

STATEMENT 2: FISCAL OUTLOOK

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STATEMENT 2: FISCAL OUTLOOK

Following four consecutive underlying cash surpluses, the Commonwealth Budget is again expected to be in surplus in 2001-02. The budget outlook for 2001-02 and the forward years has moderated however, since the Mid-Year Economic and Fiscal Outlook (MYEFO) 2000-01 was published — reflecting the impact of a temporary slowdown in the economy on forecast revenue and expenses, and new spending and tax reductions targeted at priority areas. This moderation in the fiscal outlook is consistent with the Government's medium-term fiscal strategy, which allows fiscal policy to respond flexibly to changes in economic conditions.

FISCAL AGGREGATES

Table 1 provides details of the Commonwealth general government budget estimates and projections for the five years from 2000-01.

Table 1: Commonwealth general government fiscal aggregates^(a)

| | Actual | Estimates | | Projections | | |
|--------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| | 1999-00(b) | 2000-01 | 2001-02 | 2002-03 | 2003-04 | 2004-05 |
| Revenue (\$b) | 166.6 | 161.0 | 158.8 | 164.9 | 175.5 | 185.7 |
| Per cent of GDP | 26.3 | 24.0 | 22.6 | 22.1 | 22.2 | 22.1 |
| Expenses (\$b) | 154.4 | 157.6 | 160.9 | 166.8 | 173.1 | 179.0 |
| Per cent of GDP | 24.4 | 23.4 | 22.9 | 22.4 | 21.9 | 21.4 |
| Net operating balance (\$b) | 12.2 | 3.5 | -2.0 | -1.9 | 2.4 | 6.7 |
| Net capital investment (\$b)(c) | -1.2 | -2.0 | -1.2 | -0.4 | -0.3 | -0.2 |
| Fiscal balance (\$b) | 13.5 | 5.4 | -0.8 | -1.5 | 2.7 | 6.9 |
| Per cent of GDP | 2.1 | 0.8 | -0.1 | -0.2 | 0.3 | 0.8 |
| Underlying cash balance (\$b) | 12.7 | 2.3 | 1.5 | 1.1 | 4.1 | 7.4 |
| Per cent of GDP | 2.0 | 0.3 | 0.2 | 0.1 | 0.5 | 0.9 |
| <i>Memorandum items:</i> | | | | | | |
| Headline cash balance (\$b) | 22.2 | 8.5 | 4.7 | -0.1 | 17.6 | 20.7 |

(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) Expenses and net capital investment have been adjusted compared with the 1999-2000 Final Budget Outcome to reflect the acquisition of defence weapons platforms as expenses rather than net capital investment (see Box 2 of the 2000-01 MYEFO).

(c) Net capital investment is defined as the net acquisition of non-financial assets.

An underlying cash surplus of \$1.5 billion is expected in 2001-02, around \$0.8 billion lower than the anticipated outcome for 2000-01. Underlying cash surpluses are also expected throughout the forward years.

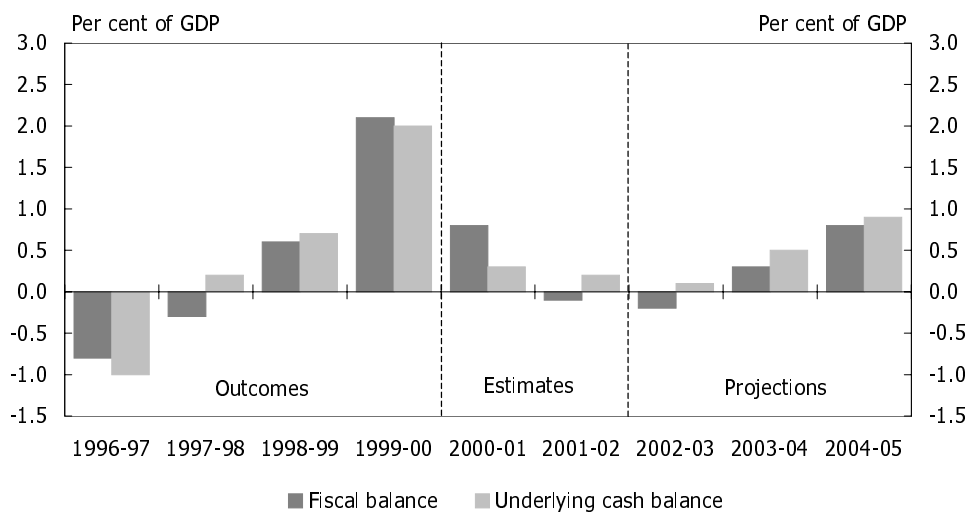
In accrual terms, a deficit of \$0.8 billion is expected in 2001-02, before returning to surplus over the forward estimates period. This follows an estimated fiscal surplus of \$5.4 billion in 2000-01.

The divergence between the expected underlying cash and fiscal balances in 2000-01 and the following years is largely explained by the impact of transitional arrangements associated with the introduction of the new Pay As You Go (PAYG) system of company taxation.

