

STATEMENT 1: FISCAL STRATEGY AND BUDGET PRIORITIES

The Government's fiscal strategy puts Australia at the forefront of the developed world. The 2004-05 Budget puts in place a series of major initiatives aimed at boosting Australia's economic growth potential, and addressing the ageing of the population through increased participation and productivity.

In this Budget the Government introduces large increases in assistance to families, improves incentives for women to re-enter the workforce after having children, continues its commitment to structural tax reform and by increasing the co-contribution to superannuation, provides significant incentives to save for retirement.

The Government's *More help for families* package will provide substantial assistance and improved rewards from work for families through changes to the Family Tax Benefit (FTB), along with a one-off lump sum payment to all families who are eligible for, or receive FTB (A) in 2003-04.

The Government will also improve the rewards from work by lifting tax thresholds so that more than 80 per cent of Australians will be in the 30 per cent tax bracket or lower, with effect from 1 July 2004.

The Budget enhances the co-contribution to superannuation, boosting incentives for low and middle income earners to make additional superannuation contributions. Further cuts to the superannuation surcharge will also boost retirement savings.

The Government is also seeking to improve productivity through a \$5.3 billion boost to science and innovation, as well as \$3.1 billion funding for AusLink, the new land transport infrastructure programme.

With the improvement of international economic conditions with growth in the United States, Japan and South-east Asia, the Australian economy is forecast to continue to grow strongly at 3 ½ per cent with unemployment forecast to remain at 23 year lows of 5 ¾ per cent.

Having met the need for further family assistance, tax cuts, and for spending in priority areas, the Budget is still forecast to be in surplus with an underlying cash balance of \$2.4 billion in 2004-05.

CONTENTS

Fiscal outlook	1-3
Economic outlook	1-4
Fiscal strategy	1-5
Budget strategy and priorities	1-6
Participation.....	1-9
Work and savings incentives.....	1-9
More help for families	1-9
Income tax cuts	1-11
Incentives to save for retirement.....	1-13
The capacity to work	1-14
More flexible work options — balancing work and family	1-14
Investing in Australia’s health.....	1-15
Investing in Australia’s science and innovation.....	1-17
Investment in Australia’s infrastructure — <i>AusLink</i>	1-18
Investing in Australia’s security	1-18
Our land, environment and people.....	1-20
Support for the Commonwealth Games.....	1-22
Appendix A: Medium-term Fiscal Strategy.....	1-23

STATEMENT 1: FISCAL STRATEGY AND BUDGET PRIORITIES

FISCAL OUTLOOK

The fiscal outlook for Australia remains positive, with the forecast of a seventh Budget surplus. Australia is in a much stronger fiscal position than most comparable economies. Across the forward estimates, the Government has maintained the budget in surplus, after providing for its *More help for families* package, consisting of \$19.2 billion for assistance to families, \$14.7 billion for structural tax reform and \$2.7 billion to boost retirement savings.

The 2004-05 Budget puts in place a series of major initiatives, particularly enhanced family assistance and further tax reforms, aimed at boosting Australia's medium-term growth potential and addressing the ageing of the population through increased participation and productivity.

An underlying cash surplus of \$2.4 billion is expected in 2004-05 compared with an estimated surplus of \$3.8 billion at the *Mid-Year Economic and Fiscal Outlook 2003-04* (MYEFO). Underlying cash surpluses continue to be projected across the forward estimates.

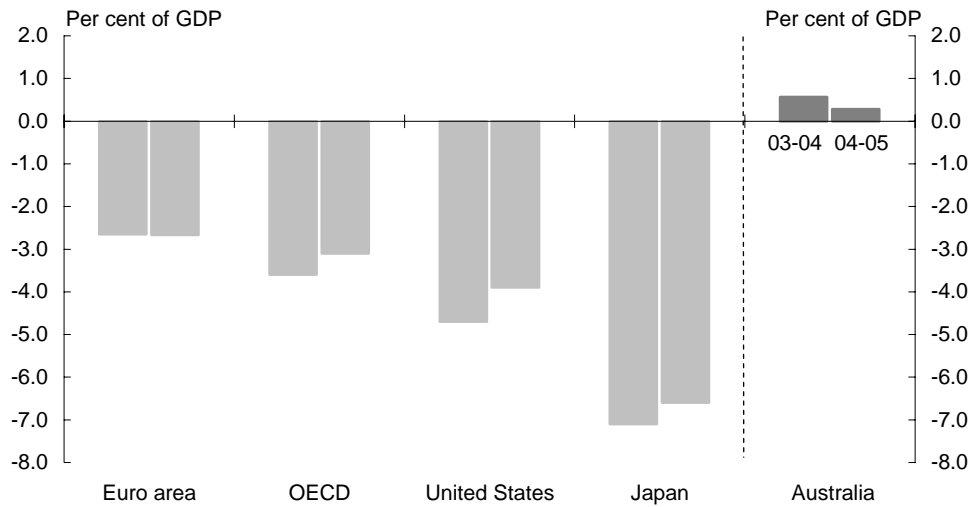
Table 1: Budget aggregates

	Actual	Estimates		Projections		
	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Underlying cash balance (\$b)	7.5	4.6	2.4	1.6	3.4	4.5
Per cent of GDP	1.0	0.6	0.3	0.2	0.4	0.4
Fiscal balance (\$b)	6.0	3.0	0.7	0.7	2.3	2.6
Per cent of GDP	0.8	0.4	0.1	0.1	0.2	0.3

In accrual terms, a fiscal surplus of \$0.7 billion is now expected for 2004-05 compared to a surplus of \$1.6 billion estimated at MYEFO.

Australia's very strong fiscal position compared to most comparable developed economies is highlighted in Chart 1. The latest OECD projections show that most of the major advanced economies are expected to record deficits in 2004 and 2005. The United States is expected to record a deficit of 4.9 per cent of Gross Domestic Product (GDP) in 2005, with significant deficits also expected in Japan and the European area.

Chart 1: International comparison of budget balances 2004 and 2005



Source: OECD Economic Outlook 74 December 2003 and Budget Paper No. 1, *Budget Strategy and Outlook 2004-05*.

