more give, less take

nab

Federal Budget 2013

What the Federal Budget means for business

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Federal Budget overview

Our economists' view

Alan Oster, Group Chief Economist, NAB

What a difference a year makes. Gone is the political rhetoric on the importance of gaining international credibility by getting a surplus no matter what. Rather, the focus is very much on a fairly timid initial approach that doesn't see a balanced Budget till 2015/16 or a surplus till 2016/17. In short, a Budget that is more in line with a "soft economy" – even if the Government doesn't describe it as such.

The Budget effectively takes nothing to the economy in the near term (compared to detraction from growth of nearly 1½% this year). From a structural viewpoint nearly all of the heavy hitting is from the revenue side and most is done in the out years. That said, the Budget is helping to repair some structural problems via:

- scrapping last year's welfare increases (last year's so called spreading the benefits of the mining boom – around $2.5bn over the estimates) and the baby bonus
- increasing the Medicare levy to help fund national disability reform (the largest saving at $11.5bn over the estimates)
- tightening offshore tax arrangements including Offshore Banking Units (a hefty $4.2bn over the estimates) and acknowledging the lower carbon price ($3.4bn over the estimates).
- measures to reduce funding costs of schooling (out of universities etc at $2.6bn) and measures to introduce PAYG systems for large tax payers.

The main expenditure items (within the estimates period) are more infrastructure ($3.1bn) school building ($2.9bn) and disability care ($1.9bn but ramping up in the beyond estimates period).

NAB's real activity forecasts are very similar to Treasury's – albeit we are a touch weaker in 2012/13 and we also have unemployment a touch higher. Of more concern, we are significantly lower for nominal GDP – which is important because this was the main cause of revenue under prediction in recent years. We are also slightly weaker for the global outlook. For more details, see Economic and Financial Outlook.

The real risks to the Budget probably revolve around how much of the package will see the light of day post the election. Also, the Budget expenditures are very much back ended which raises the question of just in what state the economy will be in 2016/17 and beyond. Finally even this modest fiscal retraction will possibly be at risk if election spending fires up. At least in that context Australia's debt position remains very strong in an international context with debt levels very low – albeit they are possibly moving towards the lower end of the remaining AAA economies. For more details, see Bond Issuance and Net Debt.

Overall then a budget for a softer economy but one that is very political in nature (as probably was inevitable in present circumstances).

Fiscal Outcome

The underlying cash deficit for 2012/13 is estimated at $19.4 billion (1.3% percent of GDP). The Budget maintains large deficits of $18 billion in 2013/14, and $10.9 billion in 2014/15, before moving into a marginal surplus of $800 million in 2015/16.

Economic Outlook

The Government's economic outlook is broadly in line with recent RBA forecasts, and only slightly stronger than NAB's. However, the Government's outlook for nominal GDP is substantially stronger than ours, at 3¼% in 2012/13 compared to our 2.1%, and 5% in 2013/14 compared to our 4.2%. Over estimating nominal GDP was the reason why revenues were overestimated in recent years – and this is clearly a concern. The Government and NAB both have growth of 2.7% and 3% for 2013/14 and 2014/15. However, we are weaker in 2012/13 (at 2.7% v the Governments 3%) largely slower near-term public sector demand and a sharper pace of decline in the terms of trade. The Government expects unemployment to rise to around 5¾% by mid 2014, while NAB expects it to edge towards 6%, reflecting our weaker view on growth. The Government, RBA and NAB share very similar views on the outlook for underlying inflation, which is expected to remain well within the RBA's 2-3% target band over the forecast horizon. Given the structural adjustment occurring in the economy at present, as well as softness in labour market conditions, we still believe the economy would benefit from another 25 bp rate cut this year (November); this would take the RBA's cash rate to 2.50%. However, further deterioration in labour market conditions could see earlier action and possibly more than one cut. For further details, see the Economic and Financial Outlook.

Financial Markets

Beyond the economic/fiscal outlook, for bond investors the two main considerations from tonight's Budget are: 1) the Government's debt programme for 2013/14, and 2) any implications for Government's stable AAA credit rating. The market reaction to the Budget was negative, with the $A quickly falling ½ a cent to under 0.9950. The reasoning was less to do with the detail of the Budget and more that investors saw a string of deficits indicating the economy remains weak. The bond market was little moved.

For more detailed analysis from NAB Group Economics, please visit **nab.com.au/fedbudget**

Industries who benefited in 2013

Through our relationship with Business Spectator and leading industry bodies, NAB is excited to share the following industry commentary and analysis.

