STATEMENT 3: FISCAL STRATEGY AND OUTLOOK

This statement outlines the fiscal outlook and how the Government has delivered on its fiscal strategy. The combined effects of a stronger economic outlook and fiscal discipline have delivered a significantly improved fiscal outlook in this Budget and brought forward the projected return to surplus by three years.

The Budget continues to deliver on the Government's strategy to return the budget to surplus. The fiscal stimulus that supported the economy during the economic slowdown associated with the global financial crisis is being withdrawn. Real growth in payments has been kept below 2 per cent in years when the economy is expected to grow above trend. And the additional tax receipts associated with a strengthening economy have been allowed to flow through to improve the budget position, while maintaining a tax-to-GDP ratio below the 2007-08 level.

A small surplus is expected in 2012-13, three years earlier than previously expected and ahead of any of the major advanced economies. In addition, the budget position in each year of the forward estimates has improved since the *Mid-Year Economic and Fiscal Outlook 2009-10* (MYEFO). An underlying cash deficit of $40.8 billion (2.9 per cent of GDP) is now expected in 2010-11, compared with $46.6 billon (3.5 per cent of GDP) in MYEFO.

While tax receipts have begun to improve in the period to 2012-13, they remain around $110 billion lower than had been expected at the time of the 2008-09 Budget.

Net debt is now expected to peak at 6.1 per cent of GDP in 2011-12, half the level expected a year ago. This is in stark contrast to the expected average net debt position of major advanced economies of 82.4 per cent of GDP in 2011.

An improved fiscal outlook has been achieved while delivering on major reforms in the areas of health, taxation and national savings, skills and infrastructure. All new spending measures have been fully offset across the forward estimates.

The focus of the fiscal strategy will remain on returning the budget to surplus, including by constraining real expenditure growth to 2 per cent and by allowing the level of tax receipts to recover naturally with economic recovery. Once the budget returns to surplus, and while the economy is growing at or above trend, the Government will maintain expenditure restraint by retaining a 2 per cent real annual spending cap, on average, until surpluses are at least 1 per cent of GDP.

Appendix A illustrates the sensitivity of the budget estimates to changes in the economic outlook.

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STATEMENT 3: FISCAL STRATEGY AND OUTLOOK

OVERVIEW OF FISCAL POSITION

The 2010-11 Budget shows a significantly improved fiscal outlook. The budget is now expected to return to surplus in 2012-13, three years earlier than previously projected.

The Government has delivered this early return to surplus by maintaining a strong commitment to its fiscal strategy. Consistent with this strategy:

- real growth in spending has been kept below 2 per cent in years of above-trend economic growth;
- all spending measures have been offset over the forward estimates by a reprioritisation of other policies; and
- the additional tax receipts associated with a strengthening economy have been allowed to flow through to improve the budget position.

These actions have improved the projected budget position in each year of the forward estimates since the *Mid-Year Economic and Fiscal Outlook 2009-10* (MYEFO). These improvements have been achieved despite tax receipts in the period to 2012-13 remaining around $110 billion lower than had been expected at the time of the 2008-09 Budget. In 2010-11, the underlying cash deficit is now expected to be $40.8 billion (or 2.9 per cent of GDP) compared with $46.6 billion (or 3.5 per cent of GDP) at MYEFO.

Australia's budget position continues to be among the strongest in the developed world. Australia's forecast deficit of 2.9 per cent of GDP in 2010-11 is well below the 9.5 per cent average for the major advanced economies in 2010. A return to surplus in 2012-13 would place Australia at the forefront of global fiscal consolidation efforts, with the major advanced economies expected to remain in collective deficit by an average of 6.0 per cent of GDP in 2012.

Improvements to the expected budget position mean that net debt is now expected to peak at 6.1 per cent of GDP. This peak is at a level less than a tenth of the average of the major advanced economies of 82.4 per cent of GDP in 2011. It is projected that net debt will be eliminated three years earlier than projected at MYEFO.

Table 1: Budget aggregates

	Actual	Estimates			Projections	
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Underlying cash balance ($b)(a)	**-27.1**	**-57.1**	**-40.8**	**-13.0**	**1.0**	**5.4**
Per cent of GDP	-2.2	-4.4	-2.9	-0.9	0.1	0.3
Fiscal balance ($b)	**-29.7**	**-54.8**	**-39.6**	**-12.1**	**2.0**	**6.3**
Per cent of GDP	-2.4	-4.2	-2.8	-0.8	0.1	0.4

(a) Excludes expected Future Fund earnings.

THE GOVERNMENT'S FISCAL STRATEGY

The Government's medium-term fiscal strategy is designed to ensure fiscal sustainability. It has remained unchanged since the Government's first Budget, in 2008-09, providing a clear and stable basis for the conduct of fiscal policy.

The strategy provides the necessary flexibility for the budget position to vary in line with economic conditions, as it has in response to the global financial crisis, while providing for long-term fiscal sustainability. As the economy recovers, the strategy provides a framework for returning the budget to surplus.

Key elements of a sustainable medium-term fiscal strategy

The Government's medium-term fiscal strategy is to:

- achieve budget surpluses, on average, over the medium term;
- keep taxation as a share of GDP below the level for 2007-08, on average; and
- improve the Government's net financial worth over the medium term.

Allowing the budget to vary in line with economic conditions is a key element of the fiscal strategy and makes an important contribution to macroeconomic stability.

In the February 2009 *Updated Economic and Fiscal Outlook* (UEFO), the Government committed to a two-stage fiscal strategy to support economic growth and jobs through the global financial crisis in a manner consistent with the medium-term fiscal strategy.

1. Support the economy during the global recession

As part of this strategy, the Government committed to take action during the global financial crisis to support the economy and jobs by:

- allowing the variations in receipts and payments, which are naturally associated with slower economic growth, to drive a temporary underlying cash budget deficit; and
- using additional spending to deliver timely, targeted and temporary stimulus, with the clear objective of other budget priorities and new policy proposals being met through a reprioritisation of existing expenditure.

The 2009-10 Budget delivered on this strategy in full.

2. Deficit exit strategy as the economy recovers

With above-trend growth forecast, the Government has taken action to return the budget to surplus by:

- allowing the level of tax receipts to recover naturally as the economy improves, while maintaining the Government's commitment to keep taxation as a share of GDP below the 2007-08 level on average; and
- holding real growth in spending to 2 per cent a year until the budget returns to surplus.

DELIVERING ON THE FISCAL STRATEGY

The Government is delivering on its two-stage fiscal strategy.

Supporting the economy and jobs

Throughout late 2008 and 2009, the Government took steps to support the economy.

The automatic stabilisers were allowed to operate and the budget moved into deficit as the impact of slower economic growth was felt on Government revenues. This provided a natural cushion for the economy against the effects of slower economic growth.

In addition, the Government put in place specific measures to support jobs, households and those sectors of the economy most affected by the global financial crisis. This included delivering timely, targeted and temporary fiscal stimulus to the economy. Along with the significant stimulus provided by the Reserve Bank of Australia cutting the official cash rate, this supported economic growth at a critical time.

