

## STATEMENT 2: FISCAL OUTLOOK

This statement summarises the main budget aggregates for the Australian Government general government sector.

The fiscal outlook for 2007-08 remains strong, with the Government forecasting an underlying cash surplus of \$10.6 billion. Across the forward estimates the Government has maintained the budget in a surplus position after providing for personal income tax relief worth \$5.3 billion in 2007-08 and \$31.5 billion over the forward estimates.

The Government's sound fiscal management has eliminated net debt which stood at \$96.3 billion in 1996-97. It is expected that net worth will be positive in 2008-09. The ageing of the population, together with rising age pension, health and aged care spending, will open a gap between revenue and expenses in the long run. By accumulating financial assets in the Future Fund and maintaining strong surpluses over the forward estimates, the Government is well placed to deal with these emerging fiscal pressures.

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## STATEMENT 2: FISCAL OUTLOOK

The fiscal outlook for 2007-08 remains strong, with the Government forecasting its tenth budget surplus. Across the forward estimates period, the Government has maintained the budget in surplus after providing for personal income tax relief worth \$31.5 billion, a \$3.5 billion investment in Australia's education system and substantial new funding for road, rail and water infrastructure.

### BUDGET AGGREGATES

An underlying cash surplus of \$10.6 billion is expected in 2007-08 compared with an estimated surplus of \$9.7 billion at the *Mid-Year Economic and Fiscal Outlook 2006-07* (MYEFO). In accrual terms, a fiscal surplus of \$10.0 billion is estimated for 2007-08 compared to \$9.9 billion at MYEFO. The fiscal outlook is for continuing underlying cash and fiscal surpluses in the forward years.

**Table 1: Australian Government general government sector budget aggregates<sup>(a)</sup>**

	Actual	Estimates		Projections		
	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
<b>Revenue (\$b)</b>	<b>221.9</b>	<b>235.5</b>	<b>246.8</b>	<b>260.7</b>	<b>274.6</b>	<b>287.3</b>
Per cent of GDP	23.0	22.8	22.5	22.8	23.1	22.9
<b>Expenses (\$b)</b>	<b>206.1</b>	<b>221.6</b>	<b>235.6</b>	<b>247.5</b>	<b>259.7</b>	<b>272.7</b>
Per cent of GDP	21.3	21.5	21.5	21.6	21.8	21.8
Net operating balance (\$b)	15.8	13.9	11.2	13.2	15.0	14.6
Net capital investment (\$b)	1.1	2.0	1.2	1.4	0.9	0.9
<b>Fiscal balance (\$b)</b>	<b>14.8</b>	<b>11.9</b>	<b>10.0</b>	<b>11.9</b>	<b>14.1</b>	<b>13.7</b>
Per cent of GDP	1.5	1.2	0.9	1.0	1.2	1.1
<b>Underlying cash balance (\$b)(b)</b>	<b>15.8</b>	<b>13.6</b>	<b>10.6</b>	<b>12.7</b>	<b>13.8</b>	<b>12.4</b>
Per cent of GDP	1.6	1.3	1.0	1.1	1.2	1.0
<i>Memorandum item:</i>						
Headline cash balance (\$b)	14.2	23.4	18.3	15.5	14.8	13.3

(a) All estimates are based on Government Finance Statistics (GFS) standards, but with goods and services tax (GST) revenue collected on behalf of the States and Territories netted off revenue and expenses.

(b) Excludes expected Future Fund earnings from 2005-06 onwards.

### VARIATIONS TO THE FISCAL BALANCE ESTIMATES

The upward revision of \$0.1 billion in the 2007-08 fiscal surplus since MYEFO reflects higher than anticipated tax revenue and lower than anticipated spending, offset by the cost of additional personal income tax relief and other new policy measures.

Table 2 provides a reconciliation of the fiscal balance estimates between the 2006-07 Budget, the 2006-07 MYEFO and the 2007-08 Budget.

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**Table 2: Reconciliation of 2006-07 Budget, 2006-07 MYEFO and 2007-08 Budget fiscal balance estimates<sup>(a)</sup>**

	Estimates		Projections	
	2006-07	2007-08	2008-09	2009-10
	\$m	\$m	\$m	\$m
<b>2006-07 Budget fiscal balance</b>	<b>10,290</b>	<b>9,940</b>	<b>10,566</b>	<b>12,972</b>
Per cent of GDP	1.0	0.9	1.0	1.1
<b>Changes between 2006-07 Budget and MYEFO</b>				
Effect of policy decisions(b)				
Revenue	-202	-1,609	-1,608	-1,753
Expenses	1,969	3,648	2,986	2,868
Net capital investment	159	134	106	307
Total policy decisions impact on fiscal balance	-2,330	-5,392	-4,700	-4,928
Effect of parameter and other variations				
Revenue	424	3,664	5,131	4,532
Expenses	-2,524	-1,883	-1,403	-2,792
Net capital investment	489	169	507	641
Total parameter and other variations impact on fiscal balance	2,459	5,378	6,028	6,683
<b>2006-07 MYEFO fiscal balance</b>	<b>10,420</b>	<b>9,926</b>	<b>11,893</b>	<b>14,728</b>
Per cent of GDP	1.0	0.9	1.0	1.2
<b>Changes between MYEFO and 2007-08 Budget</b>				
Effect of policy decisions(b)				
Revenue	-16	-5,581	-8,221	-8,497
Expenses	4,189	6,375	7,949	10,468
Net capital investment	26	352	250	80
Total policy decisions impact on fiscal balance	-4,231	-12,307	-16,419	-19,045
Effect of parameter and other variations				
Revenue	3,670	9,615	13,345	14,728
Expenses	-1,739	-3,106	-2,954	-3,484
Net capital investment	-291	341	-87	-205
Total parameter and other variations impact on fiscal balance	5,700	12,380	16,386	18,418
<b>2007-08 Budget fiscal balance</b>	<b>11,888</b>	<b>9,999</b>	<b>11,860</b>	<b>14,101</b>
Per cent of GDP	1.2	0.9	1.0	1.2

(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) Excludes the public debt net interest effect of policy measures.

### Variations in revenue estimates

Total revenue for 2007-08 has been revised up by \$4.0 billion since the 2006-07 MYEFO.