ECONOMIC OUTLOOK

The outlook for the Australian economy is for continued growth, with increasing employment and low inflation. A stronger world economy in 2004-05 will support a rebalancing of growth from domestic to external sources. In year-average terms, GDP growth is forecast to moderate slightly from 3¾ per cent in 2003-04 to 3½ per cent in 2004-05. The recovery in farm production will continue, assuming average seasonal conditions.

Unemployment is forecast to remain near 23 year lows during 2004-05, supported by moderate wage outcomes. The combination of strong growth, low inflation and low unemployment represents a sound basis for future growth and is a major achievement for the Australian economy.

Table 2: Major economic parameters (percentage change from previous year)

	Forecasts		Projections		
	2003-04	2004-05	2005-06	2006-07	2007-08
Real GDP	3 3/4	3 1/2	3 1/2	3 1/2	3 1/2
Employment(a)	1 3/4	1 3/4	1 1/2	1 1/2	1 1/2
Wages(b)	3 3/4	3 3/4	3 3/4	3 3/4	3 3/4
CPI	2 1/4	2	2 1/2	2 1/2	2 1/2

(a) Labour force survey basis.

(b) Wage Cost Index.

Source: Australian Bureau of Statistics (ABS) Cat. No. 5206.0, 6202.0, 6401.0, 6345.0 and Treasury.

FISCAL STRATEGY

The Government's medium-term fiscal strategy is an integral part of a macroeconomic framework through which the economy can deliver sustainable economic growth, rising employment and higher living standards.

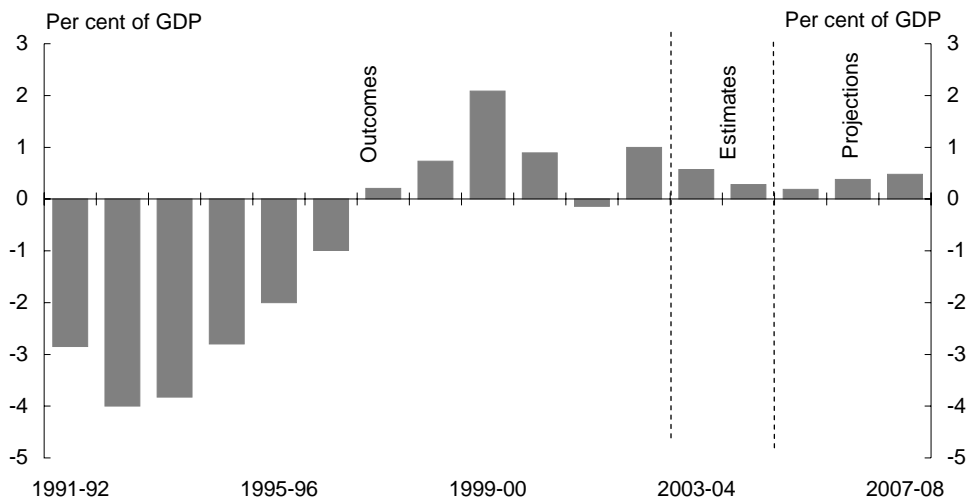
A medium-term approach to fiscal policy

The primary objective of the Government's medium-term fiscal strategy is to maintain budget balance, on average, over the course of the economic cycle. This ensures that the Government is not living beyond its means. It helps deliver macroeconomic stability, encourages private investment in a low interest rate environment, entrenches low public debt and ensures that, over time, the current account reflects private saving and investment decisions.

The Government's medium-term fiscal strategy has a number of supplementary objectives, including maintaining budget surpluses over the forward estimates period while growth prospects are sound, not increasing the overall tax burden from 1996-97 levels and improving the Australian Government's net worth position over the medium to longer-term. The supplementary objective of no increase in the overall tax burden means that the Government achieves balance over the cycle through a disciplined and prioritised approach to spending and not by recourse to increased taxation.

Over the seven years to 2003-04 the Australian Government's cumulative underlying cash surpluses have amounted to around \$35.7 billion (Chart 2).

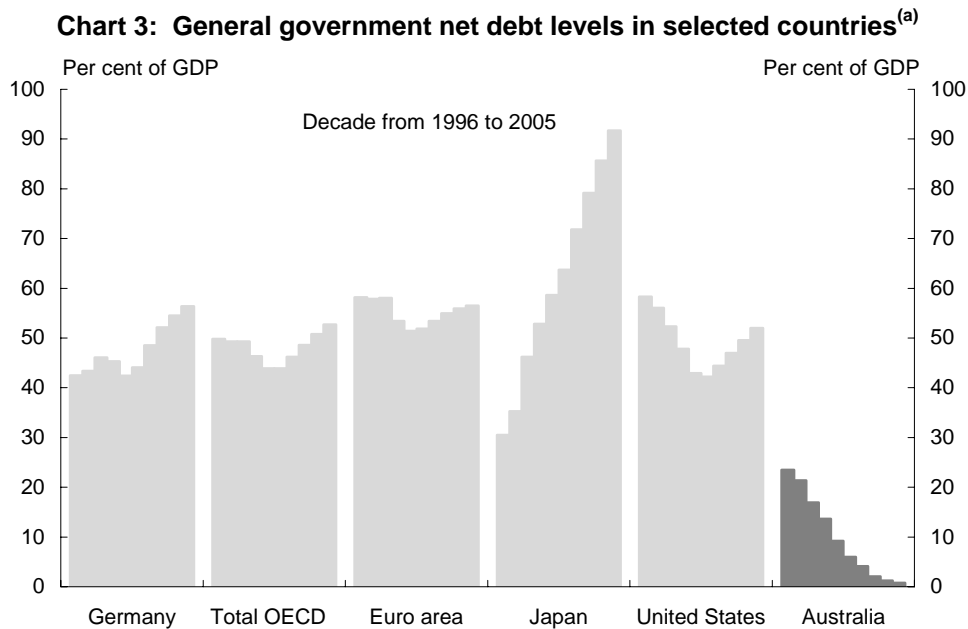
Chart 2: Underlying cash balances



The long-term fiscal pressures facing the Australian Government place a premium on maintaining good fiscal policy in the years ahead. The Government has a strong record

Part 1: Fiscal Strategy and Budget Priorities

on fiscal policy and in particular fiscal sustainability, having already delivered a major reduction in the level of general government net debt. Australia now has one of the lowest levels of net debt in the OECD (Chart 3).