It is estimated that the Government's fiscal stimulus measures added around 2 percentage points to GDP growth in 2009. The Australian economy grew by 1.4 per cent in 2009, the strongest of any of the world's advanced economies. Without the stimulus the Australian economy would have contracted by 0.7 per cent in 2009.

The stimulus was designed to be withdrawn as the economy recovered and private sector demand strengthened. The withdrawal of stimulus will detract around 1 percentage point from GDP growth over 2010 and ¾ of a percentage point over 2011. Private sector demand is now expected to drive economic growth.

Non-stimulus policy measures were funded through a reprioritisation of existing policies, ensuring that there was no deterioration in the budget position as a consequence of these decisions.

Implementing the deficit exit strategy

With the economic recovery under way, the Government's focus has shifted to implementing its strategy to return the budget to surplus as quickly as possible. With the implementation of this strategy, the budget is now expected to return to surplus in 2012-13, three years earlier than previously projected.

Allowing tax receipts to recover naturally

The commitment to allow the natural increase in tax receipts associated with an emerging economic recovery to flow through to the budget is a significant one. This commitment has delivered a substantial improvement to the budget position.

Inherent lags in the tax system mean that the weaker economic outcomes seen during the global recession are still hindering the improvement in receipts in 2009-10 despite an improvement in economic growth. Tax receipts remain around $110 billion lower than forecast at the 2008-09 Budget.

The recovery in tax receipts has occurred while maintaining the commitment to a tax-to-GDP ratio below the 2007-08 level on average. Tax receipts are estimated to be 21.0 per cent of GDP in 2010-11, well below the 2007-08 level of 23.6 per cent of GDP. Tax receipts have been held below the 2007-08 level, on average, in the medium-term fiscal projections, consistent with the fiscal strategy.

Fiscal discipline — the 2 per cent cap on spending

The Government's action to consolidate spending has played a critical role in improving the fiscal outlook.

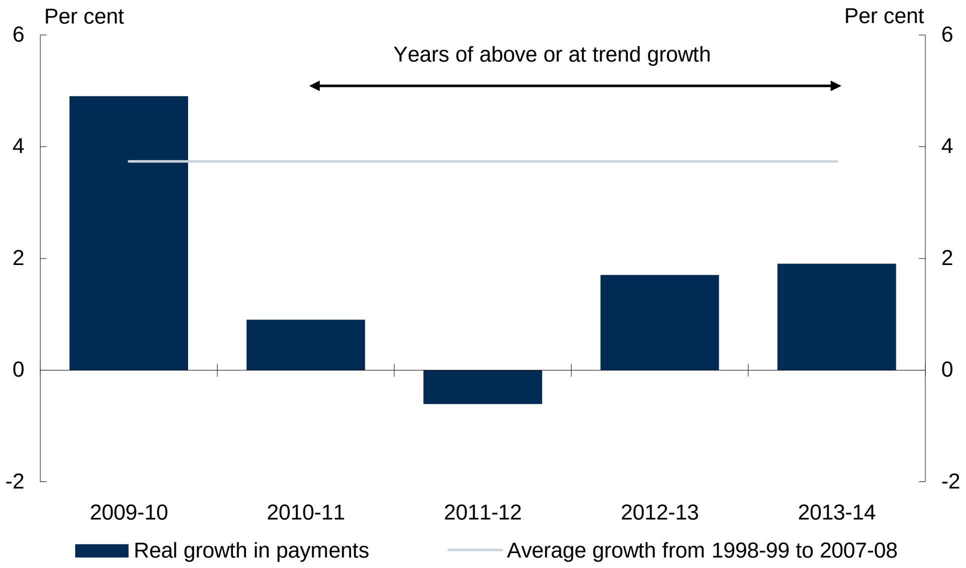
The Government has met its commitment to keep real growth in spending to 2 per cent or less in years when the economy is expected to grow above trend. This has meant the Government has kept growth below 2 per cent from 2010-11 to 2013-14 (see Table 2).

Table 2: Delivering on the 2 per cent commitment

	2009-10	2010-11	2011-12	2012-13	2013-14
Real payment growth	4.9	0.9	-0.6	1.7	1.9

The commitment to hold real growth in spending to 2 per cent has placed — and will continue to place — a significant restraint on Government expenditure. Prior to the global financial crisis, real payments growth was above 2 per cent in eight out of the previous ten years and the average over this period was around 3.7 per cent. The four year period to 1990-91 was the last time that real growth in payments was as low as is expected from 2010-11 to 2013-14.

Chart 1: Real growth in payments



In addition to meeting the 2 per cent commitment, the Government has offset all new spending measures across the forward estimates, achieving a net save of $544 million.

This net save is outlined in the table below. The net effect of policy decisions taken since MYEFO takes into account amounts that have previously been provided for in the contingency reserve. As a result, these decisions have no net impact on the budget position. These principally relate to official development assistance and exceptional circumstances provisioning for drought.

Table 3: Delivering fiscal reprioritisation[(a)]

	Estimates			Projections		
	2009-10	2010-11	2011-12	2012-13	2013-14	Total
	$m	$m	$m	$m	$m	$m
Effect of policy decisions since MYEFO						
Spends	-2,590	-4,708	-4,635	-7,094	-11,438	-30,466
Saves	466	1,684	4,862	4,446	16,693	28,150
Total effect of policy decisions since MYEFO	**-2,124**	**-3,024**	**227**	**-2,648**	**5,254**	**-2,316**
Add Contingency reserve offsets to policy decisions	212	671	664	698	615	2,860
Net budget impact	**-1,912**	**-2,354**	**890**	**-1,950**	**5,869**	**544**

(a) Underlying cash balance basis.

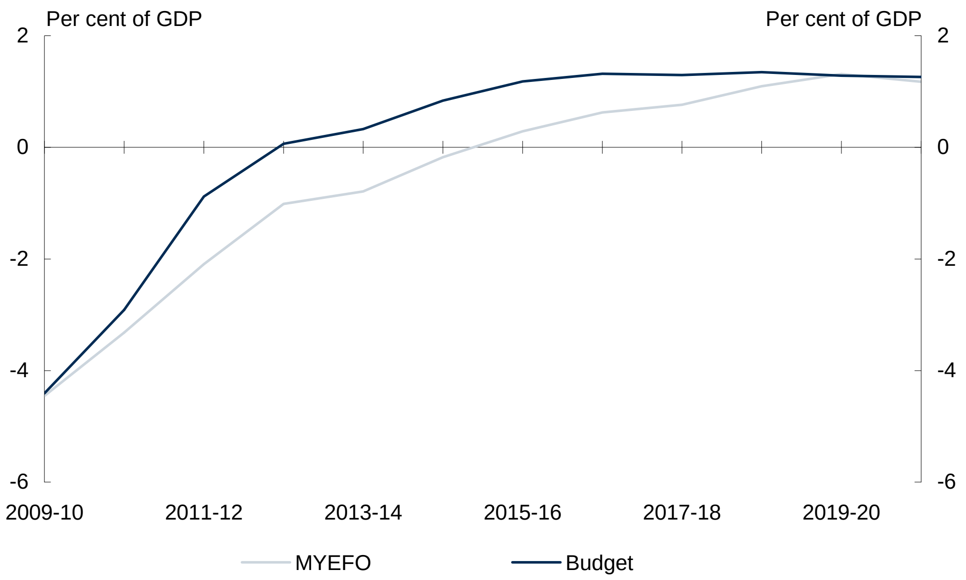
Details of the measures in the Budget are outlined in Budget Paper No. 2, *Budget Measures 2010-11*.