From 2000-01, these PAYG arrangements better align company tax payments with the period in which income is earned. This has created an overlap of company tax payments for business, because payments of tax obligations for 1999-2000 and PAYG instalments for 2000-01 both arise during 2000-01. However, under the PAYG transitional arrangements, companies may reduce the cash impact of this overlap by spreading their actual payments in interest free instalments over 2½ to 5 years (see Box 1 in Statement 5 for further information).

Whilst both sets of obligations accrue in 2000-01, in fact payments are spread into the following years. As a result of these transitional arrangements, revenues in 2000-01 are shown as higher in accrual terms and correspondingly lower in subsequent years when the payments are actually made.

Chart 1: Fiscal and underlying cash balances



VARIATIONS TO THE FISCAL BALANCE ESTIMATES

Since MYEFO, the estimated fiscal balances for 2000-01 and the forward years have been revised downwards. This is partly due to parameter variations, with the recent slowdown in economic growth expected to result in lower revenue and higher

expenses. In addition, new policy decisions in 2001-02 since MYEFO have increased expenses by around \$2.8 billion and reduced revenues by around \$1.1 billion.

Table 2 provides a reconciliation of the fiscal balance estimates between those at the time of the 2000-01 Budget, the 2000-01 MYEFO and the 2001-02 Budget.

Table 2: Reconciliation of 2000-01 Budget, 2000-01 MYEFO and 2001-02 Budget fiscal balance estimates^(a)

| | 2000-01 | 2001-02 | 2002-03 | 2003-04 |
|---|--------------|--------------|---------------|---------------|
| | \$m | \$m | \$m | \$m |
| 2000-01 Budget fiscal balance | 5,436 | 1,072 | 7,610 | 13,884 |
| Per cent of GDP | 0.8 | 0.2 | 1.0 | 1.7 |
| Changes between 2000-01 Budget and MYEFO | | | | |
| Effect of policy decisions ^(b) | | | | |
| Revenue | 88 | -66 | -294 | -276 |
| Expenses | 596 | 321 | 254 | 297 |
| Net capital investment | 1 | 6 | 0 | 0 |
| Net effect of policy decisions | -509 | -393 | -548 | -573 |
| Effect of parameter and other variations | | | | |
| Revenue | 4,066 | 2,579 | 1,512 | 1,540 |
| Expenses ^(c) | 970 | 166 | 1,709 | 2,100 |
| Net capital investment ^(c) | -384 | -192 | 95 | -78 |
| Net effect of parameter and other variations | 3,480 | 2,606 | -292 | -482 |
| 2000-01 MYEFO fiscal balance | 8,407 | 3,285 | 6,769 | 12,829 |
| Per cent of GDP | 1.2 | 0.5 | 0.9 | 1.6 |
| Changes between MYEFO and 2001-02 Budget | | | | |
| Effect of policy decisions ^(b) | | | | |
| Revenue | -164 | -1,062 | -1,664 | -2,224 |
| Expenses ^(d) | 1,467 | 2,767 | 3,303 | 4,569 |
| Net capital investment | 18 | -136 | -111 | -33 |
| Net effect of policy decisions | -1,649 | -3,693 | -4,856 | -6,760 |
| Effect of parameter and other variations | | | | |
| Revenue | 3,564 | -1,181 | -2,922 | -3,956 |
| Expenses ^(e) | 3,238 | -37 | 510 | -31 |
| Net capital investment | 1,661 | -720 | 27 | -554 |
| Net effect of parameter and other variations | -1,334 | -424 | -3,459 | -3,371 |
| 2001-02 Budget fiscal balance | 5,424 | -834 | -1,546 | 2,697 |
| Per cent of GDP | 0.8 | -0.1 | -0.2 | 0.3 |

- (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) Excluding the public debt net interest effect of policy measures.
- (c) Excludes the impact of a reclassification of expenditure on defence weapons platforms, which has no effect on the budget balances. The reclassification results in net capital investment being reduced by around \$1 billion in each year, which is fully offset by an equivalent increase in expenses.
- (d) Includes additional defence expenditure announced in the December 2000 Defence White Paper (\$507 million in 2001-02, increasing to over \$2 billion in 2004-05). Provision for this expenditure was made in the Contingency Reserve at MYEFO. The impact of this expenditure on the fiscal balance estimates is fully offset by a corresponding negative 'parameter and other' variation.
- (e) Includes the impact of the removal of additional Defence White Paper funding from the Contingency Reserve. Adjusting for this effect, parameter and other variations since MYEFO increase expenses by \$470 million in 2001-02 and by around \$1.4 billion in 2003-04.

Variations in revenue estimates

Despite recent stronger than expected collections of non-GST taxation, forecast general government revenue in 2001-02 has been revised down by \$2.2 billion since MYEFO. This is partly due to the lagged effect of the slowdown in economic growth in late 2000. In addition, policy measures since MYEFO have substantially reduced forecast revenue in 2001-02.

However, consistent with stronger than expected non-GST taxation collections to end-March 2001, estimated revenue for 2000-01 has been revised up by \$3.4 billion since MYEFO.

