2010-11 Federal Budget Priorities

Pre-Budget Submission 29 January 2010

Invigorating Business Representation

Call > 13 26 96

nswbusinesschamber.com.au

Executive Summary

The NSW Business Chamber welcomes this opportunity to contribute to the formulation of the 2010-2011 Federal Budget. The NSW Business Chamber represents the interests of around 30,000 companies across NSW and the ACT, ranging from owner-operators to corporations, and from manufacturers to service providers.

The Australian economy has performed better than expected since the 2009-10 Budget. The IMF now expects Australian real GDP growth of 2.5 per cent in 2010, a significant increase from their April 2009 forecast of 0.6 per cent growth. A year ago Australia had just recorded its first quarter of negative growth in a decade and it was commonly thought that a technical recession was inevitable, whereas it now appears that Australia will be one of the only major advanced economies to avoid two consecutive quarters of negative growth.

With the worst of the crisis now appearing to have passed, the economy is at a turning point, and the Government will need to tackle real reforms if it is to put Australia back on a high growth path. Reforms of this kind do not occur organically; they require a driven and motivated Government that is willing to make the difficult decisions today in order to secure better outcomes for tomorrow.

The Rudd Government has now entered its third year and the time is right to take a stand on key issues. It's now or never – such reforms take a long time to implement, and failure to get the ball rolling in the current Budget may leave insufficient time for implementation before the next change of Government.

There are many significant challenges confronting Australia; challenges made more acute by the fiscal constraints currently faced by all levels of Government. Fiscal sustainability, reform of State and Federal taxation arrangements, and improving transparency around infrastructure spending are all areas where the Government can take bold actions and make significant improvements.

Both the Henry review and the third Intergenerational Report can play a central role in the Government's framing and presentation of the 2010-11 Budget, and assist in building a narrative for reform. The Government should not be deterred from pursuing significant reforms by the Federal election later this year, and should instead use this Budget as an opportunity to demonstrate a commitment to strong economic management.

To assist the Government with fiscal sustainability and expenditure constraint, none of the recommendations put forward in this submission have a detrimental impact on the Budget bottom line.

Fiscal sustainability

Despite improvements in the economic outlook, the Government's Budget position remains weak over the medium-term. Expected lags between economic activity and tax collections mean that it will take some time for the benefits of stronger economic growth to be fully reflected in the budget position. Even with the positive revenue revisions outlined in the *Mid-Year Economic and Fiscal Outlook (MYEFO)*, deficits of more than $150 billion are projected between 2009-10 and 2012-13, and a return to surplus is not projected until 2015-16.

The Government's medium term fiscal strategy is dependent on a strengthening economy to restore revenues, with limited reliance on expenditure constraint. Despite fully offsetting all policy decisions taken since the 2009-10 Budget, MYEFO forecasts an upwards revision to expenses of almost $8 billion across the forward estimates.

While the resilience of the Australian economy to date is at least in part due to the counter-cyclical fiscal measures implemented by the Federal and State Governments, continued improvements in the economic outlook will shift the focus of the recovery away from Government spending and towards business output. NSW Business Chamber's November 2009 *Business Conditions Survey* indicated that NSW businesses believe business conditions are improving, and that conditions are expected to continue improving over the next three months.

As the economy – and the Government's associated revenue receipts – continue to recover, it will be especially important that the Government demonstrates expenditure restraint and returns the Budget to surplus in a timely fashion. Failure to align expenses and revenue growth would result in unsustainable borrowing to fund recurrent expenditure and ultimately higher taxes, lower investment and employment, and lower standards of living. The Government must ensure that its level of debt is sustainable and manageable over the medium and long term.

It will be necessary to identify significant long-term savings; simply unwinding stimulus measures and making changes at the margin will not be sufficient. Increasing taxes must be avoided as this would have a detrimental impact on productivity, efficiency and growth. It would also be inconsistent with Government commitments to keep taxes as a share of GDP below 2007-08 levels.