Continuing budget surpluses

The focus of the fiscal strategy in future years will remain on returning the budget to surplus, including by continuing to reprioritise existing expenditure, consistent with 2 per cent real expenditure growth, and by allowing the level of tax receipts to continue to recover naturally as the economy improves.

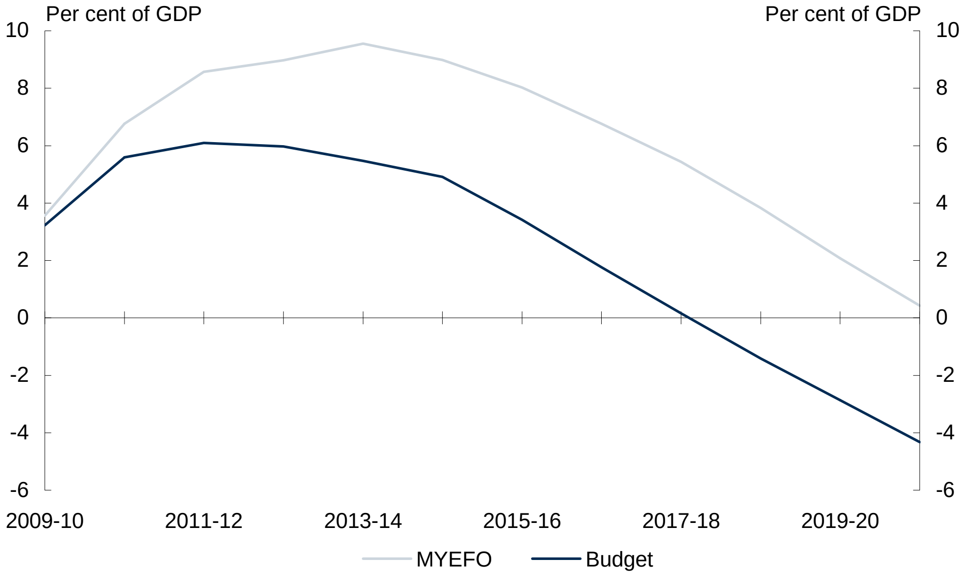
Once the budget returns to surplus, and while the economy is growing at or above trend, the Government will maintain expenditure restraint by retaining a 2 per cent annual cap on real spending growth, on average, until surpluses are at least 1 per cent of GDP. On current projections, this would be achieved in 2015-16 and net debt would return to zero in 2018-19, three years ahead of the MYEFO projections (Charts 2 and 3).

Chart 2: Underlying cash balance projected to 2020-21



Source: Treasury projections.

Chart 3: Government net debt projected to 2020-21

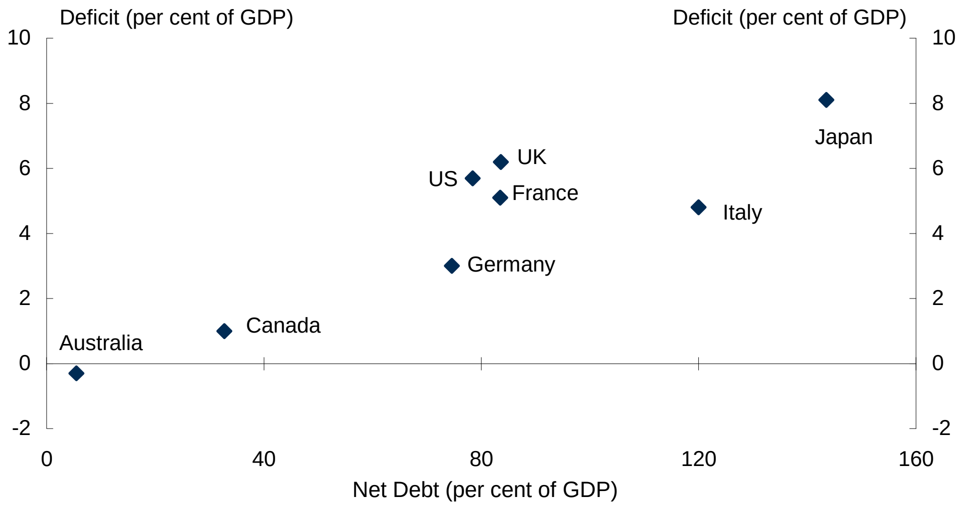


Source: Treasury projections.

Fiscal consolidation

The expected fall in the size of the deficit represents a tightening of the fiscal stance of an average of 1½ per cent of GDP a year, the most substantial fiscal consolidation in Australia's modern history (see Box 1 below.) Australia's fiscal consolidation also compares favourably with that of the major advanced economies (see Chart 4).

Chart 4: Net debt and deficits of the G7 in 2013 and Australia in 2013-14



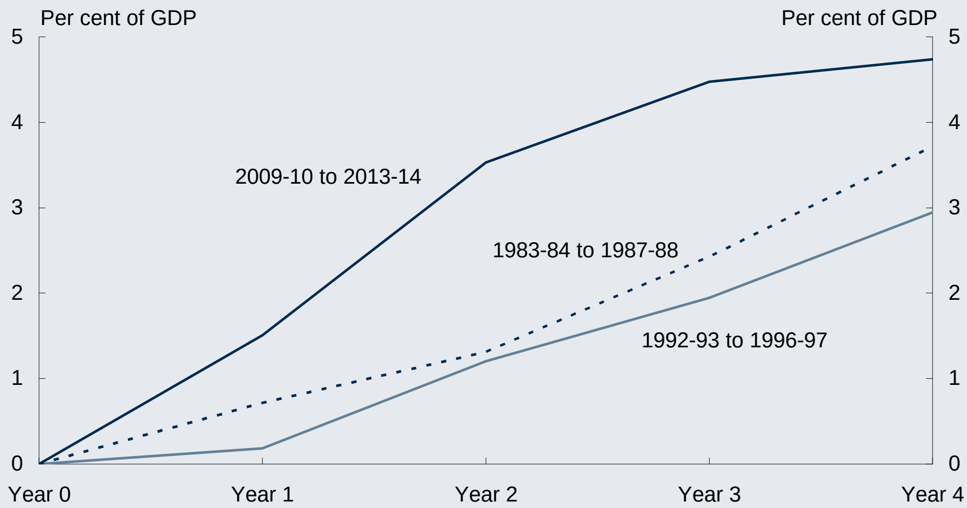
Note: Australian data are for the Australian Government general government sector and refer to financial year data for 2013-14. Data for all other economies are total Government and refer to calendar year 2013.
Source: IMF *World Economic Outlook* April 2010 and Treasury.