The recent strong collections of non-GST taxation revenue are partly explained by one-off factors, including:

- a change in the timing of some large petroleum resource rent taxation (PRRT) payments;¹ and
- the lagged impact of strong profit growth in 1999-2000 (final company taxation payments relating to the 1999-2000 income year are not received until 2000-01).

In addition, PAYG withholding tax collections from wages and salaries have been stronger than was expected at MYEFO. This indicator of labour market performance is somewhat stronger than other employment and job vacancy data. It is also possible that some of the recent strength in PAYG withholding collections reflects increased compliance by taxpayers following the introduction of *The New Tax System*, as well as a possible trend away from remunerating employees through fringe benefits.

Looking ahead, the recent slowdown in economic growth will likely result in lower revenue growth in 2001-02 and the forward years, relative to expectations at MYEFO.

- Lower profit growth relative to expectations at MYEFO, is expected to lead to a reduction in companies and other individuals tax revenue of around \$1.6 billion in 2001-02 and around \$2 billion through the forward years.
- Estimated PAYG withholding revenue in 2001-02 is broadly unchanged from the corresponding MYEFO estimate, with the positive base effect of stronger collections in 2000-01 offsetting the negative impact of lower forecast growth in employment and wages.

Partly offsetting the downwards revisions to forecast taxation revenue growth, expected dividends from the Reserve Bank of Australia (RBA) and government business enterprises (GBEs) in 2001-02 have been revised upwards since MYEFO by \$1.8 billion.

1 Changes in the expected timing of PRRT payments since MYEFO are expected to boost PRRT revenue in 2000-01 by around \$400 million, but reduce revenue by a similar amount in 2001-02.

Policy decisions taken since MYEFO are expected to reduce revenue by around \$1.1 billion in 2001-02, growing to around \$2.2 billion in 2003-04. The major policy decisions include:

- a 1.5 cents per litre reduction in petrol and diesel excise from 2 March 2001, and the decision to abolish the semi-annual consumer price index (CPI) indexation of petroleum excise (estimated to cost revenue around \$4.6 billion over the four years 2001-02 to 2004-05);
- an increase in the effective tax-free threshold and Medicare levy threshold for senior Australians and pensioners (estimated to cost around \$1.5 billion over the four years from 2001-02);
- the withdrawal of entity tax exposure draft legislation in response to concerns raised in public consultations that the existing draft legislation did not strike an appropriate balance between protecting legitimate small business and farming arrangements while addressing tax abuse in the trust area (at a cost to revenue of \$1.1 billion over the four years 2001-02 through 2004-05);
- a reduction in draught beer excise (estimated to cost \$630 million over the four years from 2001-02);
- cost recovery arrangements that will partially fund measures to prevent foot and mouth disease and other quarantine risks, involving an increase in the passenger movement charge to \$38 and full cost recovery for containers (estimated to raise around \$400 million over the four years from 2001-02);
- the initiative announced in *Backing Australia's Ability* to introduce a 175 per cent tax concession for companies that improve their research and development effort (at an estimated cost to revenue of \$335 million over 2001-02 through 2004-05);
- changes to simplify the Business Activity Statement (BAS) to allow eligible taxpayers the choice of paying their PAYG instalments annually, or use the instalment rate times instalment income method (at an estimated cost to revenue of \$230 million over the four years from 2001-02); and
- an increase in GSM 900 licence fees to align the licence fees more closely with the market value of the mobile phone spectrum (estimated to raise \$128 million over the four years from 2001-02).

Further details on variations in taxation and non-taxation revenue since MYEFO are provided in Statement 5. All revenue measures since MYEFO are described in detail in *Budget Paper No. 2 — Budget Measures 2001-02*.

Variations in expenses estimates

Since MYEFO, estimated expenses have been revised upwards by around \$2.7 billion in 2001-02, increasing to \$4.5 billion in 2003-04. These increases are largely explained by the effect of policy decisions and economic parameter revisions.

Adjusting for the removal of a provision for increased Defence White Paper expenditure, parameter and other revisions since MYEFO have led to an increase in estimated expenses of around \$470 million in 2001-02.² This increase can be partly attributed to the recent temporary slowdown in economic growth, with an upward revision to the forecast number of unemployment benefit recipients increasing estimated expenses by \$970 million in 2001-02.

Other major variations in estimated expenses include:

- an upward revision to interest expenses related to the Commonwealth's public sector and public trading enterprise superannuation liabilities (\$440 million in 2001-02, increasing to over \$700 million in 2003-04), following a recent review;
- higher budget balancing assistance payments to the States due to lower than previously anticipated collections of goods and services tax (GST) revenue (see Box 1 for further information); and
- higher forecast Pharmaceutical Benefits Scheme (PBS) expenses (\$530 million in 2001-02, increasing to \$1.2 billion in 2004-05), reflecting an increasing trend towards the use of newly listed, high cost drugs such as Celebrex (used in the treatment of arthritis) and Zyban (an anti-smoking drug).

These variations in estimated expenses since MYEFO are partly offset by the regular draw-down of the conservative bias allowance,³ which reduces estimated expenses by around \$800 million each year from 2001-02.

