STATEMENT 4: ASSESSING THE SUSTAINABILITY OF THE BUDGET

This statement discusses the current challenges for fiscal policy and examines a range of indicators to assess the sustainability of Australia's budget position.

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INTRODUCTION

The global recession is significantly affecting the Australian economy and has fundamentally shifted the challenges for fiscal policy. In the short term, the challenge is to support aggregate demand and employment so as to minimise the social and economic costs of the recession. This is complemented by pre-emptive action to strengthen the financial system.

The challenge for fiscal policy in the medium term is to return the budget to surplus, which is a key element of fiscal sustainability. The Government has a clear, achievable strategy for the return to surplus. Australia's fiscal position is currently, and will continue to be, one of the strongest in the world. This is important because fiscal sustainability remains one of the key ingredients for sustainable economic growth.

CHALLENGES FOR FISCAL POLICY

The global economy is in the midst of its worst recession since the Great Depression, and this is severely affecting the Australian economy. The challenges for fiscal policy are to stimulate aggregate demand in the short term and to return the budget to surplus in the medium term, while also investing in the long-term drivers of productivity and economic growth.

Recessions have significant costs. A rise in unemployment has immediate economic and fiscal impacts, and can lead to a loss of skills and work readiness. It also has significant negative impacts on self-esteem and health, and increases the risk of poverty. Supporting aggregate demand early, so as to lessen the depth and duration of the economic downturn, is the most effective way to support employment.

Fiscal policy is supporting aggregate demand and employment through the operation of the automatic stabilisers. The global recession has resulted in substantial downward revisions to tax revenues, which has inevitably reduced the budget balance. Given the size of the global shock, it is also important to use temporary fiscal stimulus to boost aggregate demand and thereby minimise the costs of the recession.

A responsible fiscal framework allows the budget balance to adjust to short-term movements in the economic cycle, while maintaining fiscal sustainability. Policy actions to offset these adjustments would be inherently pro-cyclical, making the impact of the global recession on the Australian economy more severe. There would be a greater loss in output and employment and the budget deficit in the medium term

would be likely to be higher. The Government is allowing the automatic stabilisers to work while maintaining a focus on fiscal sustainability.

Enhancing economic growth is also a longer-term objective of fiscal policy. In the current environment, the best policy responses will address the short-term challenge of stimulating aggregate demand, allow resources to be allocated to their most productive uses, and invest in future productive capacity. In addition, policies must be fiscally sustainable, as this is important for sustainable economic growth.

STIMULATING AGGREGATE DEMAND

In an environment where a large global shock has pushed Australia into recession, it is necessary to stimulate aggregate demand in the short term. Discretionary fiscal stimulus is needed to provide additional support to that provided by the automatic stabilisers and monetary policy.

Automatic stabilisers are the components of tax and expenditure that automatically fluctuate in response to the economic cycle. The change in the budget balance due to these cyclical factors has been dominated by changes in tax revenues from parameter variations. These changes are estimated to have reduced the budget balance by around $49 billion in 2009-10 and $55 billion in 2010-11 (Table 1). These estimates do not include increases in payments such as unemployment benefits.

Table 1: The components of fiscal policy

	2008-09 $m	2009-10 $m	2010-11 $m	2011-12 $m
2008-09 Budget underlying cash balance	**21,703**	**19,669**	**18,996**	**18,870**
Per cent of GDP	1.8	1.5	1.4	1.3
Effect of parameter and other variations	**-20,433**	**-45,301**	**-57,431**	**-50,209**
Tax receipt revisions	-22,715	-49,157	-54,854	-46,783
Other variations - non-taxation and payments	2,283	3,855	-2,577	-3,425
Effect of policy decisions	**-33,384**	**-31,960**	**-18,614**	**-13,197**
Major fiscal stimulus packages	-26,587	-22,352	-12,716	-5,056
Other policy decisions	-6,797	-9,608	-5,898	-8,141
Total variations	**-53,817**	**-77,261**	**-76,045**	**-63,406**
Per cent of GDP	-4.5	-6.6	-6.2	-4.9
2009-10 Budget underlying cash balance	**-32,114**	**-57,593**	**-57,051**	**-44,535**
Per cent of GDP	-2.7	-4.9	-4.7	-3.4

Note: Major fiscal stimulus packages are: Economic Security Strategy; November 2008 Council of Australian Governments reforms; December 2008 Nation Building Package; and Nation Building and Jobs Plan. Other policy decisions include the net effect of policy decisions in the 2009-10 Budget.
Source: Treasury.

Discretionary fiscal measures are the outcome of explicit changes in the Government's tax and expenditure policy settings. These measures can meet specific policy objectives, and can be designed with the express purpose of affecting economic activity. The major fiscal stimulus packages announced since the 2008-09 Budget have

supported aggregate demand in the face of the global recession and have reduced the budget balance by $22.4 billion in 2009-10 and $12.7 billion in 2010-11 (Table 1).

Australia is one of many countries announcing discretionary fiscal stimulus measures in response to the global recession. Most countries, including China, Japan and the United States, have announced large discretionary fiscal stimulus packages to support aggregate demand.

These measures are consistent with the commitment by G-20 countries to deliver the fiscal stimulus necessary to restore growth. The IMF (2009d) estimates that discretionary fiscal measures announced between late 2008 and mid-April 2009 will provide a stimulus of 2 per cent of world GDP in 2009 and 1.5 per cent in 2010. Some countries have had limited scope to implement fiscal stimulus measures because they entered the crisis with less fiscal space.

The most effective fiscal stimulus measures are those that provide the largest boost to aggregate demand when it is most needed. Fiscal stimulus includes direct spending by government on goods and services and measures directed at households and businesses. Stimulus measures need to be timely, temporary and targeted.

Fiscal stimulus measures may result in a deterioration in the budget balance in the short term. However, the temporary nature of these measures ensures that the budget balance will improve over the medium term as the support to aggregate demand is withdrawn. Supporting aggregate demand in the short term is also likely to result in a budget deficit that is lower in the medium term than it would otherwise have been. This is because support to aggregate demand in the short term can improve economic growth prospects, and therefore the Government's fiscal position.

The impact of fiscal stimulus measures on aggregate demand depends on their overall size and delivery. Targeted measures ensure the largest possible boost to aggregate demand. For measures directed at households and businesses, the impact on aggregate demand depends on who receives the stimulus, how and when it is received, the amount spent and what it is spent on (Box 1).

Box 1: Discretionary fiscal policy measures

A variety of tax and expenditure measures can be used to provide fiscal stimulus. The fiscal multipliers for such measures — that is, the effects they have on economic output — depend on a number of factors.