The upward revision represents the flow-on effect of stronger than expected labour market outcomes, together with a stronger outlook for corporate profits in 2007. These upward revisions have been partly offset by the impact of the Government's decision to provide personal income tax relief worth \$5.3 billion in 2007-08 and \$31.5 billion over the forward estimates.

Other major policy decisions affecting revenue over the four year period from 2007-08 to 2010-11 include:

- converting the Child Care Tax Rebate to a direct payment administered through the Department of Families, Community Services and Indigenous Affairs, which will increase revenue by \$1.4 billion over the forward estimates period. This increase is more than offset by the increase in expenses arising from the measure;
- increasing the dependent spouse rebate to \$2,100 from 1 July 2007, at a cost to revenue of \$425 million over the forward estimates period;
- not proceeding with the Review of Business Taxation recommendation relating to the taxation of finance leasing at a cost of \$260 million over the forward estimates; and
- relaxing the beneficial ownership provisions of the premium 175 per cent research and development (R&D) tax concession, to allow certain entities to claim deductions for their incremental R&D expenditure where the resulting intellectual property is held overseas. The measure is expected to have a cost to revenue of \$200 million over the forward estimates period.

Looking ahead, economic conditions remain supportive of continued strength in underlying revenue, particularly through compensation of employees, company profits and the realisation of capital gains by investors.

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 C.

Non-taxation revenue in 2007-08 is expected to be \$520 million higher than the MYEFO estimate, including a \$237 million increase in Reserve Bank of Australia dividends largely due to previously unanticipated realised gains in 2006-07, and a \$235 million increase in interest received by the Australian Office of Financial Management on term deposits.

### **Variations in expense estimates**

Since MYEFO, estimated expenses for 2007-08 have increased by \$3.3 billion reflecting increased expenses from new policy decisions of \$6.4 billion, partially offset by parameter and other variations of \$3.1 billion.

Major policy decisions since MYEFO that have increased expenses include:

- \$658 million in 2007-08 (\$3.3 billion over five years including \$452 million in 2006-07) to convert the existing Child Care Tax Rebate to a direct payment and to

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increase the rate of Child Care Benefit by 10 per cent (these costs are partially offset by an increase in revenue of \$1.4 billion);

- \$621 million in 2007-08 (\$6.6 billion over 13 years) to acquire Super Hornet aircraft for the Australian Defence Force which will improve Australia's air combat capability edge by introducing enhanced sensors, weapon and networking capabilities;
- \$534 million in 2007-08 (\$2.6 billion over four years) to increase the level and effectiveness of Australia's Official Development Assistance;
- \$531 million in 2007-08 (\$3.5 billion over four years) for investment in Australia's education system under the *Realising Our Potential* package; and
- \$448 million in 2007-08 (\$703 million over four years including \$32.4 million in 2006-07) to enhance Australia's military contribution to the reconstruction and rehabilitation of Afghanistan.

In 2007-08, parameter and other variations have decreased forecast expenses by \$3.1 billion since MYEFO largely reflecting:

- a \$993 million reduction in expenses arising from delays to some Defence acquisition projects;
- a \$477 million reduction in expenses for Newstart Allowance arising from a lower than anticipated increase following implementation of the Government's Welfare to Work measures;
- a \$276 million reduction under the Water Smart Australia programme primarily due to slippage in grant payments and fewer than expected projects from the 2006-07 grant round;
- a \$245 million reduction in expenses for Parenting Payment due to a reduction in the expected number of benefit recipients following implementation of the Government's Welfare to Work measures and strong labour market conditions; and

- the regular draw-down of the conservative bias allowance<sup>1</sup> reducing estimated expenses in 2007-08 by around \$1 billion.

The above decreases in expenses are partially offset by:

- a \$460 million increase in expenses due to higher than expected penalties remissions by the Australian Taxation Office;
- a \$336 million increase in expenses for Medicare Services reflecting higher than anticipated demand for pathology services, diagnostic imaging, and services provided by general practitioners; and
- a \$283 million increase in expenses for the Private Health Insurance Rebate reflecting annual premium increases, a trend for private health insurance customers to take out higher priced policies and an increase in private health insurance participation.

In 2006-07, estimated expenses have increased by \$2.5 billion since MYEFO. This largely reflects new spending of \$4.2 billion, including:

- \$1.3 billion for a one-off payment of \$500 to eligible older Australians;
- \$1.1 billion to pay a one-off additional superannuation co-contribution for those persons who made eligible contributions in the 2005-06 income year;
- \$486 million to fund a variety of development and expansion projects by medical research facilities and the operations of the Australian Synchrotron;
- \$390 million for a lump sum payment to eligible carers, in recognition of their contribution in caring for people with disabilities and the frail aged; and
- \$250 million for the Auslink Strategic Regional Programme to fund contributions to road, rail and multi-modal projects in Australia's regions.

These measures are partially offset by reductions in parameter and other variations including a \$301 million reduction in Newstart Allowance and a \$222 million reduction in Family Tax Benefit expenses.

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<sup>1</sup> The forward estimates include an allowance for the established tendency of existing Government policy (particularly demand driven programmes) to be higher than estimated in the forward years. To offset this, the contingency reserve includes an allowance based on past experience to preserve the overall integrity of the forward estimates. This allowance, known as the conservative bias allowance, is progressively reduced so that the budget year conservative bias is zero by budget night.

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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 2007-08*.

### **Variations in net capital investment estimates**

In 2007-08, forecast net capital investment has increased by \$693 million since MYEFO. This represents the combined effect of:

- new policy measures of \$352 million, including \$118 million for the Strengthening National Security package of measures; \$37 million for the Australian Securities and Investments Commission's redevelopment of information technology systems; and \$30 million for the Australian Nuclear Science and Technology Organisation's automation of production processes for radiopharmaceuticals; and
- parameter and other variations of \$341 million, including \$75 million for the Health and Social Services Access Card programme, reflecting changes in the project timetable and associated movements between expense and capital; \$34 million for Defence commercial vehicle sales; and \$33 million for the fit out of the Anzac Park office buildings.

In 2006-07, estimated net capital investment has decreased by \$265 million since MYEFO, including \$70 million for Health Emergency Planning and Response as a result of unavoidable delays in the purchase of items in the national medical stockpile, and \$21 million reflecting delays in the construction of significant aged care payments systems.

