STATEMENT 3: FISCAL STRATEGY AND OUTLOOK

This Budget is the Government's first major step towards meeting our election commitment to repair the Budget.

The Government's medium-term fiscal strategy is to achieve budget surpluses, on average, over the course of the economic cycle. The fiscal strategy underlines the commitment to budget discipline and outlines how the Government will set medium-term fiscal policy while allowing for flexibility in response to changing economic conditions. To deliver on this medium-term fiscal strategy over time, the Government will repair the Budget by ensuring new spending is more than offset by reduced spending, and positive variations in receipts and payments from favourable economic conditions are banked as improvements to the budget bottom-line.

The deficits inherited from the former Government over the four years to 2016-17 totalled $123 billion at the 2013-14 MYEFO. In the Government's first four years to 2017-18, deficits are estimated to total just $60 billion — an improvement of $43.8 billion over these four years compared with the 2013-14 MYEFO. This improvement will be achieved by decisions that reduce wasteful spending, improve the sustainability of our social safety net, encourage greater personal responsibility and encourage the states to take greater responsibility for their hospitals and schools. Of the decisions taken in this Budget, 77 per cent of the improvement to the bottom line is the result of reductions to spending. The Government is redirecting spending from consumption to investments that will drive economic growth.

In the 2014-15 Budget, the Government is budgeting for an underlying cash deficit of $29.8 billion (1.8 per cent of GDP) in 2014-15, improving to a deficit of $2.8 billion (0.2 per cent of GDP) in 2017-18. The pace of fiscal consolidation balances the need for structural fiscal repair with the shorter term impact on the economy.

The Budget also deals with the significant real growth in payments inherited from the former Government in 2017-18, where payments were previously growing at 5.9 per cent above inflation between 2016-17 and 2017-18. As a result of the actions in the Budget, the Government has reduced this real growth in payments to 2.6 per cent. The improvement to the budget bottom line in 2017-18 is $25.6 billion, $20.3 billion is the result of decisions to cut spending.

The structural savings we have put in place reduce the spiralling of payments growth and drive a significantly more sustainable budget position in the medium term. Based on the economy continuing to grow, the medium-term projections indicate a return to surplus by the end of the decade.

At the 2013-14 MYEFO, Commonwealth Government Securities on issue were projected to reach $667 billion in 2023-24. This is projected to reduce to $326 billion in this Budget assuming no tax relief. With a tax-to-GDP cap of 23.9 per cent, Commonwealth Government Securities on issue in 2023-24 would still reduce to $389 billion compared to $748 billion if a tax cut had been in place at MYEFO.

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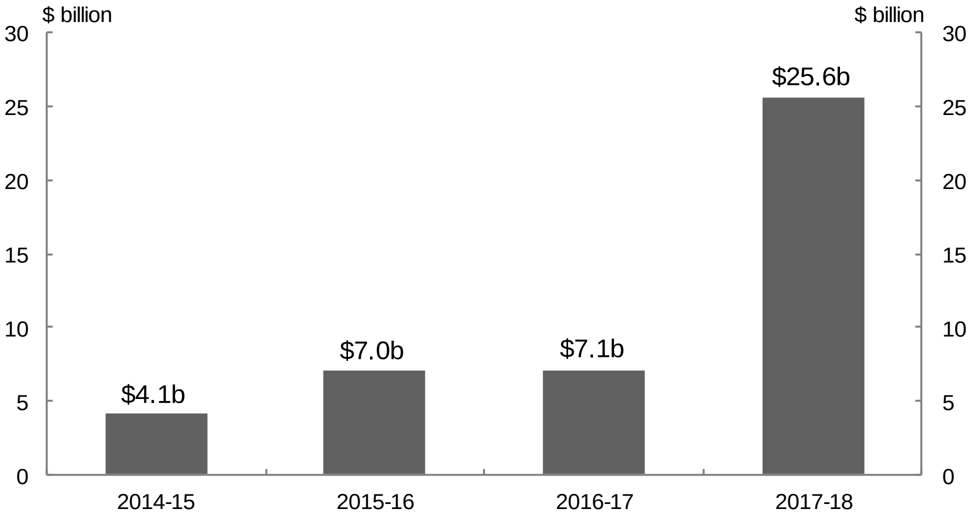
STATEMENT 3: FISCAL STRATEGY AND OUTLOOK

OVERVIEW

The 2014-15 Budget reins in wasteful spending, improves the sustainability of our social safety net and encourages greater personal responsibility. The Government is asking all Australians to make a contribution to repair the budget and refocus government spending on those areas of the economy that will drive economic growth and safeguard our future prosperity. This Budget delivers medium-term structural budget reform by ensuring government spending is on a manageable trajectory, providing a credible path to a projected surplus and ensuring Australia's medium-term fiscal sustainability.

The deficits inherited from the former Government that were outlined in the 2013-14 MYEFO for the four years to 2016-17 totalled $123 billion. In our first four years to 2017-18, deficits are estimated to total just $60 billion — an improvement of $43.8 billion over these four years compared with the 2013-14 MYEFO. Savings decisions begin to have an impact from 2014-15 where government spending is redirected from recurrent expenditure to productive investments in infrastructure. A significant contribution to this improvement in the bottom line is in 2017-18 where a $25.6 billion improvement to the deficit includes hard decisions taken to deliver $20.3 billion of savings from payments. These decisions are needed to ensure the sustainability of the budget position in the medium term, reducing the average real growth in payments to 2.7 per cent from an unsustainable 3.7 per cent at the 2013-14 MYEFO. Current medium-term projections indicate a return to surplus by the end of the decade. There is however, much work still to be done to improve on that position.

Chart 1: Improvement of $43.8 billion to the budget position since the 2013-14 MYEFO in the four years to 2017-18



Note: The starting point for 2017-18 was a deficit of $28.4 billion.

The Government is budgeting for an underlying cash deficit of $29.8 billion (1.8 per cent of GDP) in 2014-15, improving to a deficit of $2.8 billion (0.2 per cent of GDP) in 2017-18 as shown in Table 1.

Table 1: Budget aggregates

	Actual	Estimates			Projections		
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	Total(a)
Underlying cash balance ($b)(b)	**-18.8**	**-49.9**	**-29.8**	**-17.1**	**-10.6**	**-2.8**	**-110.1**
Per cent of GDP	-1.2	-3.1	-1.8	-1.0	-0.6	-0.2	
Fiscal balance ($b)	**-23.5**	**-45.1**	**-25.9**	**-12.2**	**-6.6**	**1.0**	**-88.7**
Per cent of GDP	-1.5	-2.8	-1.6	-0.7	-0.4	0.1	

(a) Total is equal to the sum of amounts from 2013-14 to 2017-18.
(b) Excludes net Future Fund earnings.

The Government's actions will also strengthen the Commonwealth's balance sheet by stabilising and then reducing debt. This will recharge the fiscal buffers to ensure we are able to respond to future economic challenges. The face value of Commonwealth Government Securities on issue is expected to fall from $667 billion in 2023-24 as outlined in the 2013-14 MYEFO to $389 billion, even with the Budget projection (unlike the MYEFO projection) building in future tax relief through an assumed tax cap of 23.9 per cent of GDP. [1]

Net financial worth is estimated to be -$329.2 billion (-20.2 per cent of GDP) in 2014-15 and is expected to stabilise at around -$352.7 billion (-18.7 per cent of GDP) in 2017-18.

FISCAL STRATEGY

The Government's fiscal strategy

In this Budget, the Government outlines its fiscal strategy, consistent with the requirements of the *Charter of Budget Honesty Act 1998* (See Box 1).

1 This is the average tax-to-GDP ratio of the years following the introduction of the GST and prior to the global financial crisis (from 2000-01 to 2007-08 inclusive).

Box 1: The Government's fiscal strategy

Medium-term fiscal strategy

The Government's medium-term fiscal strategy is to achieve budget surpluses, on average, over the course of the economic cycle.

Our strategy is underpinned by the following three policy elements:

- investing in a stronger economy by redirecting Government spending to quality investment to boost productivity and workforce participation;
- maintaining strong fiscal discipline to reduce the Government's share of the economy over time in order to free up resources for private investment to drive jobs and economic growth, with:
  - the payments-to-GDP ratio falling;
  - paying down debt by stabilising and then reducing Commonwealth Government Securities on issue over time; and
- strengthening the Government's balance sheet by improving net financial worth over time.

Budget repair strategy

The Budget repair strategy is designed to deliver budget surpluses building to at least 1 per cent of GDP by 2023-24 consistent with the medium-term fiscal strategy.

Our strategy sets out that:

- new spending measures will be more than offset by reductions in spending elsewhere within the budget;
- the overall impact of shifts in receipts and payments due to changes in the economy will be banked as an improvement to the budget bottom line, if this impact is positive; and
- a clear path back to surplus is underpinned by decisions that build over time.

The Budget repair strategy will stay in place until a strong surplus is achieved and so long as economic growth prospects are sound and unemployment remains low.

Delivering on the medium-term fiscal strategy

In the 2014-15 Budget, the Government has put the Budget on a far more sustainable footing consistent with the medium-term fiscal strategy.

Budget surpluses over the course of the economic cycle

This Budget enables the Government to deliver a substantial reduction of $43.8 billion in the underlying cash deficit since the 2013-14 MYEFO over the four years to 2017-18. The deficits at the 2013-14 MYEFO for the four years to 2017-18 totalled $104.1 billion, using the medium-term projection for 2017-18 of a deficit of $28.4 billion. The deficits over the same period in the 2014-15 Budget total $60.2 billion.

The headline annual pace of consolidation is 0.7 per cent of GDP over the forward estimates. Abstracting from the one-off nature of the Reserve Bank of Australia transaction, the pace of consolidation is 0.6 per cent of GDP. This pace of consolidation over the forward estimates strikes the right balance between the impact of fiscal consolidation on the economy and sustainable structural reforms.

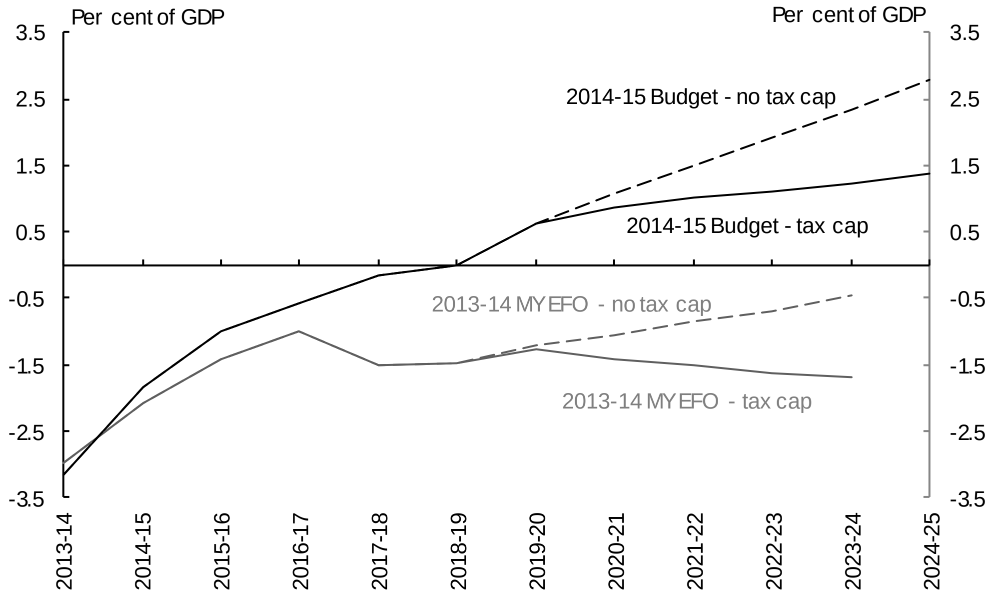
Beyond the forward estimates the savings measures in this Budget are expected to grow, contributing to a substantial improvement in the fiscal position.

Chart 2 shows the projected underlying cash balance under two scenarios. The no tax cap scenario allows the average tax rates to increase above the long-term average. If fiscal drag, including income tax bracket creep, is allowed to occur indefinitely then a rising personal income tax burden would also have negative impacts on workforce participation. This potential reduction in GDP growth has not been taken into account.