(a) International data are sourced from OECD Economic Outlook 74 December 2003. Australian data are sourced from Statement 12, Table A4. All data are for the total general government sector.

The Government's supplementary objective of improving net worth over time from the significantly negative position inherited from the early 1990s, contributes to fairness and equity between generations. The improvements in net debt and net worth have been made possible by adherence to the primary objective of balancing the budget over the cycle.

Full details of the medium-term fiscal strategy are set out in Appendix A to this statement.

BUDGET STRATEGY AND PRIORITIES

The release by the Government of the Budget Paper No. 5, *Intergenerational Report 2002-03* with the 2002-03 Budget highlighted that, due to the projected doubling in the proportion of the population aged 65 or more and other factors, there will be significant increases in government spending on areas such as health, aged care and age pensions over the next 40 years. At the same time, it projected that growth in the proportion of the population of workforce age will slow to almost zero over that period.

Statement 1: Fiscal Strategy and Budget Priorities

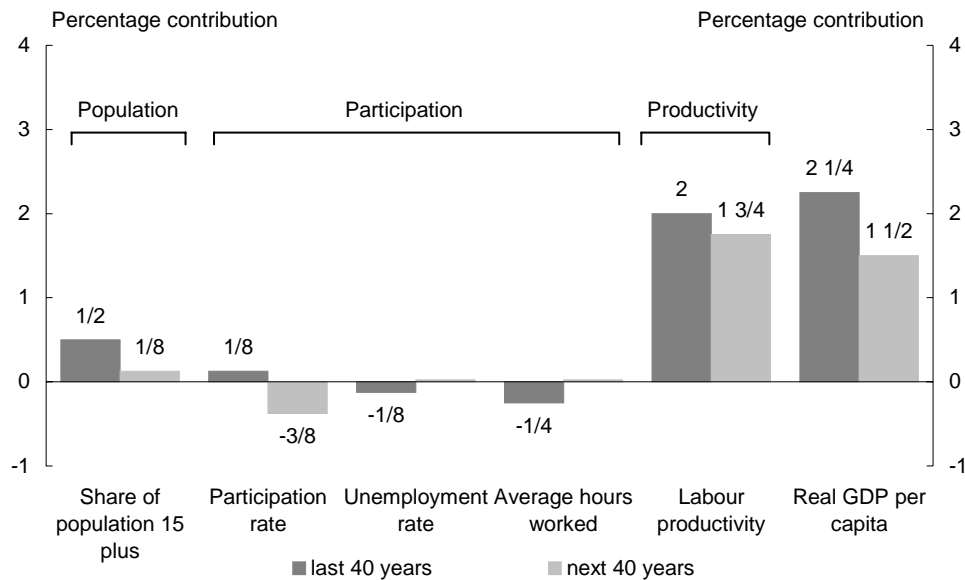
As a result, the Intergenerational Report projected that there would be a gap between the level of Government spending and the revenue raised through taxes of around five per cent of GDP by 2042.

Such a gap can be addressed in a number of ways:

- One way is to increase taxes. A second is to run large deficits and leave the resulting debt burden to future generations. The Government does not support either of these alternatives.
- A third alternative is to cut government expenditure. The Government is taking steps to ensure that spending in areas such as health and social security is maintained at sustainable levels into the future. However, announced measures such as increasing co-payments under the Pharmaceutical Benefits Scheme and moderating the growth in spending on the Disability Support Pension are yet to be passed by the Senate. Whilst expenditure restraint is an integral part of meeting the demographic challenge, the scope for reducing expenditures is not sufficient to meet the demographic challenge.
- A fourth, preferred approach is to grow the economy faster so that Australia generates sufficient income to enable it to continue to improve living standards and meet the increased costs associated with an ageing population, without increasing taxes as a proportion of GDP or leaving higher debt burdens for future generations.

Chart 4 shows the contributions that population growth, labour force participation and productivity in the economy have made to real average annual growth in GDP per person in Australia over the past 40 years and the projections for the next 40 years. Those projections indicate that, in the absence of policy changes, it is likely that real GDP per person will slow to around 1½ per cent per annum over the next 40 years, relative to around 2¼ per cent per year over the past 40 years. This is due largely to the negative contribution to growth of the projected decline in labour force participation – a direct result of the ageing of the population – and a return to the long term growth rate of productivity of 1¾ per cent a year.

Chart 4: Contributions to GDP per capita growth



These issues have been explored in depth in the Discussion Paper *Australia's Demographic Challenges* released by the Treasurer in February 2004. That paper highlights the need to take early action to increase productivity and labour force participation. It notes that the sooner steps are taken to address these issues, the more successful Australia will be in boosting its medium-term growth potential and addressing the ageing of the population that is already underway.

Boosting GDP per capita growth is valuable for other reasons, but it will also help to address the fiscal challenge highlighted by the Intergenerational Report. Other things being equal, participation and productivity measures that contributed an additional half of a percentage point to average annual GDP per capita growth would prevent government spending from increasing as a proportion of GDP as the population ages.

The 2004-05 Budget puts in place a package of major initiatives that address directly these key objectives of increasing participation and productivity. Together, they represent a further significant step in the Government's programme of economic and social policy reform that, over time, will ensure that Australia is able to continue to lift its standard of living, while also dealing effectively and sustainably with the ageing of its population.

The major initiatives in this Budget are consistent with these longer-term objectives. They assist with the cost of raising children, reduce welfare traps for those receiving family tax benefits and deliver tax cuts to increase the rewards from working.

Participation

Australia's Demographic Challenges set down three key areas where action is needed to improve labour force participation:

- improving incentives to work and save for retirement;
- improving the capacity of people to undertake work; and
- supporting more flexible work options.