### **CASH FLOWS**

In 2007-08, an underlying cash surplus of \$10.6 billion is expected, compared with the MYEFO estimate of \$9.7 billion. While the 2007-08 underlying cash balance has increased by \$1.0 billion, the fiscal balance has increased by only \$0.1 billion compared to the MYEFO estimate of \$9.9 billion. This difference between the change in the underlying cash balance and the fiscal balance is largely attributable to the increase in penalty remissions expenses by the Australian Taxation Office, which do not have a cash impact.

Table 3 provides a summary of Australian Government general government sector cash flows.



**Table 3: Summary of Australian Government general government sector cash flows<sup>(a)</sup>**

	Estimates		Projections		
	2006-07	2007-08	2008-09	2009-10	2010-11
	\$b	\$b	\$b	\$b	\$b
Cash receipts					
Operating cash receipts					
excluding Future Fund earnings	232.3	242.4	256.2	269.9	282.7
Future Fund earnings	2.1	3.0	2.8	2.9	3.0
<i>Total operating receipts</i>	<i>234.4</i>	<i>245.4</i>	<i>259.0</i>	<i>272.8</i>	<i>285.7</i>
Capital cash receipts(b)	0.2	0.3	0.2	0.1	0.1
Total cash receipts	234.6	245.6	259.2	272.9	285.8
Cash payments					
Operating cash payments	215.2	228.3	239.8	252.9	267.2
Capital cash payments(c)	3.6	3.7	3.4	3.3	3.2
Total cash payments	218.8	232.0	243.2	256.2	270.4
Finance leases and similar arrangements(d)	0.0	0.0	-0.5	0.0	0.0
<b>GFS cash surplus(+)/deficit(-)</b>	<b>15.8</b>	<b>13.6</b>	<b>15.5</b>	<b>16.7</b>	<b>15.4</b>
Per cent of GDP	1.5	1.2	1.4	1.4	1.2
<i>less</i> Future Fund earnings	2.1	3.0	2.8	2.9	3.0
<b>Underlying cash balance(e)</b>	<b>13.6</b>	<b>10.6</b>	<b>12.7</b>	<b>13.8</b>	<b>12.4</b>
Per cent of GDP	1.3	1.0	1.1	1.2	1.0
<i>Memorandum items:</i>					
Net cash flows from investments in financial assets for policy purposes(f)	7.6	4.7	0.0	-1.9	-2.1
<i>plus</i> Future Fund earnings(g)	2.1	3.0	2.8	2.9	3.0
<b>Headline cash balance</b>	<b>23.4</b>	<b>18.3</b>	<b>15.5</b>	<b>14.8</b>	<b>13.3</b>

(a) Cash flows are derived from the accrual GFS framework excluding GST.

(b) Equivalent to cash receipts from the sale of non-financial assets in the GFS cash flow statement.

(c) Equivalent to cash payments for purchases of new and second hand non-financial assets in the GFS cash flow statement.

(d) 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.

(e) Excludes expected Future Fund earnings from 2005-06 onwards.

(f) Under the cash budgeting framework, these cash flows were referred to as net advances.

(g) The earnings assume the gross proceeds from the sale of Telstra are transferred to the Future Fund. The Fund is assumed to earn a rate of return initially equal to the yield on other term deposits held by the Government then increasing to a rate consistent with the benchmark return specified in the Government's investment mandate. The earnings exclude capital gains which are reflected in the statement of other economic flows (Table B4).

Table 4 provides a reconciliation of the variations in the underlying cash balance estimates.

**Table 4: Reconciliation of Australian Government general government sector underlying cash balance estimates**

	Estimates		Projections	
	2006-07 \$m	2007-08 \$m	2008-09 \$m	2009-10 \$m
<b>2006-07 Budget underlying cash balance</b>	<b>10,828</b>	<b>10,628</b>	<b>11,225</b>	<b>12,019</b>
<b>Changes from 2006-07 Budget to MYEFO</b>				
Effect of policy decisions(a)	-2,317	-5,455	-4,712	-5,010
Effect of parameter and other variations	3,316	4,489	5,331	6,987
<b>Total variations</b>	<b>999</b>	<b>-966</b>	<b>618</b>	<b>1,977</b>
<b>2006-07 MYEFO underlying cash balance</b>	<b>11,827</b>	<b>9,662</b>	<b>11,844</b>	<b>13,997</b>
<b>Changes from MYEFO to 2007-08 Budget</b>				
Effect of policy decisions(a)	-3,937	-11,885	-15,880	-18,467
Effect of parameter and other variations	5,741	12,861	16,747	18,282
<b>Total variations</b>	<b>1,804</b>	<b>975</b>	<b>867</b>	<b>-185</b>
<b>2007-08 Budget underlying cash balance(b)</b>	<b>13,631</b>	<b>10,637</b>	<b>12,712</b>	<b>13,812</b>

(a) Excludes the public debt net interest effect of policy measures.

(b) Excludes expected Future Fund earnings from 2005-06 onwards.

### Headline cash balance

A headline cash surplus of \$18.3 billion is now forecast for 2007-08 compared with a surplus of \$17.6 billion at MYEFO. The increase in the headline cash surplus since MYEFO largely reflects the higher than expected underlying cash balance surplus.

### NET DEBT AND NET WORTH

Net debt was eliminated in 2005-06, falling from a peak of 18.5 per cent of GDP in 1995-96. Since the 2006-07 MYEFO, the forecast level of net debt has fallen from -\$11.0 billion to -\$12.0 billion. This reflects a higher than anticipated estimated underlying cash surplus in 2007-08.

As a result of the lower level of net debt, net interest payments are expected to be eliminated in 2007-08. Net interest payments peaked at \$8.4 billion in 1996-97, but from 2007-08 the Government will have net interest receipts of \$391 million.

Australian Government general government sector net worth is expected to be -\$0.6 billion in 2007-08 compared with -\$2.6 billion at the 2006-07 MYEFO. Net worth over the forward estimates is expected to improve and is projected to become positive in 2008-09.