The tax cap scenario assumes that taxes are not allowed to grow beyond the average of 23.9 per cent of GDP.

In the tax cap scenario, the budget is projected to be at balance in 2018-19, and in a strong surplus of 1.4 per cent of GDP in 2024-25, delivering on the election commitment for surpluses to build to at least 1 per cent of GDP by 2023-24.

Chart 2: Underlying cash balance projected to 2024-25



Note: The underlying cash balance excludes Future Fund earnings and payments. MYEFO tax cap projection was not published at MYEFO.
Source: Treasury projections.

These projections are based on a further 10 years of uninterrupted economic growth. Such an outcome would take our record to 34 consecutive years of growth by 2024-25, a record unparalleled amongst advanced economies.

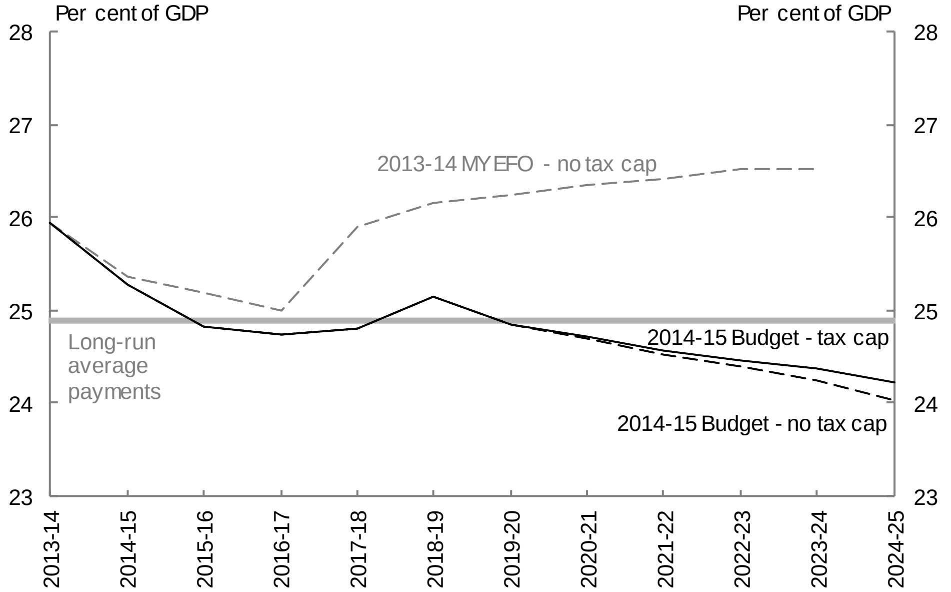
These projections do not assume a cap on real spending growth to achieve budget surpluses. Instead, the substantial improvement to the bottom line is built on a significant reduction in payments growth as a result of the Government's long-term budget savings.

In the tax cap scenario, average annual real payments growth over the medium term (the period from 2018-19 to 2024-25) falls to 2.7 per cent, compared to 3.7 per cent projected at the 2013-14 MYEFO. The payments-to-GDP ratio declines from 25.3 per cent of GDP in 2014-15 to 24.2 per cent in 2024-25, falling below the long-term average[2] as shown in Chart 3.

Total payments in the no tax cap scenario are lower than in the tax cap scenario because additional tax receipts reduce the issuance requirement for Commonwealth Government Securities and thereby lower public debt interest payments.

2 The long-term average payments-to-GDP ratio is 24.9 per cent of GDP, calculated over a 30 year period from 1983-84 to 2012-13.

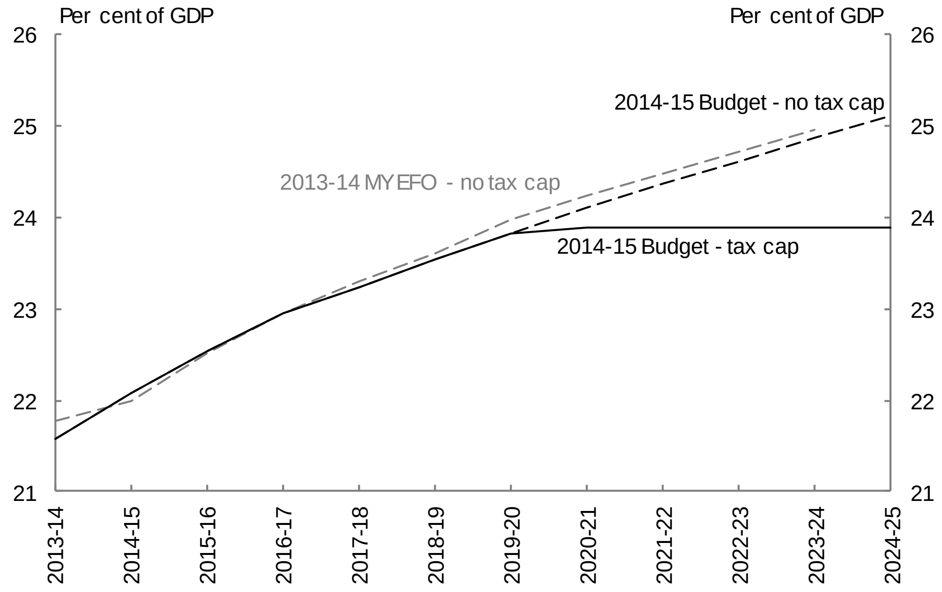
Chart 3: Total payments projected to 2024-25



Note: Total payments include Future Fund payments. MYEFO tax cap projection was not published at MYEFO.
Source: Treasury projections.

Chart 4 shows that in the scenario with no tax cap, tax receipts are projected to increase from 22.1 per cent of GDP in 2014-15 to 25.1 per cent in 2024-25.

Chart 4: Tax receipts projected to 2024-25



Note: Tax receipts make up the bulk, but not all, of total receipts. Non-tax receipts make up around 1.5 per cent of GDP.
Source: Treasury projections.

Investing in a stronger economy by redirecting government spending

A key element of the fiscal strategy is investing in a stronger economy by redirecting government spending to quality investments to boost productivity and participation.

To drive the productivity required to generate economic growth, the Government has refocused spending on infrastructure and reforms to higher education.

The Infrastructure Growth Package will provide additional infrastructure spending of $11.6 billion to address critical transport bottlenecks. This investment will take the Government's total investment in transport infrastructure to $50 billion by 2019-20. Total infrastructure investment from Commonwealth, State and local governments, as well as the private sector, will build to over $125 billion of additional infrastructure.

The Infrastructure Growth Package is designed to support economic growth in the short term and the economy's longer term productive capacity.

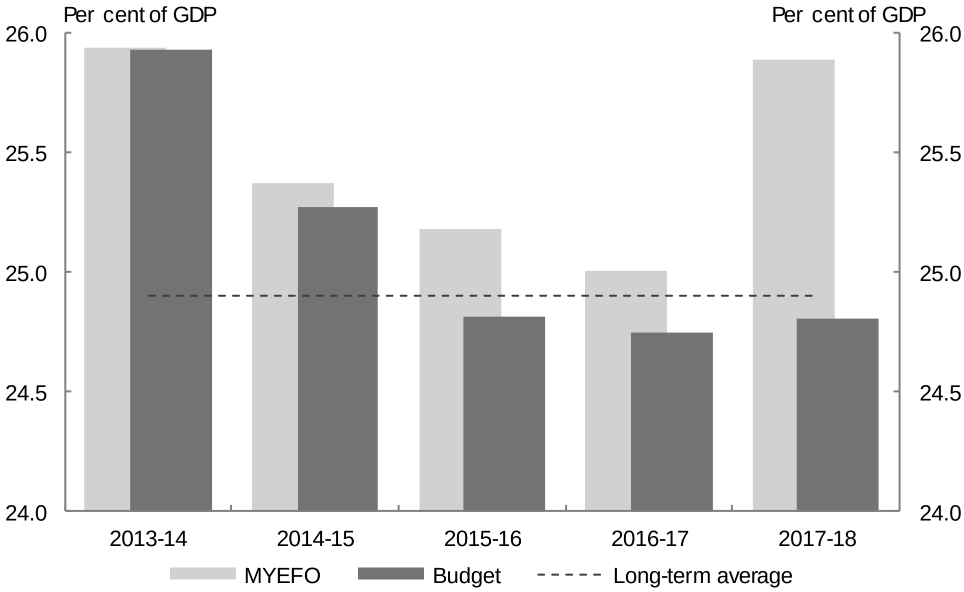
Strong fiscal discipline

The Government's fiscal strategy reflects a commitment to maintain the strong fiscal discipline required to pay down debt. This is a necessary part of reducing the Government's share of the economy over time in order to free up resources for private investment to drive jobs and economic growth, and live within our means.

The Government has begun the task of reducing the payments-to-GDP ratio which falls from 25.3 per cent of GDP in 2014-15 to 24.7 per cent of GDP in 2016-17, before returning to 24.8 per cent of GDP in 2017-18.

The Government recognises that this is only the first step in repairing the Budget and that there is further work to do.

Chart 5: Change in payments share between 2013-14 MYEFO and 2014-15 Budget



The slight rise in the payments-to-GDP ratio in 2017-18 occurs despite the Government's decisions that reduce government spending by $15.5 billion. The real growth in payments inherited in 2017-18 was 5.9 per cent. Without action, the growth in payments in 2017-18 would have been $38.0 billion, payments-to-GDP in 2017-18 would have been 25.9 per cent of GDP, and would have resulted in a deficit of $28.4 billion. The Government's decisions have reduced this real growth to 2.6 per cent and a deficit of $2.8 billion.

By 2024-25, the payments-to-GDP ratio is projected to reduce to 24.2 per cent of GDP. This is below the long term average of 24.9 per cent of GDP. A falling payments-to-GDP ratio will mean that the Government will be better placed to lower taxes.

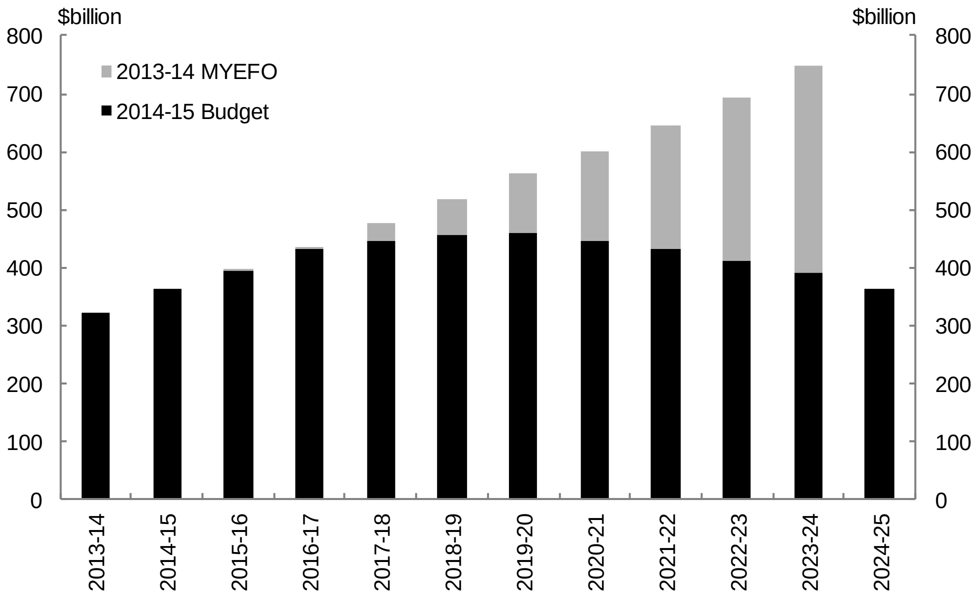
The Government will achieve fiscal consolidation through medium-term structural savings to the budget. These savings decisions will help to improve the sustainability and efficiency of Government spending. The largest savings beyond the forward estimates are through:

- changes to welfare payments for young people with full working capacity;
- changes to the funding of the Official Development Assistance programme;
- reforms to hospital funding and health expenditure, including new patient contributions to the costs of medical services;
- reforms to schools funding to drive efficient delivery of education services;

- changes to family tax benefits, including tightening of eligibility requirements;
- changes to the method of indexation of age and disability pensions; and
- reforms to higher education funding and student contributions.