The most effective measures for an immediate boost to aggregate demand are those that can be implemented quickly and targeted at those most likely to spend. This can include direct purchases of goods and services, transfers or temporary tax cuts and bonuses. Expenditure measures directed at credit-constrained households may have quite high short-term multipliers.

In the case of a prolonged downturn, discretionary fiscal policy can be more effective if it includes measures that add directly to demand and provide a boost to the economy over a longer period, such as infrastructure. Infrastructure investments may have a smaller impact in the short term as they take time to implement, but they provide a larger boost to output once implemented. Such measures also improve the productive capacity of the economy in the longer term.

Multipliers may also differ with economic circumstances. Where the economy is operating with a large amount of excess capacity, stimulus measures are expected to have a larger impact on activity. In contrast, where the economy is close to full employment, the multiplier would be close to zero as a result of exchange rate and price movements and the reaction of monetary policy.

Numerous studies estimate a wide range of fiscal multipliers. The OECD (2009) estimates that the multipliers for direct spending and infrastructure range between 0.6 and 1.3 in Australia (Table A). Multipliers for transfer payments are estimated at between 0.4 and 0.8, while the multipliers for revenue measures are between 0.2 and 0.8. The IMF (2009a) estimates multipliers of between 0.5 and 1.8 for infrastructure measures across the G-20 economies and between 0.3 and 0.6 for personal income tax cuts.

Table A: OECD and IMF estimates of fiscal multipliers

	OECD - Australia		OECD - US		IMF - G-20
	Year 1	Year 2	Year 1	Year 2	
Spending measures					
Infrastructure	0.9	1.1-1.3	0.9	1.1-1.3	0.5-1.8
Government consumption	0.6	0.7-1.0	0.7	0.8-1.1	
Transfers to households	0.4	0.7-0.8	0.5	0.8-0.9	
Revenue measures					
Personal income tax cuts	0.3-0.4	0.4-0.8	0.3-0.5	0.5-0.9	0.3-0.6
Indirect tax cuts and other	0.2-0.3	0.3-0.5	0.2-0.3	0.3-0.5	

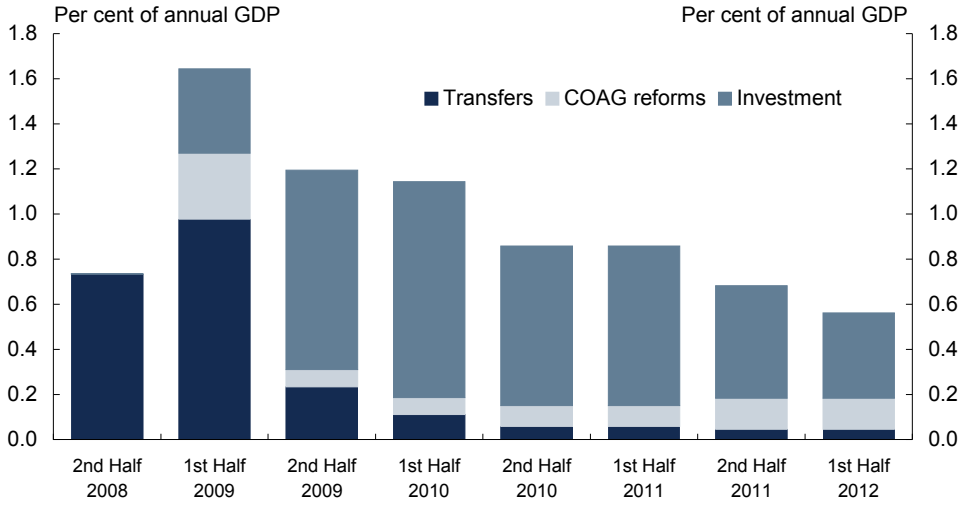
Source: OECD 2009 and IMF 2009a.

The Budget uses multipliers for the fiscal stimulus of between 0.5 and 1. These multipliers may prove to be conservative. In particular, the multiplier effects for infrastructure investment may be larger (Table A).

The OECD (2009) has found that Australia's fiscal stimulus measures are among the most effective in the OECD in terms of stimulating economic activity and supporting employment. The first phase of Australia's fiscal stimulus provided an immediate, significant and temporary boost to household incomes. Cash transfers to low-income households are a quick and effective way to support aggregate demand, as these households are more likely to be credit constrained and affected by a recession.

The second phase of fiscal stimulus focused on infrastructure investments that could be implemented within a relatively short timeframe, while the third phase, outlined in this Budget, moves to major economic infrastructure projects. While infrastructure investment can involve lengthy implementation lags, it provides longer term support to aggregate demand and employment and boosts the economy's productive capacity. These phases are reflected in the change in the composition of Australia's fiscal stimulus over time (Chart 1).

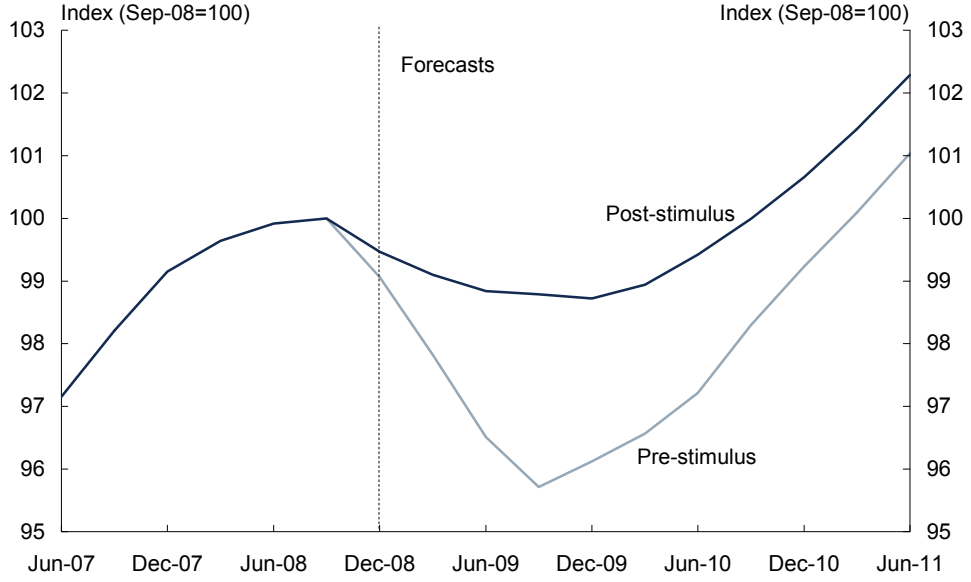
Chart 1: Composition of fiscal stimulus



Source: Treasury.