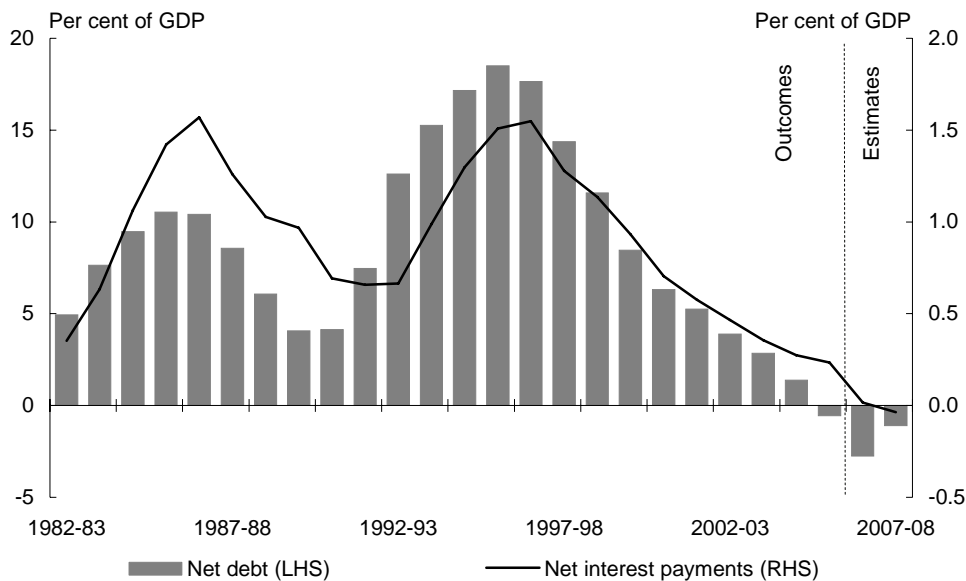
Table 5 and Chart 1 provide a summary of Australian Government general government sector net worth, net debt and net interest payments.

**Table 5: Australian Government general government sector net worth, net debt and net interest payments**

	Estimates		Projections		
	2006-07 \$b	2007-08 \$b	2008-09 \$b	2009-10 \$b	2010-11 \$b
Financial assets	151.1	166.6	184.9	202.8	214.0
Non-financial assets	47.8	49.1	50.6	51.5	52.6
<b>Total assets</b>	<b>198.9</b>	<b>215.7</b>	<b>235.5</b>	<b>254.3</b>	<b>266.5</b>
<b>Total liabilities</b>	<b>209.8</b>	<b>216.3</b>	<b>221.4</b>	<b>225.2</b>	<b>222.4</b>
<b>Net worth</b>	<b>-10.9</b>	<b>-0.6</b>	<b>14.1</b>	<b>29.1</b>	<b>44.1</b>
<b>Net debt(a)(b)</b>	<b>-28.4</b>	<b>-12.0</b>	<b>-28.4</b>	<b>-43.9</b>	<b>-59.2</b>
Per cent of GDP	-2.8	-1.1	-2.5	-3.7	-4.7
<b>Net interest payments</b>	<b>0.2</b>	<b>-0.4</b>	<b>-0.2</b>	<b>-1.2</b>	<b>-1.1</b>
Per cent of GDP	0.0	0.0	0.0	-0.1	-0.1

(a) 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.

(b) Includes the impact of the sale of the Government's holding in Telstra. The net debt estimate in 2007-08 assumes that the Future Fund will increasingly be invested in equities, which are not included in the calculation of net debt.

**Chart 1: Australian Government general government sector net debt and net interest payments**

Source: Data are from ABS cat. no. 5501.0, Australian Government Final Budget Outcomes and Treasury estimates.

## **MEDIUM-TERM FISCAL OUTLOOK**

### **Importance of fiscal sustainability**

The Government's economic and budget management over the past decade has delivered strong fiscal outcomes and supported economic growth. Delivering sustainable fiscal policy is a key requirement of good government. It avoids costly burdens being placed on future generations, as well as providing a secure and stable investment environment that encourages growth.

A sound fiscal policy framework involves maintaining government debt at sustainable levels, ensuring that government has the capacity to finance its continuing expenditure programmes and other budgetary obligations, and managing the Government's exposure to fiscal risks. The Government is continuing to address these issues through making necessary reforms today to avoid the need for larger adjustments in the future.

### **Fiscal outlook**

The Government has achieved strong fiscal outcomes over recent years which have allowed it to eliminate net debt and establish the Future Fund. By eliminating net debt, the Government has put its finances in a sound position and has created a positive investment environment as investors and consumers have greater certainty about the stability of government finances. By setting aside resources in the Future Fund for the Australian Government's largest balance sheet liability – its superannuation obligation to its employees – the Government has ensured that these superannuation costs are not passed on to future generations.

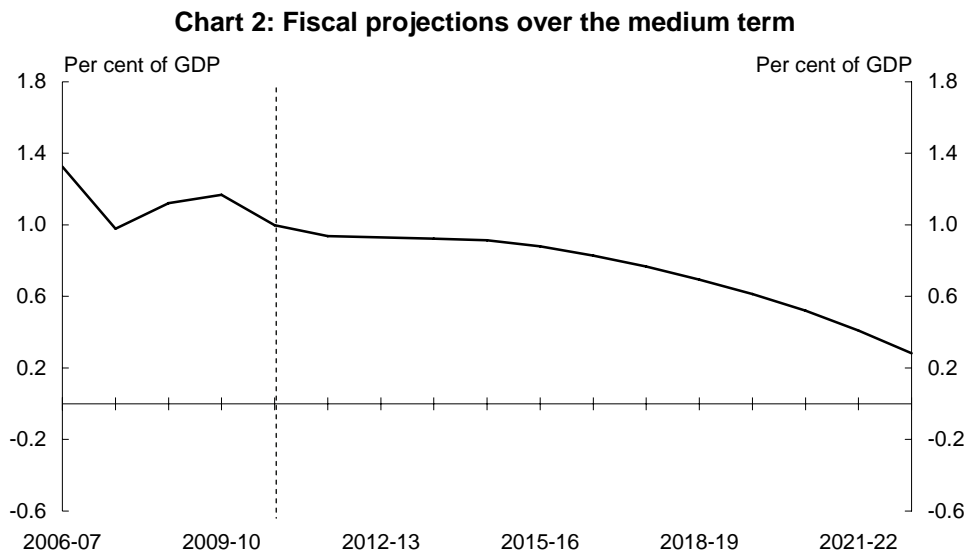
The second Intergenerational Report released in April 2007 (IGR2) showed that the Government's long-term fiscal sustainability has improved since the first report in May 2002 (IGR1). In IGR2, the 'fiscal gap', or the amount by which spending is expected to exceed revenue, was projected to be around 3½ per cent of GDP by 2046-47. This compares to a projected fiscal gap in IGR1 of 5 per cent of GDP by 2041-42.