In the scenario with a tax cap, Commonwealth Government Securities on issue in 2023-24 are expected to be $389 billion, compared to $748 billion if a tax cap had been in place at the 2013-14 MYEFO as shown in Chart 6.

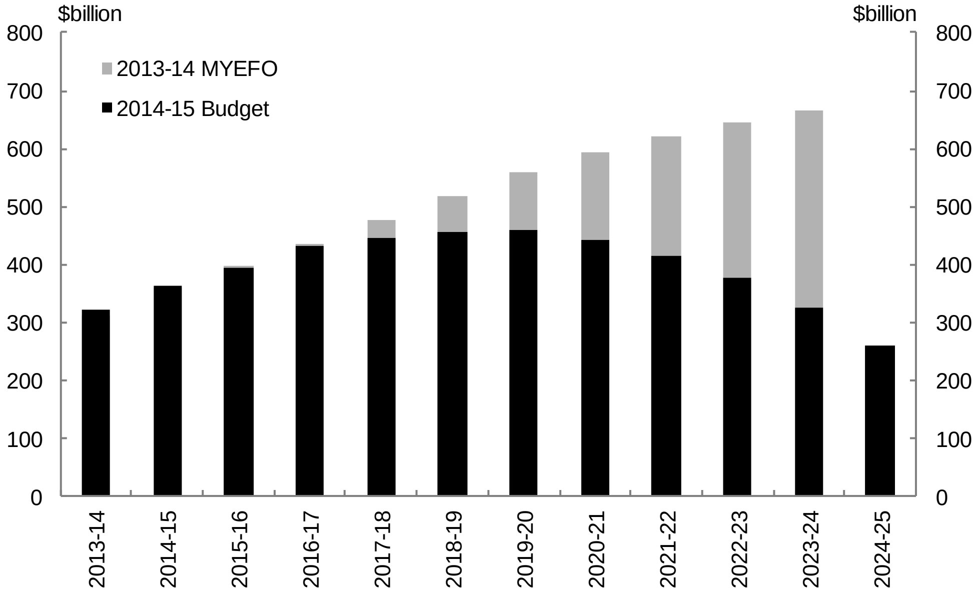
Chart 6: Face value of Commonwealth Government Securities on issue projected to 2024-25 — with tax cap



Note: A tax-to-GDP cap of 23.9 per cent has been applied on these projections. MYEFO tax cap projection was not published at MYEFO.
Source: Australian Office of Financial Management and Treasury projections.

In the scenario with no tax cap, Commonwealth Government Securities on issue in 2023-24 are expected to reach $326 billion, compared to $667 billion at the 2013-14 MYEFO as shown in Chart 7.

Chart 7: Face value of Commonwealth Government Securities on issue projected to 2024-25 — no tax cap



Source: Australian Office of Financial Management and Treasury projections.

Further details on debt reduction can be found in *Statement 7: Debt Statement, Assets and Liabilities*.

Strengthening the Government's balance sheet

Improving net financial worth over time, and stabilising and then reducing government debt will generate a stronger Commonwealth balance sheet and help to ensure ongoing fiscal sustainability. Returning the budget to surplus is a key part of achieving this outcome.

A strong balance sheet provides the Government the flexibility to respond to unanticipated events during times of financial crises or economic shocks. It can also provide flexibility in facilitating economic reform, address shortfalls in infrastructure investment and respond to structural changes in the economy, such as the ageing population.

Strengthening the Government's balance sheet means that government debt is kept at manageable levels, which reduces the interest cost burden. This has the benefit of more stable tax and spending policies and ensures future generations do not have to bear the burden of restoring weak finances.

Some key aggregates that provide indications of fiscal sustainability are net financial worth, net debt, net worth, and net interest payments set out in Table 2. Net financial worth is the primary indicator of fiscal sustainability articulated in the medium-term fiscal strategy. It provides a broader measure of the Government's assets and liabilities as it includes both the full assets of the Future Fund and the superannuation liability that the Future Fund is intended to offset.

Table 2: Net worth, net financial worth, net debt and net interest payments

	Estimates			Projections	
	2013-14	2014-15	2015-16	2016-17	2017-18
	$b	$b	$b	$b	$b
Financial assets	279.8	297.4	322.6	361.1	380.8
Non-financial assets	113.2	117.2	119.9	122.0	125.3
Total assets	**393.0**	**414.6**	**442.5**	**483.2**	**506.1**
Total liabilities	**579.4**	**626.6**	**665.0**	**712.2**	**733.4**
Net worth	**-186.4**	**-212.0**	**-222.5**	**-229.0**	**-227.4**
Net financial worth(a)	**-299.6**	**-329.2**	**-342.4**	**-351.0**	**-352.7**
Per cent of GDP	-18.9	-20.2	-20.0	-19.6	-18.7
Net debt(b)	**197.9**	**226.4**	**246.4**	**261.3**	**264.2**
Per cent of GDP	12.5	13.9	14.4	14.6	14.0
Net interest payments	**10.7**	**10.5**	**11.5**	**12.2**	**12.9**
Per cent of GDP	0.7	0.6	0.7	0.7	0.7

(a) Net financial worth equals total financial assets minus total liabilities.
(b) Net debt equals the sum of deposits held, government securities, loans and other borrowing, minus the sum of cash and deposits, advances paid and investments, loans and placements.

Net financial worth is estimated to be -$329.2 billion (-20.2 per cent of GDP) in 2014-15, $6.0 billion worse than estimated at the 2013-14 MYEFO.

This deterioration reflects a downward revaluation of superannuation liabilities, and a fall in the value of the Government's investments in public sector entities. These negative impacts are partially offset by the higher value of investments held by the Government in newly established funds and other deposits. In 2016-17, net financial worth is projected to improve by $10.4 billion since the 2013-14 MYEFO. By 2017-18, it is projected to start stabilising at around -$352.7 billion. Net financial worth improves as a share of GDP, falling from -20.2 per cent of GDP in 2014-15 to -18.7 per cent of GDP in 2017-18.

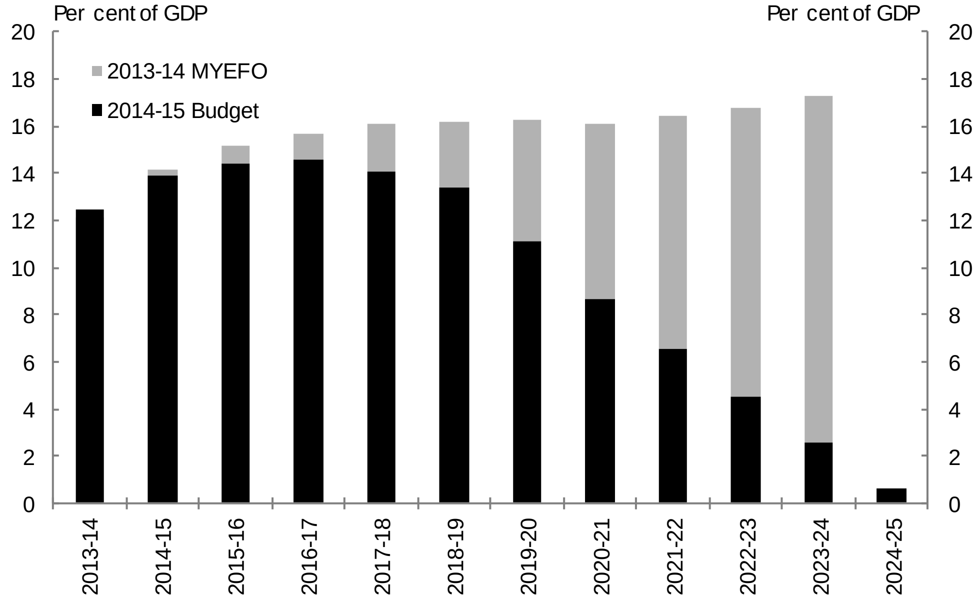
Net worth is expected to be -$212.0 billion in 2014-15, $5.0 billion worse than estimated at the 2013-14 MYEFO. Net worth is expected to be -$227.4 billion by the end of the forward estimates.

Net debt is estimated to be $226.4 billion in 2014-15 (13.9 per cent of GDP). As the definition of net debt does not include superannuation liabilities or equity investments (which drive the fall in net financial worth), net debt has improved by $4.7 billion in 2014-15 compared to the 2013-14 MYEFO. Net debt is expected to be $264.2 billion by the end of the forward estimates.

In the medium term under the tax cap scenario, net debt is projected to decline to 0.7 per cent of GDP in 2024-25 as shown in Chart 8. Given the fall in

Commonwealth Government Securities on issue, net financial worth is also expected to improve over the medium term.

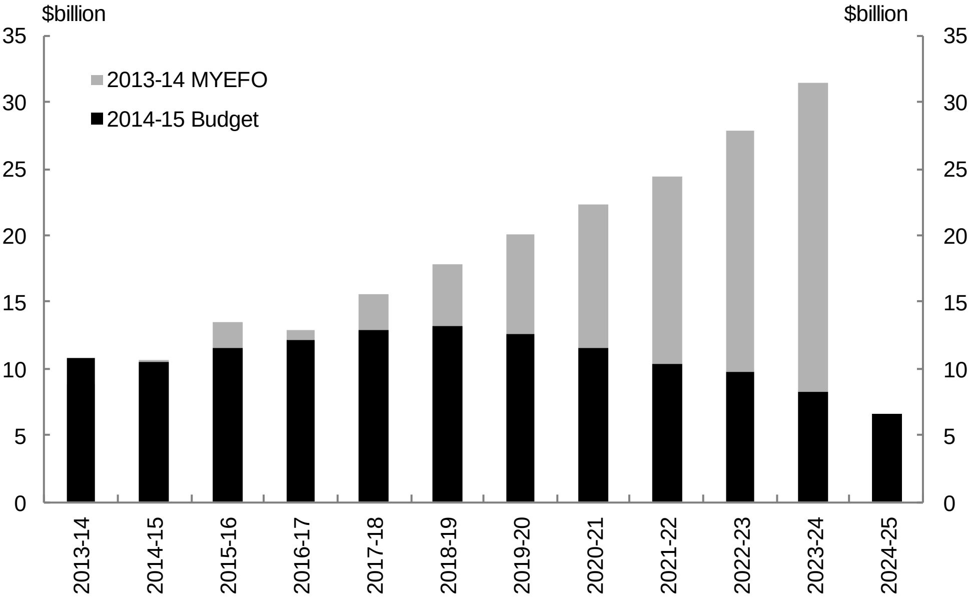
Chart 8: Net debt projected to 2024-25 — with tax cap



Note: A tax-to-GDP cap of 23.9 per cent has been applied on these projections. MYEFO tax cap projection was not published at MYEFO.
Source: Treasury projections.

The Government is determined to reduce the impact that servicing debt has on the budget. In the tax cap scenario, net interest payments are expected to peak at $13.1 billion in 2018-19 and decline to $6.6 billion in 2024-25 (0.2 per cent of GDP) as shown in Chart 9. In 2023-24, net interest payments would reduce from the 2013-14 MYEFO projection of $31.5 billion to $8.3 billion in this Budget. This is a reduction in net interest costs of $23.2 billion. With a AAA credit rating, Australia faces a relatively low cost of borrowing.

Chart 9: Net interest payments projected to 2024-25 — with tax cap



Note: Net interest payment is total interest receipts minus total interest payments. A tax-to-GDP cap of 23.9 per cent has been applied to these projections.
Source: Treasury projections.

Further details on debt interest costs can be found within *Statement 7: Debt Statement, Assets and Liabilities*.

Delivering on the budget repair strategy

The 2014-15 Budget drives the budget repair strategy that is designed to deliver budget surpluses building to at least 1 per cent of GDP by 2023-24.

All new decisions taken in this Budget have been more than fully offset, contributing to a clear path back to surplus. The Government has not used estimates variations from increased receipts or decreased payments to fund new spending.

The net budget impact of policy decisions is a $36.0 billion improvement to the underlying cash balance over the forward estimates to 2017-18. Over the same period, net increases in receipts from policy decisions have improved the underlying cash balance by $8.3 billion, while net savings from payments have improved the underlying cash balance by $27.7 billion. Of the decisions taken in this Budget, 77 per cent of the improvement to the bottom line is the result of reductions to spending.