Major new policy decisions since MYEFO include:

- measures to build a more effective welfare system by providing new welfare services, incentives and obligations, at a gross cost of \$1.7 billion over four years;

2 In Table 2, additional defence expenditure announced in the November 2000 Defence White Paper, *Defence 2000* (\$507 million in 2001-02, increasing to over \$2 billion in 2004-05) is recorded as a policy decision since MYEFO. However, provision for this expenditure was made at MYEFO. Therefore, the impact of this expenditure on the fiscal balance estimates is fully offset by a corresponding negative 'parameter and other' variation.

3 The forward estimates include an allowance for the established tendency for actual spending on existing government policy (particularly demand driven programmes) to be higher than estimated in the forward years. This allowance, known as the conservative bias allowance, is gradually reduced so that the budget year conservative bias allowance is zero.

- enhancements to quarantine and inspection arrangements in response to foot and mouth disease and other quarantine risks, totaling around \$500 million over five years;
- exempting superannuation assets from the social security means test for those aged between 55 years and the age pension age, at a cost of around \$360 million over four years; and
- an increase in budget balancing assistance payments of around \$670 million over the three years from 2000-01, largely as a result of lower GST revenue following the decision to allow full input tax credits for motor vehicles purchased by business from 23 May 2001.

A number of other major measures have been announced since MYEFO, including:

- additional funding of \$5.1 billion over four years to enhance Australia's military capabilities, as announced in the Defence White Paper;
- additional funding of around \$3 billion over five years, to fund the innovation package, *Backing Australia's Ability*; and
- funding of \$1.6 billion over five years for the *Roads to Recovery* and *Roads to Outer Metropolitan Areas* Packages.

More detailed information on expenses can be found in Statement 6. A full description of all policy decisions taken since the 2000-01 MYEFO can be found in *Budget Paper No. 2 — Budget Measures 2001-02*.

Box 1: The revised outlook for GST collections and budget balancing assistance payments to the States

Under *The New Tax System*, the Commonwealth has undertaken to ensure that the States and Territories are not financially disadvantaged by their changed funding arrangements. During the initial transitional period, the Commonwealth meets this undertaking by providing budget balancing assistance (BBA) payments to the States.

Budget balancing assistance (BBA) is calculated as the difference between GST revenue and the guaranteed minimum amount (GMA). The GMA ensures that the States and Territories are not financially disadvantaged against earlier funding arrangements and includes estimated revenues forgone by the States as well as additional expenses that the States incur.

GST revenue is paid directly to the States and does not directly affect the Commonwealth budget. However, during the transitional period, changes to GST revenue affect the Commonwealth budget indirectly through variations to BBA payments.

Estimated GST revenue in 2001-02 has been revised down by around \$550 million since MYEFO. This is primarily due to the impact of new policy decisions, including the decision to allow full input tax credits for motor vehicles purchased by business from 23 May 2001.

Forecast GST cash revenue in 2000-01 has been revised downwards even further, by around \$2.1 billion. This significant revision mainly reflects a reassessment of the net effect of transitional factors on GST revenue in the first year.

Recent collections data suggests that the boost to first year GST revenue from one-off transitional factors identified at MYEFO, while still substantial, will not be as large as anticipated. In particular, the wholesale sales tax (WST) credits on existing stock that taxpayers are entitled to claim in their initial GST returns have now totaled almost \$2 billion — around \$1 billion higher than anticipated at MYEFO.

- As part of the introduction of *The New Tax System*, businesses were able to claim credits against GST for WST paid on goods acquired before 1 July 2000 and sold from 1 July 2000. This credit could be used to offset a GST liability and could be claimed until January 2001.

In addition, the estimated proportion of GST revenue relating to sales in 2000-01 but collected in 2001-02 has been revised upwards since MYEFO. This arises mainly because a greater share of GST revenue than originally expected is being paid by quarterly rather than monthly payers, and only three quarterly payments are being made in 2000-01. In addition, more GST collected on imports is being recognised in activity statement collections than initially estimated. This overall revision has led to a downwards revision to GST revenue in 2000-01, but has little impact on expected GST revenue in 2001-02.

Box 1: The revised outlook for GST collections and budget balancing assistance payments to the States (continued)

Abstracting from transitional factors — which have been difficult to identify and estimate — the underlying GST base appears to be very close to initial expectations.

As a result of changes in expected GST revenue, together with small upward revisions to the GMA, the Budget estimates provide for increases in BBA payments to the States in 2000-01 and throughout the forward estimates period. All of these payments are expected to take the form of grants.

The table below shows the expected impact of revised GST collections and revisions to the GMA on BBA grant payments. Further details are provided in *Budget Paper No. 3 — Federal Financial Relations 2001-02*.