Box 1: Returning the budget to surplus

The application of the deficit exit strategy from 2010-11, the first year of above-trend growth since the global financial crisis, combined with the planned withdrawal of economic stimulus, generates a substantial fiscal consolidation over the forward estimates.

Chart A: Australian fiscal consolidations

Change in the underlying cash balance



This consolidation is projected to be considerably faster than after previous economic downturns (Chart A). The fiscal strategy is expected to result in the underlying cash balance improving by close to 4 percentage points of GDP in the two years after the deficit reaches its peak in 2009-10. This is more than double the pace of consolidation that followed the 1980s and 1990s recessions.

The faster improvement in the underlying cash balance in the current episode is helped by the timely implementation of economic stimulus. The economic stimulus was more closely synchronised with the economic cycle, with stimulus being withdrawn sooner, coinciding with the natural recovery in tax receipts.

FISCAL OUTLOOK

An underlying cash deficit of $40.8 billion is expected in 2010-11, compared with an estimated deficit of $46.6 billion at MYEFO. In accrual terms, a fiscal deficit of $39.6 billion is expected for 2010-11.

Table 4: Australian Government general government sector budget aggregates

	Actual	Estimates			Projections	
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Revenue ($b)	**298.9**	**294.2**	**321.8**	**356.4**	**381.9**	**407.2**
Per cent of GDP	23.7	22.7	22.9	24.0	24.3	24.6
Expenses ($b)	**324.6**	**343.1**	**354.6**	**364.6**	**381.0**	**398.0**
Per cent of GDP	25.8	26.5	25.2	24.5	24.3	24.0
Net operating balance ($b)	-25.6	-48.9	-32.8	-8.2	0.9	9.2
Net capital investment ($b)	4.1	5.8	6.8	3.9	-1.0	2.9
Fiscal balance ($b)	**-29.7**	**-54.8**	**-39.6**	**-12.1**	**2.0**	**6.3**
Per cent of GDP	-2.4	-4.2	-2.8	-0.8	0.1	0.4
Underlying cash balance ($b)(a)	**-27.1**	**-57.1**	**-40.8**	**-13.0**	**1.0**	**5.4**
Per cent of GDP	-2.2	-4.4	-2.9	-0.9	0.1	0.3
Memorandum item:						
Headline cash balance ($b)	-31.3	-59.2	-48.0	-14.6	-2.2	4.1

(a) Excludes expected Future Fund earnings.

Underlying cash balance estimates

In 2010-11, an underlying cash deficit of $40.8 billion is estimated, which is $5.8 billion lower than the MYEFO estimate of $46.6 billion. A headline cash deficit of $48.0 billion is forecast for 2010-11. Table 5 provides a summary of Australian Government general government sector cash flows.

Table 5: Summary of Australian Government general government sector cash flows

	Estimates			Projections	
	2009-10	2010-11	2011-12	2012-13	2013-14
	$b	$b	$b	$b	$b
Cash receipts					
Operating cash receipts					
excluding Future Fund earnings	282.1	311.1	344.9	370.4	395.5
Future Fund earnings	2.8	2.9	2.9	2.9	3.0
Total operating receipts	284.9	314.0	347.8	373.3	398.5
Capital cash receipts(a)	0.3	0.4	1.0	4.7	0.5
Total cash receipts	285.2	314.4	348.8	378.0	399.0
Cash payments					
Operating cash payments	328.7	340.4	349.0	365.3	381.9
Capital cash payments(b)	10.8	11.7	10.0	8.8	8.7
Total cash payments	339.5	352.1	359.0	374.1	390.5
Finance leases and similar arrangements(c)	0.0	0.2	0.0	0.0	0.0
GFS cash surplus(+)/deficit(-)	**-54.3**	**-37.8**	**-10.2**	**3.9**	**8.5**
Per cent of GDP	-4.2	-2.7	-0.7	0.3	0.5
less Future Fund earnings	2.8	2.9	2.9	2.9	3.0
Underlying cash balance(d)	**-57.1**	**-40.8**	**-13.0**	**1.0**	**5.4**
Per cent of GDP	-4.4	-2.9	-0.9	0.1	0.3
Memorandum items:					
Net cash flows from investments in financial assets for policy purposes	-4.9	-10.2	-4.5	-6.1	-4.4
plus Future Fund earnings	2.8	2.9	2.9	2.9	3.0
Headline cash balance	**-59.2**	**-48.0**	**-14.6**	**-2.2**	**4.1**

(a) Equivalent to cash receipts from the sale of non-financial assets in the cash flow statement.
(b) Equivalent to cash payments for purchases of non-financial assets in the cash flow statement.
(c) The acquisition of assets under finance leases decreases the underlying cash balance. The disposal of assets previously held under finance leases increases the underlying cash balance.
(d) Excludes expected Future Fund earnings.

Table 6 provides a reconciliation of the variations in the underlying cash balance estimates.

Table 6: Reconciliation of 2009-10 Budget, 2009-10 MYEFO and 2010-11 Budget underlying cash balance estimates

	Estimates			Projections
	2009-10	2010-11	2011-12	2012-13
	$m	$m	$m	$m
2009-10 Budget underlying cash balance(a)	**-57,593**	**-57,051**	**-44,535**	**-28,150**
Per cent of GDP(b)	-4.9	-4.7	-3.4	-2.0
Changes between 2009-10 Budget and MYEFO				
Effect of policy decisions(c)	-516	1,587	367	256
Effect of parameter and other variations	423	8,842	13,001	11,993
Total variations	**-93**	**10,429**	**13,368**	**12,249**
2009-10 MYEFO underlying cash balance(a)	**-57,685**	**-46,622**	**-31,167**	**-15,901**
Per cent of GDP(b)	-4.5	-3.5	-2.2	-1.1
Changes from MYEFO to 2010-11 Budget				
Effect of policy decisions(c)	-2,124	-3,024	227	-2,648
Effect of parameter and other variations	2,730	8,890	17,895	19,564
Total variations	**606**	**5,866**	**18,122**	**16,917**
2010-11 Budget underlying cash balance(a)	**-57,079**	**-40,756**	**-13,045**	**1,016**
Per cent of GDP(b)	-4.4	-2.9	-0.9	0.1

(a) Excludes expected Future Fund earnings.
(b) GDP forecasts for the 2009-10 Budget were prepared according to the System of National Accounts 1993, while forecasts for MYEFO and the 2010-11 Budget were prepared according to the System of National Accounts 2008.
(c) Excludes secondary impacts on public debt interest of policy decisions and offsets from the contingency reserve for decisions taken.

Policy decisions

Policy decisions since MYEFO are expected to increase the underlying cash deficit by $3.0 billion in 2010-11.

Further detail of the impact of these policy decisions on the fiscal outlook is provided in the 'Fiscal balance estimates' section below. More detail on the decisions can be found in Budget Paper No. 2, *Budget Measures 2010-11*.