Australia's fiscal stimulus measures are expected to have a substantial impact on economic output and employment. As a result of the Government's fiscal stimulus measures, the level of real GDP is forecast to be higher than it would otherwise have been by 2¾ per cent in 2009-10 and 1½ per cent in 2010-11 (Chart 2). The stimulus measures are estimated to reduce the forecast peak in the unemployment rate by 1½ percentage points. Without the fiscal measures, the impact of the global recession on Australia's economy would be more severe. In the absence of policy action, the forecast unemployment rate would have reached 10 per cent.

Chart 2: Effect of fiscal stimulus on real GDP



Source: ABS cat. no. 5206.0 and Treasury.

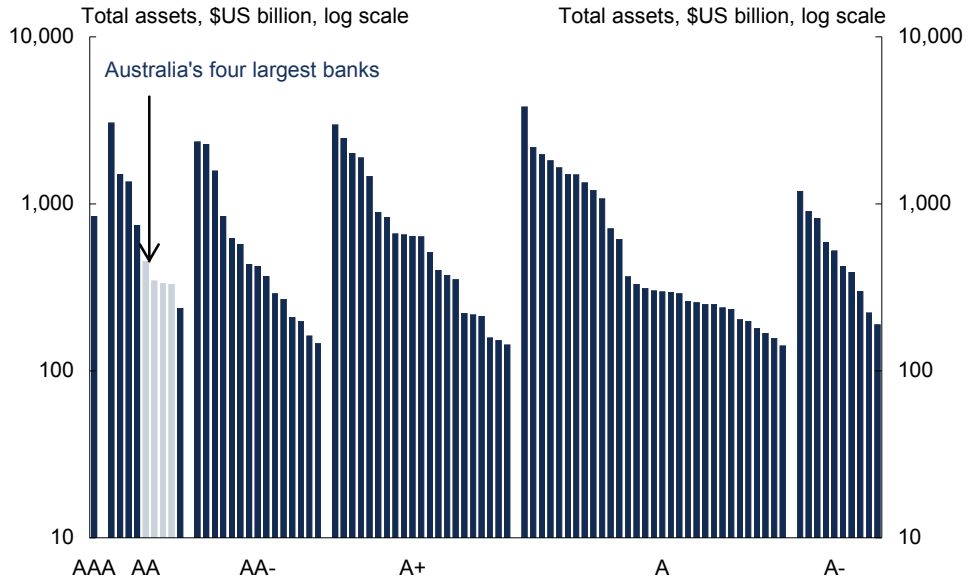
STRENGTHENING THE FINANCIAL SYSTEM

Given that the underlying cause of the global recession is a global financial crisis, it has been necessary in the current environment to support the financial system. While the financial crisis is centred in credit markets in the United States, the United Kingdom and Europe, there have been significant spill-over effects to the rest of the world.

While Australia is not immune from these impacts, its financial system remains sound. Australian banks have some of the highest credit ratings in the world — 4 of the world's 10 highest-rated large banks are Australian (Chart 3) — and Australia has not had to 'bail out' any financial institutions.

The Government, in conjunction with the regulators, has taken pre-emptive action to strengthen the resilience of Australia's financial sector. This has included moving quickly to protect the financial system from the wholesale funding disadvantage that may have resulted from the policy interventions of other countries. These actions also support the effectiveness of fiscal stimulus measures in the current environment.

Chart 3: World's largest banks by credit rating



Note: Data refer to bank ratings as at 20 April 2009 and assets as at late 2007 (latest available data).
Source: Bloomberg and The Banker.

The Government and regulators have enhanced liquidity arrangements, increased prudential oversight, introduced bank guarantees for large deposits and wholesale funding, and introduced the financial claims scheme to give effect to the Government's guarantee of deposits under $1 million. Other actions include the Government's investment in residential mortgage-backed securities and the provision of particular financing vehicles for viable businesses where financiers have withdrawn from debt financing arrangements as a result of the global financial crisis. The Government is also supporting state government access to funding through a guarantee of state and territory government borrowing.

In addition, Australia is actively engaged in international efforts to address the global financial crisis. The global integration of financial markets makes it important for Australia to work with the G-20, IMF and Financial Stability Board to address the systemic problems currently confronting the global financial system.

Not all of the measures implemented to support the financial system have a direct negative impact on the budget balance. In particular, the guarantees for large deposits and wholesale funding and the guarantee of state and territory government borrowing are contingent liabilities. Contingent liabilities are liabilities that depend on the occurrence of some uncertain future event.

The Government is taking on these contingent liabilities because of extraordinary circumstances and is charging a fee for the guarantees. The fee is designed such that it will no longer be in the interests of financial institutions and state and territory governments to use the guarantees when financial market conditions return to normal.

Under these contingent liabilities, Government expenditure would only arise if an institution fails to meet its obligations with respect to a guaranteed commitment. Given that Australia's banks, and the Australian financial system, are among the strongest in the world, the risk of these contingent liabilities being realised is remote.

RETURNING THE BUDGET TO SURPLUS

A plan to return the budget to surplus is a key element of fiscal sustainability. Fiscal sustainability is the capacity of the Government to efficiently finance present and future expenditure programs. Efficient financing requires choosing financing methods that support economic growth and living standards.

Fiscal sustainability is essential for maintaining macroeconomic stability, reducing economic vulnerabilities and improving economic performance. It reduces the degree of uncertainty about future fiscal policy settings and facilitates decision-making within the economy, especially regarding the accumulation of physical and human capital, technological progress, workforce participation and productivity.

The Government has a clear, achievable strategy to return the budget to surplus. The Government will allow the level of tax receipts to recover naturally as the economy strengthens and will hold real growth in spending to 2 per cent per annum, once economic growth is above-trend, until the budget returns to surplus.

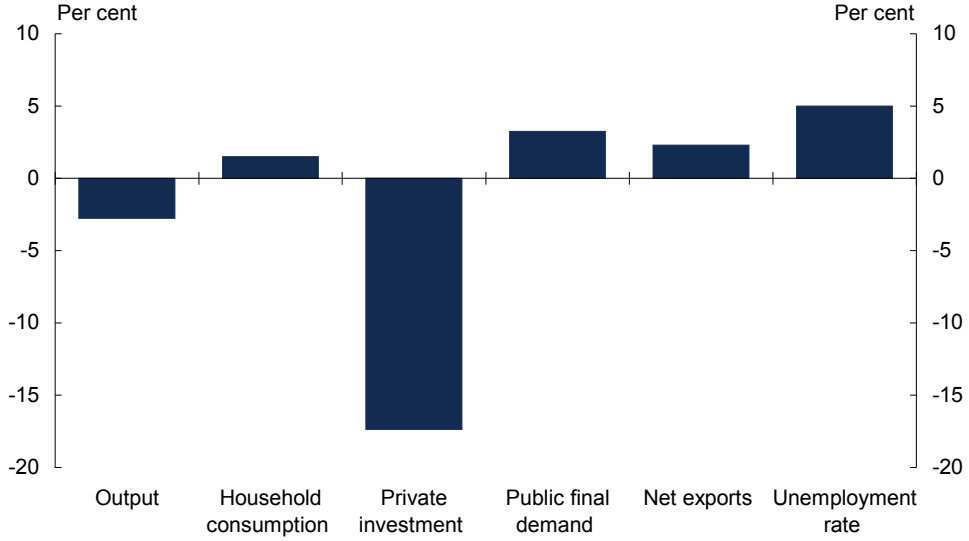
The return to surplus depends on the trajectory of economic growth

The return of the budget to surplus depends on policy decisions taken and the future trajectory of economic growth in Australia and globally. The speed of Australia's economic recovery will determine the rate at which the automatic stabilisers reverse and tax revenues recover.