As a result of decisions, receipts have increased by $8.9 billion over the forward estimates period to 2017-18, offset by decreases in receipts of $0.6 billion. Increases in receipts are as a result of decisions taken to repair the budget by introducing a temporary levy on individuals' incomes above $180,000 and removing poorly targeted tax concessions. In addition, receipts are increased by the reintroduction of the indexation of fuel excise rates which will be used to fund roads.

The Government has made $47.7 billion in savings from payments in this Budget over the forward estimates to 2017-18, to pay for new spending of $20.0 billion. The impact of these savings decisions builds over time, reducing payments growth, consistent with the policy to repair the Budget.

Real growth in payments is estimated to be -1.7 per cent in 2014-15, 0.4 per cent in 2015-16, 2.1 per cent in 2016-17 and 2.6 per cent in 2017-18. Over the four years to 2017-18, the average real growth in payments in the 2014-15 Budget of 0.8 per cent more than halves the average at the 2013-14 MYEFO of 1.9 per cent.

In the 2017-18 year, the Government has taken significant decisions to address increasing program costs, with savings from payments totalling $20.3 billion. This has reduced real payments growth between 2016-17 and 2017-18 from 5.9 per cent at the 2013-14 MYEFO to 2.6 per cent in this Budget. These structural savings decisions build over time and are instrumental in restoring the budget to a more sustainable position over the medium term.

FISCAL OUTLOOK

Budget aggregates

An underlying cash deficit of $29.8 billion (1.8 per cent of GDP) is expected in 2014-15, improving to a deficit of $2.8 billion (0.2 per cent of GDP) in 2017-18.

A headline cash deficit of $33.5 billion (2.1 per cent of GDP) is expected in 2014-15, improving to a deficit of $11.4 billion (0.6 per cent of GDP) in 2017-18.

In accrual terms, a fiscal deficit of $25.9 billion (1.6 per cent of GDP) is expected for 2014-15, improving to a surplus of $1.0 billion (0.1 per cent of GDP) in 2017-18.

Table 3 provides key budget aggregates for the Australian Government general government sector.

Table 3: Australian Government general government sector budget aggregates

	Actual	Estimates			Projections		
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	Total(a)
	$b	$b	$b	$b	$b	$b	$b
Receipts	**351.1**	**363.5**	**385.8**	**410.4**	**436.8**	**468.0**	**2,064.5**
Per cent of GDP	23.1	23.0	23.6	24.0	24.4	24.9	
Payments(b)	**367.2**	**410.7**	**412.5**	**424.2**	**443.9**	**467.1**	**2,158.4**
Per cent of GDP	24.1	25.9	25.3	24.8	24.7	24.8	
Net Future Fund earnings	2.7	2.7	3.1	3.3	3.5	3.8	16.3
Underlying cash balance(c)	**-18.8**	**-49.9**	**-29.8**	**-17.1**	**-10.6**	**-2.8**	**-110.1**
Per cent of GDP	-1.2	-3.1	-1.8	-1.0	-0.6	-0.2	
Revenue	**360.2**	**374.3**	**391.3**	**419.6**	**449.8**	**480.4**	**2,115.5**
Per cent of GDP	23.6	23.6	24.0	24.5	25.1	25.5	
Expenses	**382.6**	**415.3**	**414.8**	**431.1**	**453.8**	**475.4**	**2,190.5**
Per cent of GDP	25.1	26.2	25.4	25.2	25.3	25.3	
Net operating balance	-22.5	-41.0	-23.5	-11.5	-4.0	4.9	-75.0
Net capital investment	1.0	4.0	2.4	0.7	2.6	4.0	13.7
Fiscal balance	**-23.5**	**-45.1**	**-25.9**	**-12.2**	**-6.6**	**1.0**	**-88.7**
Per cent of GDP	-1.5	-2.8	-1.6	-0.7	-0.4	0.1	
Memorandum item:							
Headline cash balance	-21.0	-53.7	-33.5	-26.6	-22.7	-11.4	-148.0

(a) Total is equal to the sum of amounts from 2013-14 to 2017-18.
(b) Equivalent to cash payments for operating activities, purchases of non-financial assets and net acquisition of assets under finance leases.
(c) Excludes net Future Fund earnings.

Table 4 provides a summary of the cash flows of the Australian Government general government sector.

Table 4: Summary of Australian Government general government sector cash flows

	Estimates			Projections	
	2013-14	2014-15	2015-16	2016-17	2017-18
	$b	$b	$b	$b	$b
Cash receipts					
Operating cash receipts	363.0	383.5	407.7	436.6	467.8
Capital cash receipts(a)	0.5	2.2	2.7	0.2	0.2
Total cash receipts	363.5	385.8	410.4	436.8	468.0
Cash payments					
Operating cash payments	400.4	401.7	414.4	434.5	456.1
Capital cash payments(b)	9.8	10.8	9.8	9.4	11.0
Total cash payments	410.2	412.5	424.2	443.9	467.1
Finance leases and similar arrangements(c)	0.5	0.0	0.0	0.0	0.0
GFS cash surplus(+)/deficit(-)	**-47.2**	**-26.7**	**-13.8**	**-7.1**	**0.9**
Per cent of GDP	-3.0	-1.6	-0.8	-0.4	0.0
less Net Future Fund earnings	2.7	3.1	3.3	3.5	3.8
Underlying cash balance(d)	**-49.9**	**-29.8**	**-17.1**	**-10.6**	**-2.8**
Per cent of GDP	-3.1	-1.8	-1.0	-0.6	-0.2
Memorandum items:					
Net cash flows from investments in financial assets for policy purposes	-6.6	-6.8	-12.8	-15.6	-12.4
plus Net Future Fund earnings	2.7	3.1	3.3	3.5	3.8
Headline cash balance	**-53.7**	**-33.5**	**-26.6**	**-22.7**	**-11.4**

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

Underlying cash balance estimates

The estimated underlying cash deficit in 2014-15 has improved by $4.1 billion, to $29.8 billion compared to the 2013-14 MYEFO.

As outlined in the 2013-14 MYEFO the deficits inherited from the former Government from the four years to 2016-17 totalled $122.6 billion. In the Government's first four years to 2017-18, deficits are estimated to total $60.2 billion.

The change in the estimated underlying cash balance since the 2013-14 MYEFO is largely a result of major policy decisions, saving the bottom line $17.6 billion over the four years to 2016-17. As a result of decisions, the Government has improved the bottom line by a further $18.5 billion in 2017-18.

Since the 2013-14 MYEFO, parameter and other variations have worsened the bottom line by $2.2 billion in the four years to 2016-17. There have also been changes made to the projection methodology used to formulate projections for economic parameters factored into the budget. Further information on this change is detailed in *Statement 2: Economic Outlook*. Over the projection period, as a result of the revised methodology nominal GDP is higher, with stronger real GDP growth only partially offset by a lower GDP deflator, the number of unemployment benefit recipients is lower and growth in wage-indexed payments is slower. Compared with the 2013-14 MYEFO, the revised projection methodology results in a reduction in the underlying cash balance of $0.3 billion (0.02 per cent of GDP) in 2016-17 and an increase of $0.9 billion (0.05 per cent of GDP) in 2017-18. By 2024-25, the new methodology increases the underlying cash balance by $3.4 billion (0.12 per cent of GDP).

Table 5: Reconciliation of underlying cash balance estimates

	Estimates			Projections	
	2013-14	2014-15	2015-16	2016-17	Total
	$m	$m	$m	$m	$m
2013-14 Budget underlying cash balance(a)	**-18,043**	**-10,888**	**849**	**6,591**	**-21,491**
Per cent of GDP	-1.1	-0.6	0.0	0.4	
Changes from 2013-14 Budget to 2013 PEFO					
Effect of policy decisions(b)	-374	-1,663	3,315	6,915	8,193
Effect of parameter and other variations	-11,725	-11,429	-8,826	-9,307	-41,288
Total variations	**-12,099**	**-13,093**	**-5,511**	**-2,392**	**-33,095**
2013 PEFO underlying cash balance(a)	**-30,142**	**-23,981**	**-4,662**	**4,199**	**-54,586**
Per cent of GDP	-1.9	-1.5	-0.3	0.2	
Changes from 2013 PEFO to 2013-14 MYEFO					
Effect of policy decisions(b)	-10,266	-655	-1,505	-1,274	-13,700
Effect of parameter and other variations	-6,582	-9,272	-17,916	-20,592	-54,362
Total variations	**-16,848**	**-9,926**	**-19,421**	**-21,866**	**-68,061**
2013-14 MYEFO underlying cash balance(a)	**-46,989**	**-33,907**	**-24,083**	**-17,668**	**-122,647**
Per cent of GDP	-3.0	-2.1	-1.4	-1.0	
Changes from 2013-14 MYEFO to 2014-15 Budget					
Effect of policy decisions(b)(c)					
Receipts	*-2*	*673*	*1,916*	*2,786*	*5,373*
Payments	*512*	*-1,045*	*-4,018*	*-7,628*	*-12,180*
Total policy decisions impact on underlying cash balance	-514	1,718	5,934	10,414	17,552
Effect of parameter and other variations(c)					
Receipts	*-1,432*	*2,362*	*-573*	*1,247*	*1,604*
Payments	*1,102*	*-167*	*-1,761*	*4,430*	*3,603*
less Net Future Fund earnings	*-182*	*114*	*124*	*126*	*182*
Total parameter and other variations impact on underlying cash balance	-2,352	2,416	1,065	-3,309	-2,180
2014-15 Budget underlying cash balance(a)	**-49,855**	**-29,773**	**-17,084**	**-10,562**	**-107,275**
Per cent of GDP	-3.1	-1.8	-1.0	-0.6	

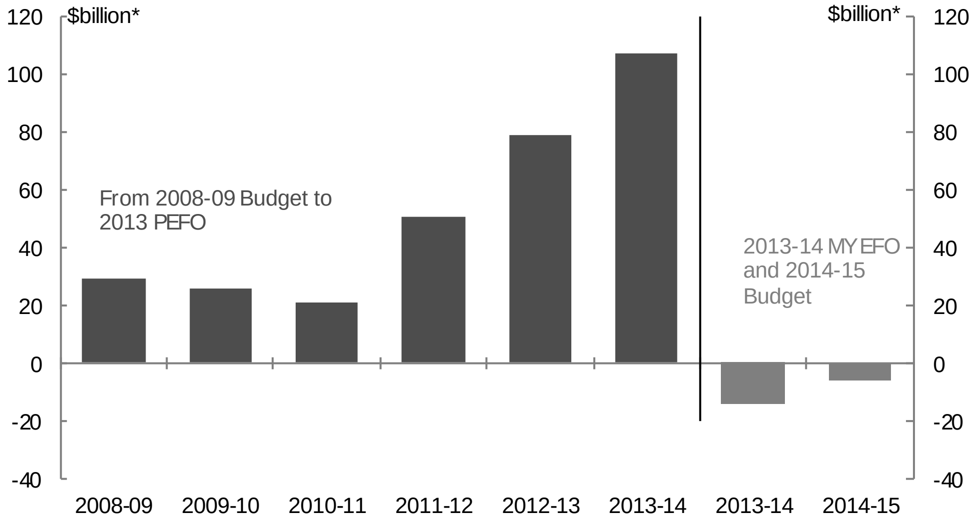
(a) Excludes net Future Fund earnings.
(b) Excludes secondary impacts on public debt interest of policy decisions and offsets from the Contingency Reserve for decisions taken.
(c) A positive number for receipts indicates an increase in the underlying cash balance, while a positive number for payments indicates a decrease in the underlying cash balance.

Receipts estimates

Total receipts are expected to be $3.0 billion higher in 2014-15 than estimated at the 2013-14 MYEFO, tax receipts are $1.8 billion higher and non-tax receipts are $1.3 billion higher.

Since the 2013-14 MYEFO, over the four years to 2016-17, total receipts have been revised up by $5.4 billion from policy decisions and revised up by $1.6 billion from parameter and other variations.