Who has benefited the most

Health & Community

Key initiatives:

- The budget allocates $14.3 billion in new investment for DisabilityCare Australia, a national disability insurance scheme that will be paid for with a 0.5 percentage point increase in the Medicare Levy (to 2% of taxable income) from July 2014. The government estimates that $20.4 billion will be raised from the increase between fiscal 2015 and fiscal 2019, which would be placed in a fund for 10 years and could only be drawn upon to fund the DisabilityCare scheme.
- $226 million to fight cancer, including $55.7 million for breast cancer screening; $18.5 million for prostate cancer research; $23.8 million for bone-marrow transplants.
- But many Australians are expected to be hit by a phase-out of the net medical expenses tax offset over the next two years, which will save the budget nearly $1 billion over four years. However, claims for aged care, disability aids and attendant care will be allowed through until June 30, 2019 when DisabilityCare is rolled out across the country.
- The Government will realign the indexation of Medicare Benefits Schedule (MBS) fees to the financial year in line with many other Government programs. MBS fees, which are currently indexed on 1 November each year, will be indexed on 1 July each year. The next indexation date will be 1 July 2014. This measure will result in savings of $664.4 million over four years.

NAB's view:

Healthcare had a mixed budget night, with long term headline projects capturing the attention, along with some stings in the tail. Cancer care is the big winner, but health was also a key area of savings through changes to Medicare.

DisabilityCare Australia was a focus, with an accompanying increase in the Medicare Levy from July 2014 to fund it, but the scheme won't be fully implemented until July 2019. Cancer treatment and research was a more immediate beneficiary, receiving $226 million ($190 million new funding).

Healthcare professionals funded under the Medicare Benefits Scheme were losers from the budget, with an eight month delay in indexation resulting in major savings in coming years.

Industry view:

The Australian Medical Association (AMA) said the delayed indexation of the Medicare Benefits Schedule from November to July next year was effectively a freeze. The AMA also expressed concern that the increase to the Medicare Safety Net threshold would push up health costs for families and "some people may choose to put off seeing their doctor".

Leading Age Services Australia (LASA) said that the budget contained "no real surprises for the age services industry or for health generally". But, LASA lamented the "lost opportunity to further enhance the reform process by ensuring that funding matches the cost of care for older Australians."

Infrastructure

Key initiatives:

- An additional $24 billion funnelled into nation-building infrastructure.
- Key urban public rail projects include the Melbourne Metro rail project ($3 billion) and Brisbane's Cross River Rail project ($715 million).
- Investment in urban roads, including an allocation for the WestConnex motorway in Sydney ($1.8 billion), as well as the gateway North upgrade in Brisbane ($718mn), widening the M80 Ring Road in Melbourne ($525 million) and the South Road upgrade in Adelaide ($448 million).
- Regional areas also benefited with spending on the Bruce Highway and an upgrade to the Midland Highway in Tasmania over 10 years.
- Other investments projects include upgrades to the Warrego Highway in Queensland and the Perth-to-Darwin National Highway (Swan Valley Bypass) in Western Australia.
- An extra $12.9 million was set aside to connect more local councils to the National Broadband Network.

NAB's view:

Infrastructure spending was a key component of the 2013 budget. A major focus of this investment seeks to address some of the problems associated with population growth and urban growth so there is a heavy focus on urban rail and roads.

The infrastructure sector has done well compared to other areas, but the second round of the Nation Building program is modest in comparison to the first phase, with around half of the funding beyond 2017 (of the $24 billion of funding commitments, only $13.5 billion is allocated in the forward estimates to 2016/17).

In addition, the overall size of the next phase in the Nation Building program has been reduced through a $2 billion reduction in the Regional Infrastructure Fund, largely a result of revenue shortfalls from the Minerals Resource Rents Tax (MRRT). The Government also plans to save $44.3 million over 4 years from other cost savings on existing projects.

Finally, some of these projects also contain conditions around funding which may serve to frustrate the delivery of the funded projects. For example, the government's $3 billion pledge towards building the $8 billion Melbourne metro project is contingent on matching funding from the State government (investment in the Brisbane Cross River Rail also requires State funding support). The WestConnex investment is also subject to conditions including no new tolls to be applied to existing roads.