Revisions to cash GST, GMA and BBA since the 2000-01 MYEFO

| | 2000-01 | | | 2001-02 | | |
|---------------|--------------|---------------|------------------|--------------|---------------|------------------|
| | MYEFO \$m | Budget \$m | Variation \$m | MYEFO \$m | Budget \$m | Variation \$m |
| GMA | 26,979 | 27,138 | 158 | 29,803 | 29,924 | 121 |
| GST | 26,303 | 24,180 | -2,123 | 28,029 | 27,480 | -549 |
| BBA grants | 677 | 2,958 | 2,281 | 1,774 | 2,444 | 670 |
| | 2002-03 | | | 2003-04 | | |
| | MYEFO \$m | Budget \$m | Variation \$m | MYEFO \$m | Budget \$m | Variation \$m |
| GMA | 30,823 | 30,719 | -105 | 31,712 | 31,628 | -84 |
| GST | 29,083 | 29,170 | 87 | 30,737 | 30,830 | 93 |
| BBA grants(a) | 1,777 | 1,549 | -228 | 1,202 | 933 | -269 |

(a) From 2002-03 BBA may be greater than the difference between aggregate GST and aggregate GMA, as States with greater GST than their GMA are entitled to retain the surplus from that time on.

Variations in net capital investment estimates

In 2001-02, forecast net capital investment has fallen by around \$860 million since MYEFO, largely reflecting changes in Defence property sales. These include the delay of \$362 million of Defence property sales from 2000-01 into 2001-02 and the acceleration of further Defence property sales into 2001-02 from later years (of around \$200 million)⁴.

The forecast increase in net capital investment in 2000-01 is largely due to reduced proceeds from the sale of non-financial assets, including the delay in Defence property sales noted above and lower than anticipated proceeds from the sale of third generation (3G) telecommunications spectrum licenses. The cancellation of the digital datacasting auction has also contributed to the increase in estimated net capital investment in 2000-01.

Further details on net capital investment can be found in Statement 6.

NET DEBT AND NET WORTH

The level of Commonwealth general government net debt has fallen consistently since the mid-1990s, from a peak of almost 19 per cent of gross domestic product (GDP) in 1995-96 to an expected 5.4 per cent in 2001-02. In dollar terms, around \$58 billion of net debt will have been repaid since 1995-96, reflecting the combined effect of budget surpluses and asset sales (principally the sale of 49 per cent of the Commonwealth's shareholding in Telstra).

Net debt is expected to fall further through the forward estimates period, although at a slower rate than anticipated at MYEFO. The slowing in the expected rate of debt reduction reflects lower projected underlying cash surpluses, and the deferral of further sales of the Commonwealth's shareholding in Telstra to 2003-04 (see Box 2). Consistent with further reductions in net debt, net interest outlays are also expected to continue to fall. As a percentage of GDP, net interest outlays have been more than halved since 1996-97, which in dollar terms, equates to a reduction of around \$4 billion.

Table 3 provides a summary of Commonwealth general government net worth, net debt and net interest outlays.

4 In the calculation of net capital investment, proceeds from the sale of non-financial assets are subtracted from purchases of non-financial assets. Consequently, proceeds from the sale of non-financial assets decrease net capital investment and increase the fiscal balance.

Table 3: Commonwealth general government net worth, net debt and net interest outlays

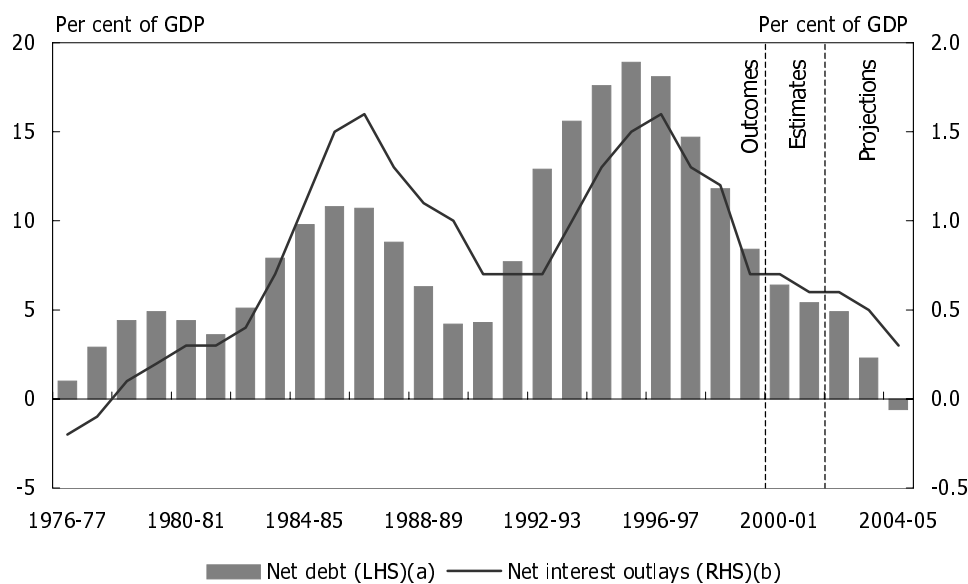
| | Estimates | | Projections | | |
|--------------------------------|----------------|----------------|----------------|----------------|----------------|
| | 2000-01 \$b | 2001-02 \$b | 2002-03 \$b | 2003-04 \$b | 2004-05 \$b |
| Financial assets | 105.3 | 100.8 | 100.5 | 85.8 | 71.8 |
| Non-financial assets | 31.3 | 30.7 | 30.9 | 31.0 | 31.1 |
| Total assets | 136.6 | 131.5 | 131.4 | 116.8 | 102.9 |
| Total liabilities | 169.2 | 165.4 | 166.7 | 150.1 | 130.0 |
| Net worth | -32.7 | -33.9 | -35.4 | -33.3 | -27.1 |
| Net debt(a)(b) | 42.8 | 37.7 | 36.6 | 17.9 | -4.7 |
| Per cent of GDP | 6.4 | 5.4 | 4.9 | 2.3 | -0.6 |
| Net interest outlays(c) | 4.9 | 4.5 | 4.2 | 3.7 | 2.6 |
| Per cent of GDP | 0.7 | 0.6 | 0.6 | 0.5 | 0.3 |