Chart 10: Government decisions have lowered the overall impact of revenue measures



*Cumulative value of revenue measures taken in each budget year

Policy decisions

Policy decisions since the 2013-14 MYEFO are expected to increase receipts by $673 million in 2014-15, $1.9 billion in 2015-16, $2.8 billion in 2016-17 and $2.9 billion in 2017-18. These decisions include: reintroducing the indexation of fuel excise, introducing a temporary levy on individuals' incomes above $180,000 and removing poorly targeted tax concessions.

Significant measures include:

- Reintroducing the indexation of fuel excise rates. From 1 August 2014, fuel excise and fuel excise-equivalent customs duty will be indexed biannually in line with the consumer price index. This is expected to increase receipts by $4.2 billion over the forward estimates period, however taking into account the corresponding payments increases, such as to fuel tax credits, the net increase in the underlying cash balance is $2.3 billion.

- The introduction of a Temporary Budget Repair Levy. From 1 July 2014 until 30 June 2017, there will be a temporary levy of two per cent on individuals' taxable income above $180,000. This measure is expected to increase receipts by $3.1 billion over the forward estimates period.

- The Mature Age Workers Tax Offset and the Dependent Spouse Tax Offset will both be abolished from 1 July 2014. Removing these tax concessions that are no longer well targeted, is expected to increase receipts by $1.1 billion over the forward estimates period.

Parameter and other variations

While the forecast for nominal GDP is similar to the 2013-14 MYEFO, estimated changes to the components of growth have affected the composition of tax receipts. Stronger than expected company profits and household consumption have resulted in upward revisions to company tax and GST, while weaker than expected wage growth has contributed to the write-down to taxes from individuals and superannuation funds.

This has resulted in a small overall downward revision to total tax receipts of $1.8 billion in 2013-14 and $2.9 billion over the four years to 2016-17 compared with the 2013-14 MYEFO. Excluding GST, tax receipts are expected to be lower by $2.6 billion in 2013-14 and $7.4 billion over the four years to 2016-17.

Since the 2013-14 MYEFO, non-tax receipts have increased by $1.3 billion in 2014-15 and $4.8 billion over the four years to 2016-17. The increase in 2014-15 primarily reflects higher forecasts of expected dividend and interest receipts ($479 million). In addition, recognition of State and Territory contributions to the National Disability Insurance Scheme (NDIS) for the first time has increased non-tax receipts by $176 million in 2014-15 ($3.1 billion over the four years to 2016-17). These State and Territory contributions are directly offset by a corresponding increase in payments to NDIS recipients.

Analysis of the sensitivity of the receipts estimates to changes in the economic outlook is provided in Appendix A to this Statement.

Payment estimates

Since the 2013-14 MYEFO, total cash payments for 2014-15 have decreased by $1.2 billion, comprised of new policy decisions which have decreased payments by $1.0 billion and parameter and other variations which have decreased payments by $167 million.

Policy decisions

The net impact of policy decisions since the 2013-14 MYEFO is expected to decrease payments by $1.0 billion in 2014-15, $4.0 billion in 2015-16, $7.6 billion in 2016-17 and $15.5 billion in 2017-18. These decisions include:

- establishing the Asset Recycling Initiative, which will provide State and Territory governments with incentive payments to unlock capital from state-owned assets and reinvest the proceeds in new productivity-enhancing economic infrastructure. The Initiative is expected to increase cash payments by $335 million in 2014-15 ($5.0 billion over the five years to 2018-19);

- funding for new infrastructure investments, under the Infrastructure Investment Programme to support economic growth, which is expected to increase cash payments by $202 million in 2014-15 ($3.7 billion over the five years to 2017-18). Funding will be provided to States and Territories to expedite existing large infrastructure projects and new high productivity infrastructure projects ($2.9 billion), and to boost funding for the existing Black Spot Programme ($200 million), Roads to Recovery Programme ($350 million), and the National Highway Upgrade Programme ($229 million);

- delivering a Western Sydney Infrastructure Plan, by funding major road projects for the development of a second Sydney airport at Badgerys Creek and providing the transport infrastructure necessary to support a growing population in Western Sydney. This Plan is expected to increase cash payments by $103 million in 2014-15 ($2.9 billion over the ten years to 2023-24);

- establishing the Emissions Reduction Fund from 1 July 2014, which will provide an incentive based approach to support abatement activities across the economy to contribute to Australia meeting its target of reducing emissions by 5 per cent below year 2000 levels by the year 2020. This measure is expected to increase cash payments by $75 million in 2014-15 ($2.6 billion over the ten years to 2023-24); and

- strengthening incentives for mature age job seekers to re-enter the workforce with the creation of a new wage subsidy — *Restart* — which is expected to increase cash payments by $18 million in 2014-15 ($304 million over the four years to 2017-18). A payment of up to $10,000 will be available to employers who hire a mature age job seeker aged 50 years or over. The $221 million over four years for a seniors employment incentive payment, previously announced at the 2013-14 MYEFO, will also be redirected to the *Restart* Programme.

The impact of these policy decisions on payments has been more than offset over the five years to 2017-18 by a number of decisions that have reduced cash payments, including:

- maintaining official development assistance (ODA) at its nominal 2013-14 level of $5 billion in both 2014-15 and 2015-16 and growing it in line with the consumer price index from 2016-17. This measure is expected to decrease cash payments by $559 million in 2014-15 ($7.9 billion over the five years to 2017-18, which includes $2.0 billion in 2017-18 from extinguishing a provision for new ODA spending);

- reducing Medicare Benefits Schedule rebates by $5 for general practitioner consultations and out-of-hospital pathology and diagnostic imaging services and allowing the providers of these services to collect a $7 patient contribution, which is expected to reduce cash payments by $3.4 billion over the five years to 2017-18. These savings will be reinvested in the Medical Research Future Fund, which will be established on 1 January 2015;

- maintaining current Family Tax Benefit (FTB) payment rates in nominal terms for two years from 1 July 2014, which is expected to reduce cash payments by $377 million in 2014-15 ($2.6 billion over the four years to 2017-18);

- limiting eligibility for the FTB Part B to families whose youngest child is younger than six years of age from 1 July 2015, with transitional arrangements for two years, which is expected to increase cash payments by $17 million in 2014-15 but reduce cash payments by $1.6 billion over the five years to 2017-18; and

- changing access to income support arrangements for people under 30 years of age, to encourage young people with full work capacity to be earning, learning or participating in Work for the Dole. This is expected to reduce cash payments by $221 million in 2014-15 ($1.2 billion over the four years to 2017-18).

Further details of Government policy decisions are provided in Budget Paper No. 2, *Budget Measures 2014-15*. The expense estimates provided in Budget Paper No. 2 are in accrual terms and may not align with the payment figures provided in this Statement.

Parameter and other variations

This Budget also incorporates some major changes in expected payments in 2014-15 as a result of parameter and other variations since the 2013-14 MYEFO. Major increases include:

- Disability Support Pension payments, which are expected to be $325 million higher in 2014-15 ($962 million over the four years to 2016-17), largely reflecting higher than expected average payment rates and marginally higher than expected customer numbers;

- Private Health Insurance Rebate payments, which are expected to be $300 million higher in 2014-15 ($1.8 billion over the four years to 2016-17), largely reflecting stronger than expected growth in the number of people with subsidised private health cover and more people upgrading their level of health insurance;

- Child Care Fee Assistance payments, which are expected to be $298 million higher in 2014-15 ($1.1 billion over the four years to 2016-17), largely reflecting higher than expected utilisation of child care services;

- Payments under the Natural Disaster Relief and Recovery Arrangements, which are expected to be $244 million higher in 2014-15 (although a reduction in payments of

$96 million is expected over the four years to 2016-17). This primarily relates to an expected delay in disaster recovery payments to Queensland, which largely reflects a delay in the completion of reconstruction works as a result of drought;

- Defence payments, mainly in relation to capital purchases, which are expected to be $186 million higher in 2014-15 ($436 million over the four years to 2016-17) as a result of foreign exchange rate movements; and
- National Disability Insurance Scheme (NDIS) payments, which are expected to be $176 million higher in 2014-15 ($3.1 billion over the four years to 2016-17), reflecting the recognition of payments made on behalf of the States and Territories for the first time. This increase in payments is directly offset by an increase in non-tax receipts reflecting State and Territory contributions to the Scheme.

Major reductions in expected payments in 2014-15 as a result of parameter and other variations since MYEFO, include:

- Illegal Maritime Arrival management costs, which are expected to be $309 million lower in 2014-15 ($1.6 billion over the four years to 2016-17), reflecting the impact of reduced forecasts and projections of the numbers of Illegal Maritime Arrivals;
- Income Support for Seniors payments, which are expected to be $307 million lower in 2014-15 ($2.1 billion over the four years to 2016-17), reflecting lower than expected customer numbers and average payment rates, related to the incremental increase in the Age Pension age and an improvement in the value of financial assets held by part–rate pensioners;
- Payments under the National Health Reform Agreement, which are expected to be $243 million lower in 2014-15 ($1.0 billion over the four years to 2016-17), due to a lower than expected rate of hospital utilisation and slower than expected growth in the price of hospital services;
- Payments under the National Rental Affordability Scheme which are expected to be $121 million lower in 2014-15 ($312 million over the four years to 2016-17), reflecting a lower than anticipated number of dwellings delivered through the National Rental Affordability Scheme; and
- Fuel Tax Credit payments, which are expected to be $119 million lower in 2014-15 ($140 million over the four years to 2016-17), reflecting lower than expected usage of fuels which are eligible for the payments.

Consistent with previous budgets, the underlying cash balance has been improved by the regular draw down of the conservative bias allowance. Details of this draw down are provided in the Other Purposes section of *Statement 6: Expenses and Net Capital Investment.*

Analysis of the sensitivity of payments estimates to changes in the economic outlook is provided in Appendix A to this Statement.

Fiscal balance estimates

The fiscal deficit is expected to be $25.9 billion (1.6 per cent of GDP) in 2014-15, which reflects an improvement of $5.6 billion compared to the 2013-14 MYEFO.

Table 6 provides a reconciliation of the variations in the fiscal balance since the 2013-14 Budget.

Table 6: Reconciliation of fiscal balance estimates

	Estimates			Projections	
	2013-14	2014-15	2015-16	2016-17	Total
	$m	$m	$m	$m	$m
2013-14 Budget fiscal balance	**-13,497**	**-6,255**	**5,955**	**10,819**	**-2,978**
Per cent of GDP	-0.8	-0.4	0.3	0.6	
Changes from 2013-14 Budget to 2013 PEFO					
Effect of policy decisions(a)	-749	-3,835	4,712	6,515	6,643
Effect of parameter and other variations	-11,262	-11,988	-8,820	-9,543	-41,613
Total variations	**-12,011**	**-15,823**	**-4,109**	**-3,028**	**-34,970**
2013 PEFO fiscal balance	**-25,508**	**-22,078**	**1,847**	**7,792**	**-37,948**
Per cent of GDP	-1.6	-1.3	0.1	0.4	
Changes from 2013 PEFO to 2013-14 MYEFO					
Effect of policy decisions(a)	-8,063	-207	-1,450	-1,185	-10,905
Effect of parameter and other variations	-8,272	-9,218	-19,173	-21,062	-57,726
Total variations	**-16,335**	**-9,426**	**-20,623**	**-22,247**	**-68,631**
2013-14 MYEFO fiscal balance	**-41,843**	**-31,504**	**-18,776**	**-14,456**	**-106,579**
Per cent of GDP	-2.7	-1.9	-1.1	-0.8	
Changes from 2013-14 MYEFO to 2014-15 Budget					
Effect of policy decisions(a)(b)					
Revenue	1	720	2,032	2,762	5,515
Expenses	51	-1,939	-5,498	-7,688	-15,075
Net capital investment	460	388	688	216	1,753
Total policy decisions impact on fiscal balance	-510	2,271	6,842	10,234	18,837
Effect of parameter and other variations(b)					
Revenue	343	2,746	157	2,046	5,292
Expenses	3,184	-974	597	4,384	7,190
Net capital investment	-139	343	-160	36	80
Total parameter and other variations impact on fiscal balance	-2,702	3,377	-280	-2,374	-1,978
2014-15 Budget fiscal balance	**-45,055**	**-25,855**	**-12,214**	**-6,596**	**-89,720**
Per cent of GDP	-2.8	-1.6	-0.7	-0.4	

(a) Excludes secondary impacts on public debt interest of policy decisions and offsets from the Contingency Reserve for decisions taken.