The economic recovery in Australia's forecasts and projections is informed by the dynamics of past economic cycles, but economic experiences can vary markedly (Box 2). There is variation across countries and across types of economic downturns, as well as variation depending on the shape and timing of the policy responses.

Australia has experienced eight recessions since the Great Depression. However, there is more difficulty in making comparisons with economic cycles that are further back in time. The recessions of the early 1980s and early 1990s provide the most insight into the current dynamics of the economy. In these recessions, real GDP fell by 2¾ per cent on average from peak to trough, while the unemployment rate rose by an average of 5 percentage points (Chart 4).

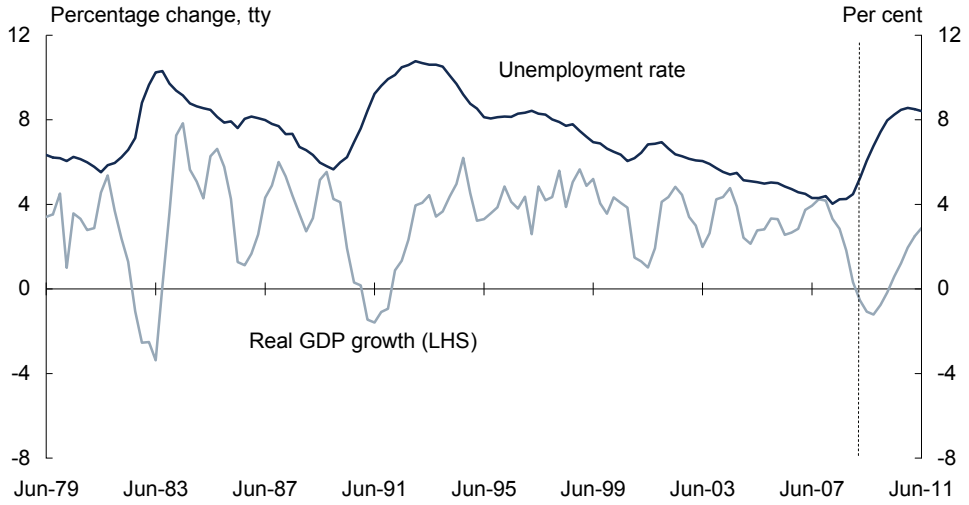
Chart 4: Average impact of early 1980s and early 1990s recessions



Note: Data are based on the percentage change in the period between the pre-recession peak and trough in output. The unemployment rate is based on the percentage point change from the pre-recession low to the post-recession high. Net exports are shown as a change in level as a per cent of GDP.
Source: ABS cat. no. 5206.0 and 6202.0.

Following a recession, it takes time for the economy to adjust and return to full employment, given the myriad of linkages, both within new and expanding firms and between firms, which need to be re-established. In particular, the unemployment rate can take significantly longer than real GDP to recover. The unemployment rate returns to its pre-recession level only after a sustained period of strong growth in the economy (Chart 5).

Chart 5: Real GDP growth and the unemployment rate

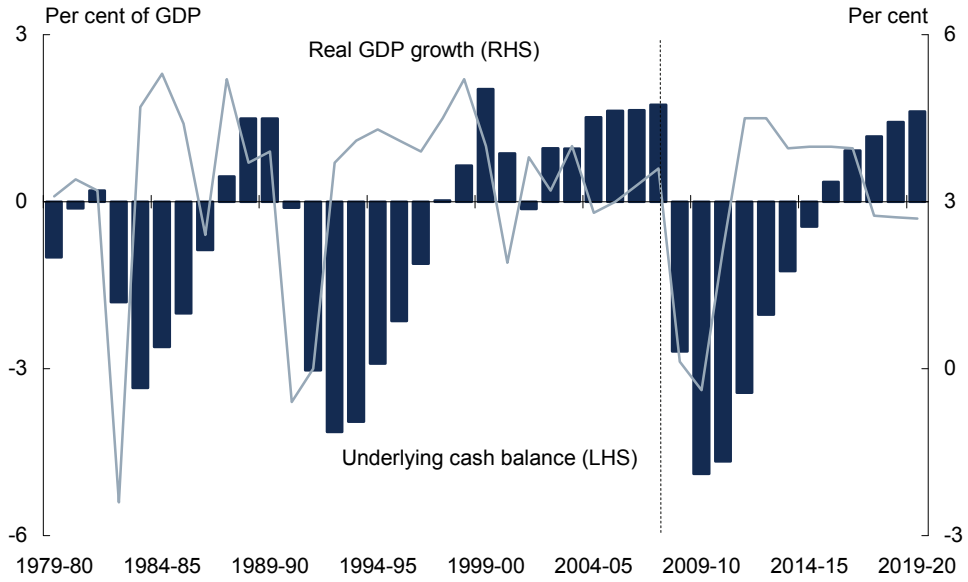


Source: ABS cat. no. 5206.0, 6202.0 and Treasury.

The risks around the return to surplus

In the economic forecasts and projections, growth in real GDP during the first three recovery years averages 3¾ per cent. This is a slower recovery than after the early 1980s and early 1990s recessions, where growth over the first three recovery years averaged 4.8 per cent and 4 per cent. Under these forecasts and projections, and the medium-term projections contained in Statement 3, the budget deficit is expected to peak at 4.9 per cent of GDP in 2009-10 and return to surplus in 2015-16 (Chart 6).