Although this is an improvement, demographic and other factors will continue to pose substantial challenges for economic growth and long-term fiscal sustainability. These factors will also present a challenge over the medium term.

Chart 2 provides illustrative projections of fiscal pressures over the next 15 years, based on the IGR2 projections. As a base, the IGR2 projections were modelled using the forward estimates from the 2006-07 MYEFO updated for major announced spending measures up to the time of the release of IGR2. The medium-term projections in Chart 2 apply IGR2 growth rates for spending from the end of the current forward estimates period included in the 2007-08 Budget. Like IGR2, revenue is assumed to remain at a constant percentage of GDP from the end of the forward estimates period.

The medium-term fiscal projections in Chart 2 include net interest payments to be on a consistent basis with the underlying cash balance across the forward estimates period. This approach differs from IGR2 where, consistent with other international long-term budget reports, the fiscal projections were modelled using the primary balance which excludes net interest payments. Primary balance is used in such reports because debt dynamics can dominate and obscure the underlying fiscal pressures that need to be addressed. The long-term fiscal gap represents a policy choice that can potentially be avoided. In contrast, policy over the short to medium-term is more certain and financing therefore becomes more relevant.

The medium-term fiscal projections show that without policy change projected spending pressures identified in IGR2 are expected to erode much of the strong fiscal starting point over the next 15 years.



Source: Treasury projections.

The spending pressures identified in IGR2 will see government spending increasing as a percentage of GDP from around 22 per cent currently to above 25 per cent in 2046-47 (Box 1).

**Box 1: Trends in Australian Government spending and economic growth**

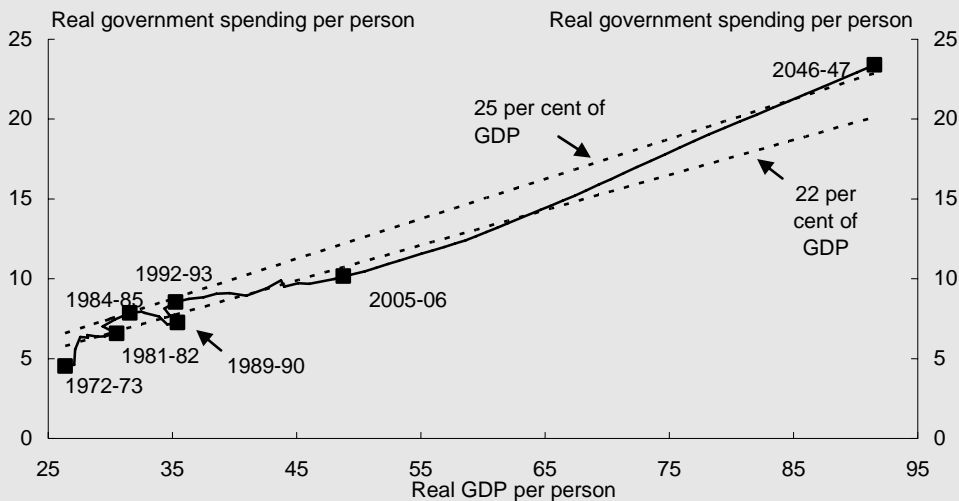
Chart 3 is a scatter chart showing real government spending per person (excluding interest) against real GDP per person from 1972-73 through to the end of the IGR2 projection period of 2046-47. Both spending and GDP are deflated by the GDP deflator. The ratio of real government spending per person to real GDP per person is equal to the ratio of government spending to GDP.

As Chart 3 shows, the historical ratio of government spending to GDP has been relatively stable, not exceeding 25 per cent. The ratio of spending to GDP tends to rise during periods of economic slowdown. This is due to both a slowing in GDP growth and an increase in real spending from automatic stabilisers and discretionary policy decisions. This is most notable in Chart 3 during both the early 1980s and the early 1990s slowdown.

In the long-term, demographic and other factors highlighted in IGR2 will place pressure on government spending per person and slow the rate of growth of GDP per person, pushing the ratio of government spending to GDP above 25 per cent towards the end of the IGR2 projection period.

Steps to manage these fiscal pressures will need to continue to address the growth in government spending and sustainably lift economic growth. The latter will be the key determinant of the Government’s capacity to deal with future fiscal challenges over the medium term.

**Chart 3: Trends in Australian Government spending and economic growth<sup>(a)(b)</sup>**  
(thousands of dollars, 2006-07)



(a) There is a structural break in the series between 1998-99 and 1999-00 due to methodological and data source changes associated with the move to an accrual accounting framework.  
 (b) The provision of GST revenue to the States and Territories from 2000-01 under the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* is not included in Australian Government spending.

## APPENDIX A: REPORTING STANDARDS

The *Charter of Budget Honesty Act 1998* requires that the budget be based on external reporting standards, and that departures from applicable external reporting standards be identified.

The major external standards used for budget reporting purposes are:

- the Australian Bureau of Statistics' (ABS) accrual Government Finance Statistics (GFS) publication, *Australian System of Government Finance Statistics: Concepts, Sources and Methods* cat. no. 5514.0, which in turn is based on the International Monetary Fund (IMF) accrual GFS framework; and
- Australian Accounting Standards (AAS), being the Australian Equivalents to International Financial Reporting Standards (AEIFRS) and AAS 31 *Financial Reporting by Governments*.

The budget tables, with the exception of tables in Statement 9, do not include goods and services tax (GST) collections and equivalent payments to the States and Territories (the States). Under the *Intergovernmental Agreement on the Reform of Commonwealth State Financial Relations*, all GST receipts are appropriated to the States and thus are not available for expenditure by the Australian Government. Because the Australian Taxation Office collects GST as an agent for the States, GST receipts are not shown as Australian Government revenue. Estimates of GST receipts are provided in Table 2 of Statement 8.

ABS GFS requires that provisions for bad and doubtful debts be excluded from the balance sheet. This treatment has not been adopted because excluding such provisions would overstate the value of Australian Government assets in the balance sheet (and would, therefore, be inconsistent with the market valuation principle).