(b) 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.

Revenue estimates

Changes in accrual revenue are generally driven by the same factors as cash receipts, though differences arise where revenue raised in a given year is not received in that year.

Expense and net capital investment estimates

Movements in accrual estimates and net capital investment over the forward estimates are broadly similar to the movements in cash payments. The key exceptions include:

- an increase in the accrued superannuation expenses for civilian and military superannuation schemes of $3.5 billion, where there are differences between the timing of cash payments and accrued expenses;
- a decrease in Higher Education Loan Programme (HELP) expenses of $2.1 billion, where the value of the concessionality of the loans has reduced as a result of changing the indexation applied to HELP debts from 1 June 2016; and
- an increase in expenses of $756 million in relation to the concessional loan the Government will provide to accelerate the delivery of the WestConnex Stage 2 project.

Detailed information on expenses and net capital investment can be found in *Statement 6: Expenses and Net Capital Investment*.

Headline cash balance estimates

The headline cash balance consists of the underlying cash balance, net cash flows from investments in financial assets for policy purposes (for example, the equity funding of NBN Co), and net Future Fund earnings.

Table 7 provides further detail between the underlying and headline cash balance estimates of the Australian Government general government sector.

Table 7: Details of the Australian Government general government sector items between the underlying and headline cash balance estimates

	Estimates		Projections			
	2013-14	2014-15	2015-16	2016-17	2017-18	Total
	$m	$m	$m	$m	$m	$m
2014-15 Budget underlying cash balance(a)	**-49,855**	**-29,773**	**-17,084**	**-10,562**	**-2,825**	**-110,099**
plus Net cash flows from investments in financial assets for policy purposes						
Student loans	-4,630	-5,598	-6,885	-8,091	-9,258	-34,462
NBN investment	-3,380	-5,200	-6,420	-6,865	-2,407	-24,272
Residential mortgage backed securities	2,894	1,556	1,495	954	611	7,510
WestConnex	0	0	-226	-854	-831	-1,912
Trade support loans	0	-144	-460	-511	-563	-1,677
Net other	-1,458	2,566	-291	-225	90	683
Total net cash flows from investments in financial assets for policy purposes	**-6,575**	**-6,819**	**-12,787**	**-15,592**	**-12,358**	**-54,131**
plus Net Future Fund earnings	2,689	3,068	3,262	3,499	3,750	16,267
2014-15 Budget headline cash balance	**-53,741**	**-33,524**	**-26,609**	**-22,656**	**-11,432**	**-147,963**

(a) Excludes expected net Future Fund earnings.

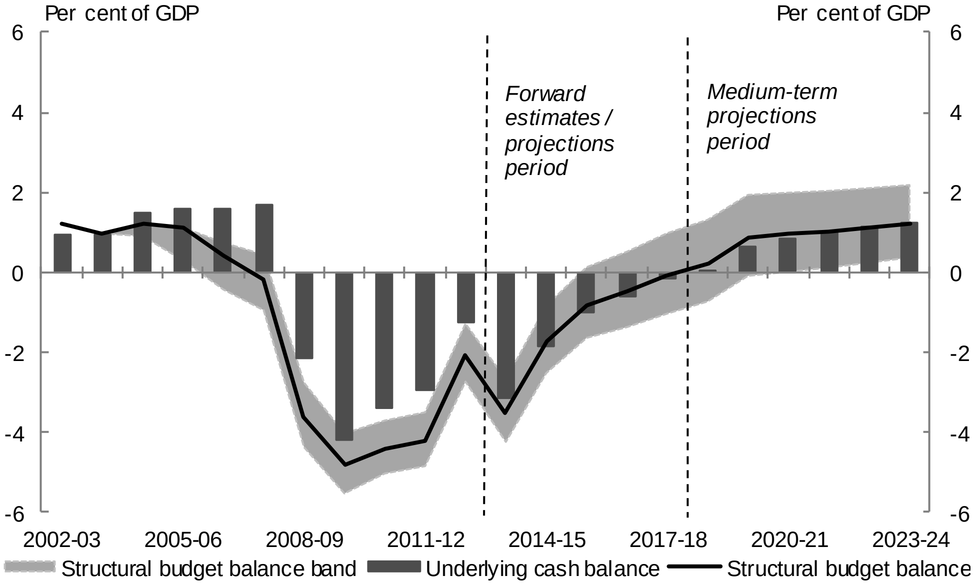
The headline cash balance for 2014-15 is estimated to be a deficit of $33.5 billion (2.1 per cent of GDP), compared with a deficit of $42.4 billion at 2013-14 MYEFO (2.6 per cent of GDP). Over the four years to 2017-18, the headline cash deficit improves by $22.1 billion, from $33.5 billion in 2014-15 to $11.4 billion in 2017-18.

The improvement in the headline cash balance is primarily driven by policy decisions that have affected the underlying cash balance. From 2015-16, this improvement from policy decisions has been partially offset by changes to the Higher Education Loan Program and bringing forward some NBN Co equity funding to within the forward estimates.

Structural budget balance estimates

The outlook for the structural budget balance has improved significantly since the 2013-14 MYEFO, in line with the improvement in the outlook for the underlying cash balance. The structural position of the budget is forecast to improve to around balance by 2018-19 and is projected to be in surplus beyond that. By comparison, at the 2013-14 MYEFO the budget was expected to remain in structural deficit throughout the entire medium-term projections period. Following a prolonged period of significant structural deficits, the policy decisions taken by the Government are projected to restore the budget to a position that is structurally sustainable in the medium term.

Chart 11: Structural budget balance estimates[3]



Note: The grey range spans structural budget estimates using the average terms of trade between 1986-87 and 2010-11 (lower bound), which is the OECD's assumption for Australia's structural level of the terms of trade, and using the forecast average from 2003-04 to 2015-16 (upper bound). The central estimate is based on the structural level of the terms of trade in the Government's medium-term economic projections. The methodology for producing the structural budget balance estimates was detailed in Treasury Working Paper 2013-01.
Source: ABS cat. no. 5206.0, 5302.0, 6202.0, 6401.0 and Treasury.

Structural budget balance measures are sensitive to the assumptions and parameters underpinning the estimates, including identifying the structural level of the terms of trade and the relationship between tax receipts and economic activity. Due to the sensitivity of estimates to assumptions, it is best to consider a range of structural budget balance estimates based on plausible assumptions for the underlying parameters as one element of a broader assessment of fiscal sustainability.

3 The structural budget balance estimates shown in Chart 11 incorporate the changes to the medium-term economic projections framework detailed in Budget Statement 2 and Treasury Working Papers 2014-01 and 2014-02. Because structural budget balance calculations are sensitive to estimates of the output gap, these methodological changes have resulted in revisions to the structural budget balance estimates. The peak impact is in 2015-16, when the structural budget deficit is projected to be 0.8 percentage points smaller than would have been the case had the previous medium-term projections framework been retained. The impact becomes smaller as the estimated output gap closes, falling to 0.5 percentage points in 2018-19 and close to zero by 2022-23. These impacts are within the range of structural balance estimates shown in the 2013-14 MYEFO and do not affect the result that the budget was projected to remain in structural deficit throughout the medium-term projections period at the 2013-14 MYEFO and is now projected to reach structural balance in around 2018-19.

APPENDIX A: SENSITIVITY OF THE BUDGET TO ECONOMIC DEVELOPMENTS

SENSITIVITY OF BUDGET ESTIMATES TO ECONOMIC DEVELOPMENTS

The estimates contained in the 2014-15 Budget are based on forecasts of the economic outlook. Changes to the economic assumptions underlying the estimates will impact on receipts and payments, and hence the size of the underlying cash balance. Even small movements in economic parameters can result in large changes to the budget aggregates.

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

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

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

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

Scenario 1

The first scenario involves a permanent fall in world prices of non-rural commodity exports in 2014-15 consistent with a fall in the terms of trade of around 4 per cent, which causes a 1 per cent fall in nominal GDP by 2015-16. The sensitivity analysis evaluates the flow-on effects on the economy, the labour market and prices. The impacts in Table A1 are stylised and refer to per cent deviations from the baseline levels of the economic parameters.

Table A1: Illustrative impact of a permanent non-rural commodity price fall consistent with a 1 per cent fall in nominal GDP by 2015-16 (per cent deviation from the baseline level)

	2014-15 per cent	2015-16 per cent
Real GDP	0	- 1/4
Non-farm GDP deflator	- 3/4	- 3/4
Employment	- 1/4	- 1/2
Wages	0	- 1/4
CPI	0	- 1/4
Company profits	-3	-3
Consumption	- 1/4	- 1/2

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

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

Given these assumptions, the overall impact of the fall in the terms of trade is a decrease in the underlying cash balance of around $2.6 billion in 2014-15 and around $5.4 billion in 2015-16 (see Table A2).

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

	2014-15	2015-16
	$b	$b
Receipts		
Individuals' and other withholding taxes	-0.6	-1.6
Superannuation fund taxes	0.0	-0.2
Company tax	-1.8	-3.1
Goods and services tax	-0.1	-0.3
Excise and customs duty	0.0	-0.1
Other taxes	-0.1	-0.1
Total receipts	**-2.6**	**-5.4**
Payments		
Income support	-0.1	-0.2
Other payments	0.0	0.1
Goods and services tax	0.1	0.3
Total payments	**0.0**	**0.2**
Public debt interest	0.0	-0.2
Underlying cash balance impact(a)	**-2.6**	**-5.4**

(a) Estimated impacts fall within the 70 per cent confidence intervals for years 2014-15 and 2015-16, as shown in Appendix B Charts B3 to B5.

On the receipts side, a fall in the terms of trade results in a fall in nominal GDP which reduces tax collections. The largest impact is on company tax receipts as the fall in export income decreases company profits. Owing to lags in the tax system, the effect on company tax is larger in 2015-16. Lower company profits are assumed to flow through to lower Australian equity prices, therefore reducing capital gains tax from individuals, companies and superannuation funds.

The weaker economy results in lower aggregate demand, which flows through to lower employment and wages, reducing individuals' income tax receipts. The decrease in disposable incomes leads to lower consumption, which in turn results in a decrease in GST receipts (decreasing GST payments to the states by the same amount) and other indirect taxes.

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

The overall estimated expenditure on income support payments (including pensions and allowances) increases in both years because of a higher number of unemployment benefit recipients. The increase in spending on unemployment benefits in 2015-16 is partly offset by reduced expenditure on pensions and allowances reflecting lower growth in benefit rates resulting from lower wages growth and lower inflation. At the same time other payments linked to inflation fall in line with the reduced growth in prices.

The reduction in the underlying cash balance results in a higher borrowing requirement and a higher public debt interest cost.

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

Scenario 2

The second scenario involves a permanent 0.5 per cent increase in both the participation rate and labour productivity, resulting in a 1 per cent increase in real GDP from 2014-15. Once again, the sensitivity analysis evaluates the flow-on effects on the economy, the labour market and prices. The impacts in Table A3 are stylised and refer to per cent deviations from the baseline levels of the parameters.

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

Table A3: Illustrative impact of an ongoing equal increase in both labour productivity and participation consistent with a 1 per cent increase in real GDP from 2014-15 (per cent deviation from the baseline level)

	2014-15 per cent	2015-16 per cent
Nominal GDP	3/4	3/4
Non-farm GDP deflator	- 1/4	- 1/4
Employment	1/2	1/2
Wages	1/4	1/4
CPI	- 1/4	- 1/4
Company profits	1 3/4	1 3/4
Consumption	1	1

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

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

The overall impact of the increase in labour productivity and participation is an increase in the underlying cash balance of around $3.1 billion in 2014-15 and around $3.8 billion in 2015-16 (see Table A4).