Work and savings incentives

The centrepiece of the 2004-05 Budget is the Government's *More help for families* package that continues the Government's commitment to assist Australian families, ongoing structural tax reforms and incentives to save for retirement. The total package amounts to \$37 billion over five years. There are three elements:

- increased assistance to Australian families and reductions in effective marginal tax rates for families;
- income tax cuts to reduce the disincentive of high marginal tax rates; and
- incentives to save for retirement through an enhanced superannuation co-contributions scheme and a reduction in the superannuation surcharge.

The package builds on the substantial reforms put in place under *The New Tax System*.

More help for families

The 2004-05 Budget includes the largest package of assistance for families ever, with an additional \$19.2 billion being provided over five years. The package builds on, and expands, the large increases in assistance for families introduced in *The New Tax System* in 2000 and the Family Tax Initiative announced in 1996.

The package increases the adequacy of assistance for all families with dependent children and improves rewards from work for low and middle income families in particular.

It includes the following elements:

- An increase in the rate of Family Tax Benefit (FTB) (A) of \$600 per child to be paid as a lump sum upon reconciliation of entitlement following the end of the financial year, commencing in respect of the 2003-04 financial year. The annual lump sum will be available, if required, to offset any overpayment of FTB that may have occurred during a previous year. FTB (A) is currently payable to families with

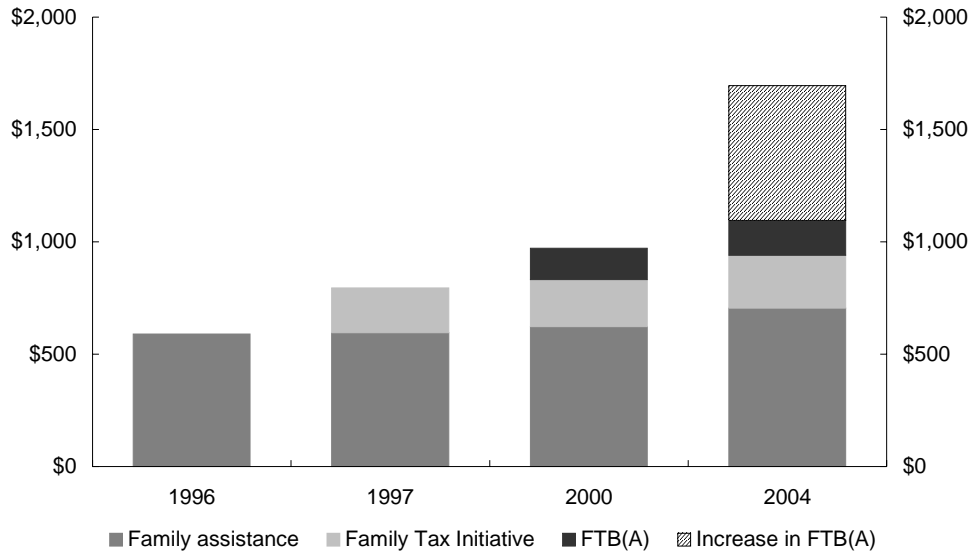
Part 1: Fiscal Strategy and Budget Priorities

incomes up to \$85,702 for one child, \$92,637 for two children and \$99,572 for three children.

- In order to provide an immediate benefit a lump sum payment of \$600 per child will be paid before 30 June 2004 to all families receiving or eligible for FTB (A) in the 2003-04 financial year. This means eligible families will receive \$600 per child before 30 June 2004 and be entitled to a further \$600 per child after the reconciliation of their 2003-04 entitlement. As a consequence most families will be eligible for an additional \$1,200 per child in the next 12 months.
- A reduction in the income test taper rate for the maximum rate of FTB (A) from 30 per cent to 20 per cent, with effect from 1 July 2004. This builds on the taper reduction from 50 per cent to 30 per cent undertaken in *The New Tax System*. This will improve rewards from working for low and middle income families. In particular it means that for each additional dollar of income, eligible families lose only 20 cents rather than 30 cents of family payment. Combined with the \$600 per child per annum rate increase, it will provide substantial additional assistance to families with incomes up to \$87,702 for one child and higher levels for subsequent children.
- A relaxation of the income test for FTB (B), with the income test threshold for the secondary earner in a family being increased from the current level of \$1,825 a year to \$4,000 a year and the income test taper being reduced from 30 per cent to 20 per cent:
 - this too builds on the income test relaxations in *The New Tax System*, which also increased the rate of FTB (B). The current maximum rate is \$2,920 per year for a family with a child under five and \$2036.70 for families with a child aged between five and 16;
 - it will improve incentives for a second earner in a family to take up part time or casual work, providing additional assistance for those combining work and family responsibilities.
- Mothers returning to work will also be assisted by the quarantining of FTB (B) payments. This means that income they receive from returning to work will not count against their eligibility for FTB (B) already received in that year prior to commencing work.
- The introduction from 1 July 2004 of a new Maternity Payment, paid as a lump sum, of \$3,000 for each new born child. This will be a universal payment to all families (usually the mother). This payment will increase to \$4,000 from 1 July 2006 and increase again to \$5,000 from 1 July 2008. This new payment will incorporate the existing Maternity Allowance and the Baby Bonus, with the Baby Bonus still available for births prior to 1 July 2004.

Chart 5 below shows the total increase in the base rate of assistance for families through FTB (A) and its predecessors since 1996. Over this period the Government has increased the maximum and base rates of payments by \$940 per child per year – a real increase in the base rate of over 100 per cent.

Chart 5: Increases in base rate per child assistance to families since 1996



Income tax cuts

Building on the substantial income tax cuts provided in *The New Tax System* and in the 2003-04 Budget, the Government will introduce new thresholds for marginal tax rates which will cut income tax by \$14.7 billion over four years. This will ensure that high marginal tax rates are not a disincentive for those taking on additional work, wishing to work overtime, seeking promotion or improving their skills or productivity. The thresholds will be lifted in two stages:

- from 1 July 2004 the 42 per cent threshold will be increased from \$52,001 to \$58,001 and the 47 per cent threshold will be increased from \$62,501 to \$70,001;
- from 1 July 2005 the 42 per cent threshold will be further increased to \$63,001 and the 47 per cent threshold to \$80,001.