Chart 6: Underlying cash balance



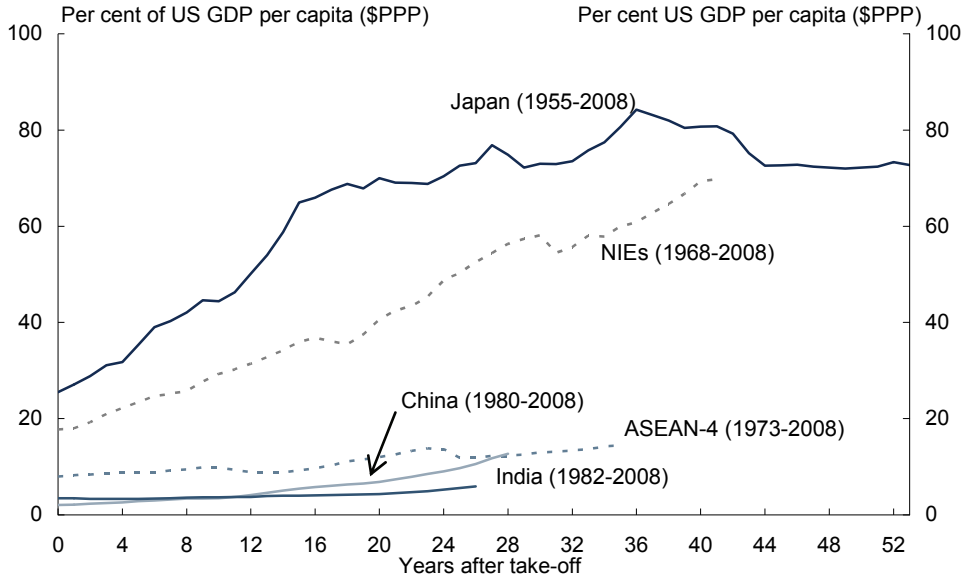
Source: ABS cat. no. 5206.0 and Treasury.

The economic forecasts and projections involve both upside and downside risks. A discussion of these risks allows an evaluation of fiscal sustainability in an environment of significant economic uncertainty.

On the upside, the speed and size of the global fiscal and monetary policy responses may result in a stronger 'bounce-back' in the global economy. This would provide support to the Australian economy and would be expected to lead to stronger growth in nominal GDP over the recovery phase. It would also hasten the return to surplus.

The emerging economies of China and India may provide particular support to such a scenario. These economies have a significant process of 'catch-up' ahead of them, which presents substantial opportunities for the Australian economy (Chart 7).

Chart 7: Per capita GDP convergence for selected Asian economies



Note: The first year of take-off for economies, excluding China and India, is the year when the three-year moving average of constant price export growth first exceeded 10 per cent. The first year of take-off is 1980 for China and 1982 for India. The ASEAN-4 consists of Indonesia, Thailand, Malaysia and the Philippines. The Newly Industrialised Economies (NIEs) consist of Hong Kong, Korea, Singapore and Taiwan.
Source: The Conference Board Total Economy Database, IMF 2009c and Treasury.

On the downside, the world is currently facing a significant challenge in responding to the consequences of the global financial crisis and addressing its underlying causes. The longer this takes, the longer it will take for the global economy to recover. An extended period of global adjustment could result in weaker global growth, dragging on Australia's nominal GDP growth and delaying the return to budget surplus.

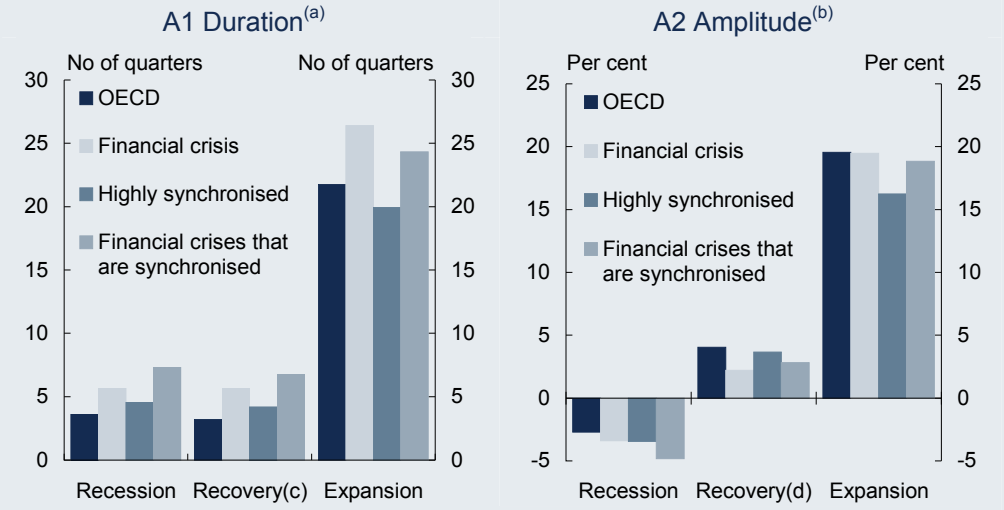
While global developments may impact on Australia's budget deficit and the exact timing of the return to surplus, this should not generate risks to Australia's fiscal sustainability. Australia has a clear, achievable fiscal strategy that ensures that tax receipts recover naturally, stimulus measures are temporary and real growth in spending is restrained when the economy recovers.

Box 2: IMF research on the general dynamics of recessions and recoveries

The IMF (2009c) has examined the general dynamics of recessions and recoveries in the economic cycles of 21 OECD economies over the past 48 years. This research shows that economic cycles are asymmetric. Changes to output and employment tend to be larger and sharper in both recessions and recovery phases of expansions than during full expansions.

The IMF has found that following a recession, an economy typically recovers to its previous peak output in less than a year (Chart A1). Recoveries tend to be steeper than recessions, with the average growth rate in real GDP being around 25 per cent higher than the contraction rate in a recession. There is also evidence of a bounce-back effect: output growth during the first year of recovery is significantly and positively related to the severity of the preceding recession.

Chart A: Average duration and amplitude of stages of the economic cycle



(a) Duration is the number of quarters from peak to trough for recessions.
(b) Amplitude is the percentage change in output from the peak to the following trough of a recession.
(c) From the trough, recovery is the number of quarters taken for output to reach the previous peak.
(d) Recovery amplitude is the percentage change in output in the four quarters following the trough.
Source: IMF 2009c.

While these are the results for a typical OECD recession, the IMF finds more sobering results for recessions associated with financial crises or those that are highly synchronised across the world. Such recessions have been more severe and longer lasting than the typical recession (Charts A1 and A2). Recoveries from these recessions have also been slower and tend to be characterised by weak domestic demand and tight credit conditions. In recoveries from globally synchronised recessions, exports play a much more limited role in the recovery than in the typical business cycle. The current downturn is both highly synchronised and associated with a deep financial crisis, a rare combination in the past 50 years.

ASSESSING FISCAL SUSTAINABILITY

Assessing fiscal sustainability involves examining the Government's capacity to repay debt without placing undue upward pressure on interest rates or impeding economic growth. The Government's finances are fiscally sustainable when it is expected to be able to meet its financial obligations without making unrealistically large adjustments to tax and expenditure programs.