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

	2014-15	2015-16
	$b	$b
Receipts		
Individuals' and other withholding taxes	1.7	1.4
Superannuation fund taxes	0.1	0.2
Company tax	1.1	1.7
Goods and services tax	0.5	0.6
Excise and customs duty	0.3	0.3
Other taxes	0.0	0.0
Total receipts	**3.7**	**4.2**
Payments		
Income support	-0.1	-0.1
Other payments	0.0	0.1
Goods and services tax	-0.5	-0.6
Total payments	**-0.6**	**-0.6**
Public debt interest	0.0	0.2
Underlying cash balance impact(a)	**3.1**	**3.8**

(a) Estimated impacts fall within the 70 per cent confidence intervals for years 2014-15 and 2015-16, as shown in Appendix B Charts B3 to B5.

On the receipts side, individuals' income tax collections increase because of the rise in the number of wage earners and, additionally, higher real wages. The stronger labour market also increases tax collections from superannuation funds because contributions (including compulsory contributions) are higher. The increase in personal incomes leads to higher consumption which results in an increase in GST receipts (with the corresponding receipts passed on in higher GST payments to the states). In addition, the stronger economy results in higher levels of corporate profitability, increasing company taxes.

On the payments side, overall estimated expenditure on income support payments (including pensions, unemployment benefits and other allowances) is higher, reflecting a higher number of unemployment benefit recipients (as higher labour force participation increases both employment and the number unemployed) and also growth in benefit rates through their indexation to wages. Lower inflation has a partially offsetting effect.

On balance, the rise in estimated tax collections is only partially offset by increased payments. This improves the underlying cash position, which results in a lower borrowing requirement and lower public debt interest cost.

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

SENSITIVITY OF THE BALANCE SHEET TO ECONOMIC AND FISCAL RISKS

Consistent with the medium-term fiscal strategy, this Budget places emphasis on the strength of the Government's balance sheet. This section supplements the analysis of Australia's fiscal sustainability in Statement 3, and discusses the resilience of our balance sheet to adverse economic and fiscal shocks. The baseline case and the downside scenario are analysed:

- Baseline case: discussion of how current economic and fiscal risks may impact the balance sheet.
- Downside scenario: discussion of how significant but remote economic and fiscal downside risks may impact the balance sheet.

A strong balance sheet provides the Government with the flexibility to respond to adverse fiscal and economic risks, and is an indicator of fiscal sustainability. Fiscal risks refer to developments or specific events that are unpredictable in both timing and magnitude, which result in a significant increase in Government payments. This includes events such as emergency defence or foreign aid requirements and natural disasters. These payments generally result in an erosion of existing budget surpluses and/or higher government borrowings. Economic risks refer to economic shocks, such as a financial crisis, that result in a fall in GDP, employment, wages and therefore tax receipts, and increased payments for example for unemployment benefits. These effects generally result in lower receipts and higher payments, eroding surpluses or widening deficits and resulting in higher levels of net debt.

This analysis focuses on the impact of large risks eventuating and the impact to the balance sheet and fiscal sustainability in broad terms.

Baseline case

The estimates contained in the Budget are based on forecasts of the economic and fiscal outlook. Risks that have a probable chance of materialising are already taken into account in the Financial Statements. Australia holds AAA credit ratings from all three rating agencies, and the balance sheet is strong given current economic conditions.

There are a number of existing contingent liabilities and assets that are not included in the Financial Statements on the basis that they are currently assessed as unlikely to occur, but under certain and potentially extreme circumstances they could crystallise in the future. These contingencies include loan guarantees, warranties, indemnities, uncalled capital and letters of comfort, and are outlined in *Statement 8: Statement of Risks*.

Downside scenario

If fiscal or economic risks come to fruition, the strength of the balance sheet is called upon as it will need to respond to the initial shock to the economy or the budget. In a large economic shock, the Government will likely be pressed to intervene in a riskier environment by drawing down assets, issuing more debt and/or providing guarantees to give certainty to the market. This poses a challenge to the Government and tests the ability and strength of the balance sheet to support economic activity and so ameliorate the impact of the shock on businesses and households.

A higher level of payments necessitating higher borrowings

When economic conditions deteriorate the budget position can decline significantly as receipts fall and payments increase. This can lead to an erosion of existing budget surpluses and/or an increase in borrowings to fund these additional payments. The section below discusses how a number of fiscal and economic risks increase payments if they materialise.

A deterioration in economic conditions and economic activity is usually signalled by a fall in demand for labour and for goods and services. Eventually excess supply in product and labour markets will generate falls in wages and domestic prices, and the quantity of labour employed and goods and services exchanged. The decline in wages and employment will lead to a fall in personal income tax receipts. Weak labour market conditions would also lead to lower household consumption and falls in GST receipts. The fall in nominal GDP (driven by falls in domestic prices and the level of goods and services exchanged) reduces revenue raised from company tax. At the same time a higher unemployment rate would lead to increased expenditure on income and other Government support payments. To fund this deterioration in the Government's fiscal position, assets would need to be run down or borrowings would need to increase through the issuance of more Commonwealth Government Securities (CGS).

During an economic downturn, increases in payments could be funded by an increase in CGS issuance thereby increasing the liability. This would lead to higher interest payments until the Government begins to repay its debt.

A weakened economic environment also increases the likelihood of contingent liabilities (for example, guarantees) crystallising or defaults on loans, resulting in higher liabilities and an increase in payments.

Statement 8 provides further detail on contingent liabilities, contingent assets and other fiscal risks. Information on contingent assets and liabilities is also provided in the Australian Government's annual consolidated financial statements and in the annual financial reports of departments and non-budget entities.

Some of the Government's large guarantees are those introduced during the Global Financial Crisis. As described below, even a large deterioration in conditions would be unlikely to trigger some of these guarantees.

The Guarantee Scheme for Large Deposits and Wholesale Funding is applicable to certain liabilities covered by the guarantee. The liabilities currently have a value of around $25 billion. Government expenditure would only arise in the unlikely event that an institution failed to meet its obligations with respect to a commitment that was subject to the guarantee and the guarantee was called upon. In such a case, the Government would likely be able to recover any such expenditure through a claim on the relevant institution.

The Financial Claims Scheme provides depositors of authorised deposit taking institutions (ADIs) and policyholders of general insurers with timely access to their funds in the event of a financial institution failure. In relation to ADIs payments are capped at $250,000 per account holder per ADI, and a mechanism exists to make payments to eligible beneficiaries with a claim against a failed insurer. ADI deposits eligible for coverage under the scheme are estimated to be approximately $722.8 billion at 31 December 2013. Initial amounts available to meet payments and administer the scheme are $20.1 billion per institution. In the unlikely event of a failure, any payments made under the Financial Claims Scheme would be recovered through a liquidation of the failed institution. Any shortfalls would be recovered through a levy on the industry.

The IMF has analysed and tested the financial strength of Australian banks in its Financial Stability Assessment Programme Report 2012. The report found that Australia's financial system is sound, resilient, and well-managed, and that the major banks are conservatively run, well capitalised and profitable, and they are likely to withstand severe shocks. The IMF concluded that if necessary, given Australia's modest public debt, there is space for both monetary and fiscal policy to respond to a significant shock.[1]

The guarantee of State and Territory Borrowings, also introduced in response to the considerable financial market turbulence in the Global Financial Crisis, only applies to outstanding securities for New South Wales and Queensland covered by the guarantee before it closed on 31 December 2010. As at 31 March 2014, the face value of guaranteed securities was $19.0 billion. While the risk of default of either government is remote, if a significant economic event were to cause a default by either or both governments, the Commonwealth is likely to be able to recover its guarantee payments through a claim on the relevant State or Territory at a future date.

In addition to payments resulting from shocks to the economy, natural disasters are highly unpredictable and are outside the Government's control. They can pose devastating consequences on the Australian community and result in large unexpected increases in payments for disaster aid and recovery funding. While the Government's current balance sheet strength is able to provide capacity for further borrowings without putting at risk existing spending programmes and Australia's debt sustainability, if a natural disaster occurs in conjunction with a significant economic downturn, the burden on the Government's finances would put further pressure on the budget.

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1 IMF's Australia: Financial Stability Assessment Programme Report, February 2012.

A fall in the strength of the balance sheet

In addition to an increase in borrowings, certain balance sheet items are required to be recorded at market value and the market valuation of these items make them susceptible to significant economic downturns as prices fluctuate. As a result market movements may have temporary impacts on the strength of the balance sheet.

The Higher Education Loan Program (HELP) is the largest asset on the balance sheet, in terms of individual programs, and represents the net present value of expected loan repayments and therefore future sources of funds. The HELP asset is estimated to be around $25.2 billion at 30 June 2014 and is projected to grow to around $30.0 billion in 2014-15 and $51.4 billion by the end of the forward estimates. This growth is largely a result of improved access to student loans and students paying a greater share of the cost of their education. A slow-down in wages growth as a result of a deterioration of economic conditions may lead to slower loan repayments meaning the government cannot repay its debt as quickly.

The investments of the Future Fund are also susceptible to market changes. The Future Fund's investments are estimated to be around $97.6 billion at 31 March 2014. However, if the Future Fund were to experience negative returns on its investments due to an external financial market shock, its value could fall substantially.

The CGS liability is estimated to be $346.6 billion as at 30 June 2014. Movements in interest rates impact upon the market value of the Government's CGS liability. For example, lower interest rates that may be used to stimulate the economy will contribute to a higher market value of the liability. This increases the market value of the CGS liability.

Appendix B: Confidence Intervals Around the Economic and Fiscal Forecasts

Estimates of economic and fiscal variables over the forward estimates period are subject to inherent uncertainties, which generally tend to increase as the forecast horizon lengthens. Confidence intervals quantifying estimates of uncertainty around the key 2014-15 Budget forecasts have been constructed using a set of historical forecasting errors based on forecasts made since 1998 (where errors are defined by the difference between the forecasts and actual outcomes). These confidence intervals highlight that there is a range of plausible alternative outcomes around any given point estimate and provide a guide to the degree of uncertainty around these forecasts, typically spanning a wide range of outcomes.[1] As part of continuing to improve its forecasting processes, Treasury is implementing the recommendations of the 2012 *Review of Treasury Macroeconomic and Revenue Forecasting*.

Measures of Uncertainty Around Economic Forecasts

For real and nominal GDP forecasts, confidence intervals could be presented around forecasts of annual growth rates, average annualised growth rates or cumulative growth rates. While all three measures have merit, a key role of GDP forecasts is as an input for producing revenue and expenses forecasts. For this purpose, the average annualised GDP growth rate or cumulative GDP growth rate is the more relevant summary statistic, since the level of GDP depends on cumulative growth over time. The average annualised growth rate is reported as it captures the effects of cumulative growth, while still giving a sense of what the annual growth rate would be.

Chart B1 suggests that the average annualised growth rate in real GDP in the two years to 2014-15 is expected to be 2½ per cent, with the 70 per cent confidence interval ranging from 1¾ to 3½ per cent. In other words, if forecast errors are similar to those in the past 15 years, there is a 70 per cent probability that the growth rate will lie in this range.

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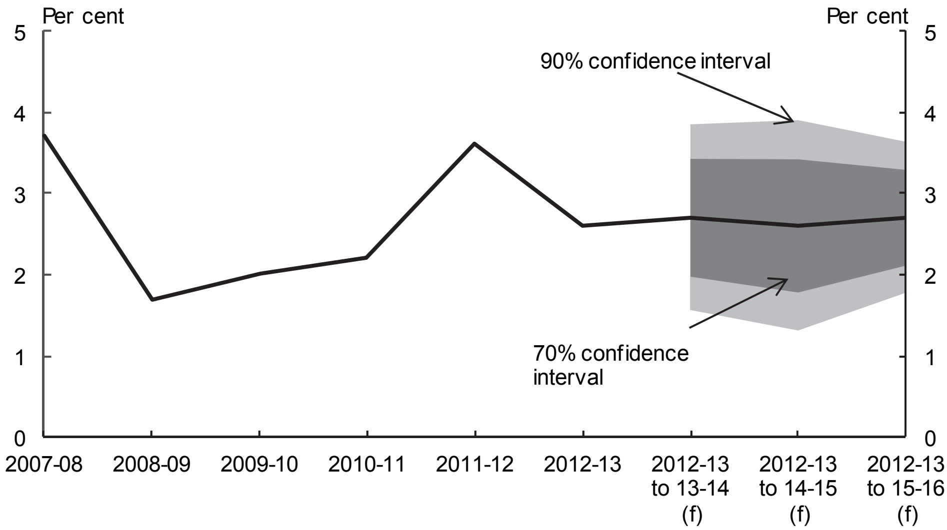
1 The 2012 *Review of Treasury Macroeconomic and Revenue Forecasting* found that the official macroeconomic and tax revenue forecasting performance is comparable with or better than that of other forecasters, suggesting that the uncertainty around the forecasts is similar to or smaller than those of other forecasters.