(a) Net debt comprises a sub-set of liabilities (deposits held, advances received and borrowing) less a sub-set of financial assets (cash and deposits; advances paid; and investments, loans and placements).

(b) Includes the impact of the further sale of Commonwealth shareholdings in Telstra.

(c) Commonwealth cash interest payments less cash interest receipts.

Chart 2: Commonwealth general government net debt and net interest outlays



(a) Includes the impact of the further sale of Commonwealth shareholdings in Telstra.

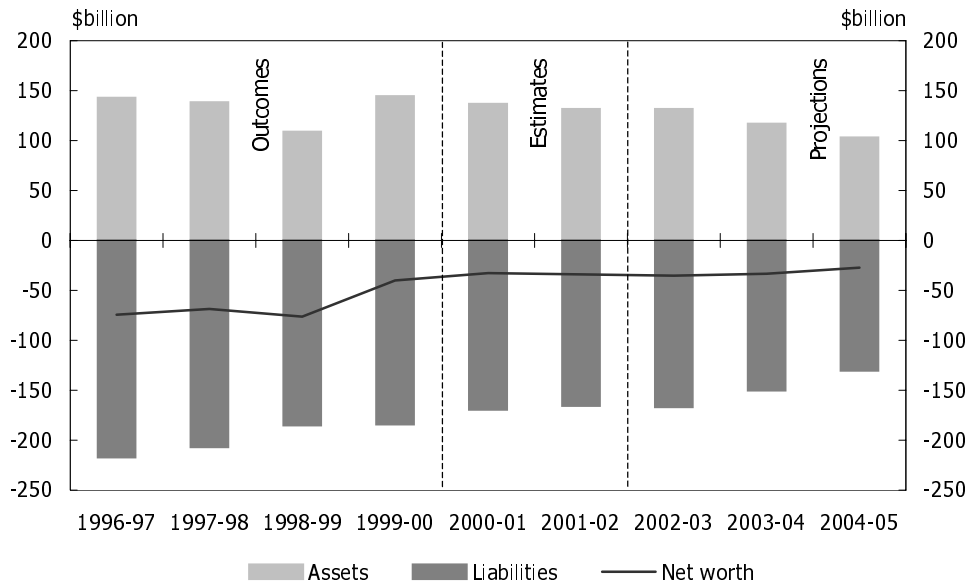
(b) Commonwealth cash interest payments less cash interest receipts.

Source: Data to 1997-98 are from *1997-98 ABS Government Finance Statistics*; data for 1998-99 onwards are from Treasury and DOFA estimates.

Consistent with the move to accrual budgeting, net worth is reported in the Commonwealth general government sector balance sheet. Net worth measures total assets less total liabilities and is therefore a broader measure than net debt, which only incorporates a subset of assets and liabilities.

Net worth is projected to fall in 2001-02 and 2002-03 reflecting accrual operating deficits before improving later in the forward estimates period in line with the return to accrual surpluses (see Chart 3). The overall improvement in net worth over the period 2001-02 to 2004-05 is due to a greater reduction in expected liabilities compared with the expected reduction in assets.

Chart 3: Commonwealth general government contribution of assets and liabilities to net worth



Box 2: Deferral of the further sale of the Commonwealth's shareholding in Telstra

In response to the Telecommunications Service Inquiry, the Budget includes a range of measures to strengthen telecommunications services, particularly in rural and regional Australia. To allow time for these measures to be implemented, the Government has deferred the anticipated timetable for the sale of the Commonwealth's remaining equity in Telstra. Further sales of Telstra equity are now included from 2003-04 (compared with 2001-02 at MYEFO).

The receipts from the sale of the Commonwealth's shareholding in Telstra are not included in the calculation of the fiscal or underlying cash balances. Nevertheless, the sale does have some indirect effects on the budget surplus, in both cash and accrual terms. These include sale cost expenses, changes in expected dividends from Telstra, and ongoing savings in public net debt interest.

The estimated net effect of these changes since MYEFO on the fiscal and underlying cash balances through the forward estimates period is shown in the table below. Deferring the sale improves the budget balances in 2001-02, as higher dividends and the elimination of sale costs in that year outweigh the effect of changes in public net debt interest. From 2002-03 onwards, increases in estimated public net debt interest outweigh increased dividends, leading to a reduction in the fiscal and underlying cash balances.