There is no single indicator of fiscal sustainability and economic theory does not give a definitive answer as to the optimal level of debt. The capacity to repay debt depends on a wide range of factors. These include the level of net debt, the values of financial and non-financial assets and obligations, interest rates and economic growth prospects. They also include the expenditure- and tax-to-GDP ratios, the types of expenditures financed and the quality of institutions.

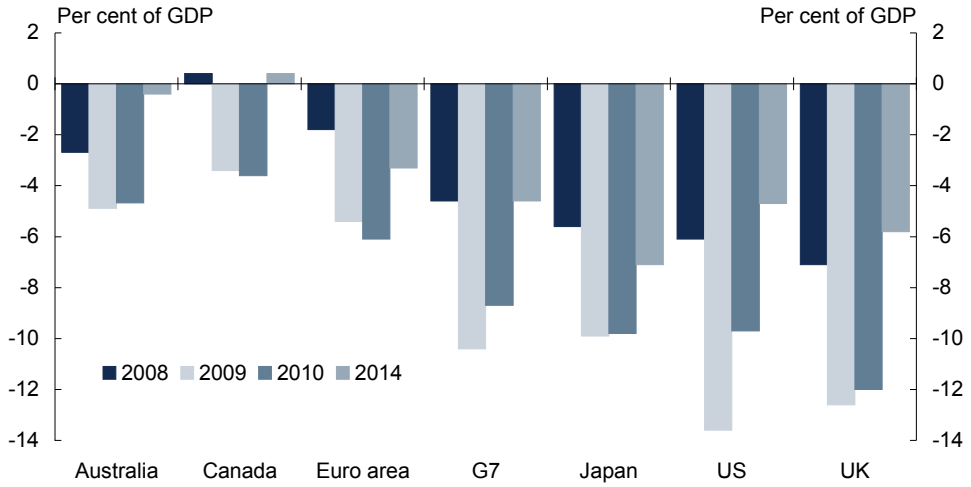
Sustainability assessments begin with the headline budget balance

The global recession has led to a deterioration of budget balances in most economies. This has occurred as a result of the operation of automatic stabilisers, the use of discretionary fiscal stimulus measures and, in some countries, large 'bail out' packages for financial institutions.

In Australia, the automatic stabilisers, predominantly through falls in tax revenues, have resulted in the budget moving into deficit. Temporary fiscal stimulus measures have also contributed to the deficit. The budget deficit is appropriate to cushion the impact of the recession, and is consistent with fiscal sustainability given the plan to return the budget to surplus when the economy recovers.

In an environment where many countries are facing similar challenges, international comparisons are a useful benchmark for assessing fiscal sustainability. Australia's budget position continues to compare extremely favourably with other advanced economies (Chart 8). The collective budget deficit for advanced economies is forecast to be 8.8 per cent of GDP in 2009 and 7.7 per cent in 2010. By comparison, Australia's budget deficit is 4.9 per cent of GDP in 2009-10 and 4.7 per cent in 2010-11.

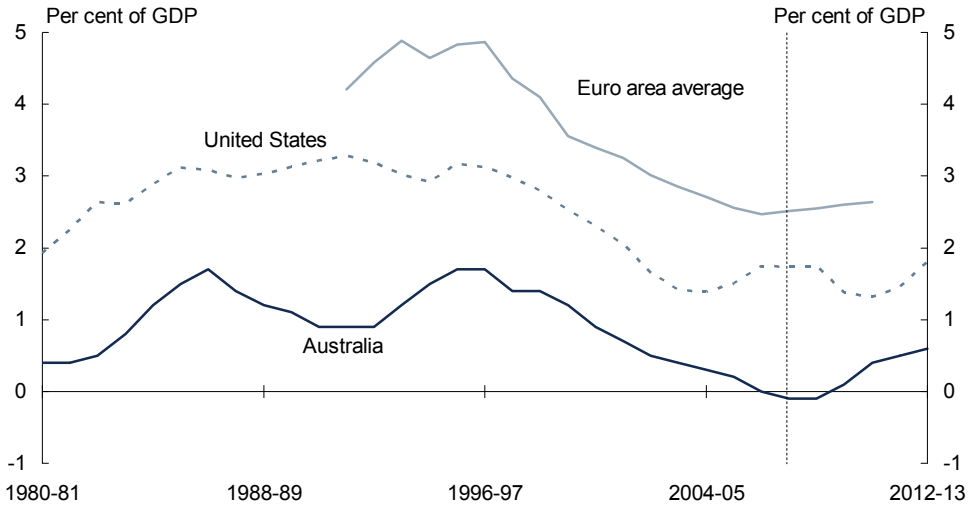
Chart 8: Budget balance positions for selected countries



Note: Data are general government budget balance, except for Australia which is Australian Government. Data include announcements up to 22 April 2009. UK data are for financial years beginning 2008-09 and data for 2014 refers to 2013-14. Australian data are for financial years beginning 2008-09. US data include financial support measures.
Source: IMF 2009c, HM Treasury 2009 and Treasury.

Australia is also in a strong position in terms of net interest payments. As a result of the strong net debt position prior to the economic downturn, and the current low world interest rates, the net interest payments on the debt accumulated as a result of the downturn are expected to be relatively small (Chart 9). Australia's net interest payments are also small by international comparison.

Chart 9: Net interest payments



Note: Australian and US data are federal government data. Euro area data are general government data and are for calendar years beginning 1991. Data include announcements up to mid-November 2008 for the euro area and up to March 2009 for the US.
Source: United States Congressional Budget Office 2009, OECD 2008 and Treasury.