The majority of these policy decisions have broadly the same underlying and fiscal impacts. The deferral of the Carbon Pollution Reduction Scheme (CPRS) has different underlying cash and fiscal impacts. The deferral of the CPRS is estimated to reduce the underlying cash balance by $375 million in 2010-11 (and increase the underlying cash balance by $545 million over four years). In fiscal terms, the deferral of the CPRS is expected to increase the fiscal balance by $439 million in 2010-11 (an increase of $2.9 billion over four years). The deferral of the CPRS has a negative impact on the underlying cash balance in 2010-11 because of the removal of receipts from the advance sale of future vintage permits ahead of the related fiscal balance impact (see Box 2).

Box 2: Budget impact of the Carbon Pollution Reduction Scheme

The Australian Government remains committed to tackling the challenge of climate change through the Carbon Pollution Reduction Scheme (CPRS). The economic and environmental risks posed by climate change remain undiminished, and governments around the world recognise that market-based approaches are the most effective and least-cost way to reduce emissions.

However the Australian Government recognises that, in light of the continued absence of Parliamentary support for the CPRS, it will not be possible to commence the CPRS on 1 July 2011.

The Government will not move to introduce legislation for the CPRS until after the end of the current commitment period of the Kyoto Protocol and only when there is greater clarity on the actions of major economies, including the US, China and India. This means that the Government will not move to legislate the CPRS before the end of 2012, and will only do so after this time if there is sufficient international action.

The budget treatment of the CPRS is affected by this delay. The forward estimates of revenue and expenses in the Budget incorporate the assumptions and judgments based on the best information available at the time of publication. Standard Budget practice requires some certainty around the timing and fiscal impacts of a policy in order for it to be included in the forward estimates. As the financial impact of deferring the CPRS will depend, in part, on the timing of its introduction, and given that a start date cannot be determined at this time, the financial implications of the Scheme have been removed from the forward estimates. The deferral of the CPRS package improves the underlying cash balance by $415 million over five years from 2009-10, with additional net departmental saves taking this amount to $652 million.

The reintroduction of the CPRS is reported as a factor which is likely to influence the actual budget outcome in future years, in Budget Paper No. 1, *Statement 8: Statement of Risks*. This is similar to the treatment of the Government's commitment to the Kyoto Protocol as an unquantifiable contingent liability.

Parameter and other variations

Total parameter and other variations since MYEFO have increased the forecast of the underlying cash balance in 2010-11 by $8.9 billion. Since the 2009-10 Budget, parameter and other variations are expected to have a total positive impact of $83.3 billion on the underlying cash balance in the four years to 2012-13.

Variations in receipts

Parameter and other variations since MYEFO have increased taxation receipts by $16.8 billion in 2010-11. The variations primarily relate to receipts from individuals, companies and GST. The $2.5 billion increase relating to GST in 2010-11 is returned in full to the States and Territories as payments.

Since the 2009-10 Budget, parameter and other variations are expected to increase taxation receipts by around $95 billion in the four years to 2012-13.

Non-tax receipts in 2010-11 are expected to be $402 million lower than forecast at MYEFO. This reduced estimate primarily reflects reductions in the Reserve Bank of Australia dividend and in fee receipts from eligible financial institutions for the Guarantee Scheme for Large Deposits and Wholesale Funding.

Variations in payments

Total payment parameter and other variations have increased the expected underlying cash deficit in 2010-11 by $7.5 billion. The main variations relate to increases in GST payments to the States and Territories, Private Health Insurance Rebate payments, and Family Tax Benefit payments, partly offset by reduced Job Seeker Income Support payments.

Variations in payments are broadly consistent with variations in expenses. Further detail is provided in the 'Fiscal balance estimates' section below.

Fiscal balance estimates

In 2010-11, a fiscal balance deficit of $39.6 billion is estimated, compared with the deficit of $46.5 billion estimated at MYEFO. Table 7 provides a reconciliation of the fiscal balance estimates.

Table 7: Reconciliation of 2009-10 Budget, 2009-10 MYEFO and 2010-11 Budget fiscal balance estimates[(a)]

	Estimates			Projections
	2009-10	2010-11	2011-12	2012-13
	$m	$m	$m	$m
2009-10 Budget fiscal balance	**-53,145**	**-55,956**	**-41,751**	**-30,323**
Per cent of GDP(b)	-4.5	-4.6	-3.2	-2.2
Changes between 2009-10 Budget and MYEFO				
Effect of policy decisions(c)	-484	1,605	383	271
Effect of parameter and other variations	-747	7,828	13,207	12,094
Total variations	**-1,232**	**9,434**	**13,590**	**12,365**
2009-10 MYEFO fiscal balance	**-54,377**	**-46,522**	**-28,161**	**-17,958**
Per cent of GDP(b)	-4.3	-3.5	-2.0	-1.2
Changes between MYEFO and 2010-11 Budget				
Effect of policy decisions(c)				
Revenue	226	1,699	-156	-2,103
Expenses	1,916	3,468	1,691	-2,574
Net capital investment	396	693	21	46
Total policy decisions impact on fiscal balance	-2,087	-2,462	-1,868	426
Effect of parameter and other variations				
Revenue	2,167	16,228	20,616	19,169
Expenses	1,039	6,196	4,377	5,496
Net capital investment	-583	645	-1,697	-5,819
Total parameter and other variations impact on fiscal balance	1,710	9,387	17,936	19,492
2010-11 Budget fiscal balance	**-54,753**	**-39,598**	**-12,093**	**1,960**
Per cent of GDP(b)	-4.2	-2.8	-0.8	0.1

(a) A positive number for revenue indicates an increase in the fiscal balance, while a positive number for expenses and net capital investment indicates a decrease in the fiscal balance.
(b) GDP forecasts for the 2009-10 Budget were prepared according to the System of National Accounts 1993, while forecasts for MYEFO and the 2010-11 Budget were prepared according to the System of National Accounts 2008.
(c) Excludes secondary impacts on public debt interest of policy decisions and offsets from the contingency reserve for decisions taken.

Revenue estimates

As a result of the improving economic outlook, total revenue has been revised up by $17.9 billion in 2010-11 since MYEFO. New policy decisions have increased revenue by $1.7 billion, and parameter and other variations have increased revenue by $16.2 billion in 2010-11 since MYEFO.

Major policy decisions that have increased revenue over the four year period from 2010-11 to 2013-14 include:

- introducing a 40 per cent Resource Super Profits Tax (RSPT) on non-renewable resources from 1 July 2012. The RSPT will raise $12 billion over four years to 2013-14;
- increasing tobacco excise by 25 per cent, with effect on and from 30 April 2010, which will raise $5.2 billion over four years (and a further $255 million in 2009-10); and
- increasing funding to the Australian Taxation Office for GST compliance which is expected to increase revenue by $3.0 billion over the forward estimates. This measure will result in an additional $1.6 billion in underlying cash GST collections that will be paid to the States and Territories.

