education because of the lack of equity and access, lack of quality provision, inadequate teacher training and the poor status of music in many schools. The Government convened a National Music Workshop in Melbourne in August 2006 to develop an action plan for implementing the Review's recommendations. Although it is now funding a music education award scheme, the Government has not yet produced a comprehensive response to the needs identified by the Review. It would appear that some of the momentum in the area of arts education has been lost with the ministerial changes in the education portfolio.

Similarly, Regional Arts Australia, after an extensive public consultation process and producing a national directions document in 2006, has requested $60 million over four years to meet a range of identified needs. The Budget, however, offered no extra funding (see the media release *Disappointment in the arts budget for the one-third of Australians living in the bush*).

Attorney-General's portfolio

Bronwen Jaggers
Catherine Lorimer
Law and Bills Digest Section

Family law

The government has announced an additional $55.6 million over four years to help separated families and their children.

Almost 37 million dollars ($36.9 million) will be used to establish two initiatives in regional Australia.

The first new programme in regional Australia will enable up to 11 000 children from separating families to participate in decisions that impact on them and help them deal with other issues arising from the breakdown of the parent's relationship. The Budget press release states: 'When children are more directly involved, the level of conflict tends to be reduced and parents can achieve more constructive outcomes.'[1]

The second initiative is an educational programme in 28 locations that will assist separated parents whose inability to communicate without conflict is affecting their contact with their children. This programme was piloted as 'Building Connections' in regional NSW in 2005-06. It will help separated parents to focus on the needs of their children.

Fifteen million dollars will assist the Family Court and Federal Magistrates Court to improve access to justice for de facto couples so that property disputes and children's matters can be heard in one court under a nationally consistent regime. $2.9 million will allow the Family Court of Australia to employ additional Family Consultants and to undertake training in a more child-inclusive approach for relevant matters that are heard by that court. This will provide a stronger focus on children's needs.

Personal Property Security Reform

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The Australian Government will provide $113.3 million over five years to harmonise Australia's personal property security laws in one Commonwealth Act and develop a single national online register of personal property security interests.

The Standing Committee of Attorneys-General (SCAG) agreed to review personal property security legislation, and the Attorney-General's department has released a series of discussion papers on the topic. The States and Territories have given in-principle agreement to join the

Commonwealth in personal property security reform, subject to further consideration of the financial arrangements for the national system.

Lenders and purchasers entering into transactions involving personal property (all property other than buildings or land) will be able to check cheaply and easily on the Internet whether there is an encumbrance in the property.

The laws regulating securities over personal property are currently contained in more than 70 pieces of State, Territory and Commonwealth legislation.

The measure will be offset by revenue of $62.9 million generated once the new national register is operational.

More information about personal property securities reform is available at www.ag.gov.au/pps.

Refugee/Migration Law

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Nauru

Under Table 12: 'AusAID country programs' in the Appendix to the DFAT Budget Paper 'Australia's Overseas Aid Program 2007-08' it states:

> 'Nauru Additional' funding is provided under a Memorandum of Understanding negotiated on an annual basis between the Australian Government and the Government of Nauru, and Budget year estimates are not for publication ('nfp').

Since 2001 Nauru has been allocated large amounts of funding under a Memorandum of Understanding in return for detention processing arrangements of asylum seekers on its territory.[2] The Senate Select Committee report into a Certain Maritime Incident questioned whether this money should be properly termed 'aid'.[3]

Funding for IOM in Indonesia

The International Organisation for Migration (IOM) will receive $7.7 million for its activities in Indonesia. Immigration Minister Kevin Andrew's press release Strengthening Australian Borders states that: 'These arrangements provide a safe and humane alternative to unsafe and illegal maritime ventures promoted by people smugglers.'

This extra funding for IOM in Indonesia has received adverse comment from refugee advocate Marion Le, although she welcomed the overall Budget initiative.

> "The IOM simply warehouses people. Does that mean we're going to establish detention centres in Indonesia?" she said. "That should be seriously looked at."[4]

The IOM Indonesia webpage can be accessed here.[5]

Australia and Indonesia will establish a joint taskforce of immigration and police agencies to deter people-smuggling. The bilateral treaty to establish this framework is currently being considered by the Joint Standing Committee on Treaties.

Treasury Portfolio

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There will be increased funding for the Australian Prudential Regulation Authority (APRA) comprising an extra $24.1 million over four years to assist with recruitment and retention of qualified staff.

The Australian Taxation Office will receive an additional $20 million in 2007-08 to implement the pre-populated tax return.

The Australian Securities and Investment Commission will receive an extra $116.7 million over four years to support new IT infrastructure.

Endnotes

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Environment

Climate Change and Forests

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Forest and Climate initiative

The Government announced on 29 March 2007 that it would provide $200 million over five years for the Global Initiative on Forests and Climate[1]. The Initiative aims to reduce greenhouse gas emissions by protecting existing forests and promoting sustainable forestry practices and reafforestation.

Other countries will be encouraged to contribute to projects under the Initiative. The USA and Indonesia have agreed to work with Australia on this initiative, but no detail of the level of financial contribution by either country has been released.

Green groups welcomed the initiative but criticised aspects of what the proposal does not do. Australian Conservation Foundation Director, Don Henry said the Government should do more to stop the bulldozing of native vegetation in Australia.[2] Greenpeace campaign director, Stephen Campbell raised the issue of Australia not banning the importation of illegally logged timber when he said:

> The problem of illegal logging in our region is massive. In Papua New Guinea and Indonesia there is ingrained corruption at all levels of the industry and within government. While it is important to combat illegal logging in our region, the Australian Government should live up to promises made in 2004 and pass strong legislation to prevent illegal timber from entering Australia.[3]

Table 1 Funding of the Global Initiative on Forest and Climate

Year	2007-08	2008-09	2009-10	2010-11	2011-12
Amount ($m)	38.3	38.3	49.9	47.8	22.8

Source: Budget Paper No.2 Budget Measures 2007-08[4]

The Budget papers indicate that $164.5 million of the Global Initiative on Forests and Climate funding will be delivered through AusAid in both existing programmes and new programmes, principally in South-East Asia and the Pacific Islands, especially Indonesia and Papua New Guinea. An important aspect is the satellite monitoring and assessment of forests and a $7 million satellite receiving station will be established in northern Australia to assist this function. The projects are intended to:

- build technical capacity to assess and monitor forest resources, and to develop national forest management plans;
- put in place effective regulatory and law enforcement arrangements to protect forests, including through preventing illegal logging;
- promote the sustainable use of forest resources and diversify the economic base of forest-dependent communities;
- support practical research into the drivers of deforestation;
- encourage reforestation of degraded forest areas;
- develop and deploy the technology and systems needed to help developing countries monitor and produce robust assessments of their forest resources; and
- pilot approaches to providing real financial incentives to countries and communities to encourage sustainable use of forests and reduce destruction of forests.[5]

The success of this programme will depend ultimately upon the cooperation of governments such as those of Indonesia and Papua New Guinea to ensure that programmes and policies are implemented so that the existing tropical forests are protected and sustainably managed. In the past corruption and mismanagement has contributed to substantial illegal logging in these countries and this needs to be dramatically curtailed or the programme's mechanisms , stated to be one of the best ways to reduce global emissions, will not succeed

The biofuels programmes of developed countries such as those in the European Union have the potential to drive the further clearing of tropical forests to establish palm oil plantations as a feedstock for the production of biodiesel.[6] It would be a major calamity if these programmes, established to protect the environment, were to produce significant unintended adverse consequences by continuing the destruction of rainforests and the release of massive quantities of greenhouse gases.