The contribution of cyclical and structural components is important

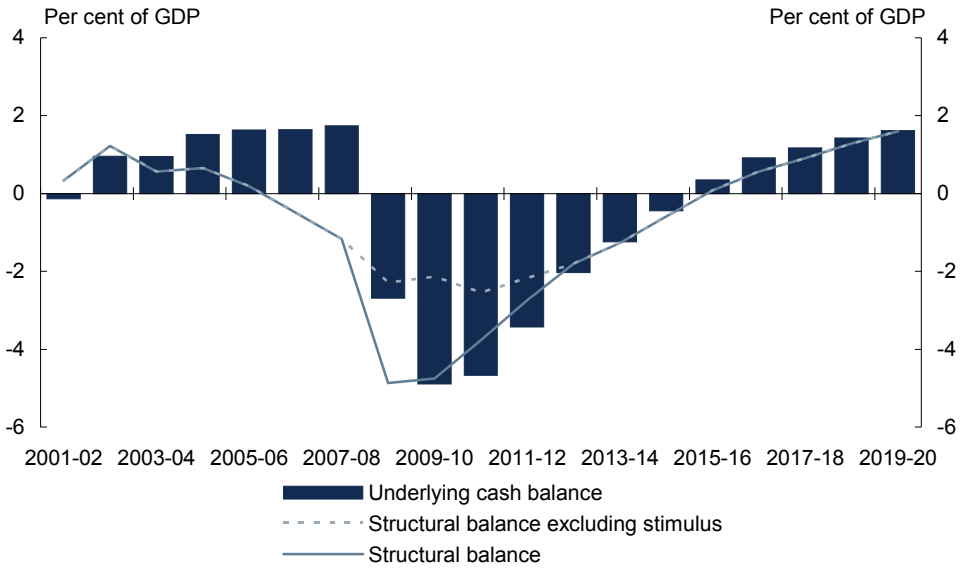
It is worthwhile to assess whether the budget deficit is driven by cyclical or structural factors. A deficit driven by cyclical factors will gradually reduce as the economy recovers. As discussed earlier, since the 2008-09 Budget, the change in Australia's budget position over the forward estimates period is largely due to cyclical factors. Changes in tax revenues from parameter variations are estimated to have reduced the budget balance by around $49 billion in 2009-10 and $55 billion in 2010-11.

The contribution of cyclical factors can also be assessed by estimating the structural budget balance. There are a range of approaches for these estimates. However, they involve considerable complexity and uncertainty (Ford 2005).

The structural budget balance estimates shown in Chart 10 use trends in productivity growth and employment levels, with the assumptions for the unemployment rate and terms of trade consistent with the end-point of the medium term projections outlined in Appendix B of Statement 3. The cyclical component includes changes in capital gains tax revenue from its decade average.

Based on these estimates, the structural budget balance deteriorated from 2002-03, moving into structural deficit in 2006-07. This shows that the actual underlying cash balances in previous years were primarily the result of the strength in Australia's terms of trade, which increased by almost 40 per cent over this period. While the temporary fiscal stimulus measures result in a widening of the structural deficit, the deficit narrows over the medium term reflecting savings measures and the Government's commitment to reduce spending as the economy recovers.

Chart 10: Structural budget balance



Source: Treasury.

These estimates are calculated using a different approach than that used by the IMF and OECD. In addition to making an explicit adjustment for capital gains tax revenue, they are based on a medium-term assessment of Australia's terms of trade. Movements in the terms of trade have sizeable impacts on real incomes and tax revenues. Alternative assumptions around the equilibrium terms of trade — that is, assumptions around the extent to which movements are structural rather than cyclical — can result in significantly different structural budget balance estimates.

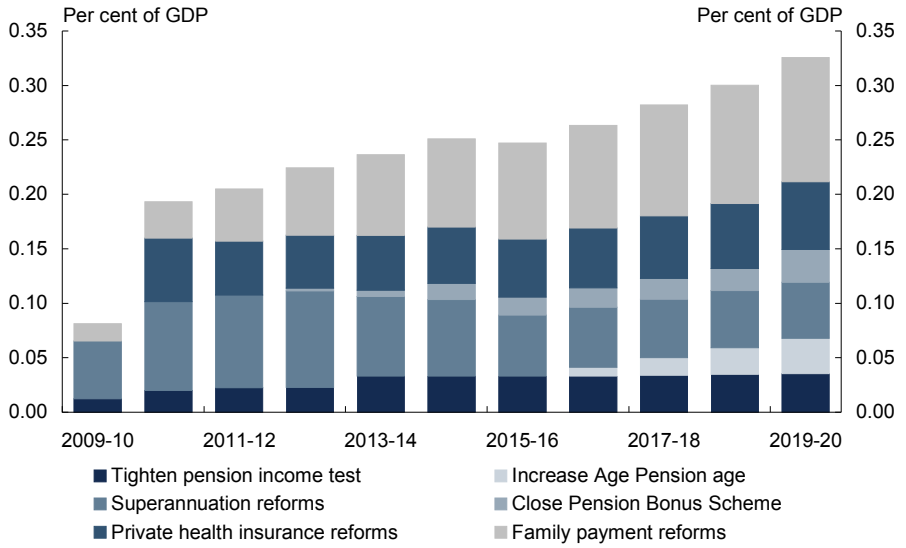
The plan to return the budget to surplus must be credible

Fiscal sustainability requires that the plan to return the budget to surplus be credible. The plan should be clear and achievable, and should consider the full path to recovery and the risks around the return to surplus.

The Government has a clear, achievable plan for the return to budget surplus. This involves allowing tax receipts to recover naturally as the economy improves. The Government is also committed to ensuring that the effect of the fiscal stimulus packages recedes and real growth in spending is restrained to 2 per cent per year once economic growth is above-trend.

The Government has ensured that by 2012-13, savings measures fully offset any increases in expenditure. Moreover, the Government has also found savings measures that address major areas of fiscal pressure in the longer term (Chart 11). The value of these structural savings increases significantly over time, increasing by around half from 2012-13 to 2019-20. This enhances the sustainability of Australia's future fiscal position.

Chart 11: Structural savings measures



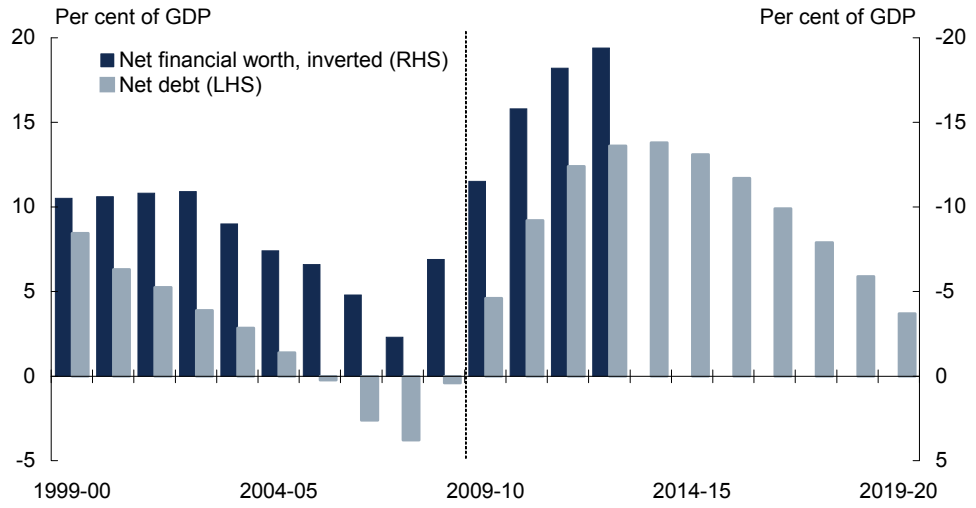
Source: Treasury.