The AAS financial statements currently record IMF Special Drawing Rights (SDRs) as a liability. This is consistent with AAS. The GFS statements also record SDRs as a liability. However, in accordance with the IMF's GFS manual, IMF SDRs are not treated as a liability in ABS GFS although the IMF treats them this way in some of its other documentation. As the statistical standard underpinning the GFS manual (the System of National Accounts 1993) is currently being updated and includes a proposal to treat SDRs as a liability, the current approach will remain in place at least until this update is finalised.

The GFS financial statements currently adopt the AAS treatment for circulating coins. Under this treatment revenue is recognised upon the issue of coins and no liability is recorded, as there is no legal obligation requiring coins on issue to be repurchased by the Australian Government. However, in ABS GFS, coins on issue are treated as a liability and no revenue is recognised. The treatment of coins on issue is listed for

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clarification as part of the update of the statistical standard referred to above and the current treatment will remain in place at least until the update is finalised.

ABS GFS also requires defence weapons be treated as expenses. The update of the statistical standard is expected to change the treatment of defence weapons to assets and the current treatment is expected to remain in place at least until the update is finalised.

Defence weapons inventories are recorded as capital investment rather than expenses until such inventories can be reliably identified and measured. This treatment does not affect the underlying cash and fiscal balances.

Additional information on the reporting standards and budget concepts is provided in Statement 8.



## **APPENDIX B: BUDGET FINANCIAL STATEMENTS**

The budget financial statements consist of an operating statement, balance sheet, cash flow statement and statement of other economic flows (reconciliation of net worth) for the Australian Government general government sector. The budget financial statements are based on GFS standards with the exception of the divergences discussed in Appendix A.

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**Table B1: Australian Government general government sector operating statement**

	Estimates		Projections		
	2006-07 \$m	2007-08 \$m	2008-09 \$m	2009-10 \$m	2010-11 \$m
<b>Revenue</b>					
Taxation revenue	220,466	231,069	244,066	256,636	267,262
Current grants and subsidies	0	0	0	0	0
Sales of goods and services	5,008	5,220	5,362	5,541	5,950
Interest income	3,841	4,147	3,979	4,879	4,562
Dividend income	2,774	2,966	3,832	3,944	4,035
Other	3,449	3,357	3,487	3,615	5,504
<b>Total revenue</b>	<b>235,539</b>	<b>246,761</b>	<b>260,726</b>	<b>274,614</b>	<b>287,312</b>
<b>Expenses</b>					
Gross operating expenses					
Depreciation	2,216	2,478	2,638	2,720	2,717
Superannuation	2,371	2,487	2,536	2,593	2,672
Salaries and wages	13,854	14,701	14,802	15,209	15,650
Payment for supply of goods and services	50,931	55,684	58,857	62,020	65,562
Other operating expenses	3,151	3,463	3,750	3,930	4,448
<i>Total gross operating expenses</i>	<i>72,523</i>	<i>78,813</i>	<i>82,584</i>	<i>86,472</i>	<i>91,049</i>
Nominal superannuation interest expense	5,730	6,192	6,294	6,517	6,706
Other interest expenses	3,957	3,836	3,754	3,722	3,588
Other property expenses	0	0	0	0	0
Current transfers					
Grant expenses	41,702	45,007	46,568	48,445	50,602
Subsidy expenses	6,890	7,337	7,498	7,691	7,945
Personal benefit payments in cash	85,036	87,448	93,323	99,410	105,498
Other current transfers	0	0	0	0	0
<i>Total current transfers</i>	<i>133,628</i>	<i>139,792</i>	<i>147,389</i>	<i>155,545</i>	<i>164,045</i>
Capital transfers	5,786	6,958	7,467	7,395	7,281
<b>Total expenses</b>	<b>221,625</b>	<b>235,590</b>	<b>247,489</b>	<b>259,652</b>	<b>272,669</b>
<b>Net operating balance</b>	<b>13,914</b>	<b>11,170</b>	<b>13,237</b>	<b>14,962</b>	<b>14,643</b>
<b>Net acquisition of non-financial assets</b>					
Purchases of non-financial assets	3,675	3,689	3,864	3,328	3,537
<i>less</i> Sales of non-financial assets	<i>184</i>	<i>199</i>	<i>216</i>	<i>109</i>	<i>109</i>
<i>less</i> Depreciation	<i>2,216</i>	<i>2,478</i>	<i>2,638</i>	<i>2,720</i>	<i>2,717</i>
<i>plus</i> Change in inventories	<i>624</i>	<i>111</i>	<i>187</i>	<i>215</i>	<i>411</i>
<i>plus</i> Other movements in non-financial assets	<i>126</i>	<i>49</i>	<i>180</i>	<i>148</i>	<i>-182</i>
<b>Total net acquisition of non-financial assets</b>	<b>2,025</b>	<b>1,171</b>	<b>1,377</b>	<b>861</b>	<b>939</b>
<b>Net lending/fiscal balance(a)</b>	<b>11,888</b>	<b>9,999</b>	<b>11,860</b>	<b>14,101</b>	<b>13,704</b>

(a) The term fiscal balance is not used by the ABS.

**Table B2: Australian Government general government sector balance sheet**

	Estimates		Projections		
	2006-07 \$m	2007-08 \$m	2008-09 \$m	2009-10 \$m	2010-11 \$m
<b>Assets</b>					
Financial assets					
Cash and deposits	2,008	2,348	2,778	2,297	2,121
Advances paid	22,468	24,122	25,849	27,439	29,277
Investments, loans and placements	67,820	51,488	66,025	79,643	85,457
Other non-equity assets	27,543	20,655	20,021	20,239	20,751
Equity(a)	31,260	68,014	70,223	73,195	76,379
<i>Total financial assets</i>	<i>151,099</i>	<i>166,627</i>	<i>184,896</i>	<i>202,813</i>	<i>213,986</i>
Non-financial assets					
Land	6,181	6,276	6,365	6,355	6,402
Buildings	15,193	15,782	16,938	17,652	18,351
Plant, equipment and infrastructure	9,481	9,898	9,881	9,748	9,824
Inventories	5,532	5,643	5,830	6,045	6,456
Heritage and cultural assets	8,074	8,109	8,134	8,164	8,188
Other non-financial assets	3,382	3,358	3,406	3,518	3,335
<i>Total non-financial assets</i>	<i>47,844</i>	<i>49,067</i>	<i>50,555</i>	<i>51,483</i>	<i>52,556</i>
<b>Total assets</b>	<b>198,942</b>	<b>215,695</b>	<b>235,451</b>	<b>254,297</b>	<b>266,542</b>
<b>Liabilities</b>					
Deposits held	300	300	300	300	300
Advances received	0	0	0	0	0
Government securities	57,275	59,269	59,355	58,723	50,715
Loans	5,846	5,940	5,774	5,653	5,834
Other borrowing	431	400	856	816	773
Superannuation liability	102,744	106,552	110,264	113,983	117,720
Other employee entitlements and provisions	8,215	8,465	8,815	9,185	9,606
Other non-equity liabilities	34,982	35,355	36,022	36,515	37,456
<b>Total liabilities</b>	<b>209,795</b>	<b>216,282</b>	<b>221,387</b>	<b>225,175</b>	<b>222,404</b>
<b>Net worth(b)</b>	<b>-10,852</b>	<b>-587</b>	<b>14,064</b>	<b>29,122</b>	<b>44,137</b>
Net debt(c)(d)	-28,444	-12,049	-28,366	-43,887	-59,233