Commonwealth / State taxation

Australia's existing intergovernmental financial arrangements present major obstacles to the effective delivery of health services, and to the long-term fiscal viability of the States. Addressing the vertical fiscal imbalance that exists between the State and Federal Governments will put State finances on a more sound footing.

The States' incapacity to finance growing health expenses out of own-source revenue could be overcome by transferring responsibility for these services fully to the Commonwealth, or by granting the States' greater fiscal autonomy. In either case, the chief aim of reforming Australia's intergovernmental financial arrangements is not to reduce vertical fiscal imbalance *per se,* but to improve the delivery of essential government services.

The Commonwealth Grants Commission (CGC) is responsible for recommending GST relativities to be used in apportioning GST revenues between the States and Territories. While achieving HFE is a legitimate objective of GST distributions, the current CGC process is overly complex and convoluted. The CGC formula involves over 400 measures and necessitates complex submissions from each State and Territory Government. The system also penalises States which improve the efficiency of their tax system and rewards those which maintain numerous taxes with narrow bases.

The CGC needs urgent reform to move Federal-State funding relations into the 21st century.

The current CGC formula could be significantly simplified by recognising the strengths of the NSW, Victorian, Western Australian, Queensland and ACT economies, and provide each State and Territory with identical per capita allocations of GST funding. Residual GST funds can then be used to provide additional assistance to Tasmania, South Australia and the Northern Territory, addressing horizontal equalisation challenges.

This reform would improve the transparency of the distribution process and reduce implementation costs of redistribution.

Infrastructure expenditure

Since the onset of the global financial crisis in September 2008, the Government has announced stimulus measures totalling around $95 billion, of which a significant proportion has been allocated to infrastructure. NSW Business Chamber strongly supports investment in critical infrastructure as it enhances national productivity and facilitates a faster rate of long-term growth.

Of the $22 billion announced in the 2009-10 Budget, only a quarter of the funding was allocated to NSW. This is despite the fact that NSW represents a third of the national economy. If NSW businesses are to remain competitive, both domestically and internationally, it is critical that the State receives its fair share of infrastructure investment.

The lack of transparency surrounding the selection of infrastructure projects to date has also been disappointing. While Infrastructure Australia has undertaken a comprehensive assessment of potential projects, it is unclear whether the projects with the greatest public benefit are the ones which have received Government funding. Publication of full cost-benefit analyses of all projects assessed by Infrastructure Australia would ensure that taxpayers can be confident that they are getting value for money.

Recommendations

<u>Recommendation 1:</u>
The Government should outline a clear plan with explicit targets to reduce or moderate expenditure – reaffirming its commitment to return the Budget to surplus as the economy recovers.

<u>Recommendation 2:</u>
GST payments to New South Wales, Victoria, Queensland, Western Australia and the ACT should be equalised on a per capita basis. The remaining States and Territories should continue to receive relatively higher payments to address horizontal equalisation challenges.

<u>Recommendation 3:</u>
The Commonwealth and States should better match tax assignment with expenditure responsibilities, by ending multiple government funding of health.

<u>Recommendation 4:</u>
In allocating funding to infrastructure, the Federal Government should have regard to the importance of NSW to the Australian economy and the significance of its contribution to GDP.

<u>Recommendation 5:</u>
The cost-benefit analysis underpinning all projects assessed by Infrastructure Australia should be fully transparent and made publicly available.

A Climate for Change

The Australian economy has performed better than expected since the 2009-10 Budget. The IMF now expects Australian real GDP growth of 2.5 per cent in 2010, a significant increase from their April 2009 forecast of 0.6 per cent growth.[1] A year ago Australia had just recorded its first quarter of negative growth in a decade and it was commonly thought that a technical recession was inevitable, whereas it now appears that Australia will be one of the only major advanced economies to avoid two consecutive quarters of negative growth.