The impact on assets and liabilities is also useful to assess sustainability

It is common to use net public debt to assess fiscal sustainability. Net debt is generally preferred to gross debt as it takes into account total debt liabilities as well as some amounts owed to the Government by others.

However, balance sheet measures, such as net worth and net financial worth, provide a more comprehensive indication of financial strength as they include an assessment of broader measures than just debt. However, because net financial worth measures are not widely available across countries and over time, fiscal sustainability assessments tend to fall back on net debt comparisons. Australia's net debt is estimated to rise in the short term, but improve over the medium term (Chart 12).

Chart 12: Australian Government net financial worth and net debt

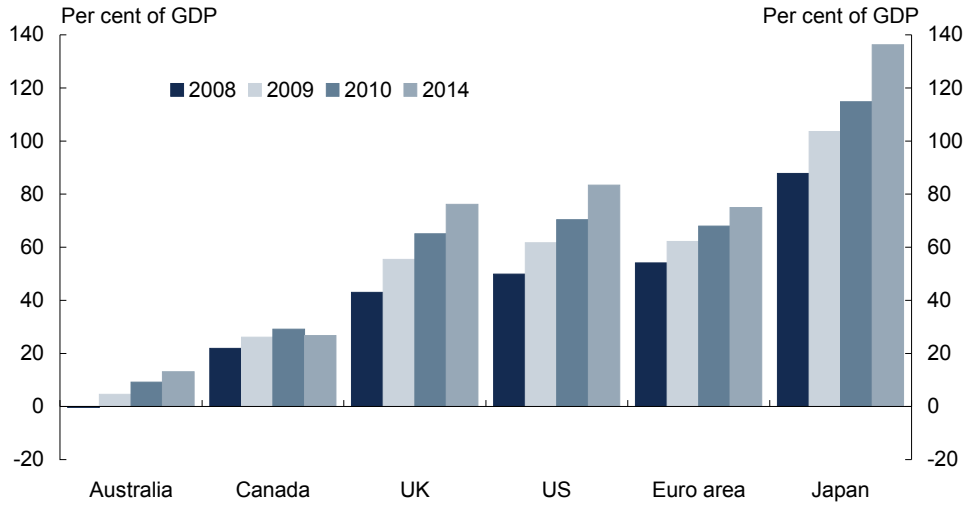


Note: The inverse of net financial worth, that is net financial liabilities, is compared with net debt.
Source: Treasury.

Australia's net debt is much lower than other advanced economies (Chart 13). It is estimated that Australian Government net debt will rise from -0.4 per cent of GDP in 2008-09 to 13.1 per cent of GDP in 2014-15. The collective net debt in 25 of the largest advanced economies is estimated to be 52 per cent of GDP in 2008 and 81 per cent in 2014.

Australia's net financial worth and net debt levels show that, notwithstanding the large impact of the automatic stabilisers on the budget balance and the implementation of temporary discretionary fiscal stimulus measures, Australia has retained its strong balance sheet position and much lower debt levels than other countries. In addition, Australia's contingent liabilities related to the guarantees for large deposits, wholesale funding and state and territory government borrowing are not likely to be realised.

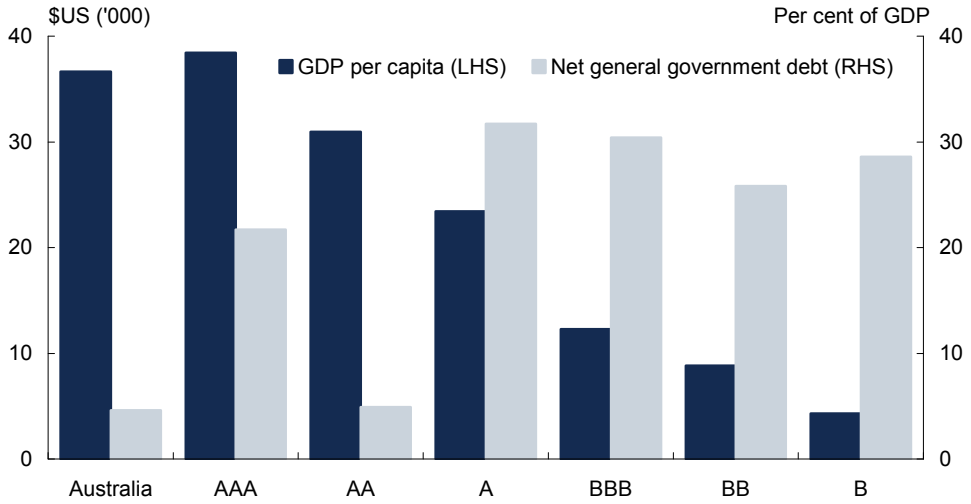
Chart 13: Government net debt positions for selected countries



Note: Data are general government net debt, except for Australia which are Australian Government debt. Data are as at end of calendar year, except for Australia and the UK where data refer to financial years beginning 2008-09. UK data for 2014 refer to financial year 2013-14.
Source: IMF 2009c, HM Treasury 2009 and Treasury.

In addition to assessing the level of net debt, debt dynamics and the capacity to service debt are important for fiscal sustainability. A strong and resilient economy will improve the capacity to respond to shocks and repay debt. Countries with AAA credit ratings have higher GDP per capita and higher net debt levels than those with AA credit ratings (Chart 14). Australia's GDP per capita is similar to other AAA-rated countries, but government net debt is much lower.

Chart 14: GDP per capita, net debt and credit ratings, 2009



Note: All categories are medians. GDP per capita data are $US PPP from the IMF. Australian net debt data are for the Australian Government in 2009-10. Net debt data for other countries refer to general government.
Source: IMF 2009c, Standard & Poor's 2009 and Treasury.

CONCLUSION

The global recession presents a significant challenge for fiscal policy in all countries, including Australia. In the short term, the challenge is to allow the automatic stabilisers to operate freely and implement discretionary fiscal policy measures that provide substantial stimulus to aggregate demand. Providing support to economic growth through fiscal and monetary policy is important to reduce the costs of the recession, particularly those associated with unemployment.

The Government has a clear, achievable strategy to return to surplus in the medium term. When the economy recovers, tax receipts will be allowed to recover naturally and real growth in spending will be restrained. Given the current global and domestic economic outlooks and the Government's fiscal strategy, it is projected that Australia's budget will return to surplus in 2015-16. While global developments may impact on the timing of the return to surplus, the Government's firm commitment to the return to surplus will ensure that fiscal sustainability is maintained.

Other measures of Australia's fiscal sustainability are also strong, despite the move to a budget deficit. This is important because fiscal sustainability remains one of the key ingredients for sustainable economic growth. Australia's fiscal position is currently, and will continue to be, one of the strongest in the advanced world.

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