Carbon Sink Forests

To qualify as a carbon sink forest under the horticultural plant provisions new forests planted over the five years after 1 July 2007 will have their establishment costs immediately deductible. From 1 July 2013 the establishment costs may be depreciated over 14 years. This initiative will cost $23.6 million over the first four years.[7] The 14 year depreciation provision, which commences in 2012-13, will be on-going but no indication of the ongoing cost to the budget appears to be given in the Budget papers.

These carbon sink forests will need to be established under the Government's Greenhouse Challenge Plus programme. It must also be demonstrated that these plantation forests comply with environmental and natural resource management guidelines applicable for their geographic location to ensure the carbon sink forests will have no adverse impacts on flora and fauna or on water resources. Deductions for carbon sink forest establishment under Managed Investment Schemes do not qualify for the provisions of this budget measure.

For forests to be effective as carbon sinks they need to remain established for a significant period of time. Under the NSW Greenhouse Gas Abatement Scheme, eligible forests must be established on cleared land and the carbon sequestered for 100 years.[8] There is no information in the Budget papers as to the length of time that carbon sink forests have to remain in the ground to qualify for this tax deduction. It is essential that they are allowed to keep growing for a similar length of time.

Climate Change Adaptation Centre

The April 2007 COAG meeting endorsed a National Adaptation Framework as the basis for jurisdictional actions on adaptation over the next five to seven years, with possible actions to assist the most vulnerable sectors and regions to adapt to the impacts of climate change. The Commonwealth announced that it would commit up to $26 million to establish and manage the Australian Centre for Climate Change Adaptation and $100 million programme funding for the Centre over five years. The Commonwealth also announced a new CSIRO Adaptation Flagship with funding of $44 million to provide more accurate information on localised climate changes.

Table 2 Funding for the Australian Centre for Climate Change Adaptation

Year	2007-08	2008-09	2009-10	2010-11	2011-12
Amount ($m)	18.6	23.8	24.9	29.4	29.4

Source: Budget Paper No.2 Budget Measures 2007-08[9]

The Commonwealth will manage the centre but will work closely with the states to ensure a coordinated national approach to the issue.[10] Examples of the types of activities that could be funded by the Centre include those involving:

- identifying how to protect coastal infrastructure from likely changes in storm surge using sea walls and flood barriers;
- the design of a heat wave warning system and ways to modify facilities to cater for those most at risk (eg the elderly);
- helping to plan for expanding the use of feedlots by farmers to reduce the exposure of their valuable stock to variation in pasture availability and heat stress; and
- identifying areas in national parks that will provide the best areas for recolonisation of plants and animals that have been displaced by climatic changes from their natural locations. [11]

The Climate Change Adaptation Centre and the CSIRO Climate Adaptation Flagship are essential initiatives for Australia in coping with the many and varied changes that will become evident over the next century. The recently released *Infrastructure and Climate Change Risk Assessment for Victoria* [12] said that a climate adaptation framework should aim to reduce the significant risks that climate change poses to the cost, service and life of significant Victorian assets. The Centre and the Flagship will be major resources used to assist with this aim.

Expansion of the Photovoltaic Rebate Programme

$150 million will be provided over 5 years to accelerate the installation of solar panels on homes and schools. $26 million will be spent in 2007-08 and $30 million per annum from 2008-09 to 2011-12.

Funding of around $20 million per annum from 2007-08 to 2011-12 for the photovoltaic (pv) rebate programme has already been included in the forward estimates, hence the additional funds committed in this Budget amount to $6 million (2007-08) and $11 million per annum to 2011-12.

Households will be rebated up to $8000 for installing an (eligible) average system retailing at about $14 000. Grants of $12 000 will be available for schools and public buildings to install solar panels. This approach aims to alleviate the higher overall cost of producing electricity by pv cells, estimated to be double the retail price paid by most households for grid supply.

This programme rejuvenates a smaller scale Government initiative which was originally put in place in 2000, extended twice and which was to finish in 2007. The take up to date of solar panels by households has been lethargic principally because of the long period (15 years) it takes to recoup, in power cost savings, the original capital investment. This programme, although possibly attractive in economic terms to individual householders because the rebate will pay for more that 50% of the capital cost, is expected to result in only about 20 000 households - or one in 500 - acquiring panels[13].

As well as contributing to greenhouse gas emission reduction in a visually non-intrusive way, an additional benefit from the programme will be through the encouragement of greater community acceptance of the technology.

A solar energy authority (ANU's Professor Andrew Blakers) has expressed the view that the market support initiatives alone, like the rebate programme, need to be augmented by government strategies to foster technology development aimed at retaining and capitalising on the technical lead that Australia's solar energy industry possesses.[14]

Methane drainage

The Australian Government will invest $18.5 million over five years, partly funded from the existing Greenhouse Gas Abatement programme, to reduce greenhouse gas emissions from underground coal mining activities. The funding ($5.9 million in 2007-08, $5.5 million in 2008-09, and around $2.3 million in each of the following three years) will be made available to reduce methane emissions from underground mines, found mainly in New South Wales and Queensland.

Underground black coal mines in Australia emit 12 million tonnes of greenhouse emissions each year. Much of that gas is of low concentration and cannot be captured and used. However where there are particularly high concentrations, cost-effective capture of methane may reduce greenhouse gas emissions by up to 900,000 tonnes of carbon dioxide equivalent, annually.

Methane is a highly flammable and potent greenhouse gas, about 22 times as potent as carbon dioxide. Generally speaking, capturing methane from coal seams and then using it to generate electricity is a relatively small scale, localised operation in terms of the power generated. However, the principal benefits are threefold – the methane issue has to be dealt with, hence effective capture enhances coal mining safety, power is generated and there is a net reduction in greenhouse gas emission intensity. Once captured, the otherwise waste methane gas formerly vented to the atmosphere can be used to generate electricity quite efficiently through small gas turbines for local industrial and domestic use, with any excess fed into the grid, or be converted to less harmful gases. The benefits of this technology are realised by having many small strategically sited methane capture/power generation installations which can collectively make a substantial contribution to emissions reduction. Hence the funding provides the incentive for more plants to be built.

Carbon capture and storage

Carbon capture and storage regulation will be established to enhance the management of the technology of geosequestration. $18.5 million will be spent over 4 years by the Department of Industry, Tourism and Resources for legislation development and Geoscience Australia for technical advice.

One hundred potential geological storage sites across Australia have been identified and are being examined for their viability to store CO_2 safely and permanently. Substantial private sector investment is now flowing into research of the technologies. This present Budget initiative is aimed at tidying up the Commonwealth, state and territory governments' regulatory regimes in order to present a consistent set of principles to govern any geosequestration (geological storage) proposals that private sector operators may bring forward in the future. There is no geosequestration of carbon dioxide in Australia at present but feasibility studies are in progress at two sites, hence the Government's initiative is timely.