Prior to the global financial crisis the economy faced capacity constraints and lagging productivity growth. With the collapse of Lehman Brothers in September 2008, these issues were quickly forgotten and replaced by the more immediate concern of minimising the impact of the global downturn. With the worst of the crisis now appearing to have passed, the economy is at a turning point, and the Government will need to tackle real reforms if it is to put Australia back on a high growth path.

Reforms of this kind do not occur organically; they require a driven and motivated Government that is willing to make the difficult decisions today in order to secure better outcomes for tomorrow.

Previous Australian Governments have demonstrated these characteristics. The Hawke and Keating Governments floated the dollar and deregulated the banking sector, while the Howard Government significantly reformed the tax system with the introduction of the GST.

Such reforms are not easy to achieve, nor are they necessarily popular. As Julia Gillard acknowledged, “Long-term reform is difficult work. It’s hard to get right. It’s also hard to convince people of its worth because it involves uncertainty, disruption and upfront investment.”[2]

However, it is equally true that these reforms will be the ones that make the biggest difference to Australians, with positive and lasting impacts on the country’s prosperity. When all is said and done, it is the significant reforms that are remembered as a Government’s legacy.

There are many significant challenges confronting Australia; challenges made more acute by the fiscal constraints currently faced by all levels of Government.

This submission does not attempt to canvass all the issues, however, it does present some of the most pressing concerns faced by the business community where the Federal Government can make a positive and lasting difference. Fiscal sustainability, reform of State and Federal taxation arrangements, and improving transparency around infrastructure spending are all areas where the Government can take bold actions and make significant improvements.

Both the Henry review and the third Intergenerational Report can play a central role in the Government’s framing and presentation of the 2010-11 Budget, and assist in building a narrative for reform. The Government should not be deterred from pursuing significant reforms by the Federal election later this year, and should instead use this Budget as an opportunity to demonstrate a commitment to strong economic management.

In his November 2009 media release, the Treasurer requested that submissions “be mindful of the impacts of the global recession on revenues, as well as the Government's strong commitment to fiscal discipline and the need to offset new spending with savings.” For this reason, none of the recommendations put forward in this submission have a detrimental impact on the Budget bottom line.

[1] International Monetary Fund, *World Economic Outlook,* April 2009, p 65

[2] Julia Gillard, *Address to the 4th Annual Australian National Schools Network Forum,* 17 November 2009

Fiscal Sustainability

The Government's Budget position remains weak over the medium-term. Expected lags between economic activity and tax collections mean that it will take some time for the benefits of stronger economic growth to be fully reflected in the budget position. Even with the positive revenue revisions outlined in the *Mid-Year Economic and Fiscal Outlook (MYEFO)*, deficits of more than $150 billion are projected between 2009-10 and 2012-13, with surpluses not projected until 2015-16. Net debt is now projected to peak at $153 billion in 2013-14, or 10 per cent of GDP.

While performing better than most of its international peers, Australia cannot afford to be complacent and the Government must remain ready to support the economy should the expected recovery stagnate.

The Government has committed to return the Budget to surplus in 2015-16. This is important; using surpluses during the good times to offset deficit spending during downturns will keep debt at sustainable levels. It is reassuring that the Government's medium-term fiscal strategy outlines how this will be achieved.

However, the "deficit exit strategy" presented is largely dependent on a strengthening economy to restore revenues, with limited reliance on expenditure constraint. It is worth noting that despite fully offsetting all policy decisions taken since the 2009-10 Budget, MYEFO still forecasts an upwards revision to expenses of almost $8 billion across the forward estimates. Although such revisions are not due to active policy decisions of Government, they will nonetheless impact on its capacity to get the Budget back into the black.