Table 3: New personal tax rates

Current tax thresholds Income Range (\$)	New tax thresholds from 1 July 2004 Income Range (\$)	New tax thresholds from 1 July 2005 Income Range (\$)	Tax rate
0 - 6,000	0 – 6,000	0 – 6,000	0
6,001 - 21,600	6,001 – 21,600	6,001 – 21,600	17
21,601 - 52,000	21,601 – 58,000	21,601 – 63,000	30
52,001 – 62,500	58,001 – 70,000	63,001 – 80,000	42
62, 501 +	70,001 +	80,001 +	47

Improved rewards from participating in the workforce will flow from taxpayers being able to earn more without moving into a higher tax bracket and from moving taxpayers onto lower marginal tax rates.

- The income range over which the 30 per cent marginal tax rate will apply will be significantly increased with the result that more than 80 per cent of taxpayers will be in the 30 per cent tax bracket or lower over the forward estimates period.
- Taxpayers on average full-time weekly earnings will remain in the 30 per cent tax bracket over the forward estimates period, even allowing for ongoing wages growth.
- The increase in the top threshold will make Australia’s personal tax system more internationally competitive, providing incentives for skilled Australians to stay and work in Australia.

The combined effect of the three stages of tax reform has been to deliver significant tax cuts for all Australians.

- Taxpayers earning \$20,000 paid \$2,770 in income tax prior to *The New Tax System* (excluding the Medicare levy) whereas taxpayers on that income would now only pay \$2,145, a reduction of around 23 per cent in tax.
- Taxpayers on \$50,000 (around average weekly earnings) paid \$14,102 in income tax prior to *The New Tax System* (excluding the Medicare levy), compared with \$11,172 now, a reduction of around 21 per cent.
- By 1 July 2005, a taxpayer on \$90,000 who paid \$32,902 in tax prior to *The New Tax System* (excluding the Medicare levy) will pay \$26,912 in tax in 2005-06, a reduction of around 18 per cent.

In an increasingly globalised world economy with increased mobility of both capital and labour, it is critical that Australia maintains an environment that is competitive with other developed nations. The income tax cuts outlined in this Budget will help ensure that Australia is able to retain people with highly regarded skills. This

complements the measures the Government has implemented and proposed arising from the *Review of International Taxation Arrangements*.

Overall, these changes to family assistance, and the tax scales will significantly assist families with the costs of raising children. They will also improve rewards from work for Australian taxpayers and families by reducing tax and easing the withdrawal of family assistance.

Incentives to save for retirement

The Government's retirement income policy provides incentives to make additional voluntary savings through the superannuation system for those who want more retirement income than the current compulsory superannuation and social security arrangements will provide.

The Government will provide \$2.1 billion over the next four years to enhance the superannuation co-contribution scheme. This will significantly boost incentives for low and middle income employees on incomes up to \$58,000 per year to make additional personal superannuation contributions.

In this Budget, the Government co-contribution will be increased to 150 percent of an employee's contribution up to a maximum of \$1,500. The income threshold, up to which the maximum co-contribution applies, will increase to \$28,000 (from \$27,500) and extend the maximum benefit to a significantly wider number of employees. The maximum co-contribution will reduce by 5 cents for each dollar of income to phase out completely at \$58,000. Currently the co-contribution phases out completely at \$40,000. People on incomes between \$40,000 and \$58,000 will become eligible for a co-contribution for the first time.

These enhancements build on the extension of the co-contribution arrangements announced by the Government on 14 March 2004 to cover more low income earners at a cost of \$195 million over the forward estimates period.

The Government will also further reduce the maximum superannuation surcharge rates to increase the incentive for higher income individuals to make contributions, at a cost of \$610 million over the next four years. The rate will progressively reduce from its original level of 15 per cent to 7.5 per cent in 2006-07. Low and middle income earners will receive more than three quarters of the benefits of these superannuation changes.

The Government is also seeking to make the retirement income system more flexible by broadening the availability of superannuation, providing more choices in financing retirement income, making superannuation more adaptable to changing work arrangements and improving the integrity of the system. These changes were announced on 25 February 2004 in the statement, *A more flexible and adaptable retirement income system*.

The capacity to work

As noted in *Australia's Demographic Challenges*, equipping people with adequate skills is an important determinant of their capacity to participate in the labour force. Equally, ensuring that people remain healthy increases their capacity to participate.

The Government has announced a series of major initiatives over the past year that will contribute to improving educational outcomes and, over time, the level of skills in society. These include the higher education reforms announced in the 2003-04 Budget, the new vocational education arrangements with the States (also announced in the 2003-04 Budget) and most recently, the new funding arrangements for schools. Over the next four years, the Government will increase funding for schools by over \$8 billion to \$32 billion in total. This will provide additional funding for both government and non-government schools.

In this Budget, the Government has also allocated funding for its expanded commitment to improving early childhood development through early intervention programmes that help young children grow up in stable and supportive environments. These programmes focus on children in need and aim to improve their life chances so that they can have a substantive and productive involvement in society as they grow up.

Since coming to office, the Government will have doubled funding for health and aged care by 2004-05. The Government's \$2.85 billion MedicarePlus package ensures that Australians have continued access to affordable primary health care. Along with the Government's \$42 billion contribution to the cost of hospital care and the funding of the Pharmaceutical Benefits Scheme, it ensures that high quality, affordable health care is available quickly for those who need it. This is supported by substantial investment in preventative health measures. Together, these programmes ensure that Australians are able to remain healthy and participate in the workforce and the community.

More flexible work options — balancing work and family

Since 1996, the Government has put in place a wide range of measures that are aimed at enhancing workplace flexibility. The *Workplace Relations Act 1996* has simplified labour relations and allowed employers and employees to tailor wages and conditions to the specific skills and needs of particular individuals and jobs. However, further flexibility is needed. Accordingly, the Government has sought for some time to reform unfair dismissal laws, improve bargaining processes and other improvements. These remain before the Senate.