Industry view:

Master Builders Australia welcomed the new $24 billion investment for urban road and rail infrastructure but noted that its impact was still likely to be "many years away". The Housing Industry of Australia (HIH) also welcomed the boost to infrastructure investment however noted that "the measures fail to address necessary infrastructure funding to support new residential development and boost new housing supply".

Education

Key initiatives:

- The budget commits $9.8 billion over six years to fund the Gonski education reforms.
- $1.1 billion investment in early childhood education - including an Early Years Quality Fund and continuation of the early childhood education national partnership funding through to end 2014.
- $97 million over five years to increase the number of Commonwealth-supported university places, an additional $186 million for research infrastructure and $135 million over five years to continue the Future Fellowships scheme aimed at attracting Australian and international researchers
- Cuts to university funding and shifting of the funding burden to university students through a range of measures including a 2% efficiency dividend, removal of discounts for up-front and voluntary payments made under the Higher Education Loan Program and conversion of student start up scholarships to income contingent loans.
- An end to various school programs such as the national partnerships on Low Socio-Economic Status School Communities ($259 million), Empowering Local Schools ($412 million), Literacy and Numeracy Funding ($567 million), and Rewards for Great Teachers ($665 million).
- As previously announced, the government will cap work-related self-education expense deductions at $2,000 from July 2014, saving the Federal Budget $514.3 million over the forward estimates period.

NAB's view:

As expected, changes in the education sector were headlined by the increase in school funding under the National Plan for School Improvement. The Government also increased funding for early childhood development and to boost the number of Commonwealth supported university places.

Recognising the importance of research and development to continued economic development, additional funding has also been provided to programs supporting Australia's research effort.

While there is a net increase in resources going to education, there were significant savings measures, including from the University sector and the ending of some school programs.

Industry view:

Universities Australia said that the budget "will challenge the ability of universities to maintain the quality of education and research" and may compromise the role that universities play in lifting national productivity. While it welcomed some of the "positive new higher education initiatives" in helping sustain Australia's research effort in the short-term, these were insufficient to offset the impact of the $3.8 billion worth of cuts to higher education announced over the last six months.

Agribusiness

Key initiatives:

- $420 million Farm Finance package to alleviate debt pressures and provide targeted financial assistance to farmers, through max $165,000 concessional loans ($210 million 2013-14 and $210 million 2014-15).
- $99.4 million Farm Household Allowance to support farmers in hardship under National Drought Program Reform.
- $25.4 million National Monitoring System for Agricultural Chemicals Residues in Food ($5 million in 2013-14).
- $750,000 boost to Rural Financial Counseling services in flood affected regions in QLD.
- Status Quo:

- $2.1 billion over five years for Caring for our Country ($200 million in second phase of Reef Rescue program over five years, starting 2013-14).
- $238.2 million commitment to RD&E funding for relevant research and development corporations.
- $379.9 million for construction of a state-of-the-art post-entry quarantine facility (announced in 2012-13 budget).

NAB's view:

Agribusiness has emerged as a net beneficiary of the budget, with the diesel fuel tax rebate – speculated as an area of possible cut prior to the release – remaining intact. That said, the overall gains are rather modest.

By agricultural sector, the largest spending has been on forestry, with the Government committing over $330 million to support the historic Tasmanian Forests Agreement.

More generally, the Government has recognised the adverse impacts of the recent drought on farmers' finances and their families, prompting them to announce a package of measures to support and assist farmers experiencing acute levels of debt, and setting up a fund under National Drought Program Reform to support farming families in times of hardships.

Industry view:

The National Farmers Federation (NFF) had previously called for agricultural funding to be bolstered to reflect a reprioritisation of the sector in Canberra and to match political rhetoric about future food opportunities in the booming Asian region during the next three to four decades.

The federation would have liked to have seen agricultural R&D increased from its existing level of 2% of the total government R&D spend to 3.5% of total R&D spend by 2015.

The NFF said that it had been expecting a tough budget although major agricultural programs remained steady. The NFF also praised the announcement of a $99.4 million Farm Household Allowance under the new National Drought Reform package agreed between the Commonwealth and State governments.

Small Business

Key initiatives:

- A $378.6 million Venture Australia package, which will provide additional finance for SME's, to be disbursed over a period of 15 years.
- Providing $29.4 million of funding over 5 years – Enterprise Solutions program – to assist SMEs to more successfully bid for Government projects and tenders.
- Maintenance of the Small Business Advisory service.
- Providing $19.2 million to expand the Enterprise Connect program to encompass the IT, transport, logistics and professional services sectors.
- An additional $7.2 million over 3 years to assist SMEs to better harness the opportunities provided by the NBN.