The impact of these policy decisions on revenue has been partially offset by a number of decisions that have reduced revenue, including:

- deferring the CPRS, with its removal from the estimates expected to reduce revenue by $15.3 billion over the forward estimates period;
- reducing the company tax rate from 30 per cent to 29 per cent for 2013-14 and 28 per cent from 2014-15, at a cost of $2.3 billion over the forward estimates;
- increasing the superannuation contribution cap for individuals over 50 years old with superannuation balances below $500,000, at a cost to revenue of $1.3 billion over the forward estimates;
- providing small businesses with an instant asset write-off for assets with an acquisition cost under $5,000, as well as a simplified pooling arrangement, at a cost to revenue of $1.0 billion over the forward estimates; and
- providing a 50 per cent discount for deposit interest income at a cost to revenue of $1.0 billion over the forward estimates.

Most revenue heads have been revised up in 2010-11 since MYEFO as nominal GDP is now forecast to be higher. The largest revisions occur in individuals' income taxes, company tax and GST.

The upwards revision to individuals' income taxes reflects the improved outlook for employment growth, unincorporated business income and capital gains. Overall, parameter and other variations have increased individuals' income taxes by $6.6 billion since MYEFO. Company profits in 2010-11 are expected to be higher than at MYEFO resulting in company tax being revised up by $7.4 billion, despite prior year losses and collection system lags. Higher forecasts for consumption have increased the forecast for GST by $2.5 billion.

In 2010-11, non-taxation revenue is expected to be $193 million lower than forecast at MYEFO, largely reflecting a range of parameter and other variations, including:

- Reserve Bank of Australia (RBA) dividend estimates decreasing by $810 million as a result of unrealised valuation losses from the appreciation of the exchange rate since MYEFO. Dividend estimates have been decreased by $2.8 billion over four years, as it is expected that the RBA will retain some future earnings to restore the balance of the Bank's Reserve Fund; and

- the Guarantee Scheme for Large Deposits and Wholesale Funding fees from eligible financial institutions having decreased by $402 million ($1.5 billion over four years) due to lower than anticipated outstanding guaranteed liabilities and closure of the Guarantee Scheme on 31 March 2010.

The decreases in non-taxation revenue are partially offset by a range of expected increases in other non-taxation revenues including from interest earnings on investments and on increases in superannuation contributions.

Further detail on how the revised outlook for the economy has affected individual revenue heads over the forward estimates is provided in Statement 5. An analysis of the sensitivity of the taxation revenue estimates to changes in the economic parameters is provided in Appendix A of Statement 3.

Expense estimates

Since MYEFO, estimated total expenses for 2010-11 have increased by $9.7 billion, reflecting new policy decisions of $3.5 billion, and parameter and other variations of $6.2 billion (see Table 7).

Policy decisions

Since MYEFO, major policy decisions to increase expenses across the forward estimates are to:

- implement a range of measures encompassing the National Health and Hospitals Network at a cost of $1.5 billion in 2010-11 ($7.3 billion over five years including $310 million in 2009-10);

- continue and enhance Australia's military contribution to international efforts in Afghanistan and the wider Middle East Area of Operations, East Timor and the Solomon Islands at an expected cost of $1.1 billion in 2010-11;

- extend the drought (exceptional circumstances) assistance for primary producers and small business, at an expected cost of $316 million in 2010-11 ($420 million over 2009-10 and 2010-11); and

- increase Australia's official development assistance (ODA), consistent with the Government's long-term commitment to increase ODA funding to 0.5 per cent of Gross National Income by 2015-16, at an expected cost of $232 million in 2010-11 ($1.8 billion over four years). This increase has been offset by a reduction for ODA contained in the contingency reserve which means there is no overall impact on the budget position.

The impact of these policy decisions on expenses has been partially offset by a number of decisions that have reduced expenses, including:

- deferring the Carbon Pollution Reduction Scheme (CPRS), which is expected to reduce expenses by $445 million in 2010-11 ($18.2 billion over four years). The deferral of the CPRS is also expected to reduce revenue over the forward estimates (see above);

- phasing in the flow through to additional ODA funding from the adoption of a new international system of National Accounts that affects the calculation of Gross National Income. This is expected to generate savings of $208 million in 2010-11 ($1.0 billion over four years), while still being consistent with the Government's commitment to increase ODA funding to 0.5 per cent of Gross National Income by 2015-16;

- introducing reforms to ensure the ongoing sustainability of the Pharmaceutical Benefits Scheme (PBS) and the Repatriation Pharmaceutical Benefits Scheme (RPBS), which are expected to deliver savings of $31 million in 2010-11 ($1.3 billion over four years) and have been negotiated with Medicare Australia; and

- negotiating the Fifth Community Pharmacy Agreement with the Pharmacy Guild of Australia, which is expected to deliver net savings of $125 million in 2010-11 ($484 million over four years).

Parameter and other variations

In 2010-11, parameter and other variations have increased forecast expenses by $6.2 billion since MYEFO. The largest increases are due to expected rises in:

- GST payments to the States and Territories, by $2.5 billion in 2010-11 ($10.2 billion over four years from 2010-11), reflecting a forecast increase in GST collections;

- Private Health Insurance (PHI) Rebate expenses, by $863 million in 2010-11 ($615 million over four years) mainly due to the delay of savings measures announced in the 2009-10 Budget measure *Private health insurance — fair and sustainable support for the future* in the Senate. The forward estimates are now based on this measure commencing on 1 July 2011. Means-testing the PHI Rebate remains the Government's policy;

- Family Tax Benefit expenses, by $678 million in 2010-11, reflecting higher than previously projected recipient numbers, expected increases in rates of payment resulting from a higher than anticipated Consumer Price Index (CPI) and higher than anticipated top-up payments after the lodgement of tax returns;

- Higher Education Support expenses, by $671 million in 2010-11 ($2.1 billion over four years), mainly due to a significant increase in enrolments at universities in 2009 and 2010, and a further projected increase in enrolments in 2011;

- Disability Support Pension (DSP) expenses, by $549 million in 2010-11, mainly due to higher than anticipated numbers of recipients and higher rates of payment. Based on historical trends, the number of people receiving the DSP is likely to remain at a higher level for a period of time after the general unemployment rate begins to decline;

- ODA expenses, by $357 million in 2010-11 ($1.8 billion over four years) as a result of the adoption of a new international system of National Accounts that affects the calculation of Gross National Income, and a strong economic growth outlook. This parameter variation is offset in part by a decision to phase in the flow through to additional funding from the methodological change; and

- Medicare Services expenses, by $389 million in 2010-11 ($1.2 billion over four years) mainly due to the extension of the Chronic Disease Dental Scheme (CDDS) to 30 September 2010 as a result of the Senate's not allowing the determination to close the program. The closure of the CDDS remains the Government's policy.

These increases in expenses are partially offset by expected decreases in:

- job seeker income support expenses by $2.3 billion in 2010-11 ($5.7 billion over four years), reflecting the reduction in the expected number of unemployment benefit recipients resulting from improvements in the economic outlook; and

- public debt interest expenses, by $137 million in 2010-11 ($5.3 billion over four years from 2010-11), largely owing to the reduced forward funding task.