(a) Equity includes holdings of the Future Fund.

(b) Net worth is calculated as total assets minus total liabilities.

(c) 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.

(d) Includes the impact of the sale of the Government's holding in Telstra. The net debt estimate in 2007-08 assumes that the Future Fund will increasingly be invested in equities, which are not included in the calculation of net debt.

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**Table B3: Australian Government general government sector cash flow statement<sup>(a)</sup>**

	Estimates		Projections		
	2006-07 \$m	2007-08 \$m	2008-09 \$m	2009-10 \$m	2010-11 \$m
<b>Cash receipts from operating activities</b>					
Taxes received	216,400	226,857	239,562	252,073	262,845
Receipts from sales of goods and services	5,221	5,437	5,596	5,749	6,160
Grants and subsidies received	0	0	0	0	0
Interest receipts	3,736	3,992	3,743	4,636	5,391
Dividends	3,120	2,926	3,837	3,949	4,085
GST input credits received by general government	3,027	2,988	2,996	3,058	3,121
Other receipts	2,932	3,160	3,263	3,357	4,133
<b>Total operating receipts</b>	<b>234,435</b>	<b>245,361</b>	<b>258,996</b>	<b>272,824</b>	<b>285,735</b>
<b>Cash payments for operating activities</b>					
Payments for goods and services	-55,675	-61,382	-64,283	-67,436	-70,468
Grants and subsidies paid	-52,340	-56,202	-57,679	-60,670	-63,179
Interest paid	-3,911	-3,601	-3,582	-3,461	-4,340
Personal benefit payments	-81,929	-84,687	-90,786	-97,076	-103,443
Salaries, wages and other entitlements	-18,558	-19,628	-19,998	-20,640	-22,041
GST payments by general government to taxation authority	-79	-81	-82	-85	-87
Other payments for operating activities	-2,734	-2,745	-3,428	-3,516	-3,641
<b>Total operating payments</b>	<b>-215,225</b>	<b>-228,326</b>	<b>-239,838</b>	<b>-252,884</b>	<b>-267,199</b>
<b>Net cash flows from operating activities</b>	<b>19,210</b>	<b>17,035</b>	<b>19,159</b>	<b>19,940</b>	<b>18,536</b>
<b>Cash flows from investments in non-financial assets</b>					
Sales of non-financial assets	184	250	222	114	104
Purchases of non-financial assets	-3,599	-3,654	-3,373	-3,323	-3,198
<b>Net cash flows from investments in non-financial assets</b>	<b>-3,415</b>	<b>-3,404</b>	<b>-3,152</b>	<b>-3,209</b>	<b>-3,094</b>
<b>Net cash flows from investments in financial assets for policy purposes</b>	<b>7,649</b>	<b>4,652</b>	<b>-18</b>	<b>-1,923</b>	<b>-2,150</b>
<b>Cash flows from investments in financial assets for liquidity purposes</b>					
Increase in investments	-22,476	-19,918	-15,425	-14,274	-6,372
<b>Net cash flows from investments in financial assets for liquidity purposes</b>	<b>-22,476</b>	<b>-19,918</b>	<b>-15,425</b>	<b>-14,274</b>	<b>-6,372</b>
<b>Cash flows from financing activities</b>					
Advances received (net)	0	0	0	0	0
Borrowing (net)	-1,312	2,336	154	-705	-6,987
Deposits received (net)	-20	0	0	0	0
Other financing (net)	426	-361	-289	-310	-108
<b>Net cash flows from financing activities</b>	<b>-905</b>	<b>1,976</b>	<b>-134</b>	<b>-1,014</b>	<b>-7,096</b>
<b>Net increase/decrease in cash held</b>	<b>63</b>	<b>340</b>	<b>430</b>	<b>-481</b>	<b>-176</b>

**Table B3: Australian Government general government sector cash flow statement<sup>(a)</sup> (continued)**

	Estimates		Projections		
	2006-07 \$m	2007-08 \$m	2008-09 \$m	2009-10 \$m	2010-11 \$m
<b>Net cash from operating activities and investments in non-financial assets</b>	<b>15,795</b>	<b>13,631</b>	<b>16,007</b>	<b>16,731</b>	<b>15,442</b>
Finance leases and similar arrangements(b)	-34	-4	-502	-6	0
<b>GFS cash surplus(+)/deficit(-)</b>	<b>15,761</b>	<b>13,628</b>	<b>15,505</b>	<b>16,725</b>	<b>15,442</b>
<i>less</i> Future Fund earnings	2,130	2,991	2,793	2,913	2,994
<b>Equals underlying cash balance(c)</b>	<b>13,631</b>	<b>10,637</b>	<b>12,712</b>	<b>13,812</b>	<b>12,447</b>
<i>plus</i> net cash flows from investments in financial assets for policy purposes	7,649	4,652	-18	-1,923	-2,150
<i>plus</i> Future Fund earnings	2,130	2,991	2,793	2,913	2,994
<b>Equals headline cash balance</b>	<b>23,410</b>	<b>18,280</b>	<b>15,487</b>	<b>14,802</b>	<b>13,292</b>

(a) A positive number denotes a cash inflow, a negative sign denotes a cash outflow.

(b) 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.

(c) The term underlying cash balance is not used by the ABS.