NAB's view:

Overall, the Federal Budget can be described as marginally positive for SMEs. Unlike their larger counterparts, who are likely to face enhanced tax scrutiny, SMEs are likely to benefit from a number of targeted programs.

More specifically, expanding the sources of finance for SMEs through the availability of venture capital funding; financial support in assisting SMEs bid for government projects; assistance with leveraging the benefits of the NBN (National Broadband Network); expanding the scope of the Enterprise Connect program. Finally, highly competitive and innovative SMEs may stand to benefit from the Government's Innovative precincts.

However, there have not been any notable measures to reduce business red tape, as well as improving the taxation impost – in terms of both regulatory compliance as well as payment schedules faced by SMEs. Furthermore, some initiatives such as the Venture Australia package have very long lead times and would require greater clarity in regards to implementation.

Industry view:

The themes described above were largely reflected by the Council of Small Business of Australia (COSBOA), who said, "Given the depth of the deficit we were pleased to see support for: the Enterprise Connect program; assistance to SMEs to apply for public sector work; and support for small businesses to engage in the digital economy and take advantage of the National Broadband Network". COSBOA also expressed a need to obtain more detail as to how these additional funds will be disbursed.

COSBOA was also concerned about the lack of measures to address administrative burdens relating to the tax system (PAYG and GST). Its other concerns related to streamlining the process of employee superannuation payments and measures to address the health issues of small business owners.

Who has benefited the least

Big Business

Key initiatives:

- As previously announced, the R&D tax incentive will be overhauled to provide a 45% refundable tax offset for companies with annual turnover of less than $20 million and a 40% non-refundable tax offset for other eligible companies. Companies with turnover above $20 billion will no longer be eligible for the tax offset.
- The monthly PAYG tax instalments will be extended to trusts, superannuation funds, sole traders and large investors, with all entities with turnover of $20 million or more moving to monthly PAYG from 1 January 2017.
- As previously announced, the superannuation guarantee charge will increase from 9% to 9.25% from 1 July 2013 and will progressively increase to 12% by 1 July 2019.
- A 10% new withholding tax on the proceeds from the sale of certain taxable Australian properties by foreign residents (including property and mining rights) will be introduced. (The measure will not apply to residential property transactions below $2.5 million).
- As widely anticipated the Government has announced changes to the current thin capitalisation rules to restrict the level of gearing that multinational companies can use. This will generally see the current safe harbour limit for non-bank entities reduced from 3:1 to 1.5:1. This will reduce the thin capitalisation safe harbour level from 75% to 60% of debt to total assets. For business, these changes are designed to restrict interest deductions and will create a need for current gearing levels to be reviewed and potentially restructured.
- Interest deductions will no longer be allowed for loans that are used to fund the acquisition of foreign investments, where the income from the investment is not subject to tax in Australia.
- The Offshore Banking Unit (OBU) concession at the rate of 10% will no longer be available for related party transactions and certain financial activities.
- Deductions for the purchase of mining rights and information have been tightened.
- Investors with franking credit tax offset entitlements of more than $5,000 will be prevented from engaging in "dividend washing", which involves a trading strategy that allows an investor to double the amount of dividend franking credits earned from franked dividend by selling the shares after they go ex-dividend and immediately buying the shares back while trading cum-dividend.

NAB's view:

Big business is a major loser in this budget as the government plans to clamp down on loopholes to retrieve $4.2 billion over the next four years.

Key reforms are crackdown on profit shifting, banning of dividend washing, reducing thin capitalisation safe harbour, removal of R&D and exploration incentives, and new requirements for all big businesses to move from quarterly to monthly PAYG tax instalments.

Companies most hit by reforms include multinationals, and companies operating in highly geared industries such as infrastructure, resources, and private equity. Moreover, there are some concerns that new reforms may discourage foreign investment in Australia.

Industry view:

The Business Council of Australia (BCA) said "the business tax changes announced today represent another lost opportunity to do tax reform properly, which risks reducing our competitiveness and affecting business confidence." In particular, the BCA cites changes to thin capitalisation rules as a risk that could "(impact) foreign investment, and potentially deterring companies from locating and investing in Australia. Piecemeal tax changes can add to perceptions of country risk when it comes to investing in Australia."