National Plan for Water Security

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Introduction

The National Plan for Water Security[15] was outlined by Prime Minister Howard in his address to the Press Club on 25 January 2007. It will be implemented with $10 billion being provided over a ten year period. The aim is to increase production with less water use and improving environmental outcomes. Aspects include: modernisation of irrigation and addressing over allocation of water in the Murray-Darling Basin (MDB); investing in information and monitoring; new governance for water management in the MDB and acceleration of the National Water Initiative implementation.[16] There is also funding to complete the Great Artesian Basin Sustainability Initiative and allow a Taskforce to examine further land and water development in Northern Australia.

At the water summit of 23 February 2007, NSW, South Australia and Queensland agreed to refer relevant constitutional powers to the Commonwealth to enable it to manage the MDB in the national interest and the ACT agreed to cooperate fully. Victoria is still negotiating with the Commonwealth to identify "mutually satisfactory ways of achieving agreed outcomes". The referral of powers is the issue upon which the Plan is based. Memoranda of Understanding with the states are being developed. The Commonwealth will introduce legislation to establish a replacement body for the Murray-Darling Basin Commission, which will enable the Commonwealth Government to oversee water management in the MDB. The States will introduce necessary legislation to transfer powers. The passage of legislation will be delayed until Victoria comes to an agreement with the Commonwealth. At the end of the water summit, the Victorian Premier, Steve Bracks, said that Victoria would be:

> "hoping for a bigger share" of the $10 billion to ensure it was not disadvantaged. Adoption of the Howard proposal would fiscally reward states with poor infrastructure and poor water efficiency, he said. "We don't want to see all the money going to the worst offenders with over-allocations and over-entitlement," Mr Bracks said.[17]

On 4 May 2007, Simon Ramsay, President of the Victorian Farmers Federation, which had opposed the original proposal for Victoria ceding its powers over water management in the MDB to the Commonwealth, was reported as rejecting a revised Commonwealth proposal.

> Canberra had shifted position from wanting all the states' powers over the Murray-Darling Basin to "only specific powers". "We have seen the draft legislation and do not believe the referral of power issue has been dealt with adequately to give either the VFF or other farming organisations the confidence to proceed with the plan," he said. "We will not agree to hand over full control of Victoria's resources. This has been our position from day one."[18]

In the same article, Victorian Minister for Water, John Thwaites, restated the state's position of wanting to work with the Commonwealth in a "co-operative and co-ordinated" way, rather than handing over powers.[19] On 17 May, he was reported as saying the Victorian Government would not agree to hand over unspecified powers to Canberra under the National Water Security Plan but it was prepared to improve the management of the MDB.[20]

Under the Plan, the Commonwealth is to be generally responsible for the water resource management in the MDB in the areas of:

- preparing a Basin-wide Strategic Plan setting a sustainable cap on surface and groundwater use at the Basin and individual catchment level;
- establishing Basin-wide water quality objectives;
- setting standards for catchment level plans, including for the management of interception and floodplain activities;
- seasonal allocation of water resources;
- directing the operation of rural bulk water supply systems;
- environmental water management; and
- setting rules for water trading and charging regimes.

All the funding in the Budget papers, except the Northern Australian Task Force, is conditional on the "governance arrangements for the Murray-Darling Basin (MDB) being placed on a national footing"[21]. There is no explanation given as to why the funding for phase three of the Great Artesian Basin Sustainability Initiative should be conditional on agreement in the MDB. The Northern Australian Taskforce is not affected by this caveat because its funding of $20 million over five years will come from the Australian Water Fund.

Table 1 outlines the funding for the five programmes of the 10 year National Water Plan for its first four years. There is rounding in the totals so the 10 year totals do not quite add up.

Table 1 Funding for the National Water Plan for Water Security

	2007-08 ($m)	2008-09 ($m)	2009-10 ($m)	2010-11 ($m)	Total over 10 years ($m)
Addressing over-allocation in Murray-Darling Basin	28.0	85.9	423.8	495.8	**3,100***
Improving water information	28.8	43.4	53.7	56.3	**417.2**
Modernising irrigation in Australia	53.3	154.0	452.2	861.4	**5,900***
Great Artesian Basin	2.5	2.5	16.0	16.0	**85.1**
Reforming the MBDC	59.5	56.6	57.4	56.9	**584.9**
Total	**172.1**	**342.4**	**1,003.1**	**1,486.4**	**10,000***

* rounding errors affect figure which is $10 billion over 10 years
Source: Budget Paper No.2 Budget Measures 2007-08[22]

Under ‘Addressing Over Allocation’ in the MBD, CSIRO is expected to estimate actual level of the overallocation of water in the MDB by the end of 2007, through the MDB Sustainable Yields Assessment.[23] Three billion dollars will be invested to buy back water entitlements and assist unviable irrigators to exit the industry. Water savings from this programme may be made available to irrigators when this is not in conflict with environmental needs.

There have been media reports that the government is not united over the voluntary buyback scheme and that the Minister for Agriculture, Fisheries and Forestry, Peter McGauran, wants the buyback of licences to be a means of last resort for the government.[24] It has also been reported that groundwater and surface water resources in the MDB are connected but have been double-counted with the result that there has been a significant overestimate of the actual amount of water flowing in the system. This overestimate has been claimed to be as high as 40 per cent. The Minister for Environment and Water Resources, Malcolm Turnbull, said this was wrong and misleading and the impact of this double counting could be as low as 3 per cent.[25] Professor Peter Cullen, a National Water Commissioner, disagreed with the Minister’s comments and said there appeared to be a massive error[26]. He said unregulated use of groundwater is one of the biggest threats to the MDB and that it needs to be regulated along with a buyback of licences.[27]

> I think for a long time people have measured and managed surface water in our rivers, and they've seen ground water as totally disconnected, so in this river, the Lachlan, where we're sitting beside at the moment, floods have been seen to come down the river, and entitlements to those floodwaters have been issued to farmers. However, we didn't really appreciate it's those floods that replenish the ground water, and so ground water licences have also been issued, and so after a period of years with this double-counting, we find we've grossly over-allocated the water in a number of our river basins.
>
> This would appear to be a massive error which would no doubt have huge implications on agriculture, urban users as well as water entitlement.
>
> Yes, there are big errors. It's not just the ground water misallocation, but other things also affect the amount of water in our rivers - the amount of water that's captured in farm dams,

> the water that's captured by forest plantations. All of those things mean less water enters our rivers, so in many ways our counting has been very crude for water, and now that water is getting short and everyone is looking to try and maximise the amount of water they get, we find that all these errors in the accounting of the water are coming home to roost and we're finding ourselves in serious trouble. [28]

The $5.9 billion to be spent to improve irrigation infrastructure under Modernising Irrigation Australia aims to achieve efficiency gains of 25 per cent of total irrigation water use or 3,000 gigalitres (GL) in savings, of which 2,500 GL will be in the Murray-Darling Basin. These water savings will be allocated 50:50 between irrigators and programmes to address over-allocation and river health issues. Four elements of this programme are projected to achieve the following savings: improving delivery system efficiency ($3.1 billion to save 1,500 GL); improving on-farm irrigation efficiency ($1.6 billion to save up to 1,200 GL); more accurate metering and monitoring ($617 million to save up to 700 GL); and improving river and storage operations ($500 million to save 200 GL). In order to receive funding and share in water savings irrigators will be required to make investments and management commitments.[29]