Estimated net impact of revisions since MYEFO to the Telstra sale assumptions on the fiscal and underlying cash balances^{(a)(b)}

| | 2000-01 | 2001-02 | 2002-03 | 2003-04 | 2004-05 |
|---|---------|---------|---------|---------|---------|
| | \$m | \$m | \$m | \$m | \$m |
| Net effect on fiscal and underlying cash balances | 0 | 97 | -163 | -373 | -327 |

(a) The estimates reflect changes to the sale timetable and estimated sale proceeds.

(b) The estimates are highly dependent on the assumptions made regarding: the structure, timing and proceeds of the sale; expected sale costs; future dividends from Telstra; interest rate assumptions; and financial management strategies.

Net worth is only marginally affected by the later sale timetable because the sale is effectively a reallocation of items in the balance sheet. The deferred sale increases net debt in the forward estimates, but also increases equity assets by an equivalent amount, leaving net worth broadly unchanged.

CASH FLOWS

Table 4 provides a summary of Commonwealth general government cash flows.

Table 4: Summary of Commonwealth general government cash flows

| | Estimates | | Projections | | |
|---|----------------|----------------|----------------|----------------|----------------|
| | 2000-01 \$b | 2001-02 \$b | 2002-03 \$b | 2003-04 \$b | 2004-05 \$b |
| Cash receipts from operating activities | 156.6 | 161.1 | 167.2 | 176.8 | 186.8 |
| Cash payments for operating activities | 155.1 | 159.6 | 165.0 | 171.7 | 178.3 |
| Net cash flows from operating activities | 1.5 | 1.5 | 2.2 | 5.1 | 8.5 |
| Net cash flows from investments in non-financial assets | 0.7 | -0.1 | -1.2 | -1.0 | -1.1 |
| <i>less</i> Finance leases & similar arrangements | 0.0 | -0.1 | 0.0 | 0.0 | 0.0 |
| Underlying cash balance | 2.3 | 1.5 | 1.1 | 4.1 | 7.4 |
| <i>Memorandum items:</i> | | | | | |
| Net cash flows from investments in financial assets for policy purposes(a) | 6.2 | 3.2 | -1.1 | 13.5 | 13.3 |
| Headline cash balance | 8.5 | 4.7 | -0.1 | 17.6 | 20.7 |

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

The underlying cash balance is forecast to remain in surplus over the forward estimates period, although the magnitude of the surpluses has fallen compared with those expected at the 2000-01 MYEFO. However, the declines in the underlying cash balance since MYEFO have not been as great as those in the fiscal balance estimates.

In most instances, government transactions have very similar effects on the accrual and cash budget aggregates. Therefore, most of the change to the underlying cash balance estimates since MYEFO is explained by corresponding variations in the fiscal balance estimates described earlier in this Statement.

However, there are a small number of variations that have significantly different cash and accrual effects (because of the different basis of recording transactions).

- Superannuation cash payments have fallen by around \$700 million in 2001-02 (with smaller falls in the forward years), compared with a \$630 million increase in accrual expenses. Lump sum cash payments have fallen in line with a lower expected rate of redundancies from the Australian Public Service. In addition, the start date for the choice of superannuation fund legislation⁵ has been deferred (Commonwealth employees will be able to direct their employer's superannuation contributions on

5 The Government's choice of superannuation fund legislation will give employees greater choice as to the superannuation fund or retirement savings account into which their employer superannuation contributions are paid.

their behalf into funds outside the Commonwealth general government sector once the legislation is in place, with a consequent reduction in the underlying cash balance, compared with current arrangements).

- A change to military superannuation estimates made at MYEFO has been reversed, reflecting a reassessment of the appropriate accounting treatment that has the effect of reducing aggregate cash payments by around \$500 million in all years (with no impact on accrual expenses).
- There has been a lower than expected take-up of the PAYG transitional arrangements to defer company and superannuation tax payments. This boosts cash estimates of company and superannuation tax revenue in 2000-01 by around \$1.1 billion but reduces cash revenue estimates in the forward years. There is no effect on accrual revenue estimates.

The headline cash balance is estimated to be in surplus in 2001-02, although smaller than forecast at MYEFO. This mainly reflects changes in the Commonwealth's asset sales programme. In particular, the sale of the Commonwealth's remaining equity in Telstra has been deferred (as outlined in Box 2), significantly reducing expected 'cash flows from investments in financial assets for policy purposes' in 2001-02 and 2002-03. The incorporation of the estimated proceeds from the sale of the Sydney Airports Corporation partially offsets the loss of Telstra sale proceeds in 2001-02.

Appendix A: External reporting standards

The Commonwealth *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 in the budget are the Australian Bureau of Statistics (ABS) accrual Government Finance Statistics (GFS) framework and Australian accounting standards, including Australian Accounting Standard No. 31 *Financial Reporting by Governments* (AAS31).

Estimates presented in Budget Paper No. 1 are prepared on a GFS basis unless otherwise indicated. AAS31 estimates are provided in Statement 10.