In 2009-10, parameter and other variations have increased estimated expenses by $1.0 billion since MYEFO. This primarily reflects:

- GST payments to States and Territories of $2.2 billion reflecting increased estimates of GST collections for the current financial year;

- Family Tax Benefit payments of $615 million due to higher than projected customer numbers, rates of payment and increased top-up payments made after the lodgement of tax returns; and

- penalty remissions of $510 million for the Australian Taxation Office, reflecting higher than previously expected March year-to-date expenses and higher trends over the March to June period in the past year.

These increases in expenses have been partially offset by decreases in estimates for:

- job seeker income support expenses, by $626 million, due to the downward revision of the expected unemployment benefit recipients resulting from improvements in the economic outlook;

- Water Reform grants, by $484 million, mainly due to movement of funds from 2009-10 into future years; and

- public debt interest expenses, by $398 million, largely owing to a lower than expected financing requirement for 2009-10.

More detailed information on expenses can be found in Statement 6. A full description of all policy measures since MYEFO can be found in Budget Paper No. 2, *Budget Measures 2010-11*.

Net capital investment estimates

In 2010-11, forecast net capital investment has increased by $1.3 billion since MYEFO. In part, this reflects new policy decisions of $693 million, including funding of $163 million to enhance force protection measures for Australian troops deployed to Afghanistan.

Parameter and other variations since MYEFO have increased estimated net capital investment for 2010-11 by $645 million. This primarily reflects:

- Broadband and Communications Infrastructure program net investment of $223 million mainly due to capital expenditure on the Regional Backbone Blackspots Program not being spent in 2009-10. This is as a result of the program expenditure profile being adjusted to reflect the actual spread of payments and construction activity agreed with the contractor responsible for delivering the infrastructure; and

- a movement of $476 million from 2009-10 mainly due to the expectation that some water purchase tenders under the Restoring the Balance in the Murray-Darling Basin component will not be settled until 2010-11.

Further information on net capital investment can be found in Statement 6. A full description of all policy measures since MYEFO can be found in Budget Paper No. 2, *Budget Measures 2010-11*.

Net financial worth, net worth and net debt

The strengthening of the balance sheet since MYEFO is largely due to the improved cash balance.

Net debt for the Australian Government general government sector is forecast to be $78.5 billion in 2010-11, which is $11.9 billion lower than estimated at MYEFO. This primarily reflects the improved budget position — and therefore a reduced financing task.

The Australian Government's net debt position, at 5.6 per cent of GDP in 2010-11, is extremely low compared with the major advanced economies.

The improvement in Australia's net debt is projected to be sustained across the forward estimates, as the reduction in the projections of the headline cash deficit relative to the 2009-10 MYEFO continue to translate into a stronger balance sheet. By the end of the forward estimates in 2013-14, net debt is expected to be $90.8 billion (or 5.5 per cent of GDP), having peaked as a proportion of GDP in 2011-12 at 6.1 per cent of GDP.

Net financial worth for the Australian Government general government sector is forecast to be -$160.6 billion in 2010-11, an improvement of $9.5 billion on the MYEFO figure.

Estimated net worth in 2010-11 has improved to -$56.5 billion, which is $10.0 billion higher than the MYEFO estimate of -$66.5 billion. As with net debt, these improvements are largely due to the Government's lower interest bearing liabilities.

Further details on the balance sheet are outlined in Statement 7 Asset and Liability Management. Table 8 provides a summary of Australian Government general government sector net financial worth, net worth, net debt and net interest payments.

Table 8: Australian Government general government sector net financial worth, net worth, net debt and net interest payments

	Estimates			Projections	
	2009-10	2010-11	2011-12	2012-13	2013-14
	$b	$b	$b	$b	$b
Financial assets	219.2	235.6	238.2	244.0	248.5
Non-financial assets	98.4	104.2	107.9	110.8	113.1
Total assets	**317.6**	**339.8**	**346.1**	**354.7**	**361.6**
Total liabilities	**337.7**	**396.2**	**412.5**	**417.7**	**417.0**
Net worth	**-20.1**	**-56.5**	**-66.4**	**-63.0**	**-55.3**
Net financial worth(a)	**-118.5**	**-160.6**	**-174.3**	**-173.8**	**-168.5**
Per cent of GDP	-9.2	-11.4	-11.7	-11.1	-10.2
Net debt(b)	**41.8**	**78.5**	**90.5**	**93.7**	**90.8**
Per cent of GDP	3.2	5.6	6.1	6.0	5.5
Net interest payments	**2.0**	**4.6**	**6.1**	**6.5**	**6.1**
Per cent of GDP	0.2	0.3	0.4	0.4	0.4

(a) Net financial worth equals total financial assets minus total liabilities. That is, it excludes non-financial assets.

(b) Net debt equals the sum of deposits held, advances received, government securities, loans and other borrowing, minus the sum of cash and deposits, advances paid and investments, loans and placements.

APPENDIX A: SENSITIVITY OF BUDGET ESTIMATES TO ECONOMIC DEVELOPMENTS

The estimates contained in the Budget are based on forecasts of the economic outlook. Changes to the economic assumptions underlying the Budget estimates will impact on receipts and payments, and hence the size of the underlying cash balance.

This appendix examines the effects on receipts and payments of altering some of the key economic assumptions underlying the estimates. Tables A2 and A4 illustrate the sensitivity of key components of receipts and payments to possible variations in the economic outlook. The two scenarios considered are:

- Scenario 1: a 1 per cent reduction in nominal GDP owing to a fall in the terms of trade.
- Scenario 2: a 1 per cent increase in real GDP driven by an equal increase in labour productivity and labour force participation.

The economic scenarios provide a rule of thumb indication of the impact on receipts, payments and the underlying cash balance of changes in the economic outlook. They represent a partial economic analysis only and do not attempt to capture all the economic feedback and other policy responses related to changed economic conditions. In particular, the analysis assumes no change in the exchange rate, interest rates or discretionary policy. The impact of the two scenarios on the economic parameters would be different if the full feedback response on economic variables and likely policy actions were taken into account. The analysis does not aim to provide an alternative picture of the economic forecasts under these scenarios, but instead gives an indication of the sensitivity associated with different components of receipts and payments to changes in the economy. As such, the changes in the economic variables and their impact on the fiscal outlook are merely illustrative.

The impacts shown in the tables below are broadly symmetrical. That is, impacts of around the same magnitude, but in the opposite direction, would apply if the terms of trade were to increase or if real GDP were to decrease.

Scenario 1

The first scenario involves a permanent fall in world prices of non-rural commodity exports, which causes a fall in the terms of trade, consistent with a 1 per cent fall in nominal GDP by 2011-12. The sensitivity analysis evaluates the flow-on effects on the economy, the labour market and prices. The impacts in Table A1 are highly stylised and refer to per cent deviations from the baseline levels of the economic parameters.