There have been concerns about the limited scrutiny of the Plan by the Treasury and the fact that the Department of Finance and Administration had only two days to cost the $10 billion National Water Plan.[30] Victorian Minister for Water, John Thwaites, said:

> We've always said that this takeover of the Murray-Darling Basin by the Federal Government was not properly prepared.
>
> The whole thing was really the back of an envelope….prepared without any input from Federal Treasury, Federal Cabinet, the Murray-Darling Basin Commission, the states or indeed the experts.[31]

Natural Heritage Trust Phase Three

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Natural Heritage Trust Third Phase

The Australian Government will provide annual funding of $395 million for the third phase of the National Heritage Trust (NHT3) over five years staring in 2008-09. NHT3 will merge the two major Natural Resource Management Programmes, the NHT2 programme and the National Action Plan on Salinity and Water Quality (NAP), both of which finish in June 2008, with the aim of reducing red tape and to allow more integrated investment. These programmes were assessed by the Keogh Review of regional delivery of NRM programmes[32]. The Review found NRM was worthy of a continued and sustained commitment from the Australian Government and that it must persist with regional NRM arrangements or be prepared to risk losing community backing and on-ground support.

The review also recommended that a process be developed where stewardship payments may be made available to those landholders who can demonstrate a public good outcome, through improved resource management systems.

Five key themes will provide a broad focus for investment decisions for NHT3:

- biodiversity decline;
- salinity and water quality;
- coastal and peri-urban areas;
- productive and sustainable landscapes; and
- capacity building and institutional change.[33]

NHT3 will continue NRM delivery at the national, state and territory, regional and local scales, eg through the regional bodies and Envirofund. Specific details of new programme operations are still to be negotiated with the states over the coming months. Details relating to allocations for each state or territory and requirements for their matching funding contributions will be determined during the bilateral agreement negotiations currently taking place with each state and territory. It is possible that the current mix of State/Territory matching contribution in dollar and in-kind funding may continue in some form. A three year strategic national investment plan will be developed to address Australian Government priorities with some of the specific programmes funded through the national stream expected to continue.

Uncompleted projects under NHT2 and NAP, delayed due to drought or other unforeseen circumstances may be able to be completed after June 2008, subject to negotiations with states and territories.

It should be noted that, while all the allocated NHT2 funding will have been spent by June 2008, it appears from the estimated actual expenditure figures that $659 million rather than the predicted $700 million in NAP funds will have been spent by June 2008.

The future NHT3 spending of $395 million per annum in 2007-08 dollars over the five years from 2008-09 will be some $40 million per annum less than the average spending in 2007-08 dollars of the combined NHT2 and NAP programme spending over the period of 2002-03 to 2007-08. This reduction in provision of resources by the Commonwealth may have some impact on the ability of NRM programmes to deliver outcomes.

Environmental Stewardship Programme

As mentioned above, the Keogh Review recommended some form of environmental stewardship programme for landholders. This Budget provides $50 million in funding over four years for an environment stewardship programme. This will involve private land managers being contracted over the next four years to protect nationally important environmental assets on their land.

There will also be a commitment from the Australian Government for an unspecified amount of follow-up payments to these contracted land managers for up to 15 years[34].

The first priority in the programme will be the protection of the national endangered box-gum woodland that extends from Queensland to Victoria and which forms important habitats for a wide range of plants and animals, including rare and threatened species such as Superb Parrots, Regent Honeyeaters and Squirrel Gliders.[35][36].

Details of the specific aims of the programme are not available and there is no definition of what is considered to be a "nationally important environmental asset". It is essential that the effectiveness of the limited funding in the programme is not diluted but remains concentrated in protecting nationally threatened ecosystems and species.

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Science and Health

Science

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Introduction

The Commonwealth Scientific and Industrial Research Organisation (CSIRO) received the bulk of the funding for science initiatives, with a focus on energy, nanotechnology and astronomy. The Australian Nuclear Science and Technology Organisation (ANSTO) received substantial funding for new measures. Energy market reforms, energy efficiency and development support initiatives were modestly funded.

CSIRO

CSIRO will receive $2.8 billion over four years as already provided for in forward estimates. The new amounts are $664.5, $681.5, $703.2 and $730.1 million over four successive years. A new quadrennial funding agreement will replace the previous triennial funding agreement.

National Research Flagships

The CSIRO National Research Flagships program received a $174 million boost to establish three new flagships for climate adaptation, niche manufacturing and minerals energy development as well as continuing energy research.

The program received $43.6 million over four years for a new National Research Flagship on Climate Adaptation to improve climate variability predictions.

The program also received $60 million to extend the existing Energy Transformed Flagship, to focus on transport technologies for a sustainable future, specifically to research bio-fuels, the storage of high density natural gas and conversion of coal to liquids, and gas to liquids.

A new Minerals Down Under Flagship for minerals and energy development will investigate new mining and processing technologies. The Flagship will receive $34.6 million from the Australian Government over four years, to enable CSIRO to work with Geoscience Australia and industry to target discovery through the development of advanced exploration systems, drilling and development of future mining systems, processing technologies for resources, and development of solutions for sustainable processing.

The Australian Government is establishing a new National Research Flagship for Niche Manufacturing within CSIRO, with a funding commitment of $36.2 million, with the aim of adding further value to existing high value-add segments of the manufacturing industry and to create a new wave of niche industries based on nanotechnology.

> A Rejuvinating Manufacturing Platform will be established within the Flagship to act as an interface for small and medium enterprises and other manufacturers….The Flagship will also support the roll-out of the Australian Government's National Nanotechnology Strategy.

The Flagship program, especially given its wide ambit and commercial focus, has attracted some criticism. In response to the Budget, the CSIRO Staff Association claimed that:

> The Government has not come to terms with the importance of wide-ranging scientific R&D to meet the very big challenges of energy, climate change and water. [It] will leave many critical areas of research, such as forestry and mainstream manufacturing still out in the cold. We expect it will hit agricultural research the hardest.

National Nanotechnology Strategy

A $21.5 million National Nanotechnology Strategy was announced on 1 May 2007, by the Prime Minister John Howard and the Industry Minister Ian Macfarlane, as part of the Industry Statement:

> Australia is already a world leader in nanotechnology. CSIRO has undertaken over 40 separate nanotechnology projects and over 60 nano-focused companies have emerged in the last five years. CSIRO's new $36.2 million Niche Manufacturing Flagship will focus on developing nanotechnology applications. The National Strategy will draw together industry, researchers, the community and government to:
> Establish a nano-particle measuring capability at the National Measurement Institute;
> Address regulations and standards; and
> Provide balanced advice to the community on nanotechnology.

The funding commitment is $21.5 million over four years to 30 June 2011. Inquiries for the National Nanotechnology Strategy are initially through Biotechnology Australia in the Department of Industry, Tourism and Resources.

Australian Nuclear Science and Technology Organisation (ANSTO)

ANSTO will receive $663 million over the next four years. Funding for new measures amounted to $61 million over the next four years; $22 million ($5.5 million per annum over 4 years) to support operations of the new OPAL research reactor; $35 million for the automation of ANSTO Radiopharmaceuticals and Industrials production ($30 million in 2007-08 and $5 million in 2008-09, the latter funded internally); and $4 million for radioactive waste compaction equipment to reduce the volume of low-level waste stored at ANSTO.