The GFS framework requires that flows and stocks are valued at current market prices (or where these are not observable, a suitable proxy indicator). While this is the case for flows in the operating statement and the cash flow statement, not all assets and liabilities in the GFS balance sheet are currently valued at current market prices. This is principally because Australian accounting standards allow reporting entities to elect to value their assets at either cost or fair value (current market value). The accounting profession is considering general valuation issues relating to liabilities. In the early years of accrual budgeting the focus has been on preparing robust GFS operating and cash flow statements. Refinements to the GFS balance sheet valuations of assets and liabilities will be considered over time, in consultation with the ABS, as the new framework is bedded down.

The Commonwealth revenue and expenses estimates in Statement 5 and Statement 6 do not include goods and services tax (GST) collections and equivalent payments to the States. Under the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (the IGA), all GST receipts are appropriated to the States and Territories and thus are not available for expenditure by the Commonwealth. Because the Commonwealth collects GST as an agent for the States and Territories, GST receipts are not shown as Commonwealth revenue. Estimates of GST receipts are provided in Box 1 in this Statement and in Table 2 of Statement 11.

In order to ensure the reporting of reliable budget estimates and outcomes, taxation revenue is recognised the earlier of when an assessment of a tax liability is made or cash payment is received by the Australian Tax Office (ATO) or the Australian Customs Service (ACS). Accordingly, for most categories of taxation revenue, there is a short lag between when the revenue is recognised and the time at which the underlying income (or economic activity) giving rise to the tax liability occurs. Longer lags, of up to a year, occur for some elements of company and superannuation funds taxation.

Additional information on the external reporting standards and budget concepts is provided in Statement 11.

Appendix B: Sensitivity of fiscal aggregates to economic developments

Table B1 provides a guide to the sensitivity of the forward estimates of expenses and revenue to variations in economic parameters in 2001-02. It is important to recognise that such guides provide only a 'rule of thumb' indication of the impact on the budget of changes in prices, wages and other parameters.

Table B1: Sensitivity of financial aggregates to changes in economic parameters

| | 2001-02 | 2002-03 | 2003-04 | 2004-05 |
|---------------------------------|---------|---------|---------|---------|
| | \$m | \$m | \$m | \$m |
| Expenses | | | | |
| Prices | 690 | 720 | 750 | 770 |
| Wages | 90 | 330 | 350 | 370 |
| Unemployment benefit recipients | 290 | 280 | 270 | 250 |
| Safety net adjustments | 60 | 120 | 190 | 250 |
| Revenue | | | | |
| Prices | 40 | 80 | 80 | 80 |
| Wages | 1140 | 1220 | 1310 | 1420 |
| Employment | 770 | 830 | 890 | 960 |
| Private final demand | 260 | 270 | 280 | 290 |

Expenses

On the expenses side, the sensitivity analysis of the estimates provides for the following assumptions about changes to four broad groups of parameters.

Prices

All price deflators are assumed to change by one percentage point at the start of the September quarter 2001, with wage deflators left unchanged.

- The effect of a change in prices on Commonwealth expenses has increased since the 2000-01 MYEFO reflecting a change to the methodology for indexing superannuation liabilities and defence expenditures.

Wages

All wage and salary growth rates are assumed to change by one percentage point from the beginning of the September quarter 2001, with price deflators left unchanged.

- The wages effect resulting from a change in wage and salary growth rates is largely determined by the effect of the Government's commitment to maintain selected pensions at 25 per cent of Male Total Average Weekly Earnings (MTAWE). The

wages effect in Table B1 above does not include changes to wage and salary payments in Commonwealth departmental expenses.

Unemployment benefit recipients (includes 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 in all the forward years.

Safety Net Adjustment

The Safety Net Adjustment (SNA) determined by the Australian Industrial Relations Commission is assumed to change by \$2 per week, taking effect from the beginning of the September quarter 2001, and each year after that.

- About \$45 billion of expenses, comprising agency departmental expenses, other Commonwealth own purpose expenses and Specific Purpose Payments to the States of a departmental expense nature, are indexed to weighted averages of movements in inflation and the SNA.

Revenue

The assumptions underlying the sensitivity of the revenue estimates to changes in prices and wages are similar to those used for expenses. 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.

The revenue effects of changes in employment and private final demand show the impact of the following assumed changes:

- employment — the level of employment is assumed to change by one percentage point from the beginning of the September quarter 2001, with no change in the composition of demand; and
- private final demand (consumption plus investment) — the level of private final demand is assumed to change by one percentage point from the beginning of the September quarter 2001, with no change in the composition of demand.

For the purposes of this analysis:

- changes in prices affect revenue primarily through changes in excise revenue;
- changes in wages and employment feed through into tax revenue largely through increases in PAYG withholding tax collections; and
- changes in private final demand affect revenue predominantly through changes in excise and customs collections.

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.

Relative to the 2000-01 Budget, the sensitivity of revenue to prices has fallen. This is attributable to the decision to abolish petroleum excise indexation. Hence, changes in the price deflator from the beginning of the September quarter 2001 no longer affect the petroleum excise revenue estimates.

