

IMPACT OF THE COALITION'S POLICIES ON THE FISCAL OUTLOOK

The Treasury and the Department of Finance and Deregulation's assessment of the costs of the Coalition's policies and their impact on the underlying cash balance is set out in the following table.

Indicative underlying cash balance					
	2010-11	2011-12	2012-13	2013-14	Total
	\$m	\$m	\$m	\$m	\$m
2010 PEFO underlying cash balance	-40,689	-10,384	3,503	4,546	-43,024
<i>UCB to GDP ratio</i>	-2.9	-0.7	0.2	0.3	
Coalition policies					
Coalition release – <i>The Coalition's Plan for Real Action for Australia's Future statement</i> – Budget Improvement ¹	2,682	3,345	2,685	2,763	11,475
Underlying cash balance	-38,007	-7,039	6,188	7,309	-31,549
Adjustments by Treasury and Finance to the underlying cash balance					
Conservative Bias Allowance adjustment	0	0	-816	-1,702	-2,518
PBS Ensuring a Sustainable Healthcare System	-272	-258	-219	-402	-1,151
NBN – adjustment to PDI saving	-196	-274	-241	-189	-900
Medibank Private – dividends and adjustment to estimated PDI	0	395	-134	-136	125
Employment Participation policy	0	-266	-319	-370	-956
Increasing the efficiency dividend from 1.25% to 2%	0	0	-190	-190	-380
Transition aged care - Additional places	0	0	158	161	319
Education Tax Refund	0	-59	-89	-87	-235
Paid Parental Leave	0	0	-258	-233	-492
All other recostings	30	-151	-176	-330	-627
<i>PDI impact</i>	-2	0	-40	-153	-194
(a) Revised indicative underlying cash balance²	-38,446	-7,652	3,864	3,676	-38,558
<i>Net impact of Coalition policies on the PEFO²</i>	2,243	2,732	361	-870	4,466
Inclusion of investment expenditures (excluding water)	-554	-855	-1,151	-729	-3,288
<i>PDI impact</i>	-13	-50	-101	-151	-315
(b) Revised indicative underlying cash balance³	-39,013	-8,556	2,613	2,796	-42,161
<i>UCB to GDP ratio</i>	-2.8	-0.6	0.2	0.2	
<i>Net impact of Coalition policies on the PEFO³</i>	1,676	1,828	-890	-1,750	863

1. *The Coalition's Plan for Real Action for Australia's Future* of 18 August 2010

2. Assumes that investment expenditures of \$3.3 billion can be accommodated from within the existing forward estimates through offsetting savings (by cancelling existing projects) not yet identified.

3. Assumes that investment expenditures of \$3.3 billion are not offset and therefore reduce the underlying cash balance

The *Charter of Budget Honesty Act 1998* (the Charter) provides for the Secretary to the Treasury and the Secretary of the Department of Finance and Deregulation to release publicly the PEFO within 10 days of the issue of the writ for a general election.

The 2010 PEFO published an updated fiscal outlook that included, to the fullest extent possible, all decisions taken by the Government before the issue of the writ. The PEFO also presented economic forecasts based on the March Quarter National Accounts. These forecasts were used to underpin the revised expense, capital and revenue estimates.

The PEFO was based on external reporting standards, as required under the Charter.

The update to the fiscal outlook published in this paper is based on the PEFO. The Departments have maintained the economic projections and assumptions set out in the PEFO.

In preparing advice on the public debt interest costs as part of this process, the Departments used the technical assumptions on interest rates used in the PEFO.

The Departments have revised the PEFO fiscal outlook only to reflect the cost of the Coalition's policies and the associated change in public debt interest costs. To prepare this material, the Departments:

- wrote to the Leader of the Opposition on 29 August 2010 to confirm their understanding of the Coalition's policies and to clarify some costing assumptions and the financial implications and funding sources for a range of election commitments not included in the Coalition's release of 18 August 2010. The Coalition responded on 31 August 2010;
- costed a large portion of those policies and commitments not previously costed under the Charter on a 'best endeavours' basis using broadly the same methodology as for Charter costings. Additional information provided by the Coalition was used to finalise these costings.
 - Fifty two of the Coalition's election commitments had previously been costed by the Departments under the Charter prior to polling day on 21 August 2010.

The revised fiscal outlook is preliminary as it does not take account of parameter variations to estimates of payments and receipts that would be made by agencies in the case of a full fiscal update such as the 2010-11 Mid-Year Economic and Fiscal Outlook (MYEFO).

Adjustments to budget impact of election commitments

The Coalition released *The Coalition's Plan for Real Action for Australia's Future* statement on 18 August 2010 setting out the impact of the Coalition's election commitments on the fiscal outlook. The Coalition announced in this statement that its election commitments would result in a cumulative improvement in the underlying cash balance of \$11.5 billion over the four years to 2013-14.

The Departments' assessment is that the Coalition's policies would result in a cumulative improvement in the underlying cash balance of \$4.5 billion over the four years to 2013-14 if the investment expenditures can be accommodated within the existing forward estimates and \$0.9 billion if they are not.

The Coalition has advised that it costed its commitments on the basis of publicly available information. Departments have costed the Coalition's policies against the PEFO forward estimates and have used the same costing models and data used to cost government policies. There were no significant differences between the costings for the vast majority of policy proposals. Several of the differences in the Coalition's and Departments' costings reflect different models and data.