Energy & Resources

Key initiatives:

- The budget defers $370 million of funding from the Australian Renewable Energy Agency (ARENA) over three years, beyond the forward estimates. As a result the program will be extended to 2021/22.
- Renewable - $225.4 million will be deferred and $32.3 million redirected from the biodiversity fund. $58 million in funding for the Clean Technology Program moved to 2017/18.
- $500 million in funding will be withdrawn from the Carbon Capture and Storage Flagships Program over three years.
- $29 million in funding will also be withdrawn from the Coal Mining Abatement Technology Support package, over two years from 2015/16.
- Exploration deductions have been targeted. From July 1, 2014, the government removing depreciation concessions available to large resource companies that purchase junior miners and then claim their exploration costs and mining rights for immediate depreciation. This measure will raise $1.1 billion over four years.

NAB's view:

This year's budget contains a number of negatives for the resources sector. In particular, the mining industry is one targeted by the government's drive to bolster the corporate tax base and reduce loopholes. Deductions for exploration are to be tightened with immediate deduction of mining rights and information now to be depreciated over 15 years, or their effective lives (whichever is shorter). The Budget estimates a $1.1 billion gain in revenue over the next four years. The introduction of a cash bidding system for certain offshore petroleum exploration is expected to raise government revenue by $160 million after 4 years.

Many mining and energy programs have also been scaled back in an attempt to cut costs, with the clean coal sector one of the clear losers – almost $900 million in related program cuts (carbon capture and storage, emission initiatives, job assistance programs etc).

However, fears that fuel rebates – of which miners are a major beneficiary – would be wound back did not come to fruition. Also, the government pledged to amend the Petroleum Resource rent Tax (PRRT) legislation that will grant petroleum producers additional certainty regarding deductions for legitimate expenditure. The change is expected to reduce government revenue by $120 million over the estimate period.

Industry view:

The Minerals Council of Australia (MCA) is concerned that higher taxes for the mining industry will compromise the industry's future investment plans. In particular, cutting thin capitalisation will "undermine Australia's reputation as a stable and attractive place for businesses to locate and invest". Removal of immediate deductibility of exploration expenses was also cited to further exacerbate Australia's declining share of global mining exploration expenditure. MCA has expressed that "continual chopping and changing of Australia's tax system will only damage investor confidence"

Personal Finances in conjunction with MLC

The 2013 Federal Budget contained a few new measures and reconfirmed some recent announcements. Here is a summary of the key take-outs.

Note: These measures are proposals only and may or may not be made law.

Gemma Dale, Head of Technical Services, MLC

Personal Taxation

- The Medicare levy will increase by 0.5% to 2% pa from 1 July 2014 to help fund a better life for Australians with significant and permanent disabilities.
- The changes to the personal income tax thresholds, marginal tax rates and low income tax offset that were to take effect from 1 July 2015 have been abolished.
- The tax offset that is available if 'Net Medical Expenses' exceed $2,120 (in 2012/13) will be progressively phased out. The impact will be immediate for many people and it will be abolished by 2019.
- The amount of self-funded education expenses that can be claimed as a tax deduction will be capped at $2,000 pa from 1 July 2014.
- The Baby Bonus will be abolished from 1 March 2014.
- Families who are eligible for Family Tax Benefit Part A (FTB(A)) will receive an extra $2,000 following the birth of their first child and $1,000 for subsequent children.
- The income thresholds that are used to determine eligibility for FTB(A) and the threshold of $7,500 pa that applies to Child Care Rebate will not be increased until 1 July 2017.

Superannuation

- Currently, pre-tax and other concessional super contributions are capped at $25,000 pa, regardless of your age. This cap will increase to $35,000 pa from:
    - 1 July 2013 for people aged 60 and over, and
    - 1 July 2014 for people aged 50 and over.
- Currently, all earnings from assets held in a super pension are tax-free. From 1 July 2014, only the first $100,000 in earnings per member will be tax-free and earnings above this threshold will be taxed at 15%.
- From 1 July 2012, the tax concession on concessional super contributions will reduce from 30% to 15% for people who earn $300,000 pa or over.

Social security

- Currently, income payments received from an account-based pension are concessionally treated under the social security income test. However, from 1 January 2015, account-based pensions will be treated the same as other financial assets and be deemed to earn a particular rate of interest, regardless of the income actually earned.
- An incentive will be provided to older Australians to downsize the home by providing an exemption from the assets test for up to $200,000, subject to certain conditions. The main one is the home must have been owned for at least 25 years.

Important information