The availability of flexible work options, such as part time and casual work, can make a substantive contribution to increasing overall participation in the labour force. Many people, particularly women combining work and family responsibilities, prefer such flexible arrangements. It is important that the labour market accommodates such

choices and that supportive policies, such as child care, are available to people wanting to exercise such choices.

In this Budget, the Government demonstrates its ongoing commitment to assisting families balancing work and family commitments. The new Maternity Payment will assist families at the birth of each child. In addition, the Government will increase significantly its commitment to supporting the provision of quality and affordable child care. Additional measures include an expansion of the number of outside-school-hours care places by 40,000 and an expansion of family day care places by 4,000. These additional places will help support working families, particularly women wishing to re-enter the labour force after having children.

Investing in Australia's health

The Government's ongoing policy reform process is focused on long term economic and social objectives of enhancing the living standards of all Australians and dealing with our ageing population. This Budget furthers that process by boosting support for carers, improving access and quality of aged care and meeting our obligations to our veterans.

Investing in Australia's aged care: more places, better care

Following the Review of Pricing Arrangements in Residential Aged Care, the Government is providing \$2.2 billion over five years to ensure that the aged care sector is able to continue to provide affordable and quality aged care for the increasing number of older Australians requiring aged care services ensuring fair and equitable access. Importantly, it will enhance the efficiency and viability of the sector, improving the capacity of providers to generate sufficient income to enable them to finance the ongoing expansion of the supply of places required as the population ages.

Major elements of the package are:

- increased subsidies to providers for the care of residents through the introduction of a Conditional Adjustment Payment. This will deliver an extra \$878 million in recurrent resources;
- an additional \$101 million for improving the aged care workforce through funding for training specialised aged care nurses and the upgrading of skills;
- additional funding of \$58 million in 2006-07 and 2007-08 to enable the Government to meet its 2001 election commitment of 108 aged care places for every 1000 Australians aged 70 years or more; and
- an increase in accommodation charges for new high-care residents by up to \$2.34 per day to \$16.25 per day to improve providers' ability to finance expanded and improved facilities, with a corresponding increase in subsidies for financially

Part 1: Fiscal Strategy and Budget Priorities

disadvantaged residents. This will deliver an additional \$439 million in capital funding.

The Government will also provide \$513 million in 2003-04 to finance improved safety and building standards for aged care homes, developed and agreed with the industry. A one-off \$3,500 payment will be made to providers for each resident in an aged care facility before 30 June this year.

Recognising the contribution of carers

Carers provide a great service to the community through supporting and caring for those with disabilities. The Government values this contribution and is providing an additional \$461 million to carers over five years from 2003-04 to 2007-08 with the following components:

- \$255 million for a one-off carer bonus to be paid in June 2004. Recipients of Carer Payment will receive a \$1,000 payment, and recipients of Carer Allowance will receive a \$600 payment, in recognition of their contribution in their role of carer to someone with a disability;
 - Carer Payment is paid to a person with limited other income who provides constant care for someone with a disability, while Carer Allowance is an income supplement paid to someone who lives with and provides daily care and attention to a person with a disability;
- \$107 million to expand the eligibility criteria for Carer Allowance to enable carers who provide at least 20 hours of personal care per week but do not live with the care recipient to receive the payment; and
- \$99 million to expand the access of carers to respite services. Ageing parents caring for adult children will be entitled to up to four weeks respite a year, depending on their circumstances, subject to matched funding from the States. Young carers aged under 25 years will benefit from expanded access to in-home respite care in addition to a range of information, referral and advice services. This will support young carers at risk of leaving education prematurely and not completing secondary or equivalent education.

Additional support for veterans

The Government places a high priority on meeting its obligations to those who have served in the defence of Australia. This Budget provides additional funding to veterans of \$443 million. Key measures are:

- a \$289 million package over five years to provide extra assistance to veterans and their families in response to the Clarke Review. This includes a new Defence Force Income Support Allowance, payable to certain disability pensioners who also receive income support payments; indexation of the above general rate component

Statement 1: Fiscal Strategy and Budget Priorities

of disability pension according to movements in male total average weekly earnings; and payment of rent assistance to war widows in addition to the income support supplement;

- \$158 million over four years to ensure that veterans can continue to have access to medical specialists by increasing the fees the Government pays to specialists for seeing veterans; and
- redevelopment of the Australian War Memorial's Post-1945 Galleries and continuation of the existing commemorations programme and the repair and replacement of war graves programme.

Investing in Australia's science and innovation

In this Budget, the Government continues to put in place measures that will contribute to a policy framework that promotes productivity growth. These measures build on the substantive reforms put in place since 1996, including the medium term monetary and fiscal policy framework, personal, company and indirect tax reform, labour market reforms, enhancement of financial sector regulation, reductions in tariff assistance, competition reforms and commercialisation and privatisation of government business enterprises.

Science and innovation plays a crucial role in lifting Australia's future productivity. They significantly enhance economic growth and create new employment opportunities.

A key feature of this Budget is the extension of the Government's Backing Australia's Ability (BAA) package. The successor programme, *Backing Australia's Ability – Building our Future through Science and Innovation*, will provide funding of \$5.3 billion over seven years from 2004-05, a sizeable contribution that reaffirms and strengthens the Government's ongoing commitment to science and innovation. Key elements of the package include:

- an ongoing commitment to high quality research through:
 - additional funding for bodies such as the Australian Research Council (additional funding of \$1.2 billion over seven years), the National Health and Medical Research Council (an additional \$200 million over seven years) and CSIRO (an additional \$305 million over seven years will be invested in the National Flagships Initiative);
 - funding of \$542 million for the National Collaborative Research Infrastructure Strategy which will link Australian Government investment in research infrastructure to the national research priorities;
- additional funding for the commercialisation of research through:

Part 1: Fiscal Strategy and Budget Priorities

- \$1 billion for the new Commercial Ready Programme that will provide support to firms to undertake research and development with strong commercialisation potential;
- an extra \$100 million over seven years for the Commercialising Emerging Technologies Programme which provides innovators with advice and financial assistance to plan their commercialisation, attract capital for their project and to establish strategic partnerships to take the innovation to market; and
- initiatives that develop critical skills, including in disciplines such as mathematics and science.