MYEFO also included a significant upwards revision in the economic outlook since the 2009-10 Budget, with deficits reduced by a total of $36 billion across the forward estimates. Despite the relative improvement in the economic outlook, the projected return to surplus remained in 2015-16. Should economic conditions continue improving in future updates, the Government should endeavour to bring this date forward, and resist the temptation to use these windfall gains to finance additional expenditure.

While the resilience of the Australian economy to date is at least in part due to the counter-cyclical fiscal measures implemented by the Federal and State Governments, continued improvements in the economic outlook will shift the focus of the recovery away from Government spending and towards business output. NSW Business Chamber's November 2009 *Business Conditions Survey* indicated that NSW businesses believe business conditions are improving, and that conditions are expected to continue improving over the next three months. This is consistent with the findings of other business confidence surveys covering Australia more broadly.

As the economy – and the Government's associated revenue receipts – continue to recover, it will be especially important that the Government demonstrates expenditure restraint and returns the Budget to surplus in a timely fashion. Failure to align expenses and revenue growth would result in unsustainable borrowing to fund recurrent expenditure and ultimately higher taxes, lower investment and employment, and lower standards of living. The Government must ensure that its level of debt is sustainable and manageable over the medium and long term.

It will be necessary to identify significant long-term savings; simply unwinding stimulus measures and making changes at the margin will not be sufficient. Increasing taxes must be avoided as this would have a detrimental impact on productivity, efficiency and growth.[3] It would also be inconsistent with Government commitments to keep taxes as a share of GDP below 2007-08 levels.

In this respect, both the Henry review and the third Intergenerational Report (IGR) provide the Government with a rare opportunity to outline plans for significant tax and expenditure reform. The Government has already received the Henry Review, and committed to release it and an initial response early in 2010. Similarly, the Government is currently scheduled to release its third IGR before the 2010-11 Budget. Previous IGRs have highlighted the need to manage growth in government spending, a particularly relevant issue in the current environment.

Recommendation 1:
The Government should outline a clear plan with explicit targets to reduce or moderate expenditure – reaffirming its commitment to return the Budget to surplus as the economy recovers.

[3] ACCI, *Submission to Australia's Future Tax System Review,* October 2008, p. 8-9.

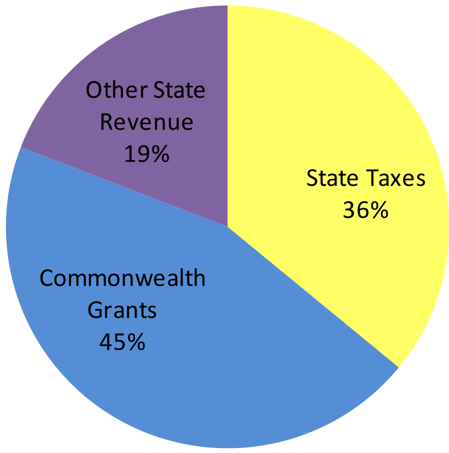
Commonwealth-State Taxation

Vertical fiscal imbalance

Australia's existing intergovernmental financial arrangements present major obstacles to the effective delivery of health services, and to the long-term fiscal viability of the States. Addressing the vertical fiscal imbalance that exists between the State and Federal Governments will put State finances on a more sound footing.

The vertical fiscal imbalance between Australian governments arises because the Commonwealth enjoys the most robust and broad-based taxes, whereas the States depend on taxes that have narrow bases and whose revenues are highly sensitive to changes in the business cycle. This accounts for why, in 2007-08, the Commonwealth collected 84 per cent of total tax revenue in Australia,[4] while Commonwealth grants made up more than 50 per cent of total State revenues.[5]

Chart 1: Sources of NSW Government funding, 2008-09[6]



There is a significant degree of overlap between Australian levels of government in areas such as health, education, economic affairs, housing and community amenities, and recreation and culture. The result is that the Australian Federation suffers from a 'confused mix of responsibilities' along with a lack of transparency and diminished accountability.[7]

Currently, expenditure on health is shared almost evenly between the Commonwealth and the States. As Treasury acknowledges, when citizens can hold either level of government accountable, a State can blame any shortfall in service on inadequate funding from the Commonwealth, while the Commonwealth can blame poor outcomes on either the administrative or financial incompetence of the State.[8]

The problem is further compounded by the fact that pressures on State finances will only intensify. The growth in health service costs is accelerating, owing to Australia's ageing population and rising community expectations.