Funding to maximise OPAL's potential and to provide state-of-the-art radiopharmaceutical production processes is consistent with ANSTO's critical role in the production of Australia's radiopharmaceutical supply for medical applications in Australia and its near neighbours.

Co-operative Research Centres (CRCs)

Funding for the CRCs program was increased from $189.4 million (2006-07) to $212.3 million (2007-08).

The Cooperative Research Centre Association has voiced its disappointment claiming that the forward budget commitment for the CRC program has remained unchanged, despite their hopes that there would have been an increase in funding. Under the CRC rolling program arrangement, existing CRCs may rebid late in their 7-year life in competition with new CRC proposals, for the government component (averaging around 22% of a CRC's total funding) of the next seven year funding. Failure in this bid process will mean an existing CRC will be wound up.

> 2008 is a key year for this highly successful Programme. We have 22 existing CRCs eligible to apply for a rebid, plus a yet unknown number of new prospects. The simple fact is that with no change to the Programme's budget, we could see as many as 15 CRCs being forced to wind up their operations.[1]

Synchrotron

The Budget provided a $50 million grant in support of the Australian Synchrotron, in addition to $14 million provided through the National Collaborative Research Infrastructure Strategy towards the cost of constructing the beam-lines.

The Synchrotron[2] is located adjacent to Monash University at Clayton, Victoria and is expected to open in 2007. The device allows the structure of materials to be examined at molecular and atomic scale, and compositions determined quickly. It has applications in medical research through its finely detailed x-ray capabilities and it can be used in micro-manufacturing.

Astronomy and Space

The Australian Square Kilometre Array Pathfinder radio-telescope – design, development and building; is to receive $37.2 million over the four year period along with a $27.5 million related capital expenditure by CSIRO over three years to purchase plant and equipment. The telescope will enhance Australia's reputation in astronomy as a contender to host the $1.8 billion international square kilometre array project to build the world's largest radio telescope in the outback of Western Australia. South Africa remains the other contender in the global bid.

There was no funding to rejuvenate the former National Space Program, despite the call by the Space Policy Advisory Group "Space: A Priority for Australia" 2006 policy submission, seeking a framework for national program action, security and space data access. Meanwhile, the first Australian Decadal Plan for Space Science is in preparation.

Energy Market Reforms and Development Support

$12.7 million over 6 years has been appropriated for energy market reform initiatives to be managed by the Department of Industry, Tourism and Resources. Energy efficiency in the gas and electricity markets, as well as overall efficiency across industry, government and the community, oil and gas security in the context of fuel emergency preparedness, and geothermal energy and hydrogen technology initiatives will be developed to improve the competitiveness and reliability of the Australian energy sector. The initiatives will principally have a support role but include attention to the roll-out of smart meters[3], the development of a national gas market, gas and electricity retailing regulation, and the creation of a Geothermal Industry Development Framework for the geothermal energy industry[4] and a Hydrogen Technology Roadmap[5].

Any substantial developments of the exciting energy technologies, geothermal and hydrogen, have great potential to transform the Australian energy supply profile. Geothermal energy is a near-term prospect. This energy source has the potential to provide greenhouse gas emission-free base load electric power generation. Currently listed-company Geodynamics Ltd geothermal project near Innamincka (SA) is at advanced feasibility stage and electric power generation could commence as early as 2009 or 2010. The hydrogen technology program aims to articulate what contribution hydrogen technology may make to Australia's energy needs.

Sustainable, efficient and secure energy supply and greenhouse gas reduction imperatives clearly deserve serious attention. *The Australian* regards the commitment in this Budget to energy market reform as "modest".[6]

Health and Food

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Introduction

Medical Research Institutes will share around $500 million to fund development and expansion projects addressing innovative drugs and new treatments for conditions such as cerebral palsy, cancer, heart disease and mental health problems. It is expected that other initiatives in the Budget such as immunization programmes, Type 2 diabetes tests, mosquito eradication programmes and provision for assistance with the psychological impact of the drought will alleviate community needs in the Health Science area.

Highly respected medical authorities including Professor Ian Frazer and the AMA have argued that more attention needed to be given to medical issues. Professor Ian Frazer lobbied for $100 million investment is a new centre to test potential new products through to the point of commercialisation. As well, the AMA identified Indigenous health and rural health measures as under-resourced in the Budget. The AMA had called for a minimum of $460 million recurrent new Indigenous health funding each year.

Medical Research and Development

Through Department of Health and Ageing programs, the Government will provide $486 million in 2006-07 to fund development and expansion projects by medical research facilities. Funding will go to 15 facilities (NSW 4; Qld 2; SA 1; Vic 4;WA 2; NT 2) and will focus on cancer, brain, heart research and infectious diseases.

Immunisation

The Department of Health and Ageing will administer the following funds for immunisation programmes under the banner Protecting your Health:

- National Human Papillomavirus (HPV) (a common virus in the population) $103.5 million over 5 years to vaccinate 2-13 year old girls and catch-up programmes for 13-18 year old girls and 18-26 year old women.
- Q fever is a bacterial condition affecting abattoir workers and others who have close contact with livestock and their products. The Government has allocated $16.6 million for immunisation over 5 years.
- Rotavirus gastroenteritis vaccine $124.4 million over 5 years targeting the 250,000 babies born in Australia each year. Vaccination of babies aged 2-6 months will reduce the risk of developing severe rotavirus gastroenteritis by over 86 per cent.

Type 2 Diabetes

Type 2 diabetes is one of the most common chronic diseases among people aged 40 years and over, in particular among those with excess weight and a family history of diabetes. However, the number of children and people under 40 years of age being diagnosed with the condition is increasing. Type 2 diabetes accounts for 85–90 per cent of people with diabetes.

Through the Department of Health and Ageing the Commonwealth Government will fund up to $103.5 million over 4 years as its contribution to a cost-shared initiative with state and territory governments focusing on 40–49 year olds to take a “tick” test; funding includes $1.0 million over two years to develop the “tick” test – a national risk assessment tool.

Mosquito Eradication in Torres Strait and Groote Eylandt

Following recent incursions of species of mosquito capable of spreading dengue fever, the Government will provide $2.7 million over three years to help Queensland and Northern Territory governments fund mosquito eradication programmes in the Torres Strait and Groote Eylandt.

Drought Affected Communities

Training is required for workforce and community leaders to be able to recognise and respond to the early warnings of emotional distress. Health practitioners and other drought relief workers need assistance and awareness of self-help and other services needs to be raised.

Some $10.1 million will be provided through the Department of Health and Ageing over two years from 2007–08 to individual Divisions of General Practice to support mental health professionals and community leaders respond to the psychological impact of drought. $20.6 million also will be provided over four years building on COAG's *Mental Health – mental health services in rural and remote areas* (2006–07 Budget).

Food Standards

Food Standards Australia New Zealand (FSANZ) develops food standards and joint codes of practice with industry covering the content and labelling of food sold in Australia and New Zealand. FSANZ also undertakes national coordination of food surveillance and food recall systems, providing food handling advice to consumers and conducting research.

The Government will provide $12.7 million over four years to increase FSANZ resources, to reduce the time taken to develop new food standards and address the demands and concerns of industry and consumers regarding food safety.