Investment in Australia's infrastructure — *AusLink*

The provision of quality physical infrastructure is crucial to increasing efficiency and productivity in the economy. In this Budget, the Government will introduce a new land transport infrastructure programme — *AusLink*.

Over the next five years, an additional \$1.9 billion will be allocated to upgrade Australia's road and rail systems. This includes \$810 million over three years from 2006-07 redirected from the Fuel Sales Grants Scheme announced in January 2004 and a grant of \$450 million in 2003-04 to the Australian Rail Track Corporation. This sum will be used to invest in new rail infrastructure projects on the interstate rail system. This additional national network funding will position Australia to cope with an expected doubling of the land freight task over the next 20 years.

In January 2004, the Government also announced the extension, for four years from 2005-06, of the Roads to Recovery programme costing \$1.2 billion within the *AusLink* framework.

The *AusLink* White Paper will be released in June 2004.

Investing in Australia's security

A strongly performing economy can only be sustained within a safe and secure environment for our nation and community.

The heightened threat posed by terrorism continues to require the Government to move quickly to upgrade national security arrangements. A strong defence capability, aligned with Australia's strategic interests, also remains a key priority for the Government.

The 2004-05 Budget provides a further \$755 million over the five years from 2003-04 to improve intelligence capabilities; incident response; protective security; border security; and security capacity and cooperation in the region. In total, the Government

Statement 1: Fiscal Strategy and Budget Priorities

has committed \$3.1 billion over seven years since 11 September 2001 to make Australia more safe and secure. This Budget includes:

- \$270 million to strengthen Australia's intelligence capabilities including through increased funding for continuing to build the capabilities of the Australian Security Intelligence Organisation (ASIO) (\$127 million over four years) and the Australian Secret Intelligence Service (ASIS) (\$46 million over four years), and enhancing Defence's intelligence operations and analytical capability (\$47 million over four years);
- an additional \$207 million to upgrade protective security, including expansion of the Air Security Officer programme to include additional priority international destinations;
- \$40 million to build further Australia's capacity to respond to incidents. The national medicines stockpile will be expanded and improvements will be made to the biosecurity surveillance system;
- \$150 million to help secure Australia's borders, through more robust identity verification processes utilising biometric technology and an integrated global visa processing system; and
- a further \$87 million to improve security capacity and cooperation in the region, including through the Australian Federal Police.

In recent years, the Government has provided substantial new funding for significantly enhanced defence capabilities and levels of preparedness, and provided for the Australian Defence Force's participation in international operations. The 2004-05 Budget continues this approach. Measures in the 2004-05 Budget exceed \$1.5 billion over five years, bringing to \$39.7 billion the total amount of additional defence spending by the Government since 1996. Key measures include:

- a continued commitment to participation in international operations. The Government will provide \$132 million for the Australian Defence Force's contribution to the stabilisation and reconstruction of Iraq. This will allow for continuation of the deployment through financial year 2004-05. The timeframe for, and composition of, Australia's commitment in Iraq will be kept under review. The Government will also provide \$20 million for an expected extension of Defence's contribution to the United Nations mission in East Timor;
- a further \$205 million funding for logistics support, including for the F/A-18 fighter aircraft fleet and Collins class submarines, along with an additional \$610 million over four years for other high priority platforms including the refit of the HMAS *Success* and support for PC-9 aircraft and army and naval aviation; and

Part 1: Fiscal Strategy and Budget Priorities

- \$458 million over the next four years for a range of personnel initiatives, including \$357 million to increase the quality of, and access to, housing for members of the Australian Defence Force without dependents and for rental assistance for those without dependents.

Our land, environment and people

A continuing high priority for the Government is to support economic and social development in rural and regional Australia, to ensure economic development is environmentally sustainable, and that our migration and resettlement programme delivers benefits, including to regional Australia.

Assisting rural and regional Australia

The drought that has affected around 62 per cent of Australia's productive agricultural land over the last two years has had major economic and social impacts. In some areas recovery is underway, while in others drought conditions persist.

The Government will provide \$73 million over three years to primary producers in regions that have been declared eligible for Exceptional Circumstances assistance since December 2003. This assistance includes income support and interest rate subsidies. Over all, the Government expects to provide \$1.1 billion in direct drought assistance to farmers and their communities over the period 2002-03 to 2005-06.

This Budget also includes a \$444 million package for the sugar industry aimed at helping the industry through the transition to restructure, diversify and provide long term certainty for the industry and the regional communities that depend on it.

Further support will be provided to primary producers through the Agriculture-Advancing Australia package, which will receive funding of \$236 million over four years. Programmes under the Agriculture-Advancing Australia package, including FarmBis, FarmHelp and the Regional Financial Counselling Service, aim to equip primary producers with the skills and support necessary to respond positively to change, to adopt and benefit from innovation and to meet the challenges of farming in Australia.

The Government will rebate \$290,000 of wine equalisation tax (WET) to every wine producer per annum. This measure will apply from 1 October 2004 and will be pro-rated for the 2004-05 financial year. The effect of this decision is to exempt \$1 million dollars of each producer's domestic wholesale wine sales from the WET on an annual basis. Around 85 per cent of the benefit of this change will be received by small wine producers in rural and regional Australia.

Further improvements to the affordability and access to vital health services in rural and regional Australia remains a strong Government commitment. Accordingly, funding for the Rural Health Strategy is being renewed at a cost of \$830 million over

Statement 1: Fiscal Strategy and Budget Priorities

four years to address gaps in and access to health services in rural and remote areas and to increase the rural health workforce.

The Government is further strengthening its commitment to the development of self-reliant regional communities by providing \$78 million over four years to the Regional Partnerships programme.

Sustaining our environment

The Government is committed to curbing Australia's greenhouse gas emissions in a manner that maintains Australia's strong and internationally competitive economy.