---

[4] Australian Bureau of Statistics, *5506.0 Taxation Revenue – Australia,* April 2009

[5] NSW Treasury, *Report on State Finances,* 2007-08, p. 3-6

[6] NSW Treasury, *Report on State Finances 2008-09,* p. 1-6, p. 1-32

[7] Neil Warren, *Benchmarking Australia's Intergovernmental Fiscal Arrangements: Final Report,* 2006, p.124

[8] Commonwealth Treasury, *Architecture of Australia's tax and transfer system,* August 2008, p.303

The States' incapacity to finance growing health expenses out of own-source revenue could be overcome by transferring responsibility for these services fully to the Commonwealth, or by granting the States greater fiscal autonomy. In either case, the chief aim of reforming Australia's intergovernmental financial arrangements is not to reduce vertical fiscal imbalance *per se,* but to improve the delivery of essential government services.

Horizontal fiscal equalisation

Australia's process of horizontal fiscal equalisation (HFE) seeks to render States equally able to deliver public services. The Commonwealth Grants Commission (CGC) is responsible for recommending GST relativities to be used in apportioning GST revenues between the States and Territories. In making its recommendations, the CGC applies a process designed to ensure that the smaller States and Territories (the Northern Territory, Tasmania and South Australia) are able to provide services at comparable standard to larger States (New South Wales, Queensland, Victoria and Western Australia).

While achieving HFE is a legitimate objective of GST distributions, the current CGC process is overly complex and convoluted. The CGC formula involves over 400 measures and necessitates complex submissions from each State and Territory Government. The system also penalises States which improve the efficiency of their tax system and rewards those which maintain numerous taxes with narrow bases.[9]

The complexity of the process and the size of the grants pool enable the States to influence their level of receipts from the Government through tax and spending manipulations.[10] Conversely, these same two factors underpin the real, practical constrains on State tax reform.

The complexity of the system was well summarised by the previous Treasurer when he said, "*The State Governments spend huge resources putting their cases to the Commonwealth Grants Commission... In fact, State Treasuries probably spend more time on this than practically anything else.*"[11]

Under the current arrangements, NSW has historically subsidised Queensland, despite Queensland consistently having stronger growth and lower unemployment. Under proposed changes to the formula currently being considered by the CGC, NSW stands to lose a further $2 billion in GST funding over the forward estimates.

The CGC needs urgent reform to move Federal-State funding relations into the 21st century.

The current CGC formula could be significantly simplified by recognising the strengths of the NSW, Victorian, Western Australian, Queensland and ACT economies, and providing each of the State economies a straight line per capita allocation of GST funding.

Tasmania, South Australia and the Northern Territory would continue to receive relatively higher payments. Business recognises that these States and Territories will need additional funding, over and above the per capita allocation of GST, as a means of honouring the Federation's commitment to economic fairness and equality.

Under such a framework, the HFE process would become less critical to the fiscal position of the States. Additionally, the incentive for States to maximise Commonwealth grants through tax and expenditure manipulations would be considerably diminished, if not removed altogether.

This reform would improve the transparency of the distribution process and reduce implementation costs of redistribution.

Recommendation 2:
GST payments to New South Wales, Victoria, Queensland, Western Australia and the ACT should be equalised on a per capita basis. The remaining States and Territories should continue to receive relatively higher payments to address horizontal equalisation challenges.

Recommendation 3:
The Commonwealth and States should better match tax assignment with expenditure responsibilities, by ending multiple government funding of health.

