MAY 2009

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Federal Budget 2009

Snapshot

Tough decisions in tough times

The pundits had been tipping a “horror budget” for weeks – a reasonable expectation given well-leaked warnings the deficit would rise to almost $60 billion and unemployment would peak at 8.5% by 2010. Surprisingly, the budget announcements by Wayne Swan last night were not particularly horrific within the context of a world wide recession and a massive blow-out in the deficit. Some cynics believe any real pain will not be felt until well after the next election, but the real reason for the unexpected tameness of this budget lies in the Reserve Bank of Australia’s (RBA) statement 2 weeks ago that this recession may be shallower than it was first perceived to be, with cautious optimism for a recovery beginning within the next 2 years.[1]

Key budget announcements - at a glance

Age Pensioners	Single age pension to rise by $32.49 per week and married pension by $10.14 per week from September 2009. However, eligibility for the age pension is to increase progressively to age 67 by 2023, starting in 2017. The pension ‘income test’ is also more restrictive now.
Family Benefits	18 weeks paid parental leave to be introduced from 2011. However family benefits for high income families will be frozen at current rates for 3 years.
Environment	$3.5 billion to be invested in greenhouse gas reduction over the next 6 years, with a new focus on clean power generation.

"Major infrastructure investment will create jobs and provide a foundation for post-recession growth"

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Health/Medicare	Government to invest $3.2 billion in health infrastructure and increase subsidies for rural services. However, the 30% private health insurance rebate will be tapered downwards for individuals earning over $75,000 and couples earning more than $150,000.
Education	The cap on the number of university places will be removed from 2012, opening up tertiary posts for an additional 50,000 students at a cost of $491 million over four years. There will also be an extra $437 million, again over four years, to boost the number of disadvantaged students in our universities.
Small Business	Tax concession for small businesses with a turnover of less than $2 million increased from 30% to 50% for investments in assets made between December 2008 and December 2009.
Superannuation	The favourable superannuation tax rates remain the same. However, from 1 July 2009 tax deductible contributions to superannuation will halve to $25,000 pa for those under 50 and $50,000 pa for those over 50. From 2012, they will reduce to $25,000 across the board. On a positive note for retirees, the Government announced the 50% reduction in minimum annual payments for Allocated, Account Based and Market Linked (term allocated) Pensions and Annuities will be extended through the 2009/10 financial year.
Infrastructure	$19.5 billion investment to upgrade rail, port and road systems nationwide and $4.6 billion allocated for the national high speed broadband network. This major infrastructure investment will create jobs and provide a foundation for post-recession growth.
First Home Buyers	Continue to be eligible for the increased grant of $14,000 for an existing dwelling and $21,000 for a new home until Sept 30 2009, reducing to $10,500 for an existing home and $14,000 for a new home.

Looking ahead

The government deficit is forecast to be $57.6 billion after last night's initiatives which will be funded by debt and will not be paid off until 2016. Who will pay the price of these increased costs in tough times? It seems the major burden will be borne by the baby boomers and working Australians. The pension age will be raised from 65 to 67, in 6 monthly increments but only starting from 2017, and working Australians will have fewer options to minimise their tax burden by using superannuation. While superannuation generally remains the most tax effective investment environment, Australians can no longer contribute as much while still claiming a tax deduction. Additionally, the government co-contribution will reduce from 150% to 100% for low income earners – nevertheless it remains a very attractive incentive!

There will also be some short-term pain for those on higher incomes, with tighter income-based restrictions on the private health insurance rebate as well as an increase in the Medicare surcharge where taxpayers choose not to take out private health insurance.

From July 1 next year, the 30% private health insurance rebate will be means tested with reductions commencing for singles earning more than $75,000 a year and families with an income greater than $150,000. Nevertheless, as long as high income earners can keep their jobs, they should weather the changes without too much pain.

In fact, this budget could be seen to mark a generational shift in budget strategy - away from the baby boomers who were the greatest beneficiaries of more than a decade of Howard era prosperity, in order to nurture younger Australians who will play a vital role in supporting our rapidly aging population.

Yet in spite of the unexpected "tameness" and long lead times for most of the changes announced last night, this is one of the most controversial budgets ever presented in Australia. Why? Because the Government, faced with a massive shortfall in revenue caused by the collapse of the mining boom and hard economic times worldwide, has made the decision to borrow money to fund the deficit.

"Government to invest $3.2 billion in health, however the 30% private health insurance rebate will be tapered downwards"

Snapshot

Why so much debt?

Wayne Swan's justification for taking this step is based on three arguments. The first is that the infrastructure investment program is essential for a speedy recovery from the recession and to limit the blow-out in unemployment to single digit figures.

The second is that the only alternative to incurring the debt would be to raise taxes sharply or cut services drastically. Both these measures are politically undesirable and potentially inappropriate in the face of rising unemployment and rapidly slowing economic growth.

The third is that the RBA predicts the recession may be shallower than was first feared, even though this current financial year will be worse than last year in terms of unemployment and economic growth.[2] The fact remains - Australia is currently in a far stronger position than most other developed economies and the RBA has expressed cautious optimism the economy will deliver positive growth rates of 4.5% pa by 2012, hence the prediction that we should be back in the black by 2016.[3]

However, the Opposition disagrees strongly with this decision and has accused the Government of recklessly borrowing $9,000 on behalf of every man, woman and child in Australia. The Shadow Treasurer, Joe Hockey, exclaimed – "buy now, pay later" is what you do at Harvey Norman, not what you do if you are Wayne Swan".[4]

Of course, this is an argument based as much on political values as economic theory – a classic clash between fiscal conservatives who believe in as little government intervention as possible, and fiscal liberals who believe that the government has a role to play in times of financial crisis and in the cause of social equity.

Only time will tell if Wayne Swan is right or wrong in his assumption (shared by the Reserve Bank) that the Australian economy should be on the rise again by 2011. We can only hope he is right!

1 The Age 12th May 2009
2 ABC – Lateline Business 12th May 2009
3 Emma Rodger, ABC News
4 ABC – Lateline Business 12th May 2009

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FIRST CAPITAL FINANCIAL PLANNING

First Capital Financial Planning
8/15 Castlereagh Street
Sydney NSW 2000

T 02 9222 1202
F 02 9222 1240
www.edplan.com.au