Endnotes

1. Cooperative Research Centre Association Budget night media release, 8 May 2007 *Budget a little disappointing, but there's still hope!*
2. A synchrotron is a large machine (about the size of a football field) that accelerates electrons to almost the speed of light. As the electrons are deflected through magnetic fields they create extremely bright light. The light is channelled down beamlines to experimental workstations where it is used for research. It is recognised internationally that research using synchrotron light is a mainstream activity that provides essential information in the materials and chemical sciences, the life sciences and molecular and environmental science.
3. A "smart meter" is an advanced meter that identifies electricity consumption in more detail than a conventional basic domestic meter. While a "basic meter" accumulates the measurement of electricity consumption for the period between reads, a "smart meter" will, typically, provide consumption data in half-hourly intervals. The "smart meter" (also referred to as an interval meter) may also deliver the readings over a communications network to a remote location for monitoring and billing purposes.
4. Geothermal energy is a renewable energy. Hot fractured rock (HFR) geothermal energy is produced using heat extracted from buried hot granites by circulating waters through an engineered, artificial reservoir or underground heat exchanger. These hot granites represent a

massive source of renewable energy, free from CO_2 emissions. The development of HFR geothermal energy relies on existing technologies. HFR geothermal projects are currently underway in France, Switzerland, Germany, California, and Japan. Australia has a recognised potential for the development of HFR geothermal energy.

5. Hydrogen is an energy storage medium, not a primary energy source, but is an environmentally cleaner source of energy to end-users, particularly in transportation applications (vehicles, aircraft) without release of pollutants (such as greenhouse gasses) at the point of end use. Commercial production is still a long way off.

6. Warren, M 2007 Incentives risk driving solar-cell costs through roof, *The Australian*, 9 May 2007, p. 8.

Defence budget

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Introduction

While 'most departments would be happy if they can stay a little ahead of the annual inflation rate of around 2.5 per cent',[1] the 2007–08 Defence Budget at $22 billion, represents an increase on the previous year of 10.6 per cent or $2.1 billion. This is the seventh consecutive budget that has met or exceeded the commitment to a 3 per cent per annum real growth in outlays made in the 2000 Defence White Paper.[2] Despite this, for Defence to meet its financial commitments over the long term it has to hope that the promised increase in real growth will not be undercut by any weakening in the economy or any loss of political will if (or when) hostilities cease and deployments lessen. It has to hope that it can overcome its military recruitment and retention problems and the skills shortage in defence industry and that money will continue to be available to cover 'spiralling capital equipment and personnel costs' which are 'rising by about 4% and 5% a year'.[3] Taxpayers will also have to hope that the Proust Review's concerns are unfounded and that Defence's 'current comparative wealth' does not mean 'that there are now less concerns about efficiency than in the past'.[4]

Retention and recruitment

On 15 December 2006 the Prime Minister announced a raft of measures costing $1 billion to increase recruitment and improve retention of military personnel. The 2007–08 Budget increases this promised spending twofold, with an additional $2.1 billion over ten years aimed at boosting recruitment and retention.

The Government is caught between its decision in August 2006 to increase the ADF by 6000 personnel to 57 000 over the next decade to meet what it sees as ever increasing future regional and global security challenges, and the strength of the civilian labour market which is not just competing with the ADF for new employees, but luring away military personnel who can earn good salaries without the stress military life can put on families or the dangers of active service.

The December 2006 reforms included $226 million over the next seven years ($38.3 million for 2007–08) for retention bonuses and allowances for those with critical skills and high value experience as well as two measures aimed at new recruits: $371 million ($26.5 million for 2007–08) to streamline recruitment; and $306 million over 10 years for a military gap year scheme for school leavers (but not beginning until 2008–09 with $8.2 million). A total of $112.5 million was also programmed for five years for the Navy Sea Change program, with $17.3 million for 2007–08. This was the first phase of measures aimed at increasing recruitment from around 4700 personnel to 6500 a year and reducing the current separation rate from around 11 per cent per annum to below 10 per cent. A drop of 3 per cent would reduce separation rates by 500 per year.[5] In April 2007 the compulsory retirement age for permanent military personnel was increased from 55 to 60, at the same time the potential recruitment pool was increased by lifting the age limit for recruitment from 51 to 56.

There are some early indications of success for the first phase of the ADF’s recruitment and retention strategy with an 86 per cent take–up of the Army expansion bonus and an 81 per cent acceptance of the $25 000 bonus offered to those in critical employment categories. The ADF has recruited 1004 more full–time and Reserve personnel than at this time last year, with an overall full–time and Reserve entry of 86 per cent.[6]

The 2007–08 Budget includes another eight measures aimed at increasing recruitment and reducing separation rates over the next decade. Three of these, totalling $399 million, could be said to be targeting new recruits: $227.8 million ($24.6m for 2007–08) for marketing and branding the three services to attract young people; $100 million ($10m for 2007–08) to enhance and expand the Defence Force Cadet scheme; and $71 million ($5m for 2007–08) for a new Defence Apprenticeship scheme to assist 16 and 17 year olds to begin an apprenticeship and then join the ADF.

The other five Budget initiatives, which at $1673 million make up the bulk of the funding, might make the ADF more attractive in the longer term, but they are aimed essentially at retaining existing personnel: $863.8 million (beginning with $40.9m in 2008–09) for a new home loans assistance scheme; $585.4 million (beginning with $59.7m in 2008–09) for a modern and more flexible pay structure for other ranks; $124.5 million ($4.4m for 2007–08) for transition and career advice aimed at encouraging retention and re-enlistment; $86.5 million ($1.9m for 2007–08) for the Navy’s Sea Change program to relieve navy personnel of some port duties and extend deployment allowance to submariners; and $12 million ($0.6m for 2007–08) for medical officer professional development.

While Defence is trying to ‘grow’ the ADF by recruiting an extra 1800 new personnel each year for the next decade, the new spending announced in December 2006 and in the Budget indicates that Defence’s monetary emphasis is on retaining its existing force. The latest attitude survey of military personnel indicates that while a significant proportion of military personnel (34.9 per cent Navy, 31.2 per cent Army and 24.7 per cent Air Force) report that they are actively looking at leaving the service, its findings also demonstrate that these are not the highest dissatisfaction figures of the last few years. In addition, ‘actively looking at leaving’ does not necessarily translate into actual separations as separation rates have been relatively steady over the past few years.[7] On the other hand, the rate of loss of new recruits within the first twelve months of service did increase between 2002–03 to 2004–05 across all three services. The Navy’s drop–out rate for recruits rose from 6.8 per cent to 16.4 per cent; the Army’s rose from 18.8 per cent to 21.6 per cent; and the Air Force’s from 9.8 per cent to 11.6 per cent.

Equipment acquisition

Two items of interest in the Budget relating to defence procurement are the Government's decision to purchase twenty-four F/A-18F Super Hornet aircraft and the necessity of reprogramming a substantial percentage of the acquisition budget to later years.