---

9 IPART, *Review of State Taxation: Final Report to the Treasurer,* October 2008, p. 38.

10 Neil Warren, *Benchmarking Australia's Intergovernmental Fiscal Arrangements: Final Report,* 2006, p.90

11 AB News, *Transcript of interview with Peter Costello,* August/September 2005

Infrastructure Expenditure

Since the onset of the global financial crisis in September 2008, the Government has announced stimulus measures totalling around $95 billion, of which a significant proportion has been allocated to infrastructure. In particular, the 2009-10 Budget included a $22 billion investment in transport, communications, energy, education and health infrastructure across Australia.

NSW Business Chamber strongly supports investment in critical infrastructure as it enhances national productivity and facilitates a faster rate of long-term growth. Adequate levels of infrastructure are also essential to encourage business innovation and improve the international competitiveness of Australian businesses.

Of the $22 billion announced in the 2009-10 Budget, only a quarter of the funding was allocated to NSW. This is despite the fact that NSW represents a third of the national economy.

In their *National Infrastructure Priorities Report* of May 2009, Infrastructure Australia identified almost $8 billion of investment in NSW projects which met their rigorous evaluation criteria. Despite this, the Budget included funding for only a quarter of this work.

Once again, it appears that NSW has been left short-changed in the allocation of Federal expenditure. If NSW businesses are to remain competitive, both domestically and internationally, it is critical that the State receives its fair share of infrastructure investment.

The lack of transparency surrounding the selection of infrastructure projects to date has also been disappointing.

On a number of occasions, the Government has publicly stated that the assessment of projects for financing from the Nation-Building Funds would not be influenced by political considerations. For example, the 2008-09 Budget Papers stated that "...specific projects will be subject to rigorous evaluation by Infrastructure Australia[12]," and the Prime Minister stated on 7 October 2008 that assessments by Infrastructure Australia would include "a serious cost-benefit analysis that for the first time will monetise economic, social and environmental costs and benefits."

The Building Australia Fund evaluation criteria, as published by Infrastructure Australia, also explicitly state that proposals *"should demonstrate through a cost-benefit analysis that the proposal represents good value for money."*

The completion of a comprehensive and rigorous cost-benefit analysis is a fundamental prerequisite to the selection of appropriate infrastructure projects. Such analysis allows for an impartial and objective comparison of proposals and demonstrates whether they are worthy of Government financing. Given the real constraints on Government finances, it is essential that investment is directed to those projects that give the biggest bang for their buck.

Publication of cost-benefit analyses would ensure that taxpayers can be confident that they are getting value for money. It is important that the analyses of all projects assessed by Infrastructure Australia are published, not just the ones the Government chooses to finance. While Infrastructure Australia has undertaken a comprehensive assessment of many potential projects, it is unclear whether the projects with the greatest public benefit are the ones which have received Government funding.

Recommendation 4:
In allocating funding to infrastructure, the Federal Government should have regard to the importance of NSW to the Australian economy and the significance of its contribution to GDP.

Recommendation 5:
The cost-benefit analysis underpinning all projects assessed by Infrastructure Australia should be fully transparent and made publicly available.

Should you require further information or clarification of our submission, then please do not hesitate to contact Mr Micah Green, Policy Adviser Tax & Competitiveness on 02 9458 7259 or via e-mail at micah.green@nswbc.com.au.

[12] Commonwealth Treasury, *2008-09 Budget,* Budget Paper 1, page 1-27

invigorating

Contact:
Mr Micah Green
Policy Adviser – Tax & Competitiveness
02 9458 7259
micah.green@nswbc.com.au

NSW Business Chamber
140 Arthur Street
North Sydney NSW 2060

ABN 56 077 016 874

Locked Bag 938
North Sydney NSW 2059

DX 10541 North Sydney

t> 13 26 96

f> 1300 655 277

e> navigation@nswbusinesschamber.com.au