The major differences between the estimates of the fiscal outlook published by the Coalition and that of the two Departments reflect:

- the impact of the investment expenditures from the Health and Hospitals Fund, Education Investment Fund, Building Australia Fund and Nation Building (Auslink) on the underlying cash balance;
 - The Coalition did not include these expenditures in calculating the impact of its policies on the underlying cash balance. In their letter of 31 August 2010, the Coalition advised that they will use the existing forward estimates allocations to reprioritise projects to meet their policy commitments. They did not provide any detail on cancellations or deferrals of existing projects.
 - The Departments have analysed the existing allocations in the forward estimates. It would not be possible to accommodate the Coalition's announced \$3.3 billion of investment spending within the existing forward estimates without cancelling some projects funded from the Funds. It may be possible to cancel or defer other infrastructure projects to make room for some of this spending.
 - The Departments are satisfied that the proposed investments from the Water Fund can be accommodated within the existing forward estimates. Further, the proposed investments in wireless networks are likely to be classified as an equity investment and not affect the underlying cash balance.
- the removal of the estimated savings of \$2.5 billion over two years from adjusting the Conservative Bias Allowance;
 - The Conservative Bias Allowance has been incorporated in every fiscal update since forward estimates have been included in budget documentation (1988-89). It is a tool for improving the accuracy of the forward estimates by anticipating the trend for the estimates of existing policy to be revised upwards through time. The allowance for a particular year is unwound until it is backed out completely when that year becomes the budget year;
 - From time to time, governments have adjusted the Conservative Bias Allowance (both up and down). These adjustments have been classified as parameter revisions because they do not affect actual spending. Such adjustments do not realise any actual budgetary savings;
 - The Charter requires the Departments' Secretaries to certify that the estimates of the fiscal outlook reflect the best professional judgment of the Departments. This includes all parameter variations, including the Conservative Bias Allowance. The Departments' best estimate of a prudent Conservative Bias Allowance remains that published in the 2010 PEFO;
 - Since budget documents are published by authority of the government of the day, it would be open for an incoming government to decide to adjust the Conservative Bias Allowance.

- the reversal of the estimated savings of \$1.15 billion over four years from the Pharmaceutical Benefits Scheme;
 - The Departments sought clarification of this adjustment in their letter to the Leader of the Opposition of 29 August 2010. In their reply of 31 August 2010 and subsequent consultations, the Coalition confirmed that this adjustment is based on an expectation of a higher level of savings to be realised from the 2005 and 2007 reforms to the PBS. This expectation was based on two public studies. However, the savings identified in those studies were already included in the PEFO estimates;
- a reduction of \$900 million over four years to public debt interest savings from reversing the ALP's policy to build the NBN. This adjustment reflects the actual equity contributions and PDI estimates included in PEFO;
- an adjustment to remove from the forward estimates the Medibank Private dividend stream after the health insurer is privatised and the revised public debt interest savings associated with the sale that arise from using interest rates used at PEFO. The Departments have also assumed that the capital structure of the insurer would be optimised prior to sale involving the transfer of excess accumulated reserves from the insurer to the Commonwealth; and
- a reduction in the public debt interest savings reflecting the revised budget position and the interest rates used at PEFO. The Coalition has used an interest rate assumption of 5.5% for its PDI calculations. The average interest rate used at PEFO was 4.9%.

The Departments have also costed most of the remaining Coalition election commitments, and the main adjustments relate to:

- implementing the *Employment Participation* policy (an additional cost of \$956 million over four years);
 - The Departments have costed this policy as reducing the underlying cash balance by \$356 million over four years, compared with savings announced by the Coalition of \$600 million over four years;
 - Such programs only generate savings if they increase the total level of employment, or where job placements substitute those eligible for unemployment benefits with those who are not. The Coalition has assumed an increase in aggregate employment;
 - As any employment effect would be a “second round effect”, it would be excluded from costings, in line with the Guidelines for Costing Election Commitments and consistent with the costing of all other election commitments;
- the best costing available from the Departments for the Coalition's Paid Parental Leave scheme (an additional cost of \$492 million over four years);

- This includes an estimate of the paid parental leave levy which is \$200 million lower than the Coalition costing over the forward estimates, reflecting lower collections in 2012-13 when only three instalments of tax would be expected to be collected within the year, with this partly offset in 2013-14 by a higher level of underlying collections;
- increasing the *efficiency dividend from 1.25% to 2%* (an additional cost of \$380 million over four years);
 - The methodology used by the Coalition is based on three times the cost of increasing the efficiency dividend from 1% to 1.25% in 2012-13 in a related costed proposal. However, the savings in the related proposal also include the cumulative effect of increasing the efficiency dividend from 1% to 1.25% in the previous year;
- discontinuing the *transition aged care – additional places* measure (an additional saving of \$319 million over four years);
 - The funding is ongoing (instead of terminating in 2011-12), and savings of \$319 million over four years in addition to those identified by the Coalition will be realised; and
- expanding the *Education Tax Refund* (an additional cost of \$235 million over four years);
 - The Coalition costed this proposal using assumptions of the increase in the average claim amount stemming from the increased cap and additional eligible items. The Departments have costed this proposal based on analysis of expenditure on eligible items in the latest Household Expenditure Survey and have not included any increase in the number of claims as a result of the policy.

On the basis of advice received from the Coalition on 31 August 2010, the Departments are satisfied that the funding for the commitments that were not included in the Coalition's release on 18 August 2010 can be met from within the existing forward estimates.

Given the time and information available, the Departments have been unable to cost reliably the Coalition's commitments relating to the establishment of an offshore immigration processing centre on Nauru and the proposed Border Security Dividend (\$258 million over two years from 2012-13).

*Department of the Treasury
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 1 September 2010*