Super Hornets

The capital expenditure project which Defence has highlighted in the *Portfolio Budget Statement* (PBS) as a Project of Interest is project AIR 5349 phases one and two—the unexpected acquisition of twenty-four F/A-18F Block II Super Hornets from the US as a stopgap measure in case of 'an air combat capability shortfall during the transition to the JSF [Joint Strike Fighter]'.[8]

The Super Hornet decision was so sudden, with both its first and second pass approvals happening on 1 March 2007 (mirroring the first and second pass approvals for the C–17 procurement on 1 March 2006), that it did not make it on to the PBS table of the top 30 Defence Materiel Organisation (DMO) projects by 2007–08 expenditure. This is despite the 2007–08 Budget allocation of $621 million being the highest estimated expenditure for the year by a factor of nearly 50 per cent more than its nearest rival.

The timing of the Minister's first public suggestions that the Government was considering buying or leasing the 24 Super Hornets coincided with Australia signing up to the second phase of the JSF development program, but it was advice to the Minister from the chief defence scientist on the risks associated with flying the F-111s beyond 2010 that evidently prompted the Super Hornet decision.[9] Despite this, it has been reported that the Defence Department 'backed by the RAAF, told Cabinet it did not want the Super Hornets'.[10] Certainly their purchase adds to the debate and controversy surrounding the proposed acquisition of up to one hundred F-35 Joint Strike Fighters.

There is an apparent inconsistency within the Minister's Budget press release about the Super Hornet.[11] On the one hand, the introduction of the Super Hornets is timed to coincide with the withdrawal of the F-111s; on the other hand, the press release states that introduction of the aircraft poses a relatively low risk transition because of the considerable similarity in support, training and tactics to the current F/A-18 fleet. However, while there will be some similarity between the F/A-18 A/B Hornets (the current aircraft) and F/A-18Fs (the Super Hornets), the Super Hornets will be replacing the F-111s, not the existing F/A-18s; and, as well as air crew training, it is the workforce supporting the F-111s at Amberley which will have to transition to the new fighter. However, the Air Force does see the Super Hornet offering low risk transition to the stealth and network–centricity of the F-35.[12]

As well as the change from the F-111s to F/A-18F Super Hornets, the Air Force is facing a number of other major capability transitions over the next decade or so: the introduction of the F-35 Joint Strike Fighter from 2013 to 2018; the retirement of the older F/A-18 Hornets from 2014; and the subsequent retirement of the Super Hornets in around 2020, with the current Air Force leadership keen to have a fourth squadron of F-35s.[13]

Reprogramming of the Capital Investment Program

In 2007–08, $1.113 billion of major capital equipment project spending in current and forward estimates, 'has been reprogrammed into later years due to industry capacity and schedule slippage'.[14] This is listed in the PBS on page nine under two line items: 'reprogramming of approved capital investment program' (-$615 million); and 'further reprogramming of approved capital investment program' (-$378 million), both in 2007–08 with no explanation of why the separation or which projects are contributing to these variations. Elsewhere the PBS explains that the -$615 million represents 'reprogramming of the Approved Major Capital Investment Program due to industry capacity issues and slippage of approved projects'. The -$378 million is made up of -$350 million of 'reprogramming of the Approved Major Capital Investment Program following a review of the estimates in the 2007–08 Budget to reflect industry capacity issues and reprogramming of project schedules', and -$28 million of 'reprogramming of the Major Capital Facilities funds from 2007–08 to later years', evidently facilities for the Enhanced Land Force.[15]

Current slipped expenditure on the Airborne Early Warning and Control (AEW&C) system and the M113 tank upgrade projects is noted in the 2007–08 PBS as the reason behind an expected higher level of expenditure between 2008–09 to 2010–11.[16] Slippage in these two projects caused Defence to reprogram -$390 million to later years in the 2006–07 Defence Portfolio Additional Estimates.[17]

The DMO's performance target in 2007–08 for its Output 1.1—Management of Capability Acquisition, is $4827.5 million.[18] The reprogramming of -$993 million for 2007–08 represents a 16 per cent variation in the planned expenditure on capital equipment in this one year. That is, it is an underspend of 16 per cent before money has been appropriated for 2007–08. This disclosure loses some of its impact without a clear and detailed explanation of which projects have brought this about, and why—how much of this is down to projects which are problems for DMO and how much is in the nature of normal updating of project estimates?

Conclusion

Defence will struggle to translate the 2000 White Paper commitment of 3 per cent real growth into greater security for Australia, unless Defence is successful in promoting greater recruitment and retention in the ADF, and problems in acquisition, such as those which have caused Defence to have to reprogram $1.1 billion, are overcome.

Endnotes

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8. *Portfolio Budget Statements 2007–08: Defence portfolio*, Section Two—Defence Materiel Organisation, p. 254; Brendan Nelson, *Joint Strike Fighter*, media release, 002/07, 1 February 2007.
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11. Brendan Nelson, *Budget 2007–08: Super Hornet bridging air combat capability*, media release B05/2007, 8 May 2007.
12. G. Ferguson, '$6B for Super Hornet', *Australian Defence Magazine*, April 2007, Vol. 15, No. 4, p. 24.
13. Presentation by Air Marshal G Shepherd, Chief of the Air Force, to the RUSI Conference on 16 May 2007.
14. G. Barker, 'Generous allocation reflects confidence in economy', *Australian Financial Review*, 9 May 2007, p. 17.
15. *Portfolio Budget Statements 2007–08: Defence portfolio*, op. cit. pp. 41–42, 69.
16. *Portfolio Budget Statements 2007–08: Defence portfolio*, op. cit. p.68.
17. *Portfolio Additional Estimates Statements 2006–07: Defence portfolio*, p. 45.
18. *Portfolio Budget Statements 2007–08: Defence portfolio*, op. cit. p. 251–254.

Funding measures to protect national security and combat serious and organised crime

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Although national security remains, not unexpectedly, a major feature of the Budget and is addressed with several new initiatives, it has received less emphasis this year than in previous years. However, the 2007–08 Budget also sees a number of new operational initiatives targeting serious and organised crime. These initiatives include new funding to, amongst other things, combat illicit drugs, increase efforts against people smuggling, and enhance the management of criminal intelligence, as well as funding for the continuation of existing programmes, such as those targeting money laundering and fraud.

National security

In January 2007, the Attorney-General declared that Australia had spent 'more than $8 billion on security-related measures since 2001'.[1] In the 2007–08 Budget, the Government is providing an additional $702 million over four years to strengthen Australia's national security—approximately half of last year's expenditure on national security.[2] The Government also claims that in total it has now committed an additional $10.4 billion to national security over the ten years to 2010–11.3 However, according to the Australian Homeland Security Research Centre, expenditure on national security (excluding defence) in the 2007–08 Budget amounts to just $665 million over four years and a total of some $7.6 billion over the ten years to 2010–11.[4]

According to Government figures, national security funding includes the provision of $73.6 million over four years to a range of agencies for the implementation of a national 'e-security' agenda to protect and secure Australia's online environment. It also includes a total of $57.2 million over four years to further enhance aviation security, one of the main features of which is the extension of checked baggage screening to 26 regional airports that are serviced by passenger jet aircraft, at a cost of $15.4 million. This funding will provide explosive detection equipment to all 26 airports and X-ray screening to 18 airports. The lack of checked baggage screening at regional airports has long been one of the Opposition's main criticisms of the Government's existing aviation security programme.[5]

Other specific national security funding initiatives include:

- $151.4 million over four years to develop purpose-built police accommodation at Australia's eleven Counter-Terrorism First Response airports to provide space for office, operational and training facilities and cater for the permanent posting of police and security personnel under the Unified Policing Model

- $14.5 million over four years to a number of agencies for the development of the Chemical, Biological, Radiological and Nuclear (CBRN) Security Strategy, part of a package of counter-terrorism measures adopted by the Council of Australian Governments (COAG) on 13 April 2007

- $18.6 million over four years for Department of Transport and Regional Services (DOTARS) (part of the $57.2 million aviation security package) to introduce an accreditation scheme for operators of land transportation (eg: trucking companies) that carry air cargo. This new scheme will complement the existing Regulated Air Cargo Agent scheme that applies to freight forwarders and cargo terminal operators

- $5 million over four years for DOTARS (part of the $57.2 million aviation security package) to fund the posting of two senior transport security officers to the US where they will work closely with US aviation security authorities and the International Civil Aviation Organization (ICAO)

- $31.7 million over four years for the Australian Customs Service (Customs) to lease a charter vessel to replace the Australian Customs Vessel currently on station at Ashmore Reef National Nature Reserve and obtain two high-speed response craft to strengthen Customs surveillance and environmental management of the area

- $79.5 million over four years for Customs to develop, implement and operate the new Australian Maritime Identification System (AMIS), the aim of which will be to consolidate maritime data currently collected by several different agencies and enable the Border Protection Command to detect and respond to all vessels entering or operating in Australia's maritime region

- $23.1 million for Customs to replace the current Passenger Analysis Clearance Evaluation (PACE) system to enhance the ability of Customs to identify international travellers of interest to various agencies, and improve the sharing of information between such agencies

- $65.2 million over five years to upgrade the Australian Federal Police's (AFP) operations and intelligence IT systems

- $4.7 million over four years to create a new AFP team which will manage human sources of intelligence in an effort to increase the collection overseas of intelligence on people smuggling. A further $9 million over four years has also been provided to the Australian Secret Intelligence Service (ASIS) to enhance its collection of intelligence on people smuggling; and

- $1 million over four years to conduct police background checks for all staff employed under the *Members of Parliament (Staff) Act 1984* and to provide security awareness training for those employees with a Top Secret clearance with the aim of improving security in Parliament House.

There is also funding to continue or expand existing programmes, such as the continued operation of the national crisis management Watch Office ($5.5m over four years); the continued operation of the National Security Hotline ($19m over four years); a reinvigorated national security awareness campaign ($20m over two years); an expansion of the counter-terrorism exercise programme ($24.6m over four years); the completion of implementing arrangements under the *Anti-Terrorism Act (No. 2) 2005* ($35.7m over four years); the enhancement of aviation security audit and compliance ($21m over four years); the continuation of the secure communications network, Australian Secure Network ($21.2m over four years); and an expansion of the strategy to combat people trafficking ($26.3m over four years).

Agency funding

Australian Security Intelligence Organisation

The Australian Security Intelligence Organisation's (ASIO) total budget for 2007–08 is $446.984 million (comprising $149.616m in equity injections and $297.368m in departmental appropriations and other revenue). This represents a total increase of just over $100 million from last year. ASIO receives $78.8 million over four years to complete refurbishments to ASIO state offices.

Australian Secret Intelligence Service

The budget of the Australian Secret Intelligence Service has increased from a total of $168.234 million in 2006–07 to a total of $179.883 million in 2007–08 (comprising $166.134m in departmental income and other revenue of $13.749m). This is an increase of $11.6 million.

Australian Federal Police

The Australian Federal Police's total budget for 2007–08 is $1261.078 million (comprising $90.066m in equity injections and $1171.012m in departmental income). This compares to a total last year of $1140.305 million, which represents an increase of some $121 million.

Australian Customs Service

The total budget of the Australian Customs Service for 2007–08 is $1326.992 million (comprising $36.609m in equity injections and $1290.383m in departmental income). This represents an increase from last year of just over $75 million (up from $1251.621m).

Serious and organised crime

There are a number of significant initiatives to receive funding in this year's Budget which aim to address some growing trends in serious and organised crime. Central to these is the Government's *Combating illicit drugs* initiative, under which the AFP, Customs and the Australian Crime Commission share in some $150 million designed to address the problem of amphetamine-type stimulants, and which the Prime Minister claims will strengthen the Government's 'zero tolerance approach to illicit drugs'. A breakdown of this funding was provided by the Prime Minister in his press release of 22 April 2007, as follows:

Table 1—summary of measures to further combat illicit drug use

Measure	Agency	Funding to 2010–11 ($ million)
Strengthening the non-government organisation treatment grants program *(designed to increase rehabilitation services)*	---	79.5
Amphetamine-Type Stimulants grants program	---	22.9
Strengthening drug prevention education *(will supplement existing funding for the national drugs campaign, including the production of education booklets for all households)*	---	9.2
Response to the production and distribution of amphetamines and other synthetic drugs	Australian Crime Commission	20
Enhanced technical capacity	ACC and AFP	4.3
Amphetamine-Type Stimulants enhanced investigative capacity *(will fund the creation of a dedicated investigation team based in Sydney)*	Australian Federal Police	5.9
Expansion of the international liaison officer network *(will fund the deployment of one AFP officer to Laos and additional staff for the AFP's China post)*	Australian Federal Police	4.5
Expansion of reference spectral libraries, upgrade of spectroscopic detection fleet, and installation of portable fumehoods at container examination facilities *(to be used when sampling commercial-sized chemical shipments)*	Australian Customs Service	1.3
Drug Use Monitoring in Australia *(expansion to Darwin and Melbourne of a programme which analyses urine samples and responses to questionnaires from police detainees)*	Australian Institute of Criminology	1.9
TOTAL		**149.5**

(Table based on the attachment to the Prime Minister's press release on the issue of 22 April 2007)

Other measures to combat illicit drugs which are funded from within the existing resourcing of the Australian Customs Service include $0.8 million over four years to provide additional training to border security personnel in the detection and analysis of precursor chemicals used in the manufacture of illicit drugs, and $0.7 million over four years to improve drug detection and prevention in the Oceania region.

Funding for the continuation of existing programmes includes $5.2 million over four years for the AFP to continue with the connection of AFP overseas posts to the AFP's national computer system; $8.8 million over four years for the AFP to continue joint efforts with overseas law enforcement agencies in disrupting transnational criminal threats and improving the sharing of criminal intelligence; $6 million over four years for the AFP to continue joint efforts with overseas agencies to disrupt the supply of illicit drugs to Australia; and $30.8 million over four years for the Australian Crime Commission to continue targeting money laundering and fraud against the Commonwealth.

Other significant new initiatives include some $13 million for the Australian Crime Commission to enhance the management and sharing of criminal intelligence ($4.3m over four years), and to investigate the involvement of organised crime in the private security industry ($8.7m over two years).

Conclusion

With the exception perhaps of the funding of the new 'e-security' agenda and the screening of checked baggage at regional airports, the bulk of this year's national security budget is largely allocated to structural and administrative enhancements, or enables the continuation of existing programmes. By comparison, the funding of measures to combat growing trends in serious and organised crime is significant. Law enforcement agencies (rather than public service departments) appear to benefit the most, suggesting that the funding is specifically designed to boost operational capability.

Endnotes

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