Table A1: Illustrative impact of a permanent non-rural commodity price fall consistent with a 1 per cent fall in nominal GDP in 2011-12 (per cent deviation from the baseline level)

	2010-11 per cent	2011-12 per cent
Real GDP	0	- 1/4
Non-farm GDP deflator	- 3/4	- 3/4
Employment	- 1/4	- 1/2
Wages	0	- 1/4
CPI	0	- 1/4
Company profits	-3	-3
Consumption	- 1/4	- 1/2

Assuming no change in exchange rates or interest rates, the fall in export prices leads directly to a lower non-farm GDP deflator (from the export component of GDP) and lower domestic incomes. Lower domestic incomes cause both consumption and investment to fall, resulting in lower real GDP, employment and wages. The fall in aggregate demand puts downward pressure on domestic prices.

In reality, a fall in the terms of trade would be expected to put downward pressure on the exchange rate, although the magnitude is particularly difficult to model. In the event of a depreciation in the exchange rate, the impacts on the external sector would dampen the real GDP effects, and there would be some offsetting upward pressure on domestic prices.

Given these assumptions, the overall impact of the fall in the terms of trade is a decrease in the underlying cash balance of around $2.1 billion in 2010-11 and around $5.1 billion in 2011-12 (see Table A2).

Table A2: Illustrative sensitivity of the budget balance to a 1 per cent decrease in nominal GDP due to a fall in the terms of trade

	2010-11 $b	2011-12 $b
Receipts		
Individuals and other withholding taxation	-0.6	-1.5
Superannuation taxation	-0.1	-0.1
Company tax	-1.2	-3.1
Goods and services tax	-0.1	-0.2
Excise and customs duty	-0.1	-0.1
Other taxation	0.0	0.0
Total receipts	**-2.0**	**-5.0**
Payments		
Income support	-0.1	-0.1
Other payments	0.0	0.1
GST	0.1	0.2
Total payments	**0.0**	**0.2**
PDI	-0.1	-0.3
Underlying cash balance impact	**-2.1**	**-5.1**

On the receipts side, a fall in the terms of trade results in a fall in nominal GDP which reduces tax collections. The largest impact falls on company tax receipts as the fall in export income decreases company profits. Lower company profits are assumed to flow through to lower Australian equity prices, therefore reducing capital gains tax from individuals, companies and superannuation funds.

The contracting economy results in lower aggregate demand which flows through to lower employment and wages. For this reason, individuals' income tax collections fall and the decrease in disposable incomes leads to lower consumption, which in turn results in a decrease in GST receipts (decreasing GST payments to the States by the same amount) and other indirect tax collections.

On the payments side, a significant proportion of government expenditure is partially indexed to movements in costs (as reflected in various price and wage measures). Some forms of expenditure, in particular income support payments, are also driven by the number of beneficiaries.

The overall estimated expenditure on income support payments (including pensions and allowances) increases in both years due to a higher number of unemployment benefit recipients. The increase in unemployment benefits in 2011-12 is partly offset by reduced expenditure on pensions and allowances reflecting lower growth in benefit rates resulting from lower wages growth. At the same time other payments linked to inflation fall in line with the reduced growth in prices.

The lower underlying cash balance also has a negative interest impact in both years owing to a higher borrowing requirement and higher public debt interest cost.

As noted above, under a floating exchange rate, the depreciation of the exchange rate would dampen the effects of the fall in the terms of trade on real GDP, meaning the impact on the fiscal position could be substantially more subdued. Also, to the extent that the fall in the terms of trade is temporary rather than permanent, the impact on the economic and fiscal position would be more subdued.

Scenario 2

The second scenario involves a combination of an equal 0.5 per cent increase in the participation rate and in labour productivity, resulting in a 1 per cent increase in real GDP by 2011-12. Once again, the sensitivity analysis evaluates the flow-on effects on the economy, the labour market and prices. The impacts in Table A3 are highly stylised and refer to per cent deviations from the baseline levels of the parameters.

The 1 per cent increase in real GDP increases nominal GDP by slightly less but the magnitude of the effects on receipts, payments and the underlying cash balance differ from the first scenario because this variation in the outlook affects different parts of the economy in different ways.

Table A3: Illustrative impact of an ongoing equal increase in both labour productivity and participation consistent with a 1 per cent increase in real GDP in 2011-12 (per cent deviation from the baseline level)

	2010-11 per cent	2011-12 per cent
Nominal GDP	3/4	3/4
Non-farm GDP deflator	- 1/4	- 1/4
Employment	1/2	1/2
Wages	1/4	1/4
CPI	- 1/4	- 1/4
Company profits	1 3/4	1 3/4
Consumption	1	1

The increase in labour force participation and labour productivity both have the same impact on output, but different impacts on the labour market. Higher productivity leads to higher real GDP and higher real wages, while an increase in the participation rate increases employment and real GDP. Imports are higher in this scenario, reflecting higher domestic incomes.

Since the supply side of the economy expands, inflation falls relative to the baseline. The fall in domestic prices makes exports more attractive to foreigners, with the resulting increase in exports offsetting higher imports, leaving the trade balance unchanged. The exchange rate is assumed to be constant.

The overall impact of the increase in labour productivity and participation is an increase in the underlying cash balance of around $2.5 billion in 2010-11 and around $3.7 billion in 2011-12 (see Table A4).

Table A4: Illustrative sensitivity of the budget balance to a 1 per cent increase in real GDP due to an equal increase in both productivity and participation

	2010-11 $b	2011-12 $b
Receipts		
Individuals and other withholding taxation	1.6	1.3
Superannuation taxation	0.0	0.1
Company tax	0.7	1.8
Goods and services tax	0.4	0.4
Excise and customs duty	0.2	0.4
Other taxation	0.0	0.0
Total receipts	**2.9**	**3.9**
Payments		
Income support	-0.1	-0.1
Other payments	0.0	0.0
GST	-0.4	-0.4
Total payments	**-0.5**	**-0.5**
PDI	0.1	0.3
Underlying cash balance impact	**2.5**	**3.7**

On the receipts side, individuals' income tax collections increase because of the rise in the number of wage earners and, additionally, higher real wages. This in turn increases individuals' refunds in the following year when tax returns are lodged, reducing total individuals' income tax. The stronger labour market also increases superannuation fund taxes through higher contributions (including compulsory contributions) to superannuation funds. The increase in personal incomes leads to higher consumption which results in an increase in GST receipts (with the corresponding receipts passed on in higher GST payments to the States) and other indirect tax collections.

In addition, the stronger economy results in higher levels of corporate profitability, increasing company taxes. Higher profits are assumed to increase Australian equity prices, generating higher capital gains tax from individuals, companies and superannuation funds.

On the payments side, overall estimated expenditure on income support payments (including pensions and allowances) is slightly higher primarily reflecting growth in benefit rates flowing from higher wages growth. Lower inflation has a partially offsetting effect.

The higher underlying cash balance also has a positive interest impact in both years, owing to a lower borrowing requirement and lower public debt interest cost.

To the extent that the increases in productivity and participation are temporary rather than permanent, the impact on the economic and fiscal position would be more subdued.