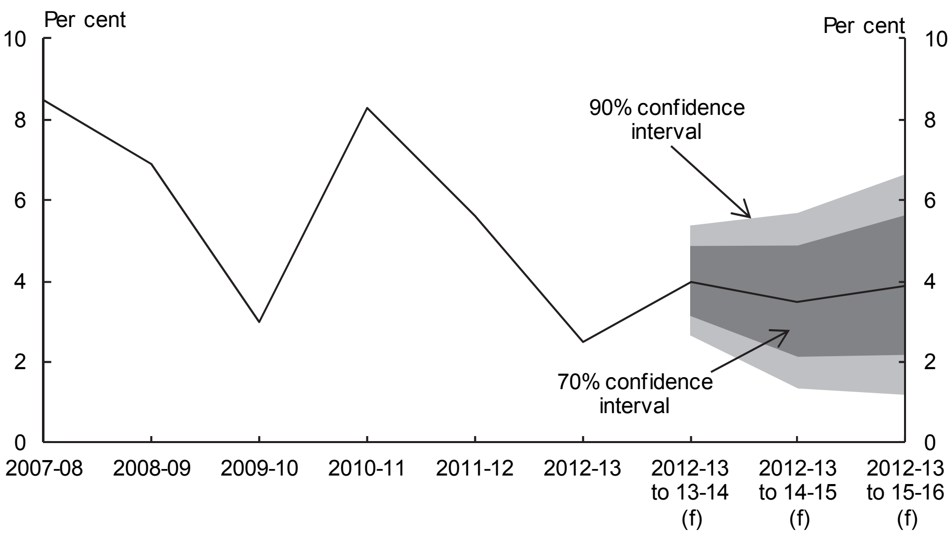
Chart B1: Confidence intervals around real GDP growth rate forecasts



Note: The central line shows the outcomes and the 2014-15 Budget forecasts. Annual growth rates are reported for the outcomes. Average annualised growth rates from 2012−13 are reported for 2013−14 onwards. (f) are forecasts. Confidence intervals are based on the root mean square errors (RMSEs) of Budget forecasts from 1998-99 onwards, with outcomes based on December quarter 2013 National Accounts data.
Source: ABS cat. no. 5206.0, Budget papers and Treasury.

The uncertainty around nominal GDP is larger, reflecting uncertainty about the outlook for real GDP and uncertainty about the outlook for prices or the GDP deflator. Chart B2 suggests that the average annualised growth rate in nominal GDP in the two years to 2014-15 is expected to be 3½ per cent, with the 70 per cent confidence interval ranging from 2 to 5 per cent.

Chart B2: Confidence intervals around nominal GDP growth rate forecasts



Note: See note to Chart B1.
Source: ABS cat. no. 5206.0, Budget papers and Treasury.

MEASURES OF UNCERTAINTY AROUND FISCAL FORECASTS

The following charts illustrate measures of uncertainty around the key 2014-15 Budget fiscal forecasts. These charts show confidence intervals around the forecasts for receipts (excluding GST and including Future Fund earnings), payments (excluding GST) and the underlying cash balance (which excludes Future Fund earnings). These confidence intervals have been calculated by comparing the historical forecasts of the relevant fiscal variable with the outcome, expressed as a proportion of the GDP outcome in the relevant year.[2]

Impacts of future policy decisions are beyond the scope of fiscal forecasts. To account for this, confidence intervals constructed around the fiscal variables exclude historical variations caused by policy decisions. These intervals take into account errors caused by parameter and other variations in isolation, but include the public debt interest impact of policy decisions.[3]

It should be noted that excluding historical variations due to policy decisions does not exclude cases that are classified in budget documentation as parameter and other variations, but have more in common with decisions of government. For example, specific decisions to re-profile spending due to changes in timing of projects are captured for reporting purposes as parameter and other variations. Similarly, new and often substantial spending decisions to provide assistance for the impacts of natural disasters are covered under the *Natural Disaster Relief and Recovery Arrangements* and are captured for budget reporting purposes as parameter and other variations. The treatment of these spending decisions contributes to the size of the confidence intervals around payments. Further uncertainty from this source can be expected over the forecast period as provisions for impacts of future natural disasters are not included in estimates beyond the budget year.

GST was not reported as a Commonwealth tax in budget documents prior to the 2008-09 Budget. As a result, GST data have been removed from historical receipts and payments data to abstract from any error associated with this change in accounting treatment.

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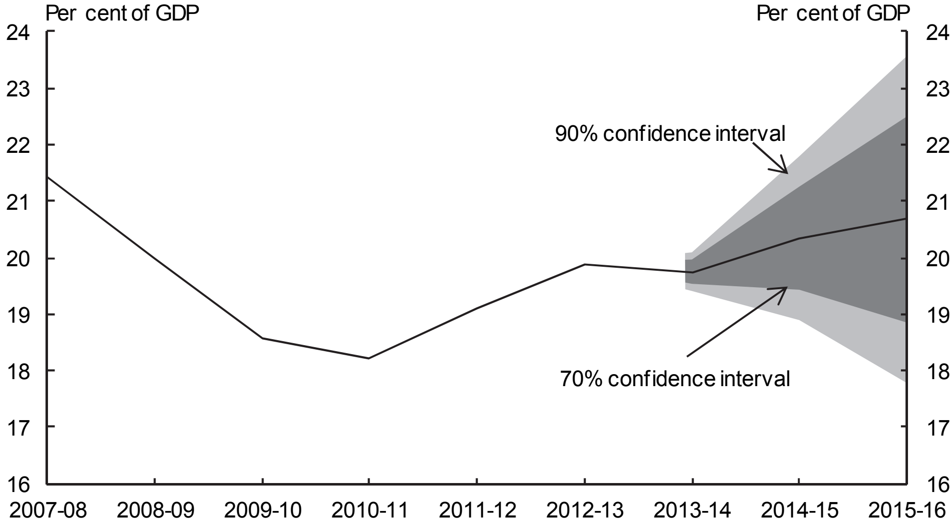
2 The confidence intervals around the fiscal forecasts are based on GDP outcomes, rather than GDP forecasts, as discussed in Treasury Working Paper 2013-04: *Estimates of uncertainty around budget forecasts* which found that forecast errors for GDP and receipts (in particular) are highly correlated.

3 The impacts of past policy decisions on historical public debt interest through time cannot be readily identified or estimated. For this reason, no adjustment has been made to exclude these impacts from the analysis.

Receipts

Chart B3: Confidence intervals around receipts forecasts (excluding GST)

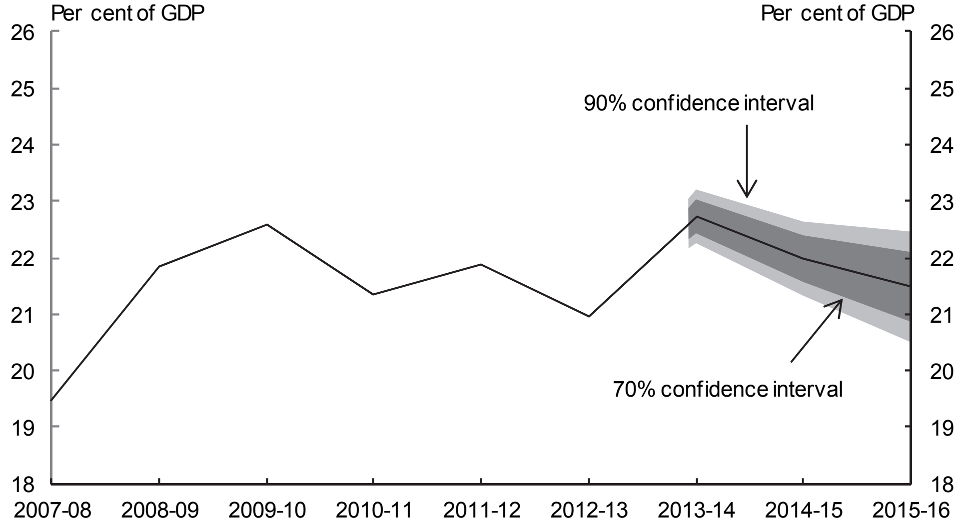


Note: The central line shows the outcomes and 2014-15 Budget point estimate forecasts. Confidence intervals use RMSEs for Budget forecasts from the 1998-99 Budget onwards.
Source: Budget papers and Treasury.

Chart B3 suggests that there is notable uncertainty around receipts forecasts and that this uncertainty increases over the estimates period. It suggests that in 2014-15, the width of the 70 per cent confidence interval for the 2014-15 Budget receipts forecast (excluding GST) is approximately 1.8 per cent of GDP ($30 billion) and the 90 per cent confidence interval is approximately 2.9 per cent of GDP ($45 billion).

Payments

Chart B4: Confidence intervals around payments forecasts (excluding GST)

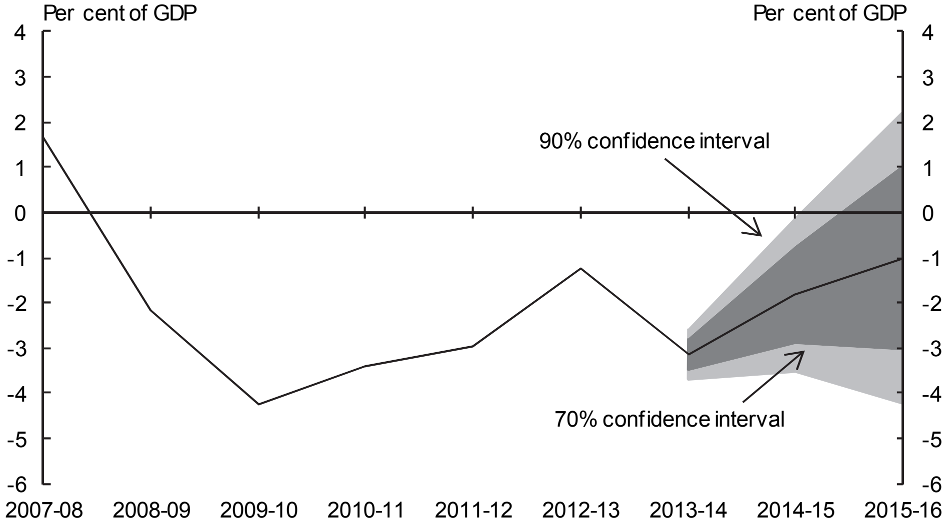


Note: See note to Chart B3.
Source: Budget papers and Treasury.

Chart B4 suggests that there is moderate uncertainty around payments forecasts and that this uncertainty exhibits apparent but contained growth over the estimates period. It suggests that in 2014-15, the width of the 70 per cent confidence interval for the 2014-15 Budget payments forecast (excluding GST) is approximately 0.8 per cent of GDP ($15 billion) and the 90 per cent confidence interval is approximately 1.3 per cent of GDP ($20 billion).

Underlying cash balance

Chart B5: Confidence intervals around the underlying cash balance forecasts



Note: See note to Chart B3.
Source: Budget papers and Treasury.

Chart B5 suggests that there is notable uncertainty around the underlying cash balance forecasts and that this uncertainty exhibits pronounced growth over the estimates period. It suggests that in 2014-15, the width of the 70 per cent confidence interval for the 2014-15 Budget underlying cash balance forecast is approximately 2.2 per cent of GDP ($35 billion) and the 90 per cent confidence interval is approximately 3.4 per cent of GDP ($55 billion).

Further details on the methodology used to construct confidence intervals around the economic and fiscal forecasts can be found in Treasury Working Paper 2013-04: *Estimates of uncertainty around budget forecasts* available online at: http://www.treasury.gov.au/PublicationsAndMedia/Publications/2013/Estimates-of-uncertainty-around-budget-forecasts.