Funding of \$248 million will be provided over the period 2004-05 to 2007-08 to implement the Government's Climate Change Strategy. The Climate Change Strategy will encourage industry and the community to reduce emissions, and facilitate Australian industry's preparedness to respond to the future challenges posed by climate change. Funding of \$27 million will foster the development of innovative low emissions technologies, with \$31 million for scientific research to better understand and predict how future changes in Australia's climate will affect our environment, communities and industry.

The World Heritage listed Great Barrier Reef is a significant part of Australia's unique natural environment, supporting coastal communities and a vibrant tourism industry. From 1 July 2004, the size of 'no take' fishing areas will increase from less than 5 per cent to 33 per cent of the Great Barrier Reef Marine Park. To support this, the Budget provides \$23 million for activities such as enforcement, compliance and education associated with the implementation of this change.

Migration and resettlement

Australia's strong commitment to a large, ongoing migration programme has delivered significant economic and social benefits. In 2004-05, the programme will increase by up to 6,000 places to a maximum of 120,000 places, with an additional 1,000 places for medical practitioners and their families and 5,000 places for skilled migrants living and working in regional Australia. The Australian Government has also increased the size of the Refugee Programme, from 4,000 to 6,000, within an increased total Humanitarian Program of 13,000.

Orderly resettlement of humanitarian entrants and migrants is crucial to the success of Australia's migration and humanitarian programmes. The Government is providing additional funding of \$268 million over four years to enhance key settlement and other services for an increased number of humanitarian entrants and migrants, including those settling in regional Australia.

Support for the Commonwealth Games

Reflecting Australia's proud sporting heritage and recognising the opportunity to secure longer term benefits from showcasing Australia to the world, the Government will provide assistance for the staging of the 18th Commonwealth Games (M2006) in Melbourne in 2006.

The Government will provide \$273 million over four years from 2003-04, including \$140 million in new funding with a further \$133 million in services and support which will be absorbed from within existing resources. Key elements include:

- a \$103 million grant to the Victorian Government to meet the cost of specific M2006 initiatives, such as the Opening and Closing Ceremonies;
- \$85 million to enhance security arrangements in the lead-up to and during the Games; and
- an estimated \$55 million for the Australian Sports Commission to assist Australian athletes to perform at their best.

APPENDIX A: MEDIUM-TERM FISCAL STRATEGY

The Government's medium-term fiscal strategy is an integral part of the macroeconomic framework that creates an environment in which the economy can deliver sustainable economic growth, rising employment and higher living standards.

A medium-term approach to fiscal policy

The primary objective of the Government's medium-term fiscal strategy is to maintain budget balance, on average, over the course of the economic cycle.

The supplementary objectives of the fiscal strategy are:

- maintaining budget surpluses over the forward estimates period while economic growth prospects remain sound;
- no increase in the overall tax burden from 1996-97 levels; and
- improving the Australian Government's net worth position over the medium to longer term.

The primary fiscal objective of budget balance over the cycle ensures that the Government is not living beyond its means. It helps deliver macroeconomic stability, encourages private investment in a low interest rate environment, entrenches low public debt and ensures that, over time, the current account reflects private saving and investment decisions. The supplementary objective of no increase in the overall tax burden means that the Government achieves balance over the cycle through a disciplined and prioritised approach to spending and not by recourse to increased taxation. Consequently, an important element in achieving the strategy is containing spending growth by eliminating waste and placing programme spending on a sustainable basis.

A credible and sustainable framework

The broader budgetary framework of discipline, transparency and accountability underpinning the Government's fiscal strategy is embodied in the *Charter of Budget Honesty Act 1998* (the Charter). The purpose of the Charter is to improve fiscal policy outcomes. It achieves this by requiring that fiscal strategy be based on principles of sound fiscal management (Box 1) and by facilitating public scrutiny of policy settings and performance.

Box 1: Charter of Budget Honesty Act 1998 — Principles of sound fiscal management

The Charter states that fiscal policy should be directed at maintaining the economic prosperity and welfare of the people of Australia and therefore should be set in a sustainable medium-term framework. It does not stipulate specific rules or objectives for fiscal policy but requires that fiscal strategy be framed in accordance with the following principles of sound fiscal management:

- managing financial risks faced by the Australian Government prudently, having regard to economic circumstances, including by maintaining Australian Government general government debt at prudent levels;
- ensuring that fiscal policy contributes to achieving adequate national saving and, as appropriate, moderates cyclical fluctuations in economic activity by taking account of the economic risks the nation faces and their impact on the Australian Government's fiscal position;
- pursuing spending and taxing policies that are consistent with a reasonable degree of stability and predictability in the level of the tax burden;
- maintaining the integrity of the tax system; and
- ensuring that consideration is given to the financial effect of policy decisions on future generations.

Australia's longer-term fiscal sustainability was examined in the Intergenerational Report released as part of the 2002-03 Budget. This report raised awareness of the potential long-term fiscal pressures facing the Australian Government arising from ageing of the population and projected strong rises in Australian Government health expenditures. In particular, the Intergenerational Report projected a gap between the level of government spending and revenues of around 5 per cent of GDP by 2042. Recently, the Government released the discussion paper, *Australia's Demographic Challenges*, which discussed policy challenges in light of the fiscal pressures highlighted in the Intergenerational Report.

Low public debt

The Government's fiscal strategy ensures that the current low levels of Australian Government general government net debt will be maintained through time and will fall as a share of GDP.

- The Government will have successfully reduced Australian Government general government net debt by around \$70 billion, from 19 per cent of GDP in 1995-96 to

Statement 1: Fiscal Strategy and Budget Priorities

around 3.2 per cent of GDP in 2003-04. This fall is due to a combination of accumulated cash surpluses and proceeds from the sale of financial assets.

- Good fiscal management has meant that the Government has been able to deliver tax cuts and priority spending without the need to borrow in net terms. This ensures that the fiscal position is sound and sustainable.
- Australia now has one of the lowest levels of general government net debt in the OECD. Unlike countries such as the United States, Japan and Germany, which are running up debt, Australia's net debt is falling. This places Australia in a relatively better position than many other countries to respond to future economic shocks.