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**Table B4: Australian Government general government sector statement of other economic flows (reconciliation of net worth)**

	Estimates		Projections		
	2006-07 \$m	2007-08 \$m	2008-09 \$m	2009-10 \$m	2010-11 \$m
<b>Opening net worth</b>	<b>-23,122</b>	<b>-10,852</b>	<b>-587</b>	<b>14,064</b>	<b>29,122</b>
<b>Opening net worth adjustments(a)</b>	287	0	0	0	0
<b>Adjusted opening net worth</b>	<b>-22,835</b>	<b>-10,852</b>	<b>-587</b>	<b>14,064</b>	<b>29,122</b>
<b>Change in net worth from operating transactions</b>	<b>13,914</b>	<b>11,170</b>	<b>13,237</b>	<b>14,962</b>	<b>14,643</b>
<b>Change in net worth from other economic flows</b>					
Revaluation of equity(b)	964	880	3,334	2,308	2,572
Net writedowns of assets (including bad and doubtful debts)	-2,050	-2,271	-2,023	-2,339	-2,448
Assets recognised for the first time	161	7	14	26	19
Liabilities recognised for the first time	0	0	0	0	0
Actuarial revaluations	-1,245	1	1	1	0
Net foreign exchange gains	-52	0	0	0	0
Net swap interest received	8	-76	-70	-60	-62
Market valuation of debt	564	212	124	92	105
Other economic revaluations(c)	-281	341	34	68	186
<b>Total other economic flows</b>	<b>-1,931</b>	<b>-905</b>	<b>1,414</b>	<b>96</b>	<b>373</b>
<b>Closing net worth</b>	<b>-10,852</b>	<b>-587</b>	<b>14,064</b>	<b>29,122</b>	<b>44,137</b>

(a) Change in net worth arising from a change in 2005-06 outcomes.

(b) Revaluations of equity reflects changes in the market valuation of investments. This line also reflects any revaluations at the point of disposal or sale.

(c) Largely reflects revaluation of assets and liabilities.

## APPENDIX C: SENSITIVITY OF FISCAL EXPENSES AND REVENUE TO ECONOMIC DEVELOPMENTS

A guide to the sensitivity of the forward estimates of expenses and revenue due to variations in economic parameters in 2007-08 is provided in Table C1. It is important to note that the sensitivity analysis gives only a 'rule of thumb' indication of the impact on the budget of changes in prices, wages and other parameters. In each case, the analysis presents the estimated effects of a change in one economic variable only, and does not attempt to capture the linkages between economic variables that characterise changes in the economy more broadly.

**Table C1: Sensitivity of fiscal expenses and revenue to changes in economic parameters**

	2007-08 \$m	2008-09 \$m	2009-10 \$m	2010-11 \$m
<b>Expenses</b>				
Prices	730	820	870	880
Wages	120	520	550	570
Federal Minimum Wage decision	50	80	130	190
Unemployment benefit recipients	260	270	280	290
<b>Revenue</b>				
Prices	70	160	160	150
Wages	1,980	1,790	1,900	2,050
Employment	1,900	1,690	1,800	1,940
Private final demand	290	300	310	320
Profit	340	730	760	790

### EXPENSES

On the expenses side, the sensitivity analysis of the estimates provides for the following assumptions about changes to four broad groups of parameters. An increase in any of the parameters considered will lead to an increase in expenses, and a decrease in any of the parameters will lead to a reduction in expenses.

#### Prices

All price growth rates are assumed to change by one percentage point in the September quarter 2007, and to remain unchanged subsequently, with all wage and salary growth rates left unchanged through the budget and forward years.

- The effect of a change in prices is due to the indexation of Australian Government expenses (which impacts more in the forward years than the budget year) and a large one-off impact on military superannuation liabilities in 2007-08 (which in turn impacts on the defence superannuation interest expense).

## **Wages**

All wage and salary growth rates are assumed to change by one percentage point in the September quarter 2007, and to remain unchanged subsequently, with all price growth rates left unchanged through the budget and forward years.

- The effect of a change in wage and salary growth rates is largely due to the Government's commitment to maintain selected pensions at a minimum of 25 per cent of Male Total Average Weekly Earnings. This effect on pensions is smaller in the budget year than in each of the forward years due to the timing of adjustments to pension rates. The wages effect in Table C1 above does not include changes to wage and salary payments in Australian Government departmental expenses.

## **The Federal Minimum Wage decision**

The Federal Minimum Wage increase determined by the Australian Fair Pay Commission (AFPC) is assumed to be \$2 per week higher in the budget year and all forward years.

- Around \$65 billion of expenses in 2007-08, comprising agency departmental expenses, other Australian Government Own Purpose Expenses and Specific Purpose Payments to the States of a departmental expense nature, are indexed to weighted averages of movements in the Consumer Price Index and the Federal Minimum Wage decision.

## **Unemployment Benefit Recipients (Newstart Allowance and Unemployed Youth Allowance recipients)**

The total number of recipients is assumed to change by 5 per cent in the budget year and all the forward years.

## **REVENUE**

On the revenue side, the sensitivity analysis of the estimates provides for the following assumptions about changes to five broad groups of parameters. An increase in any of the parameters considered will lead to an increase in revenue and a decrease in any of the parameters will lead to a reduction in revenue.

### **Prices**

All price deflators and world oil prices are assumed to change by one percentage point at the start of the September quarter 2007, with wage deflators left unchanged.

- A change in prices affects revenue primarily through changes in excise revenue and petroleum resource rent tax.



### **Wages**

All wage and salary growth rates are assumed to change by one percentage point from the beginning of the September quarter 2007, with price deflators left unchanged.

- A change in wage and salary growth rates affects revenue through changes in gross income tax withholding, refunds, superannuation fund contributions tax, and fringe benefits tax.

### **Employment**

The level of employment is assumed to change by one percentage point from the beginning of the September quarter 2007, with no change in the composition of employment.

- A change in employment affects revenue through changes in gross income tax withholding, refunds, and superannuation fund contributions tax.

### **Private final demand**

The level of private final demand (consumption plus investment) is assumed to change by one percentage point from the beginning of the September quarter 2007, with no change in the composition of demand.

- A change in private final demand affects revenue primarily through changes in excise and customs duty collections.

### **Profits**

The level of profits is assumed to change by one percentage point from the beginning of the September quarter 2007.

- A change in the level of profits affects revenue through changes in company and other individuals tax collections.

